Issuer Profile – Jefferies Financial Group

Markets Strategy & Floor Research

5 June 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: 05 June 2023
Source: Bloomberg

Key Facts

Homepage:
www.jefferies.com

Bloomberg-Ticker:
JEF US

As at: 05 June 2023
Source: Bloomberg, Jefferies

Transformation of the Jefferies Financial Group, Merchant Banking being wound down

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, the Group saves costs and has become more flexible in its overall management and financial resources. 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. The activities were transferred to the Asset Management segment in 2022. 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

As at the end of February, the number of employees worldwide at Jefferies Financial Group stood at 5,401, reflecting a reduction of 224 versus the previous quarter. Both the sale of Idaho Timber and the spin-off of Vitesse Energy were decisive factors in this development. 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 40 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. Since year-end 2022, business activities are no longer divided into the segments "Merchant Banking" and "Corporate". The Merchant Banking business is to be gradually liquidated (see above) and general expenses from the Corporate segment will now be allocated directly to the existing segments. Clients are offered a broad product portfolio, ranging from shares to fixed income and currency products. The portfolio is rounded off by research services. Moreover, the strategic alliance first agreed in 2021 with the Japanese institution Sumitomo Mitsui Financial Group (Sumitomo) is to be further expanded, more details of which can be found in a press release. In this context, Sumitomo will increase its stake in Jefferies from 4.5% to 15%. The partnership focuses on M&A consulting in addition to the equity and debt markets.

Stable rating development continues

Jefferies is rated by all three reputable rating agencies (Fitch: BBB, Moody's: Baa2, S&P: BBB). Following rating upgrades in 2021, the ratings were most recently confirmed with stable and positive (Fitch) outlooks. In their rating evaluations, the rating agencies highlight that Jefferies is making efforts to diversify and expand its investment banking activities. However, liquidity and leverage control as well as the reduction of the merchant banking portfolio are also regarded as positive aspects. The implementation of the corporate strategy (restructuring), capitalisation and focus on stable, high-margin income sources are appraised as strengths. Moody's has looked at the details of the recently expanded strategic alliance with Sumitomo and takes a positive view about the closer connection between the two partners. The agency believes this will provide Jefferies with greater financial flexibility and improved access to customers of Sumitomo. By increasing its stake above 10%, Sumitomo has the right to appoint a director.

Balance Sheet

(USDm)	2021Y	2022Y	2022Q1	2023Q1
Cash and Cash Equivalents	18,398	14,250	15,058	10,888
Investments	5,195	4,756	5,510	4,901
Total Assets	56,107	51,058	60,036	52,033
Total Debt*	22,829	19,326	22,394	20,592
Capital: Equity	10,580	10,295	10,549	9,811
Net Leverage Ratio	4.53	4.46	5.01	4.96

Income Statement

(USDm)	2021Y	2022Y	2022Q1	2023Q1
Total Revenue	8,014	5,979	1,693	1,283
Total Expenses	5,760	4,923	1,301	1,125
Operating Revenue	8,014	5,660	1,693	1,283
Operating Income	2,267	752	392	158
Pre-tax Profit	2,254	1,056	392	158
Net Profit	1,677	782	328	129

* total debt includes repurchase agreements and stock loans
Balance sheet date for financial year 30 November; as at 05 June 2023; source: S&P Global Markets, NORD/LB Markets Strategy & Floor Research

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 the end of February 2023, the net capital of Jefferies LLC stood at USD 1,189.9m and the surplus net capital came in at USD 1,086.7m. Total equity stood at USD 9,811.4m. The leverage ratio rose by 30bp year on year to 5.3% (Q1 2023; according to the quarterly report). In every country in which Jefferies conducts business via subsidiaries, these subsidiaries are subject to the respective national laws and regulations.

Specialised offerings via subsidiaries and capital investments

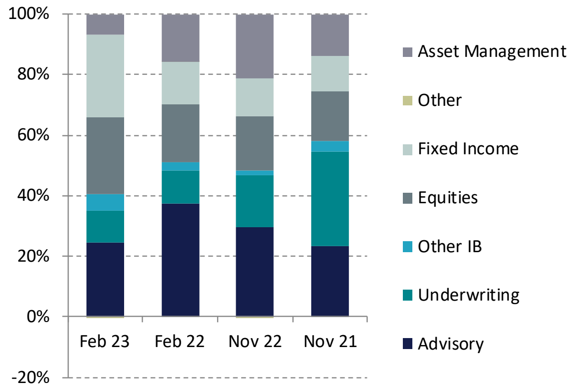
JFG is active in a wide range of business segments via capital investments. These include its 50/50 joint venture Jefferies Finance (JFIN) which, in cooperation with the Massachusetts Mutual Life Insurance Company, primarily underwrites and syndicates secured corporate loans. Furthermore, JFIN manages internal and external investments for syndicated and direct loans. Berkadia Commercial Mortgage Holding LLC is another 50/50 joint venture in which JFG holds a stake. Berkadia offers its customers capital solutions, investment consulting and mortgage services for apartment buildings and commercial properties. 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 securitisation. Other investments have also been made.

