Issuer Profile – Jefferies Financial Group

Markets Strategy & Floor Research

27 March 2023

Marketing communication (see disclaimer on the last pages)

Issuer Profile – Jefferies Financial Group

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Credit Ratings

	LT	Outlook
Fitch	BBB	Positive
Moody's	Baa2	Stable
S&P	BBB	Stable

As at: 27 March 2022
Source: Bloomberg

Key Facts

Homepage:
www.jefferies.com

Bloomberg-Ticker:
JEF US

As at: 27 March 2023
Source: Bloomberg, Jefferies

Jefferies Group merged with Jefferies Financial Group

Jefferies Financial Group (JFG; headquarters New York) is an internationally active investment bank and securities company. The bank offers its clients a broad portfolio of products and services from the areas of investment banking, equity, fixed income and asset management. Founded in the USA in 1962, Jefferies opened its first international subsidiary in the UK in 1986. Alongside New York as the global headquarter, regional headquarters are operated out of London and Hong Kong. In order to simplify and streamline its corporate structure, Jefferies Group LLC (previously the largest subsidiary) was merged with JFG effective from 01 November 2022. As a result, Jefferies Group LLC is no longer obligated to prepare periodic reports, which in turn allows potential cost savings. JFG is pursuing the corporate goal of gaining further market shares, increasing its competitiveness and developing into the best full-service investment bank in the world. The long-term strategy is centred on strengthening the investment banking, capital market and asset management businesses as well as reducing the merchant banking portfolio. Following two corporate transactions worth USD 1.6bn (31 May 2022), the merchant banking portfolio was reduced by around USD 550m. Following the successful corporate restructuring, this will no longer be reported as a separate business segment. In Q3 2022, JFG decreased its merchant banking portfolio by USD 122m after concluding the sale of Idaho Timber. A further reduction of USD 427m took place on 17 January 2022 with the successful spin-off of Vitesse Energy (oil and gas company) as a new independent listed stock corporation.

Jefferies offers broad product portfolio

In financial year 2022, the number of employees at Jefferies Financial Group decreased by 175 to 5,381 (November 2022). The sale of Idaho Timber was a decisive factor in this development, which reduced the number of employees by 561. The opposite trend can be seen in investment banking, technology and other core segments, where a growth in staff numbers has been registered. The employees are split between the global and regional headquarters in addition to more than 30 national and international locations. In the "Investment Banking and Capital Markets" segment, JFG focuses on the sub-segments Investment Banking (incl. Advisory), Equities and Fixed Income. Asset Management, which comes under the umbrella of Leucadia Asset Management (LAM), covers activities related to Investment Management Services via Jefferies Investment Advisors and Partnerships. In our previous publications, business activities were also divided into the segments "Merchant Banking" and "Corporate". However, this segmentation will no longer be applied in the annual financial statements, as they are set to be liquidated at some point in the future. Following the reduction in the merchant portfolio in 2022, the remaining business activities were mainly allocated to the Asset Management segment. Clients are offered a broad product portfolio, ranging from shares to fixed income and currency products. The portfolio is rounded off by research services. Clients have at their disposal around 1,400 investment bankers in the USA, Europe and Asia with profound industry expertise.

Business focus

The majority of income is generated in the institutional clients business, which reflects the firm's heavily client-oriented approach. Jefferies Investment Banking covers a number of different industries: Consumer, Energy, Financial Services, Healthcare, Industrials, Technology, Media & Telecommunications, Real Estate, Gaming & Lodging, Financial Sponsors and Public Finance. In terms of products, Jefferies offers services in the field of equity capital markets, debt capital markets and advisory (including M&A transactions, restructuring and recapitalisation).

