Jefferies Insights
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To Our Clients:

DO THESE TRAITS, CHARACTERISTICS, AND QUALITIES DESCRIBE YOU?

2017 is upon us and the turn of the year is often a period to take stock of oneself, make new resolutions, and plan goals and aspirations for the New Year. In writing our first employee letter of calendar 2017, we have decided to reflect upon the traits, characteristics and qualities that we believe describe our most important and treasured partners at Jefferies. These are the people whom we count on day after day, quarter after quarter, year after year, and often decade after decade. No organization can ever have enough of these special men and women. Remarkably, even if you are fortunate enough to just have a handful of them pulling in the same direction in your company, it is amazing what can be accomplished. Human capital will always be our most valuable asset at Jefferies and since we believe most of our clients feel the very same way, we thought we would share our employee letter with each of you as our first quarterly client letter of 2017.

Our most valuable and prized employee-partners:

1. Enthusiastically embrace honesty and integrity. It is not in their DNA to cut even one corner. They understand that every problem needs to be escalated transparently and that, just like we tell our children, "the cover up is always worse than the crime." They "own" our brand and recognize that there are thousands of co-workers and their families depending upon them to do the right thing every day.
2. Always put the interests of our clients, our firm and our colleagues ahead of their own. They share a sense of responsibility of which they are proud and realize it is not an obligation or burden to do the right thing – it is a privilege and honor.
3. Are creative, flexible, adaptive and hungry for the best solutions for complex problems. Our best partners constantly push themselves outside of their comfort zones and use all of their partners' collective abilities at Jefferies to add value to our clients every day. At the end of the day, they realize that all we are is a collection of people with a common goal of constantly adding value to our incredible group of clients as they tackle their most important challenges.
4. Are hungry, ambitious, and willing to work tirelessly and passionately to achieve the firm's, our clients' and their own personal long-term goals. They realize it is a strength to be "aspirational" and "highly competitive," and want to be measured and rewarded honestly based on their and our firm's contributions to our clients. They understand it is a positive to have long term personal wealth creation be one of their goals. They also understand that with that success comes the opportunity, luxury and responsibility to give back to society and to others less fortunate.

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5. Appreciate their team members and our support people, and strive to help, teach and mentor, as well as show their appreciation. They remember that it was just yesterday when they were junior and how much it meant to them when senior leaders cared about them, took the time to train them, and helped them navigate their own career path. Unfortunately every one of us in business also remembers the few senior people throughout our own careers who took them for granted, used them for their own self-interest, and never made a personal sacrifice to help them in any way. Our real leaders at Jefferies willingly give up smaller accounts, allow juniors to help them on large accounts, always bring the junior people who “did the work” to the meetings with clients, care about the life balance of the people who support them, and never forget what it was like when they wore the shoes of an aspiring junior future leader.
6. Know that, when the fit is not right with someone in our firm, the situation must be handled with respect, kindness and compassion. If it is at all possible or practical, they give as much of a “heads up” in advance as they can and they even try to help with the next job placement where there is hopefully a better fit for all parties. Our best partners know that treating everyone with courtesy and respect is not just the right thing to do from a business perspective, but it is how decent people live their lives.
7. Never rest on yesterday’s success and are always learning, investing in themselves, adapting to the changing environment and reinventing themselves. They realize that no matter how great a result he or she achieved yesterday, last quarter or last year, the only goal that currently matters is building and succeeding today, tomorrow, and driving towards the future.
8. Always help us recruit more of the best and the brightest. They fully understand that the smarter the team around them, the smarter they will be. And they know that a diverse team is the right thing for Jefferies not because it’s politically correct but because it makes Jefferies a better and more productive company. They are always on the look-out for talent, and it doesn’t matter if it is for their specific business or any other area within the firm. They are constantly spreading the word about Jefferies, and always looking to help build our firm. They are also great judges of which talent will make a positive long term difference for our clients and our firm. They also serve as “gate keepers” to make sure we do our best to keep out everyone who does not share our collective values. Importantly, they also recognize that sometimes remarkable talent becomes available and while at first it may appear threatening or career limiting in some short sighted way, they fully embrace the concept that new smart A players combined with our existing smart A players is great for everyone. That is why they work so hard to welcome, integrate, and bond with our new partners immediately.
9. Understand the importance of their personal work-life balance. They recognize that an unhappy, unhealthy or unbalanced person will not survive in the long term. They realize their family and friends need them to be healthy. They also have enough self-respect to know they deserve it for themselves. The demands, challenges and pressures are great in our industry. Our best leaders know that if they can’t be good role models themselves in this important area, the rest of the firm who looks up to them will get the wrong message on priorities.
10. Are long-term greedy and never short-term greedy and always rise to the occasion during crunch time. Our best partners know that their direct rewards depend upon our clients' success, each of our operating businesses success, the overall success of our firm AND their individual success. They recognize that careers and life are long (hopefully) and everyone one of us remembers how our co-workers acted not just in good times, but especially in challenging times or circumstances. In fact challenging times or difficult circumstances are perfect for magnifying the best in someone's character, but they also can do the same for the unfortunate other side as well. Our best partners choose to have a career versus a job, and to build lifelong relationships and have the goal of creating a true legacy for themselves and for our firm. They also know how fortunate they are to be in this industry and to call Jefferies our home.

