

Fitch: Jefferies' 2Q'14 Slowdown Shows Lack of Market Momentum

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--Jefferies Group LLC (Jefferies) reported weaker results in second quarter 2014 (2Q'14), following two consecutive quarters of strong financial performance. The sequential decline in net revenues was driven by slower activity across all of the firm's businesses. The recent dearth of volatility and trading volumes in the markets has made it challenging for Jefferies and its peers to generate stable revenues. Jefferies' 'BBB-/F3' ratings, which were last affirmed by Fitch Ratings in March, incorporate the inherent cyclicity of the business, and are therefore not acted by the decline in net revenues.

Quarterly net revenues of \$723 million were down 19.6% from a record 1Q'14, but up 13.1% year-over-year (including mark-to-market impact on holdings of Harbinger Group, Inc. [HRG] and KCG Holdings [KCG]). All of Jefferies' business segments reported weaker revenues during the quarter, with the biggest declines in Fixed Income and Equity Trading, as well as M&A Advisory. Total Sales & Trading net revenues were down 16.8% from the linked quarter, while Investment Banking revenues declined 20.1%. Jefferies' 2Q'14 net income of \$61.3 million was down 45.5% from the linked quarter, but 55.2% higher than the prior year period.

Net revenues for Fixed Income Trading were down 24% from the first quarter, which tends to be a seasonally stronger period. The magnitude of the decline is generally consistent with the guidance provided by Jefferies' larger peers, which will report their results next month. However, Fitch believes that Jefferies' product mix and unique reporting periods make it difficult to draw parallels to competitors' performance. On a year-over-year basis, Jefferies' fixed income revenues were virtually flat compared to a challenging 2Q'13.

Equities Trading revenues fell approximately 5% from the prior year period, excluding the impact of HRG and KCG. In March 2014, Jefferies sold its entire position in HRG (18.6 million shares) to its parent company, Leucadia National Corp. (Leucadia, rated 'BBB-'). Fitch views this transaction positively for the stand-alone credit profile of Jefferies, as it removes a sizeable block of equity from the firm's balance sheet. That said, Fitch equalizes the ratings of Jefferies and Leucadia to reflect the potential for capital movement between the entities and the shared senior management, so the transfer is generally viewed as neutral from perspective of the combined enterprise.

The Asset Management segment had a negative impact on results during the quarter,

Fitch: Jefferies' 2Q'14 Slowdown Shows Lack of Market Momentum

Written by Australian Business

with a net loss of \$3.1 million. This was caused by write-downs in certain funds partially owned by Jefferies, as well as a reduction in fee income. Fitch believes both of these items were at least in part caused by Jefferies' ongoing consolidation of the asset management businesses at the Leucadia level.

The firm's risk appetite remained relatively consistent, as evidenced by a virtually flat balance sheet and lower firm-wide value-at-risk (VaR), although the recent benign market conditions also contribute to lowered VaR. Jefferies' average assets during 2Q'14 increased by a modest 2.7% and stood at \$50.4 billion. Adjusted net leverage (net assets divided by tangible equity) decreased to 10.5x as of May 31, 2014 from 10.7x as of Feb. 28, 2014. Fitch continues to view Jefferies' leverage and VaR levels as relatively conservative. The liquidity buffer has increased from 1Q'14, which tends to be a seasonally lower period as a result of cash bonus payments.

Jefferies, a Delaware-incorporated holding company, is a full-service investment banking and institutional securities firm primarily serving middle-market clients and investors. Its primary broker/dealer operating subsidiary, Jefferies LLC, holds the vast majority of the firm's consolidated assets and is regulated by the SEC. At May 31, 2014, Jefferies had U.S. GAAP total assets of \$43.6 billion and shareholders' equity of \$5.5 billion (including non-controlling interests and \$2 billion of goodwill). Fitch considers Jefferies to be a core subsidiary of Leucadia based on Jefferies' significance relative to Leucadia's equity and the likely role it will play in the combined company's future strategic direction.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'Fitch Affirms Jefferies' Long- and Short-Term IDRs at 'BBB-/F3'; Outlook Stable', March 6, 2014;

--'Fitch Affirms Leucadia's Long-Term IDR at 'BBB-'; Outlook Stable', March 6, 2014;

--'2014 Outlook: U.S. Securities Firms', Nov. 21, 2013.

Applicable Criteria and Related Research:

2014 Outlook: U.S. Securities Firms (Capital and Liquidity Counterbalance Challenging Market Conditions)

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=722741

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE '

[WWW.FITCHRATINGS.COM](http://www.fitchratings.com)

' PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.