Balance Sheet

(USDm)	2019Y	2020Y	2021Y	2022Y
Cash and Cash Equivalents	11,978	14,152	18,398	14,250
Investments	3,856	3,941	5,195	4,756
Total Assets	49,460	53,118	56,107	51,058
Total Debt*	19,461	21,306	22,829	19,326
Capital: Equity	9,602	9,439	10,580	10,295
Net Leverage Ratio	4.64	5.02	4.53	4.46

Income Statement

(USDm)	2019Y	2020Y	2021Y	2022Y
Total Revenue	4,009	5,851	8,014	5,979
Total Expenses	3,530	4,783	5,760	4,923
Operating Revenue	3,529	5,851	8,014	5,660
Operating Income	-2	1,076	2,267	752
Pre-tax Profit	479	1,067	2,254	1,056
Net Profit	963	768	1,677	782

* total debt includes repurchase agreements and stock loans

Balance sheet date for financial year 30 November; as at 27 March 2023; source: S&P Global Markets, NORD/LB Markets Strategy & Floor Research

Stable development continues: following a rating upgrade by Moody's in 2021, Fitch upgrades rating outlook to "positive" in 2022

In July 2021, Moody's confirmed the rating of Baa3 (outlook: positive) for Jefferies Financial Group, having earlier raised the outlook from stable to positive (03/2021). In November 2021, Moody's then upgraded the rating to Baa2 with a stable outlook, recently confirming this in November 2022. The agency carried out this latest confirmation after Jefferies Group was merged into Jefferies Financial Group. Moody's sees the merger as a consistent implementation of its corporate strategy, which consists of simplifying business operations, reducing the merchant banking portfolio and focusing on its core business (investment banking, capital markets and asset management). In August 2022, S&P Global confirmed its BBB rating for the company with a stable outlook. In its analysis, Fitch also offers a rating of BBB, recently raising the outlook from stable to positive in January 2022.

Regulatory capital requirements in the USA

With the merger of Jefferies Group LLC into JFG, all regulatory requirements of Jefferies Group were transferred to JFG. As a result, JFG is registered both as a broker-dealer and as a Futures Commission Merchant (FCM) and is therefore subject to various capital requirements. As a broker-dealer, Jefferies is obliged to comply with the net capital rule of the Securities and Exchange Commission (SEC) and the minimum requirements of the Commodity Futures Trading Commission (CFTC). As part of the Net Capital Rule, Jefferies had the option of being able to decide in favour of a calculation in accordance with the "Alternative Net Capital" requirement. This stipulates that net capital must not total less than 2% of the aggregated debit balance (primarily receivables attributable to customers) or USD 250,000 (USD 1.5m for prime brokers). Potential loans, dividends and other types of payments to be made are also limited. As an FCM without clearing function, Jefferies is required to maintain adjusted minimum net capital of USD 1.0m. Jefferies Financial Services Inc. (JFSI; 100% subsidiary of JFG) is also subject to the SEC and CFTC requirements as a registered swap trader. Moreover, JFSI is obligated to meet the net capital requirements as defined by the National Futures Association (NFA). Jefferies Financial Group is not subject to any banking supervisory capital requirements.

Regulatory requirements have been fulfilled
In contrast to other investment banks, Jefferies is not obliged to meet strict requirements for risk-based capital and liquidity ratios, although it does not benefit from access to central bank liquidity either. Jefferies is only obliged to calculate its net capital in line with SEC requirements. Following the successful merger of Jefferies Group LLC into JFG, key metrics pertaining to net capital and surplus net capital, which are relevant to the financial supervisory authorities, were reported for Jefferies LLC and JFSI as at 01 November 2022. As at the end of November 2022, the net capital of Jefferies LLC stood at USD 903.3m and the surplus net capital came in at USD 806.2m. Total equity stood at USD 10,295.5m, equating to a reduction of around USD -284m compared with November 2021. The leverage ratio fell by 30bp year on year to 5.0% (FY 2022; according to the annual report).

Specialised offerings via subsidiaries and capital investments
Jefferies Financial Group is active in a wide range of business segments via its three main capital investments. These include its 50/50 joint venture Jefferies Finance (JFIN) which, in cooperation with the Mass Mutual Life Insurance Company, primarily underwrites and syndicates secured corporate loans. Furthermore, JFIN manages internal and external investments for syndicated and direct loans. The Berkadia Commercial Mortgage Holding LLC is another 50/50 joint venture, in which JFG hold a stake. Berkadia offers its customers capital solutions, investment consulting and mortgage services for apartment buildings and commercial properties. In financial year 2022, net income from the stake in Berkadia fell by 4.7% to USD 124.4m. This was due to a switch to products with lower margins and higher borrowing costs. JFG is active in the purchase and management of car loans via its 100% subsidiary Foursight Capital LLC. This generates net interest and service income, which Foursight Capital realises by transferring the car loans to a trust company for securitization.

