Issuer Profile – Jefferies Group LLC

Markets Strategy & Floor Research

10 October 2022

Marketing communication (see disclaimer on the last pages)

NORD/LB

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Authors: Melanie Kiene // Dr Frederik Kunze

Credit Ratings

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

As at: 06 October 2022
Source: Bloomberg

Key Facts

Homepage:
www.jefferies.com

Bloomberg-Ticker:
JEF US

As at: 06 October 2022
Source: Bloomberg, Jefferies

Jefferies Group to be merged into Jefferies Financial Group at the end of November 2022

The Jefferies Group LLC (Jefferies; headquarters in New York) operates as an intermediate holding company for the global investment banking operation of the Jefferies Financial Group Inc. (JFG). It offers investors, corporates and governmental institutions a broad portfolio of services related to the securities market. Founded in the USA in 1962, Jefferies opened its first international subsidiary in the UK in 1986. Alongside New York as the global headquarters, regional headquarters are operated out of London and Hong Kong. Since March 2013, Jefferies has been an indirect and wholly owned subsidiary of Jefferies Financial Group Inc. (formerly Leucadia National Corp.). For its part, Jefferies Financial Group Inc. (Moody's: Baa2 stable; Fitch: BBB positive; S&P: BBB stable) is a US holding company that holds equity interests in financial companies and in firms operating across various sectors of the manufacturing industry. Jefferies Group LLC is the most significant equity interest of Jefferies Financial Group Inc. The change of name to Jefferies Financial Group in May 2018 was accompanied by a strategic realignment at the same time, which saw the Jefferies Group dispose of various holdings, among other aspects. Moreover, the transformation into a diversified financial services company has progressed further. Following this restructuring, the Asset Management business was hived off and established as an independent operating segment. In July 2022, Jefferies then announced that it was planning to merge Jefferies Group LLC into Jefferies Financial Group Inc at the end of the financial year with effect from 30 November 2022. This will streamline the corporate structure while also helping to leverage synergies. Moreover, the plans to wind down the merchant banking portfolio (valued at USD 1.6bn) have been continued. The spin-off of Vitesse Energy, which is being established as a new, independent public limited company under shareholder ownership, and the agreed sale of Idaho Timber (purchase price: USD 239m) are also part of the group's overarching strategy.

Jefferies offers broad product portfolio

The Jefferies Group employs 4,825 staff (data: May 2022), equating to an increase of slightly more than 704 full-time employees versus the prior-year period. Around 200 employees were acquired following the takeover of Foursight Capital LLC. Otherwise, the increase in staff numbers is down to the general growth in business. The employees are split between the global and regional headquarters in addition to more than 30 national and international locations. The "Investment Banking and Capital Markets" segment comprises the sub-segments of Investment Banking (incl. Advisory), Equities and Fixed Income in addition to connected services. "Asset Management", which comes under the umbrella of Leucadia Asset Management (LAM), covers activities related to investment management services via Jefferies Investment Advisers and partnerships. Customers are offered a broad product portfolio, ranging from shares to pensions plans and currency products. The portfolio is rounded off by research services. Customers have at their disposal around 1,300 investment bankers in the USA, Europe and Asia with profound industry expertise. In the equity business, around 400 researchers offer coverage focused on the shares of more than 2,750 companies around the world.

Balance Sheet
(USDm)

	2019Y	2020Y	2021Y	2022 H1
Cash and Cash Equivalents	9,868	12,209	16,456	11,700
Investments	2,790	2,933	4,334	2,018
Total Assets	43,516	47,752	54,769	53,156
Total Debt*	17,524	19,309	21,023	19,519
Capital: Equity	6,130	6,366	7,079	7,858
Net Leverage Ratio	6.40	6.70	6,66	6,16

Income Statement
(USDm)

	2019Y	2020Y	2021Y	2022 H1
Total Revenue	3,113	5,197	7,044	2,671
Total Expenses	2,788	4,020	4,860	2,045
Operating Revenue	3,027	5,183	6,839	2,583
Operating Income	240	1,172	1,992	551
Pre-tax Profit	325	1,177	2,184	626
Net Profit	244	875	1,625	483

* total debt includes repurchase agreements and stock loans
Balance sheet date for financial year 30 November; as at 16 September 2022; source: S&P Global Markets, NORD/LB Markets Strategy & Floor Research

Stable development continues: after Moody's implements rating upgrade 2021, Fitch changed its rating outlook to "positive" in January 2022