To our employees, we hope you are well rested (we are) and ready to hit the ground running hard in 2017. Our firm is extremely well positioned and we have not been as optimistic of what we can accomplish together since the financial crises in 2008 nine years ago. That said, we fully recognize the world can change in a moment and we will all stand ready to adapt to whatever comes our way. We accept that everyone is human and we all have our bad moments, but we would like to leave you with one question to ponder: "Are you willing to give it your absolute best effort every single day of 2017 to embody these important traits so all of us at Jefferies can win together?"

To our clients, we are tremendously appreciative of your support, partnership and trust. We look forward to seeing as many of you as possible in 2017 and are always personally available if we can assist each of you in any way possible.

To all we wish you and your families the happiest and healthiest New Year!

Sincerely,

Rich and Brian

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Economics and Strategy

How can we follow the QE if there is no QE to follow?

Before I write more on the implications of a U.S./Japan U.S. Treasury purchase for yen weakness accord – and to be sure this development, if it comes to pass, would create some serious longer-term troubles in EM, commodities and China – I want to tackle one other very important issue - the significant changes that are likely in store for U.S. monetary policy.

Looking back over my seven years of writing for our clients at Jefferies, one basic message permeates all of the trading recommendations – follow the QE! And to be sure, this message consistently frustrated many in the investment community who felt that our fragile post-crisis global financial markets needed more than just lower risk-free real rates to sustain gains.

The pushback to this thesis certainly waned over the years as global stock markets rose and economies stabilized. But beneath the surface there was always a healthy skepticism associated with the power of monetary policy. Even earlier this year when the markets swooned, the “See, I told you it doesn’t work” crowd came out in force to proclaim yet another victory on their long-standing call for financial Armageddon. But as usual, the Fed executed a dovish monetary pivot – and the doomsayers were once again trounced while the risk parity crowd sailed on to another post-crisis victory.

Our baseline strategy of following the QE kept us in the U.S. reflation trade from 2010-2014, the Japanese reflation trade from 2013-2015 and the European reflation trade in 2015. However, when the commitment to QE in Japan and Europe became questionable at the end of 2015, we abandoned both. We have only recommended following the QE if there was a clear commitment to expand its breadth in the event that the economic outlook started to darken. The ECB and Bank of Japan failed on that front. And it was only the Fed which ultimately stayed completely committed to QE-style policies until a reflationary recovery was fully in place.

In retrospect, our long-time trading strategy could be characterized more as a combination of QE following and QE commitment – BOTH were necessary for success. And our pivot back to a “spoos and blues” strategy at the start of 2016 was really just a slightly different bet on the “conditional” commitment component. Not of course a commitment to restart QE, but rather a commitment to pivot towards more monetary accommodation in the event that the U.S. outlook deteriorated. It was just a bet on the Fed reaction function.

But in looking ahead to U.S. monetary policy under a Trump administration, we will clearly lose this commitment structure. Trump will immediately have two FOMC governors to appoint, as well as a vicechair for financial stability. Then, in early 2018, he will appoint a new chair and vice-chair for the FOMC.

To be sure, these newcomers will NOT be in favor of using QE-style monetary policies except under the most extreme of circumstances. And they will not be easily pivoted into a dovish stance upon every minor deterioration in the economic outlook. In fact, most of the names floated for these positions signed a petition in the WSJ back in 2010 against QE2 – and by the time we got to QE3, most were penning, in major financial publications, vitriolic tirades on Fed policy gone wild. There is a seismic shift in the Fed policy reaction function looming, and it is highly unlikely we can return to a strategy of following the QE in the U.S., since there will be no QE to follow.

