EQUITY RESEARCH

COMPANY UPDATE

November 23, 2011

FINANCIAL INSTITUTIONS/COMMERCIAL & INVESTMENT BANKING

Jefferies Group

Another Hack Attack

Stock Rating:

PERFORM

12-18 mo. Price Target	NA
JEF - NYSE	$10.06
3-5 Yr. EPS Gr. Rate	NA
52-Wk Range	$27.12-$9.50
Shares Outstanding	199.7M
Float	148.3M
Market Capitalization	$2,009.2M
Avg. Daily Trading Volume	5,454,349
Dividend/Div Yield	$0.30/2.98%
Fiscal Year Ends	Nov
Book Value	$14.90
2011E ROE	9.8%
LT Debt	$3,779.0M
Preferred	$125.0M
Common Equity	$3,175M
Convertible Available	Yes

Book Value Per Share: Pro forma book value per share adjusted for outstanding restricted stock units.

EPS Diluted	Q1	Q2	Q3	Q4	Year	Mult.
2008A	(0.43)	(0.03)	(0.18)	(2.39)	(3.23)	NM
2009A	0.19	0.30	0.42	0.47	1.38	7.3x
2010A	0.35	0.41	0.22	0.31	1.28	7.9x
2011E	0.42A	0.36A	0.30A	0.24	1.30	7.7x
2012E	--	--	--	--	1.40	7.2x

SUMMARY

Every analyst is entitled to his or her opinion, but one would think that one aspiring to become a significant rating agency would do a minimum of proof reading and fact checking before launching a highly controversial report. In a report yesterday from Egan-Jones we read: "JEF has seen a decline of approximately 37.8% per annum over the last couple of years which is disappointing." Well aside from the absurdity of saying "approximately" when one drills down to a tenth of a percent, while at the same time leaving "last couple of years" totally vague, the number is just flat out wrong by a country mile.

KEY POINTS

- JEF had record net revenues of $2.1B in 2009, up 36% from the prior record in 2007; in the 11-month year ended Nov. 2010 revenues were $2.2B (i.e., so about $2.4B annualized); and for the first three quarters of 2011, revenues are running at a $2.7B annual rate.
- The Egan-Jones report shows total revenues of $524M for full-year 2010 and $897M for 2011. Now that's what we call a miss. The $524M incidentally is the exact same number as 3Q11. Another peculiar aspect of the analysis is that Egan-Jones' downgrade note from 11/2 showed 2010 revenue of $680M.
- Try as we might, we could not reverse engineer a 37.8% decline rate to figure out what the "couple of years" time-frame was. The report also claimed that "operating margin fell to 0.0% for the fiscal year ended 2010. In fact JEF earned $397M on $2.2B of revs which we calculate to be 18.1%.
- The report also bizarrely projects JEF's assets to increase from $45B today to $67B by fiscal year-end, to $102B in 2012 and to $153B in 2013. All analysts make an occasional numerical mistake, but these numbers are so grotesquely wrong they should immediately jump off the page to anyone remotely familiar with the numbers.
- The report's main contention is that JEF needs to reduce its assets by $5B and raise $1B of equity or face a downgrade from them. Every analyst is entitled to his or her opinion, but we doubt that the market will pay much heed given the gross miscalculations we see in this report.

Stock Price Performance

Company Description

Jefferies is one of the largest independent investment banks in the U.S.

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One would think that anyone so keenly attuned to the needs of Jeffries' balance sheet as Egan-Jones would intuitively grasp the folly of grossing up the company's balance sheet assets by nearly 50% by year-end, and then compound the folly by basing a "liquidation analysis" based on this assumption. In the "base case" scenario the balance sheet is first grossed up by "approximately" 50% and then a 10% haircut is applied to marketable securities and short-term investments, a 20% haircut to loans, and 15% to other long-term investments and fixed assets. The resulting analysis shows a 10.6% haircut on Total Assets or $7.1B in absolute terms. Where these numbers come from is anyone's guess. It is interesting to juxtapose this with the company's own disclosure earlier in the week that 77% of its long inventory is readily financeable at a haircut of 10% or less. Lenders would want a margin of safety, and thus clearly the market is giving these assets a higher value than Egan-Jones.