In July 2021, Moody's confirmed the rating of Baa3 (outlook: positive) for the Jefferies Group LLC, having earlier raised the outlook from stable to positive in March 2021. Thereafter, on 10 November 2021, the agency upgraded the rating to Baa2 with a stable outlook. The rating was most recently confirmed in July 2022 with a stable outlook. The agency proceeded with the most recent rating confirmation after Jefferies announced plans to further reduce concentration risks, monetize its equity participations, sell off the old merchant banking portfolio and streamline the corporate structure. From the perspective of Moody's, bond creditors also stand to benefit from the streamlining of the business model and the corporate structure. For its part, S&P Global rates the company at BBB, having raised the outlook from negative to stable at the end of October 2020. In its analysis, Fitch also reaches a rating of BBB, having recently raised the outlook from stable to positive in January 2022.

Regulatory capital requirements in the USA

Jefferies Group LLC is registered both as a broker-dealer and as a Futures Commission Merchant (FCM) and is therefore subject to various capital requirements. For its role as a broker-dealer, Jefferies is obliged to fulfil the SEC's net capital rule. As part of the Net Capital Rule, Jefferies had the option of being able to decide in favor 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 Group LLC 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. As at the end of May 2022, net capital stood at USD 1,880.1m, with surplus net capital totalling USD 1,772.9m. Total equity amounted to USD 7,342m as at the end of May 2022 and USD 6,280m as at the end of November 2021. The leverage ratio as at the end of the 2021 financial year came in at 5.7%, with the equivalent figure standing at 6.8% as at the end of May 2022.

Capital contributions of the Jefferies Financial Group
As at year-end 2021, the parent company Jefferies Financial Group Inc. transferred certain loans, securities and equity participations to the Jefferies Group LLC. These included the participation in Foursight Capital LLC (Foursight), a specialist supplier of car financing. Since then, Foursight has been fully recognized in the balance sheet of the Jefferies Group. The transfers were implemented in the form of a capital contribution and were transferred at the respective book values as at 31 December 2021. As a result, total assets increased by USD 1.27bn, while total liabilities rose by USD 800.4m and total equity by USD 476.5m.

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 requirements, consumer protection, 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 and 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. In relation to Brexit, services have continued to be offered to customers in the UK as well as those based in the European Union (EU) via Jefferies GmbH, a broker dealer regulated by the Federal German Financial Supervisory Authority (BaFin), since the UK's formal withdrawal from the EU.

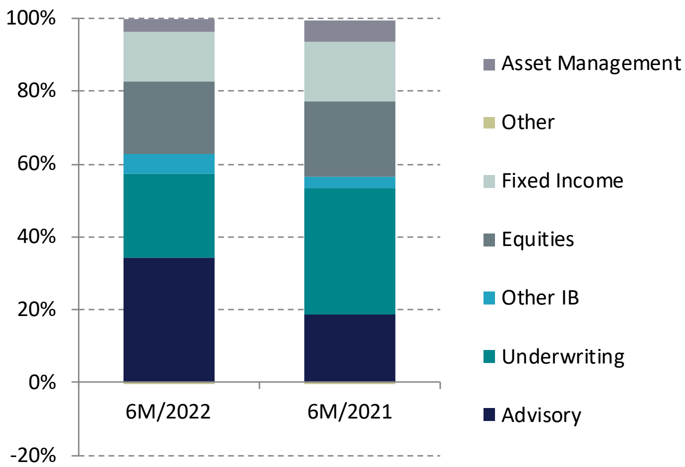
Business focus
The majority of income is generated in the corporate clients business, which reflects the institute's heavily customer-oriented approach. Jefferies Investment Banking covers a number of different industries: Consumer, Energy, Financial Services, Healthcare, Industrials, Technology, Media & Telecommunications, Real Estate, Gaming & Lodging, Technology, 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 recapitalization).

Robust income development despite general challenges in the business environment
The net earnings of the Jefferies Group declined in both the second quarter of 2022 (USD 1,130m) and across the first half of 2022 as a whole (USD 2,671m) by 30.2% and 28.7% respectively in comparison with the respective prior-year periods. However, it should still be mentioned here that net earnings generated in the first six months of 2022 amounted to the second-highest value ever recorded for this metric. The record value of USD 3,747m was achieved by Jefferies in the first half of 2021. In Q2 2022, there was a significant decline in pre-tax profit as well, which at USD 189m has fallen by 56% across the previous three months (Q2 2021: USD 429m). There was a similarly sharp decline in pre-tax profit for the first six months of the year, which declined to USD 626m as against USD 1,100m (H1 2021). This is primarily reflected in lower net earnings from the issuance business involving bonds and equity, as well as reduced income from the pensions business, which, despite the challenging market environment, still managed to perform fairly robustly.