Regulatory capital requirements for international subsidiaries
In every country in which Jefferies conducts business via subsidiaries, these subsidiaries are subject to the respective national laws and regulations. These include capital adequacy and consumer protection requirements, anti-money laundering and anti-corruption laws as well as adhering to regulations that govern trading and investment banking. Relevant international authorities include, among others, the European Commission, the European Banking Authority, the European Securities and Market Authority, the UK Financial Conduct Authority, the Hong Kong Securities and Futures Commission, the Japan Financial Services Agency and the Monetary Authority of Singapore. Jefferies has also been subject to MiFID II requirements since the start of 2018. As part of the final implementation of the capital requirements in accordance with Basel III in EU and UK law, securities companies will be subject to new supervisory regulations as of financial year 2023. These apply to the UK-based Jefferies International Limited and its European subsidiary Jefferies GmbH. Among other aspects, the new requirement stipulates that a certain amount of variable remuneration is to be paid for key risk bearers.

Income development in the demanding underwriting business

Compared with the record year 2021, income in 2022 fell to just under of the level recorded shortly before the Covid-19 pandemic. In financial year 2022, net income at JFG decreased by 53.4% from USD 1,677.4m (FY 2021) to USD 777.2m (FY 2022). As a result, net income stood 19.3% below the level from 2019 (USD 963m). A significant slump was also recorded in the pre-tax earnings, which, at USD 1,056m versus USD 2,254m (FY 2021), fell by 53,2% in the previous year. This trend is, in particular, reflected in the low net income from the underwriting business, which fell from USD 2,492m (FY 2021) to USD 1,030m. While the issuance business was dominated by unusually high levels of activity across all segments in 2021, particularly in connection with new issues of leveraged loans and the refinancing of high-yield bonds, the market cooled down significantly in 2022.

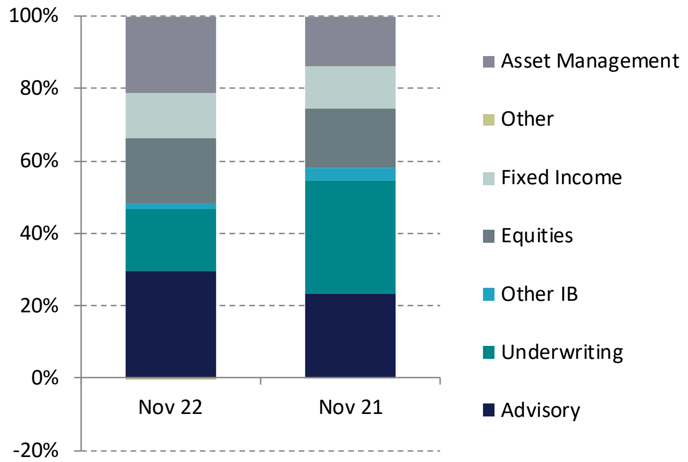
A challenging market environment: declines recorded by almost all segments, although “Advisory” remains stable

As at 30 November 2022, net revenues in Investment Banking amounted to USD 2,900.0m. This compares with the record value of USD 4,657.1m recorded as at 30 November 2021. In the Advisory segment (part of Investment Banking), Jefferies achieved net revenues of USD 1,778.0m compared with USD 1,873.2m in the same period of the previous year. As a result, net revenues in the Advisory segment remained largely stable, which can be attributed to the continued high activity levels on the M&A market. In contrast, revenue in the Underwriting segment reduced by 58.7% compared with the record year 2021. In this context, both Equity Underwriting (decline in net revenues in 2022 by USD 1,018m down to USD 539m) and Debt Underwriting (decline of USD 444m to USD 491m) were impacted negatively. Revenues from other investment banking business activities also declined in financial year 2022 by USD 199.3m to USD 92.2m. The main factors in this development were lower market activity levels and higher provisions for the loan portfolio of the Jefferies Finance joint venture, as well as non-realised net losses from different investments. Net revenues from the equity business fell by 18.5% (USD 1,061m). According to Jefferies, these results were compromised by challenging market conditions for equity trading as a result of a declining new issue business and reduced activities in connection with special purpose acquisition companies. Reduced client activity levels across most products and regions was therefore also a pivotal factor in the decline in the fixed income result (FY 2022: -20.2% to USD 756.6m). In contrast to all other business segments, the Asset Management segment registered income growth of 15.1% in 2022. This is due to higher income levels from certain merchant banking positions as well as the sale of certain other items, including the shares in Oak Hill. Total asset management fees and revenues and asset management investment returns fell by 26.2% and 39.8% respectively on a year-on-year basis.

