

# Fellow Shareholders:

## The year 2007 was challenging in the markets and for the financial services sector in particular.

For Jefferies, the first six months of 2007 were inspiring, with our Firm firing on almost every cylinder, our new businesses and integration efforts working in our favor, and our delivering on our mission to be the premier global investment bank and securities firm serving growing companies and their investors. The second half of 2007 saw a marked change in the environment, with many of our competitors suffering massive write-downs, and the debt markets experiencing rapidly declining liquidity and increasing volatility. We do not recall a more challenging period for financial services companies. This ultimately disrupted the balance of business growth and financial performance that we've been able to achieve for the prior seven and one-half years of this decade.

Though our second-half results were not as strong as we had expected, 2007 saw many very positive developments for our Firm, and we are pleased to have announced our eighth consecutive year of record net revenues, totaling \$1.57 billion, up 8 percent, and our third best net earnings ever, \$144.7 million. Investment banking revenues were up nearly 40 percent to \$750 million, and our revenues in equities increased more than 10 percent to nearly \$600 million. Net earnings per share (diluted) were \$0.97, and we ended the year with stockholders' equity of \$1.76 billion and \$3.7 billion of total long-term capital (equity, long-term debt and mandatorily redeemable preferred stock).

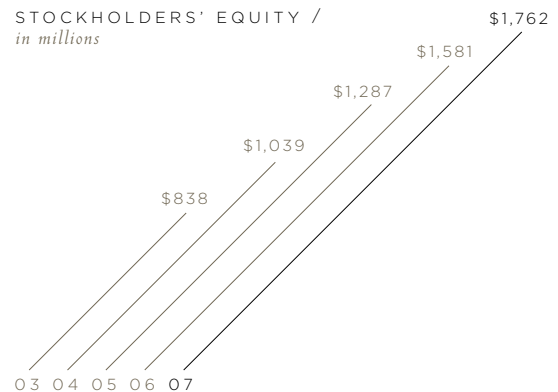
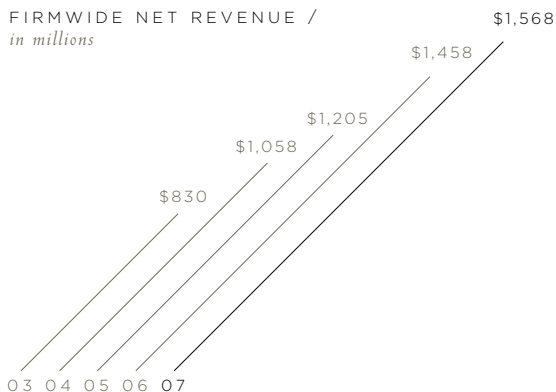
Our core businesses weathered the markets well, our financial position is strong and highly liquid, and our focus is clear.

### ALIGNED TO CONTINUE TO EXECUTE ON OUR STRATEGY

We often use the year 2000 as a benchmark, or starting point, because for us it marked the beginning of the Firm's transition from a substantially brokerage-driven business to a full-service, multi-sector, integrated securities and investment banking firm. During that time, we have achieved progressively higher net revenues, from \$617 million in 2000 to \$1.57 billion in 2007, with diversification as a Firm overall and within virtually all operating segments.

We have continued to attract top talent and forge new partnerships. Our employees are heavily staked through significant equity ownership in our Firm and, as such, we are well aligned with our external shareholders. Our motivated employee-shareholders, who collectively own nearly 40 percent of our Firm, have now completed transactions in more than 35 countries and we are connected to virtually every global exchange.

In the past five years, we have merged six investment banking boutiques into Jefferies and added a large number of talented bankers to our core team. With our partners at MassMutual, we created and funded Jefferies Finance to add direct lending capabilities to our corporate product offering. We also undertook a complete overhaul of our research effort, and continue to invest in this important and valuable component of our platform. In 2003 and 2004, we started commodity derivatives and US asset management as core businesses, and we continue to support the growth of these areas. In 2006 and 2007, we focused on driving the development of our trading platforms,



with an influx of hires and substantial changes to our business model in equities in order to deliver full-service, more integrated capabilities to our clients. We built a formidable and aligned sector trading capability, added prime brokerage and equity derivatives, and strengthened our securities finance effort. We also expanded and improved our research sales team and our infrastructure and technology, enhanced our electronic trading capabilities—consistent with the direction of our customer base—and established a quantitative trading platform that has been a solid contributor, among other initiatives.