Thus, the question becomes, what do we follow? Well, as highlighted in my first post-Trump commentary, the new policy levers to consider in the U.S. are fiscal, regulatory, trade, and immigration.

And for now, the market seems set on following just the fiscal and regulatory shifts. Lower taxes, higher spending, and less regulation have ratcheted expected real rates of return on capital higher. The dollar, spoos, and bond yields are therefore rising. But of course monetary policy will likely move real rates even higher via the Trumpian institutional shift discussed above. This implies the dollar and bond yields have even further to run (which in turn is not great news for spoos). For the moment, the only macro trades which stand out are a stronger dollar and higher rates – In particular, shorter term rates. But even then, the risks associated with lower expected real rates of return on capital from protectionist trade and immigration policies lurk in the background. There are sadly many moving parts on this new policy front. And in the end only one thing is quite clear: This new world is much more complicated than the old one with an effective and committed QE-driven Fed.

Of course we could pivot to Japan and Europe, where QE is still in place; but as mentioned above, those commitments still look dubious. Nonetheless, as I've previously written, the Japan story does look quite intriguing only because the U.S. fiscal expansion will endogenously accelerate a Japanese monetary expansion. So in a sense there is a yield curve control (YCC) plus U.S. fiscal policy driven commitment to Japanese QE which could certainly reaccelerate the long NKY (Nikkei 225) / short yen reflation trade. But honestly, I'm just not overly excited about any global risk assets given the prospect of higher real rates in the U.S. – especially when these higher rates are likely to generate some systemic risks in commodities, EM and China (which I promise I will elaborate on in the next note). For now, and as I mentioned in my last two notes, the stronger dollar, especially against the yen, is really the only standout macro trade which comes out from all this analysis.

But going forward I suspect there will be many new opportunities for those focused on a traditional bottoms-up approach to trading. The QE-dominated world of the past seven years masked individual corporate and sector weakness as ubiquitous credit was delivered to even the weakest and most leveraged non-financial companies. One of the most common complaints I heard from the equity long/short community over this time was "QE is killing my shorts." With tax, spending, and regulatory policies likely to have very different effects across both sectors and companies, those who dig deeper into corporate-level balance sheet leverage, taxation structure, and regulatory impediments will likely be handsomely rewarded. And without a QE backstop, weaker business models will have a higher probability of failing while stronger business models will have a higher probability of succeeding.

Naturally, I will leave these deep dives at the corporate level to my sector specific equity research colleagues at Jefferies. But it suffices to say that their work will take on even more importance as we move forward into a brave new U.S. market without any QE to fall back upon.

— David Zervos, Chief Market Strategist

Reflation to Dominate Global Equities in 2017

Reflation will be the dominant theme for global equity markets in 2017. With Trump's policies set to mean higher growth and inflation in the U.S., as well as China exporting inflation for the first time in four years, global equities will take their direction from the steepening of yield curves. This should mean that low PE and PB stocks will do well. This is good news for active investors. The main risk for equities is if the dollar strengthens too fast and U.S. rates were to rise too quickly.

A regime shift occurred almost overnight following Trump's victory. Trumponomics: fiscal relaxation and protectionism are both inflationary and USD bullish. The unfolding of Trump's policies will occur at a time when wages are increasing – buy the U.S. consumer. The shift in temperature for the U.S. economy from monetary stimulus to fiscal has finally changed perceptions over inflation. This ought to mean that the flow of money emanating from fixed income will seek stocks with pricing power.

Despite better economic growth in 2016 and an improvement in headline inflation, investor sentiment remains depressed towards European bourses. A front-loaded election cycle in 2017 has once again raised question marks over the viability of the euro system. However, it would seem a lot of the bad news is in share prices with many stocks trading below 1.25 times book. Europe is cheap, the corporate sector in most cases is running free cash-flow while investor sentiment is bearish. A change in the inflation temperature might be the first catalyst to reignite investor appetite.

In September, the Bank of Japan (BoJ) pledged to target a zero yield on 10-year Japanese Government Bonds until deflation is finally beaten. The BoJ Governor promised to keep increasing the monetary base until inflation is above 2%. In essence, the BoJ is committed to keeping nominal yields pegged near zero and allowing inflation to rise. The equity market remains attractive: 30% of the stocks are trading below book value while the running yield spread (dividend plus buyback yield minus treasury yield) is still around 2%.