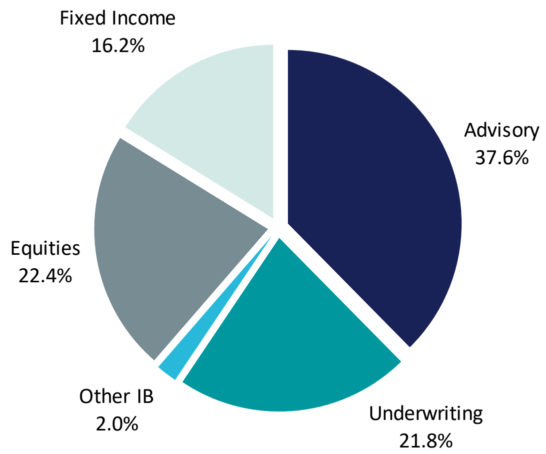
Decline in expenses

In financial year 2022, non-interest expenses of USD 4,923m were reported. In comparison with the previous year, this value has reduced by 14.5%. At USD 2,589.0m, the largest cost item was personnel expenses (comprising expenses in relation to remuneration and social security contributions), although this has also fallen significantly versus the prior year period, when it amounted to USD 3,554.8m as at 30 November 2021. Jefferies puts this development down to the decline in staff numbers in the wake of corporate disposals and the high share of variable remuneration linked to the net revenues.

Net Revenues FY/2022 vs FY/2021



Net Revenues FY/2022



Source: Jefferies, NORD/LB Markets Strategy & Floor Research

Decline in expenses

In the twelve months to 31 November 2022, expenses unrelated to remuneration rose by USD 129.3m to USD 2,334.2m, compared with USD 2,205.0m in the same period of the previous year. This increase is mainly due to higher expenditure levels for business development: during the COVID-19 pandemic, business trips, conferences and other events were significantly limited, which in turn to led to a decrease in expenditure in this area. Once all restrictions were lifted, these costs have started to rise again. In addition, there were higher floor brokerage and clearing fees in line with increased technology and communication costs that are associated with the development of various trading and administrative systems, as well as higher market data costs. Other expenses incurred during the reporting period included expenses in connection with a comparison between JFG and the supervisory authorities SEC and CFTV as well as donations to charitable causes. As a result, net income of USD 777.2m was recorded for 2022, reflecting a decline of 53.4% compared with the previous year, with a return on average equity of 7.5%.

Average VaR shaped by market volatility

To measure the risk in the trading portfolio, Jefferies uses a value-at-risk (VaR) model to calculate potential profits and losses. A one-day VaR for a historic period of one year is calculated with a confidence level of 95%.

Value-at-Risk in the Trading Portfolio* (USDm)

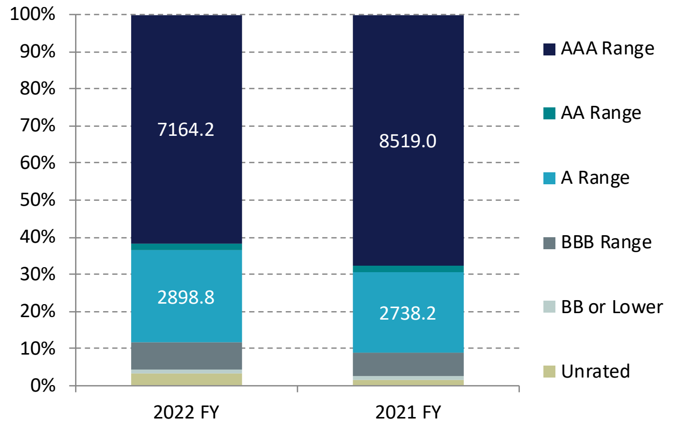
Risk categories	November 30th, 22	November 30th, 21	Daily VaR for the Three Months Ended Nov 30th, 2022		
			Average	High	Low
Interest Rates and Credit Spreads	6.26	4.60	5.93	9.01	3.63
Equity Prices	7.91	9.85	7.83	17.59	3.55
Currency Rates	0.22	0.12	0.12	0.34	0.02
Commodity Prices	0.09	0.15	0.29	0.83	0.09
Diversification Effect	(3.12)	(2.06)	(3.13)	N/A	N/A
Firmwide	**11.36**	**12.66**	**11.04**	**18.94**	**5.90**