Income development
Operating net income in the first quarter of 2023 amounted to USD 1.28bn, which equates to a decline of -24.2% versus the first quarter of 2022. This reflects in particular a fall in income from Investment Banking activities and a decline in the Merchant Banking result, which comes under the Asset Management segment. The latter was impaired by the sale of Idaho Timber, with improved results in the area of Fixed Income and Equities only able to partially able to offset this development. Overall, a pre-tax profit of USD 158.0m (-59.7% Y/Y) was recorded.

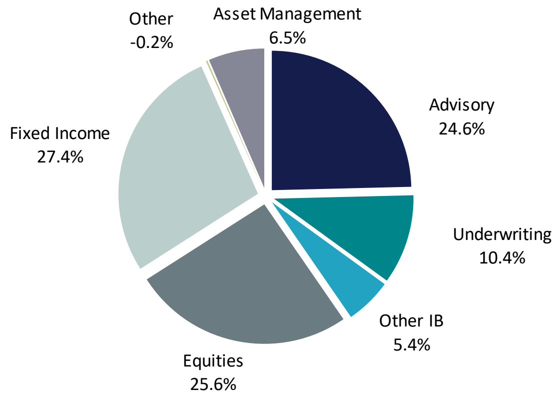
Market environment and sale of Idaho Timber leave their mark on financial results
Net income from Investment Banking amounted to USD 567.9m as at 28 February 2023 and the end of the first quarter of the year. This stands against a sum of USD 982.5m for the same period in the previous year. In the Advisory segment (advisory activities come under Investment Banking), net income fell by -45.3% to USD 297.2m. While Jefferies mentions that the market position remains strong, demand for activities in the area of mergers and acquisitions was down. Another industry-wide negative trend was reflected in the Underwriting results (equity and debt capital). An active business with convertible bonds and cash equity led to an increase in the Equities result in the first quarter of 2023 (+11.4% to USD 308.7m). The Fixed Income sub-segment also developed positively, with an increase of +63.1% to USD 330.7m recorded here. In Asset Management, net income came to USD 78.3m. This was driven by the sale of Idaho Timber (Q3 2022), with higher asset management fees and increased investment income partially offsetting this decline.

Further decline in expenses
In the first three months of the current financial year, non-interest expenses amounted to USD 1.13bn (-13.5% Y/Y), having stood at USD 1.30bn at the end of the first quarter of 2022. The decline was primarily due to lower wage and employee expenses that can also be contextualised by lower revenues in the Investment Banking and Capital Markets businesses, in addition to a reduction in revenues in the wake of the sale of Idaho Timber. The overall development was also shaped by increases in floor brokerage and clearing fees, technology and communications costs, and business and development costs, which were partially offset by a decline in actuarial expenses. In the period under review, the number of employees fell by 224, which also contributed to the reduction in personnel expenses mentioned at the start of this section. In this context, the sale of Idaho Timber in particular, as well as the spin-off of Vitesse Energy, were again the main reasons for this.

Net Revenues



Net Revenues Q1/2023



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

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

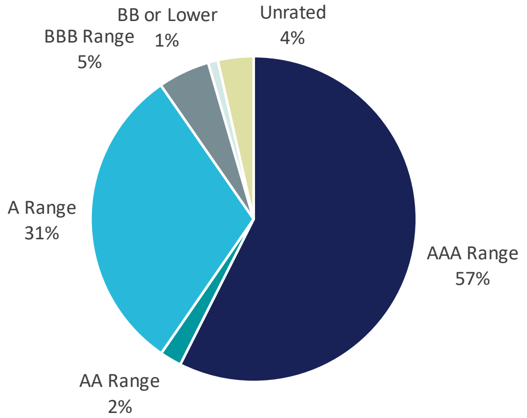
Risk categories	February 28th, 23	November 30th, 22	Daily VaR for the Three Months Ended February 28th, 23		
			Average	High	Low
Interest Rates and Credit Spreads	7.72	6.26	6.32	9.16	4.31
Equity Prices	13.31	7.91	9.57	13.39	6.53
Currency Rates	0.37	0.22	0.25	0.37	0.22
Commodity Prices	0.15	0.09	0.15	0.32	0.37
Diversification Effect	(3.85)	(3.12)	(3.44)	N/A	N/A
Firmwide	**17.70**	**11.36**	**12.85**	**19.93**	**9.12**