We formed a new trading platform in high yield, and aligned day-to-day operations of our convertible and high yield trading desks. Internationally, we have enlisted new leadership and committed to meaningful expansion around the world.

We have supported our growth with increased and enhanced efforts in legal, compliance, risk, finance, accounting, operations and technology. Seasoned leaders have been installed in all of these areas, and our ability to support and control our businesses is strong.

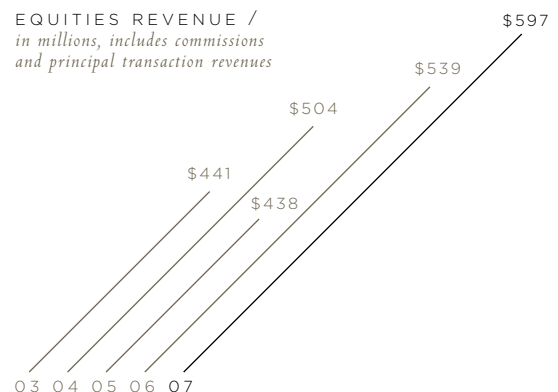
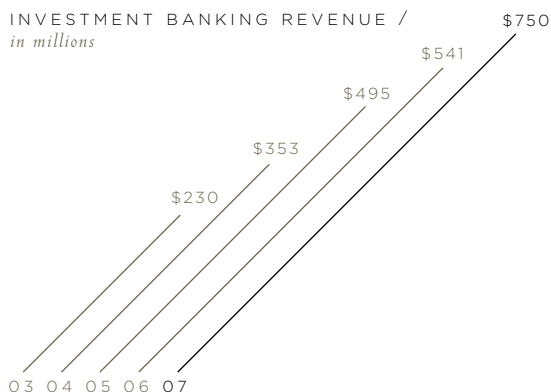
We have maintained a secure balance sheet, and a strong and liquid capital position, with a conservative risk profile and ample access to additional capital. Our balance sheet contains assets that we understand clearly, and that are marked properly and almost entirely against transparent market valuations.

**BALANCING RISK AND GROWTH IN CYCLICAL MARKETS**

We have constantly balanced investing for the future with realizing results today. We have invested heavily in our Firm for the past eight years, and there is always a lag time between new hires and new businesses, and corresponding production and revenues. We consider this an important and necessary investment for the long term.

Our financial performance was adversely affected in 2007 by lower revenues in the second half of the year, in part due to several business units that generated negative revenue. Prospects for 2008 are, at best, uncertain. The liquidity crisis that began in the sub-prime space in mid-2007 has now spread to other segments of the structured and leveraged products arena. While Jefferies has essentially no direct balance sheet exposure to the securities that have been directly affected by the sea change in sentiment and valuation, we cannot avoid the reality of increased volatility, economic challenges and overall negative financial trends. In response to all this and our own weaker second-half 2007 results, we reduced our principal trading activities, shifted certain management, modified selected compensation formulae and focused on tightening costs in order to regain our equilibrium as quickly as possible.

The challenge in a period of potential contraction is the mirror image of that which we have experienced in managing growth over these recent years. We must now align costs to our expected revenue levels, without losing the benefit and value



of the incredibly capable firm we have developed. As we write this letter, we are deeply focused on this challenge, aiming to mitigate risk and control our costs as best as possible, while maintaining Jefferies' long-term value and potential.

### THE JEFFERIES INVESTMENT BANK

We are extremely proud of what our Firm was able to achieve for our clients in 2007, working on more than 470 advisory and capital markets transactions. We made several key additions to our investment banking platform: LongAcre Partners, a leading UK-based, European media and Internet M&A advisory firm; the Putnam Lovell global investment banking group, a leading advisor to the financial services sector; a dedicated consumer-focused team in the US; and a Frankfurt-based investment banking team serving German-speaking markets. Collectively, these new teams added a total of more than 80 new professionals, primarily around the middle of 2007, and significantly enhanced our product and industry expertise, as well as our regional presence. These new teams, whether acquired or directly hired, are consistent with the other high-quality specialist efforts that we have added to our Firm over the past six years. Given their cultural fit, we expect these new teams to thrive on and leverage our full-service platform. With experience, our process of integrating these new partners has become much more streamlined, and should help reduce the lag time between integration and contribution.