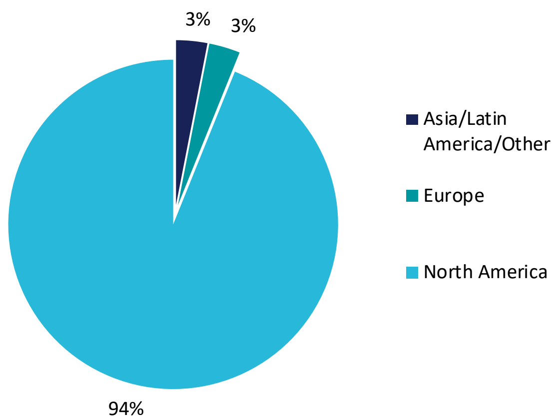
*Average daily VaR for the past three months
Source: Jefferies, NORD/LB Markets Strategy & Floor Research

Average VaR at the end of FY 2022 totals USD 11.04m

The average daily VaR of USD 11.04m as at the end of November 2022 decreased against the value recorded in the prior year (USD 13.63m). This movement is mainly due to lower risks from asset management activities. At times, the opposite effect was recorded with the average VaR due to periodic residual risks from share block transactions. During the period under review, the share exposure was often the cause of stronger VaR movements. From January to February 2022, the VaR fell slightly, a development which reflects the reduction in exposure due to market volatility from inflation, expectations of rising interest rates and the Russian invasion of Ukraine. The higher equity exposure was a pivotal factor behind an increased VaR in March 2022. A subsequent reduction in the equity exposure in combination with a defensive positioning led to lower values in June to mid-July 2022. High VaR values from mid-July 2022 are due to subsequently reduced risks as a result of a share block transaction. The VaR remained relatively stable for the rest of the year. The VaR is also to be interpreted against the backdrop of the coronavirus pandemic in 2021 in addition to the war in Ukraine and resultant ramifications here at present. Since the last twelve months are considered in each case, high values during the COVID-19 crisis are not included in later calculations and must be evaluated accordingly against this backdrop. As the VaR model does not take into account certain financial instrument positions, various other procedures such as stress tests (including scenario analyses) and profit/loss analyses are also used to supplement it.

Counterparty Credit Exposure by Credit Rating (in USDm) and by Region (in %)





Source: Jefferies, NORD/LB Markets Strategy & Floor Research

In total, 62% of the counterparty credit exposure with AAA rating

In financial year 2022, the counterparty credit exposure (with cash and cash equivalents) stood at USD 11,617.2m (FY 2021: USD 12,554.4m). The share of exposures with the extremely high credit rating of AAA stood at 62% compared with 68% as at the end of November 2021. The reduction in the percentage of AAA exposures (-15.9% versus FY 2021) went hand in hand with growth in all other ratings. Exposures categorised as AA and A grew by 16.6% and 5.9% respectively. It is worth noting that, as previously stated, the total exposure has dropped significantly. The share of BBB exposures rose by 70 basis points, equating to absolute growth of 2.1% (as against FY 2021). Overall, only a marginal (albeit growing) share of 4.4% is categorised in the non-investment grade area/not rated at all (FY 2021: 2.4%). When viewed in relative terms, the unrated category stands out with sharp growth of 114.5% in comparison with FY 2021.

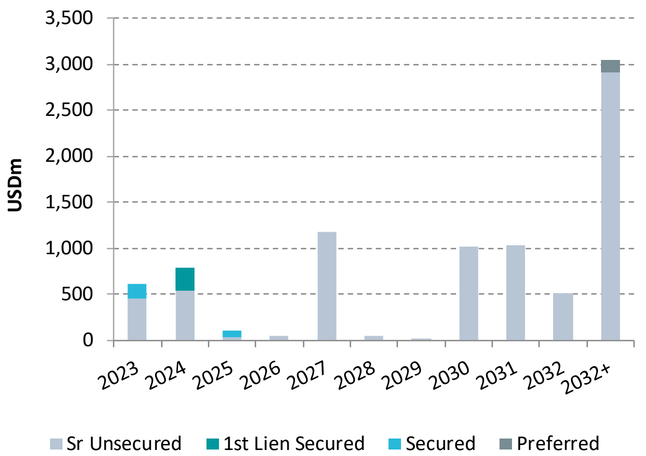
North America accounts for 94% of the counterparty credit exposure