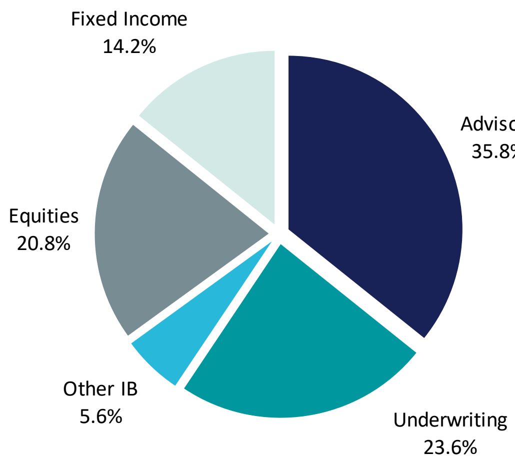
Challenging market environment: declines across nearly all segments; record for Advisory

Net earnings from investment banking totaled USD 1,690m as at H1 2022 in comparison with USD 2,115m in the record first half of 2021. In the Advisory division, Jefferies generated USD 915.5m, having recorded a value of USD 702m in the prior-year period. This rise of 30.4% is attributable to exceptionally dynamic activities in the area of mergers and acquisitions. In contrast, following a record year, earnings in the Underwriting segment fell by 51.6% to USD 630.7m. The 29.7% increase in revenues from other investment banking business to USD 144m is due to a rise in mortgage inflows, net income attributable to Foursight and certain market value gains. In the equity business, net earnings fell by 31.3% to USD 531.9m. In this context, Jefferies notes that the results were impacted by factors related to challenging market conditions for equity trading on account of market volatility and global instability, as well as significantly reduced activity in connection with special purpose acquisition companies. Reduced customer activities across the majority of products and regions were again the key to declining results in the Fixed Income (-41.3% to USD 364.3m) and Asset Management (-57.6% to USD 91.1m) business segments.

Net Revenues H1/2022 vs H1/2021



Net Revenues H1/2022



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

Declining expenses

In the first half of 2022, non-interest expenses of USD 2,045.4m were recorded. In comparison with the same period of the previous year, the value has declined by 22.7%. At USD 1,277.9m, 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 comparison period of H1 2021, when the value amounted to USD 1,909.7m. The reason for this, according to Jefferies, is a decline in business activities as a result of market volatility and the impacts of the COVID-19 pandemic. Non-remuneration expenses rose by USD 30.9m in the six months leading up to 31 May 2022 to now stand at USD 767.5m, as against the value of USD 736.6m recorded in the same period of the previous year. The increase is primarily attributable to increased business development costs, with expenses related to business trips, conferences and other events starting to be incurred again in comparison with the prior-year period, when these items were severely limited due to the COVID-19 restrictions in place. 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 include the expenses in connection with operating Foursight and donations to charitable causes. All in all, the net result for the first six months of the current financial year came in at USD 437m, representing a decrease of 35% compared with the same period of the previous year, although RoAE (return on average equity) still amounts to 13%.

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)

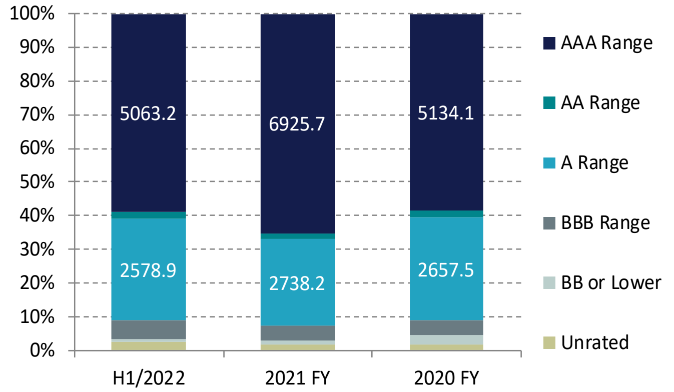
Risk categories	May 31 th, 2022	November 30th, 21	February 28 th, 2021	Daily VaR for the Three Months Ended May 31 th, 2022		
				Average	High	Low
Interest Rates	6.19	4.60	10.35	6.05	5.52	4.41
Equity Prices	8.57	9.85	11.36	8.73	13.65	6.09
Currency Rates	0.03	0.12	0.31	0.05	0.07	0.03
Commodity Prices	0.48	0.15	0.72	0.49	0.83	0.29
Diversification Effect	(5.52)	(2.06)	(6.61)	(3.48)	N/A	N/A
Firmwide	**9.79**	**12.66**	**16.13**	**11.84**	**18.41**	**8.37**