Asia is set for another character test as the U.S. moves its policy setting from monetary to fiscal in 2016. The Association of Southeast Asian Nations (ASEAN) has left its rates too low versus the U.S. and will probably need to tighten rates to defend their exchange rates. In contrast, China has accepted an inflationary route and will allow the renminbi (RMB) to weaken. North Asia sits in the 'middle ground' with a soft cushion to external threats but directly competing with China's export machine.

Jefferies sees three themes to watch. Firstly, the likely collapse of the Trans-Pacific Partnership will help China to engage in bilateral trade deals and extend its influence through ASEAN. In turn, this will allow for a wider introduction of the RMB. Secondly, Asian central banks will need to live with a stronger dollar and this may mean tightening policy earlier than anticipated. Lastly, Korea and Taiwan will need to manage a path between their declining prowess in global trade and the fact that China is stretching its political and economic power ever closer to their countries.

— Sean Darby, Global Head of Equity Strategy

U.S. Outlook – 2017: The Year of Fiscal Stimulus and Faster Rate Normalization

The U.S. economy was on track to continue to grow and had generated faster growth prior to the November election. If enacted, Donald Trump's fiscal proposals will shift the economy to yet a higher gear. These domestic fiscal policy proposals are pro-growth and will promote a stronger consumer sector, improved labor market conditions for semi-skilled and unskilled workers and increased investment spending. Reduced regulation will also free resources for more productive uses.

As it now stands, however, Trump's approach to financial deregulation is inconsistent. His immigration policy is anti-growth, and the more audacious of his trade policies are potentially both anti-growth and destabilizing. Trump's biggest challenge will be to finance his stimulus proposals against the backdrop of a U.S. fiscal condition that is already deteriorating.

The U.S. is the dominant global economy, and the election has greatly enhanced U.S. growth prospects due to lower taxes, reduced regulation and increased infrastructure spending. GDP growth will accelerate to 2.7% in 2017.

The U.S. economy is overwhelmingly dominated by a large, diverse and growing service sector and, consequently, domestically oriented. This is why the U.S. economy is resilient and survived a long list of crises since 2009. Despite the extended length of this cycle, the expansion will not end any time soon.

The U.S. labor market will continue along an erratic path toward full employment. The primary missing pieces of the labor market picture have been sustained job growth for semi-skilled and unskilled labor, as well as sustained wage growth. Infrastructure spending will enhance job prospects for semi-skilled and unskilled labor, and there are already stirrings of faster wage growth.

U.S. inflation has accelerated primarily because commodity-based goods prices have become less of a drag on headline inflation. Inflation will continue to accelerate as the convergence of service prices and commodity-based goods prices continues. Inflation will exceed the Fed's 2% target in Q1 and approach 3% by year-end 2017.

Federal Reserve monetary policy has been complicated by the combination of the advanced stage of the U.S. business cycle relative to the rest of the world, the behavior of commodity markets, as well as volatile risk and currency markets. Prospects for U.S. fiscal stimulus further complicate the picture.

There are divisions within the FOMC, and a growing number of Fed officials want to move further away from the zero bound on rates. At the December FOMC meeting, seven of the more dovish members raised their fed funds rate projections to raise the median forecast. With a shift to an expansionary fiscal policy, the Fed will eventually pursue a more aggressive normalization process after the stimulus is in place.

We expect Janet Yellen to serve out her term and be replaced with a more rules-based Chairman in 2018. Over time, Trump appointees will change the composition of the Board, and the FOMC will become less dovish. With few friends in Washington, Fed independence will be in the political crosshairs.

— Ward McCarthy, Chief Financial Economist

European Outlook – 2017: QE the Only Certainty in the Euro Area – Is it Enough? Brexit to Start, the Finished Product is Anyone's Guess

In Europe, the outlook for 2017 feels strangely familiar, with political uncertainty of one kind (the Brexit vote, the U.S. election, the Italian Referendum) being replaced with political uncertainty of another, related to domestic elections and the start of Brexit negotiations. In the background, the one steady force remains the ECB – committed to carry on with QE through 2017, with tapering potentially only becoming a story in 2018. And while the euro area economy continues to grow and unemployment is steadily declining, the recovery is still too weak for the ECB's liking.

After Renzi's resignation, we can very likely add Italy into the mix of countries heading to the polls next year – The Netherlands (15 March: Parliamentary Elections), France (23 April: first round of Presidential elections; 7 May: second round), the UK (4 May: local elections) and importantly Germany (September: Parliamentary Elections).

In fact, as UK Secretary of State for Exiting the EU, David Davis, has highlighted there are 15 political events between now and when the UK leaves the EU (just before the European Parliament elections in May 2019) that could change the eventual outturn of the Brexit negotiations.