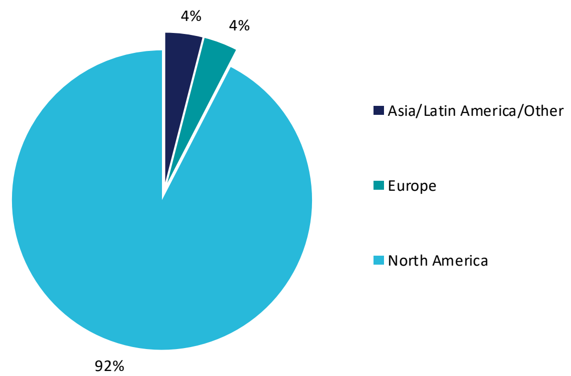
*Average daily VaR for the past three months
Source: Jefferies, NORD/LB Markets Strategy & Floor Research

Average value-at-risk 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%. The daily VaR across the three-month period up to the end of February 2023 averaged USD 12.85m, which is up slightly on the previous quarter (USD 10.62m). This increase is mainly due to higher equity exposure, primarily related to wealth management activities. Conversely, the average daily VaR for the capital market remained relatively constant, as the trading departments kept their risk positions at relatively low levels on account of the current market environment. 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

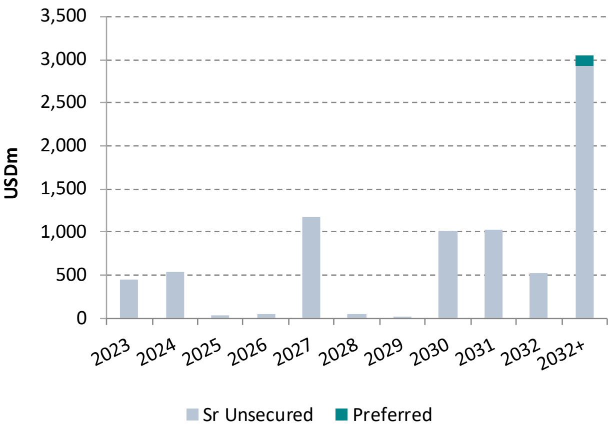
57% of the counterparty credit exposure rated "AAA"

At the end of February 2023, the counterparty credit exposure (including cash and cash equivalents) totalled USD 9,373.0m (FY 2022: USD 11,617.2m). The proportion of exposures rated "AAA", which is an extremely high credit rating, stood at 57%, as against 62% at the end of November 2022. In absolute terms, exposure was down across all areas. However, in terms of the percentage weighting, the reduction in the proportion of "AAA" exposure goes hand in hand with a higher proportion of exposures rated "A" (now 31% instead of 25%).

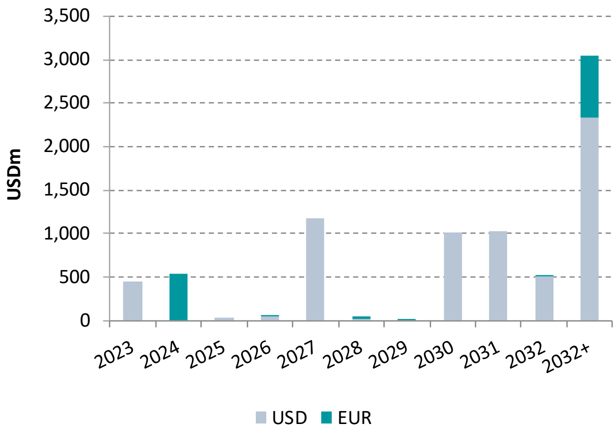
North America accounts for 92% of the counterparty credit exposure
In terms of the geographical breakdown, North America is by far the most important region and accounts for 92% of the exposure. North America also dominates net income with a share of 77% or USD 1,283.5m (Q1 2022: 84%; USD 1,692.8m). The regions of Europe and the Middle East generated 17% (Q1 2022: 13.0%; USD 217.9m) of net income, while Asia accounted for a share of 6% (Q1 2022: 2.7%; USD 83.3m).

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 28 February 2023: USD 9,721.6.0m; 30 November 2022: USD 11,641.0m; this equates to 18.7% and 22.8% of total assets respectively) in tandem with a balance sheet structure which, overall, can be described as risk-off. According to Jefferies, around 77.7% 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: 05 June 2023 11:08h (CET); Source: Bloomberg (DDIS), NORD/LB Markets Strategy & Floor Research

Funding predominantly via senior unsecured bonds
Jefferies Financial Group 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 05 June2023 amounted to the equivalent of USD 7,928m spread across 140 separate bond deals. Of this outstanding volume, around 79% is denominated in USD, with the remaining 21% denominated in EUR. The average weighted residual maturity amounts to 9.8 years. 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
+ 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

Appendix
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