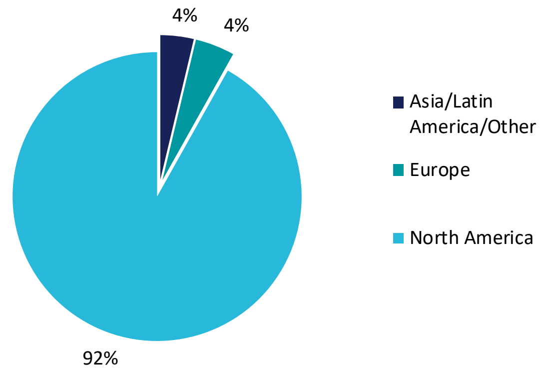
*Average daily VaR for the past three months
Source: Jefferies, NORD/LB Markets Strategy & Floor Research

Average VaR at the end of H1 2022 stands at USD 11.84m

The average daily VaR of USD 11.84m as at the end of May 2022 has fallen slightly versus the value recorded in the prior quarter (USD 12.12m). This decline can primarily be attributed to a reduction in the VaR in the area of equities, as the average exposure in share prices had fallen. The effect on the average VaR was partly offset by the increase in interest rates and credit spreads, also due to increased volatility. Equity exposure has often been behind more pronounced movements over time as well. For example, the higher equity exposure from late 2021 to early January 2022 was again responsible for the increase in the VaR. From January to February 2022, the VaR fell again, 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 VaR is also to be interpreted against the backdrop of the coronavirus pandemic in 2020 and 2021 in addition to the war in Ukraine and the 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), monitoring concentration risks and tracking set price targets/stop loss levels 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

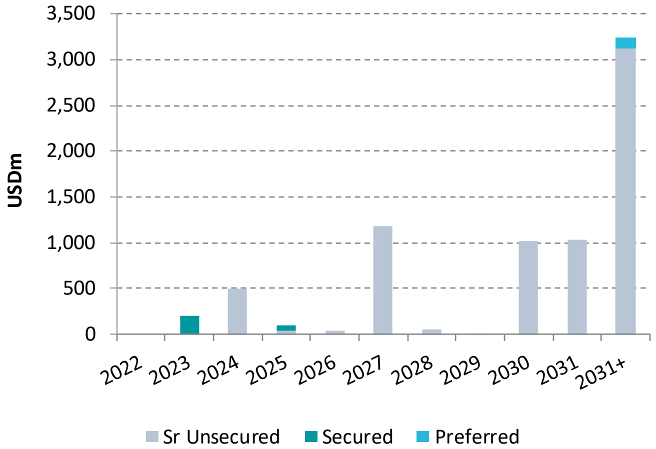
North America accounts for 92% of the counterparty credit exposure

In the first half of 2022, the counterparty credit exposure (with cash and cash equivalents) stood at USD 8,590.2m (FY 2021: USD 10,612.9m). At 59%, the share of AAA-rated exposures – a metric reflecting very high credit quality – was at a lower level in the first six months of 2022 in comparison with that recorded at the end of the 2021 financial year (65%). This again corresponds with the breakdown for the previous year and at year-end 2020. The reduction in the share of AAA-rated exposures (-26.9% vs. FY 2021) went hand in hand with a decline in the level of AA-rated exposures (-7.3%) and a fall in A-rated exposures (-5.8%). It should be noted that the total exposure, as mentioned above, has fallen significantly and that the AAA and AA segments have changed the most in both relative and absolute terms. The share of BBB-rated exposures rose by a single percentage point, although in absolute terms the increase is equivalent to just +8.4% (in comparison with FY 2021). Overall, only a marginal share of 3% is categorized in the non-investment grade area/not rated at all. In regional terms, North America is by far the most important region, accounting for 92% of total exposure. The same region dominates in terms of net revenues, accounting for a share of 77% or USD 2,050.6m (total net revenues: USD 2,671.3m; 6M 2021: 16.0%, USD 3,746.8m). Europe generated 17% of net revenues, with 6% attributable to the region Asia-Pacific (6M 2021: 4% of net revenues).