Over the past seven years, the revenue mix from our investment banking division has diversified significantly, transitioning from a primarily leveraged finance business to a well-balanced mix of advisory and capital markets, while increasing the overall revenue pool dramatically. In our view, the broad spectrum of our product capabilities is key to our ability to comprehensively serve our clients. We are adept at structuring and executing transactions of all sizes and scope, regularly integrating several

of our capabilities in a single assignment. As we face shifting markets, the range of our capabilities, coupled with our focus and dedication, should allow us to continue to increase our market share.

### A ROBUST AND DIVERSIFIED SALES & TRADING PLATFORM

Our sales and trading platform has experienced a fair amount of change over the past two years, and we are optimistic that these changes will continue to have a positive impact on our revenues going forward, as this business remains the backbone of our platform. Overall sales and trading revenues were relatively flat in 2007 at \$770 million. We continue to add new products and capabilities to innovate and expand to meet our clients' needs and adapt to new ways of doing business. Over the past several years, we diversified our equity business from being concentrated in cash equities to one that includes prime brokerage, electronic trading, derivatives, structured products, private client services and corporate services. We have also broadened our fixed income efforts and added commodities as an active component of our platform. We now have a more robust set of revenue streams, spanning a suite of investment methods and vehicles. An important component of this business is also our securities research effort, which we continue to grow and improve.

### CONTINUED GLOBAL EXPANSION

Jefferies has continued to accelerate the development of our business outside the US, with the expansion of sector teams, capital markets capabilities and senior leadership across Europe and Asia. In 2007, we completed more than 50 investment banking transactions for our clients outside the US, with a total value of nearly \$12.5 billion. We enhanced our capabilities with the additions of LongAcre Partners and Putnam Lovell, and our new Frankfurt-based team. We appointed a new president of Jefferies International Limited, with more than 25 years of financial services experience, who is also global co-head

#### TIMELINE 2002-2007



of our investment banking practice. Since January 1, 2006, our headcount outside the US has increased 50 percent from just over 300 to 460 employees, and we have opened new offices in Frankfurt, Dubai, Singapore, New Delhi and Shanghai.

We continue to seek new opportunities to serve our clients and extend the strength of our knowledge-based franchise to companies and investors around the globe.

### PROTECTING OUR PLATFORM

Jefferies' balance sheet remains very strong, with more than \$3.7 billion in capital from equity, long-term debt and mandatorily redeemable convertible preferred stock. We seek to deploy this capital intelligently and prudently. We risk capital only where we feel it is well-leveraged operationally, and it makes the most sense for our clients and our Firm. Our professionals are highly disciplined and we are selective in our commitments, as evidenced by the lack of "hung bridges" from Jefferies and Jefferies Finance.

We take measured risk throughout the organization, with checks and balances to monitor those risks. Our corporate governance, compliance and legal efforts, which serve to protect the enhancement and sustainment of shareholder value, are as important as the operational achievements of the company. To that end, in late 2007 we welcomed a new chief financial officer, Peregrine Broadbent, with 16 years of experience, and our first global head of risk management.

### ONE FIRM FOCUSED ON SERVING CLIENTS

Our goal is to be One Firm in name, culture, strategy and execution. Our business is to add value for investors and companies by delivering the best ideas and execution from a firm working seamlessly around the world. We will continue to build

our global platform based on our historic strength in sales, trading and capital markets; our expanded research presence; our multi-sector, full-service investment bank; and high-quality asset management.

We can't control the markets, but we can control how we prepare for and react to them. The year 2007 demonstrated that our businesses are strong and durable, as is our ability to serve our clients. It is important that we make well-considered and prudent decisions. Not every decision we make will be the right one, but each decision is made collectively among Jefferies' most experienced and trusted leaders and board members, with a deep understanding of the risk and opportunity, with recognition of our strategy and brand, and the best intentions of growing the value of our Firm for the long term.

Not every year will be a record year, and while our core strategy remains intact, we are absolute realists regarding the environment, and will navigate aggressively and appropriately. We are optimistic for what the long term holds for our Firm and are incredibly proud of our platform and the people who together are Jefferies. We are honored to be entrusted with the leadership of this unique Firm and are grateful to all of our constituents.

Rich Handler  
Chairman of the Board,  
Chief Executive Officer

Brian Friedman  
Chairman  
Executive Committee