Indeed, we find the whole liquidation analysis confusing and at odds with what the firm published on November 2nd. In that report the assets were $45B and the haircut on the marketable securities was 20%. Now the assets are 50% higher and the haircuts are 10% less, and all the while the report offers no rationale for the change in assumptions. Interestingly, the "conclusion" curiously comes to roughly a similar recovery rate in the '70s. Could this be a case of reverse engineering?

Investment Thesis

We continue to view JEF as one of the few good mid-cap growth stories in the financial services industry. Unlike most investment banks, it has created value for its shareholders over the past decade and in general we are favorably disposed to how it used the financial crisis to build its franchise in a non-dilutive manner. All that said, for the time being we would prefer getting our financial exposure from the plain vanilla banks and remain on the sidelines with respect to JEF.

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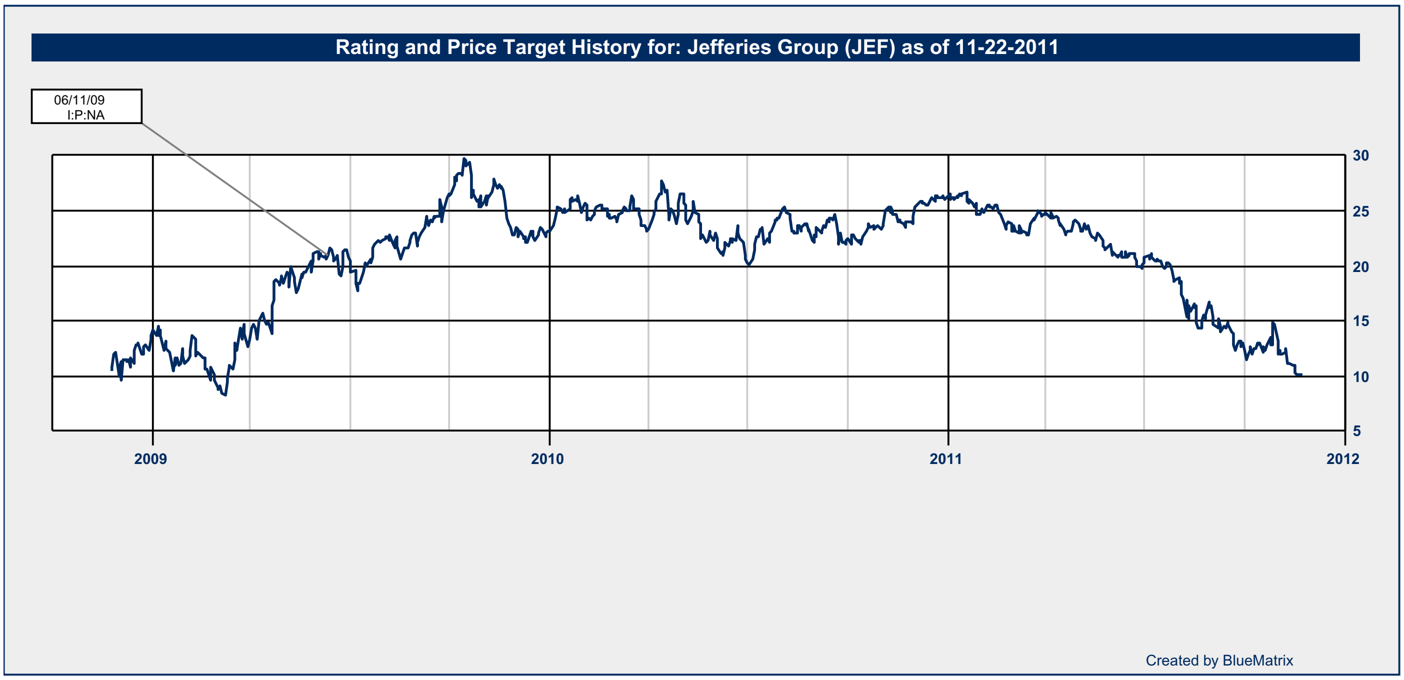

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			IB Serv/Past 12 Mos.	
Rating	**Count**	**Percent**	**Count**	**Percent**
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PERFORM [P]	257	43.30	84	32.68
UNDERPERFORM [U]	7	1.20	3	42.86

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