High liquidity pool

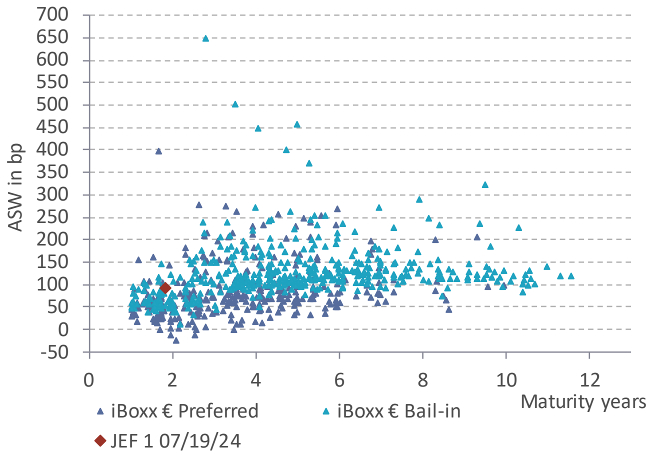
The business model of Jefferies is to a large extent based on trust. With an above-average customer orientation together with prudent risk management, Jefferies has carved out an impressive competitive position in the fiercely contested investment banking sector and has successfully increased its market share here. The institute's basic principles include, among others, maintaining a solid liquidity buffer (liquidity pool as at 31 May 2022: USD 8,662m; 30 November 2021: USD 10,746m; this equates to 16.3% and 19.6% of total assets respectively) in tandem with a balance sheet which, overall, can be described as risk-off. According to Jefferies, just under 70% 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.

Debt distribution – by currency



As at: 07 October 2022 09:05h (CET);
Source: Bloomberg (DDIS), NORD/LB Markets Strategy & Floor Research

€-Senior BMK Bonds vs. iBoxx EUR Financials Senior



As at: 07 October 2022 09:05h (CET);
Source: Bloomberg, Markit, 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 19 September 2022 amounted to the equivalent of USD 6,996.5m, spread across 129 separate bond deals. In addition, a total of USD 254.4m is allocated to the “secured” segment, with the “preferred” category accounting for a total of USD 125m. Of the outstanding volume, a total of USD 5,887.6m or 80% is denominated in USD, with the remaining 20% (USD 1,488.3m) denominated in EUR. The average weighted residual maturity amounts to 10.4 years. Of the EUR-denominated bonds, one deal was placed in benchmark format (EUR >500m). This was issued by Jefferies in July 2019 (EUR 500m; JEF 1 07/19/24). Although the bond is not included in the iBoxx EUR Financials Senior, this universe does still offer an opportunity to appraise the bond. It was allocated to the “preferred” category, where it slots into an upper mid-table position with a mid-ASW spread of around 42bp and a residual term to maturity of one year ten months. 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

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

Weaknesses / Risks

– Fiercely competitive market
– Trust-based business
– Risks in the area of leveraged loans
– Risk of earnings volatility in the investment banking segment
– Dependency on secured short-term funding
– Share of actuarial and undrawn revolving liabilities

Appendix
Contacts at NORD/LB

Markets Strategy & Floor Research

Jan-Phillipp Hensing
SSA/Public Issuers

+49 172 4252877
jan-phillipp.hensing@nordlb.de

Dr. Frederik Kunze
Covered Bonds/Banks

+49 172 354 8977
frederik.kunze@nordlb.de

Melanie Kiene, CIIA
Covered Bonds/Banks

+49 172 169 2633
melanie.kiene@nordlb.de

Dr. Norman Rudschuck, CIIA
SSA/Public Issuers

+49 152 090 24094
norman.rudschuck@nordlb.de

Sales

Institutional Sales	+49 511 9818-9440
Sales Sparkassen & Regionalbanken	+49 511 9818-9400
Sales MM/FX	+49 511 9818-9460
Sales Europe	+352 452211-515

Trading

Covereds/SSA	+49 511 9818-8040
Financials	+49 511 9818-9490
Governments	+49 511 9818-9660
Länder/Regionen	+49 511 9818-9550
Frequent Issuers	+49 511 9818-9640

Origination & Syndicate

Origination FI	+49 511 9818-6600
Origination Corporates	+49 511 361-2911

Sales Wholesale Customers

Firmenkunden	+49 511 361-4003
Asset Finance	+49 511 361-8150

Treasury

Collat. Management/Repos	+49 511 9818-9200
Liquidity Management	+49 511 9818-9620 +49 511 9818-9650

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