Despite rising from USD 177.5m (FY 2021) to USD 380.7m, the unrated category constitutes only 3.3% of the total exposure. As far as the geographical breakdown is concerned, North America is by far the most important region, accounting for 93.9% of total exposure. At 80.5% or USD 4,815.4m, North America also dominates in terms of net income (FY 2021: 84.2%; USD 6,784.8m). Europe and the Middle East generated 15.5% (FY 2021: 13.0%) of the net income, with 4.0% (FY 2021 2.7%) attributable to Asia.

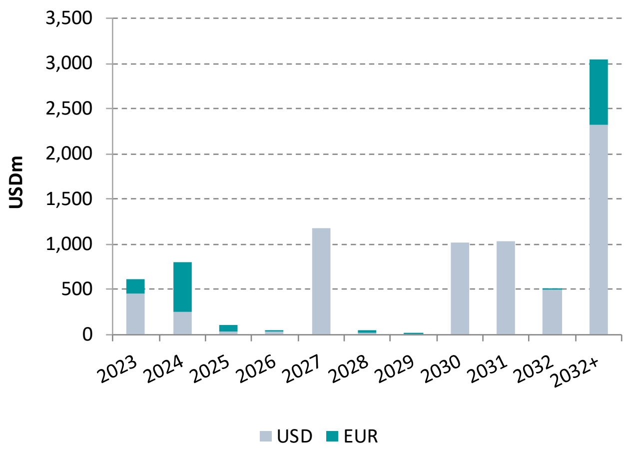
High liquidity pool

The business model of Jefferies is to a large extent based on trust. An above-average degree of customer orientation together with prudent risk management ensures that Jefferies has carved out an impressive competitive position in the fiercely contested investment banking sector and has successfully increased its market share here. The firm's basic principles include, among others, maintaining a solid liquidity buffer (liquidity pool as at 30 November 2022: USD 11,641.0m; 30 November 2021: USD 12,687.9m; this equates to 22.8% and 22.6% of total assets respectively) in tandem with a balance sheet structure which, overall, can be described as risk-off. According to Jefferies, around 78.2% of the financial instruments held can be repo-financed with haircuts of 10% and below, which reflects the high level of liquidity, while the asset portfolio is composed almost exclusively of level 1 and level 2 assets.

Redemption profile: payment rank



Redemption profile: currency



As at: 27 March 2023 10:06 Uhr (CET); Source: Bloomberg (DDIS), NORD/LB Markets Strategy & Floor Research

Funding predominantly via senior unsecured bonds

Jefferies Group LLC primarily conducts refinancing activities via the capital markets, making significant use of unsecured bonds in the process. According to Bloomberg, the outstanding nominal volume of senior unsecured bonds as at 27 March 2023 amounted to the equivalent of USD 7,804.8m spread across 134 separate bond deals. Of this outstanding volume, a total of USD 6,846.0m or around 80% is denominated in USD, with the remaining 20% (USD 1,549.1m) denominated in EUR. The average weighted residual maturity amounts to 9.6 years. Of the bonds denominated in EUR, just one benchmark bond (EUR ≥500m) is still outstanding, which is set to fall due in July 2024. Overall, the funding structure is conservative, with the funding plan providing for regular private placements and periodic benchmark bond deals. In so doing, Jefferies actively pursues a policy of broadening its investor basis.

Strengths / Opportunities

+ Business model and client focus
+ Market position in leveraged finance
+ Leverage ratio, liquidity and capitalisation
+ Risk management across many markets
+ Reduction of the merchant banking portfolio

Weaknesses / Risks

– Fiercely competitive market
– Diversification of the business model
– Risks in the area of leveraged loans
– Risk of earnings volatility in the investment banking segment
– Dependency on secured short-term funding

Appendix
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Governments	+49 511 9818-9660
Länder/Regionen	+49 511 9818-9550
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