As ever, the ECB probably lives in hope of Brussels moving to complete the project, binding countries closer together and reducing the risk of re-domination coming back into the equation. They will also no doubt hope that countries with fiscal space (Germany) will make use of it, and that when it comes to Brexit, logic will prevail so Europe probably ends up with something like the Continental Partnership proposed over the summer.

But, the ECB like the rest of us live in the world as they find it, not as they would wish it to be. As was the case a year ago, the more realistic hope is that divergent monetary trends, with the U.S. raising rates and the ECB still easing policy, will lead to a much weaker euro. The Bank of England meanwhile will be pushing for transitional arrangements to ensure that the UK and the rest of the EU do not face a cliff two years after triggering Article 50. One thing is clear: exiting the EU will be a long tortuous process. FULL REPORT

— David Owen, Chief European Financial Economist
— Marchel Alexandrovich, European Financial Economist

Actionable Ideas for Companies and Sponsors

EQUITY CAPITAL MARKETS

M&A-Related Equity Financing Continues to Grow

Equity offerings related to acquisitions represented 20% of all U.S. equity issuance in 2016, an increase of over 60% from the 2010 through 2015 average. This growing use of equity to finance M&A has been driven by clients broadening their use of equity financing across various phases of the M&A spectrum, including (i) pre-funding with no identified acquisition; (ii) concurrently funding with an acquisition announcement; or (iii) post-announcement funding to repay any temporary financing that was put in place. Investor receptivity to these offerings remains strong, as evidenced by minimal file-to-offer discounts, upsized transactions, and strong aftermarket performance.

Increase in Marketed Follow-Ons Versus Blocks

Throughout most of 2016, the preferred sell-down method for selling shareholders has been block trades, which have accounted for greater than 80% of all secondary follow-ons. Recently however – with the risk-on market backdrop – issuers and sponsors have increasingly used fully marketed offerings, and during the last 4 weeks, one-third of all follow-ons were executed on a marketed basis, representing the most active 4-week period for marketed follow-ons in 2016. Because marketed offerings allow issuers to generate demand from a broader set of investors, it can set up issuers for better execution on future block sell-downs by increasing liquidity from a larger, more diverse shareholder base.

U.S. Convertible Issuance Accelerating Post-Election

Convertible issuance has accelerated materially since the election, particularly in sectors benefitting from expected policy changes under the incoming administration. Investor receptivity has been strongest for new offerings in sectors tied to less regulation and increased infrastructure/government spending such as energy, industrials, and defense. Additionally, given rising interest rate expectations, the convertible product has become a more attractive refinancing alternative, as many companies look to refinance existing floating rate loans. Convertible issuance has historically peaked in years of high Fed Funds rates, such as 2001 and 2007, when the Fed Funds rate peaked at 6.5% and 5.25%, respectively.

DEBT CAPITAL MARKETS

U.S. Borrowers Migrating to Europe for Cheaper Bond and Loan Financing

Strong demand for leverage loans and high yield bonds by European investors has resulted in U.S. issuers, at record levels, tapping into the liquidity and tighter terms available in Europe. According to S&P Global Market Intelligence, 2016 has seen more European issuance from U.S. borrowers than any other year since 2008, with 2016 volume from such issuers up 94% through December 15th versus the same period last year.

For the 3-month period ended December, U.S.-based single-B rated issuers have on average financed term loans at [72] basis points lower in Europe than if they had raised the financing in the U.S. Looking at the year as a whole, U.S.-based single B-rated issuers have on average obtained term loan financing in Europe that is 74 basis points tighter than in the U.S. market. Similarly, cross-border high yield bond deals have seen the Euro tranches price tighter than their USD counterparts.

Dividend Recaps and Unfunded Tranches

As demand for leveraged loans continues at elevated levels, a record level of dividend recaps have come to market throughout December, and the related lender approvals on amendments necessary to allow the dividend recap have been consistently achieved. Current demand has been driven by continued cash flows into the market, including CLO volume, which in November totaled $10.3 billion, a 17-month high, as well as U.S. loan funds and ETFs continuing to see inflows.

In addition, the strength of the loan market has evolved to where loan investors are now willing to invest in "unfunded tranches." These tranches, not funded at inception, allow issuers to borrow for future uses using the capital when needed for upcoming acquisitions and capital spending events.

Quick-To-Market Add-On Loans

As the incoming administration begins to make its mark, many companies are concerned that there is a risk that investors sideline their capital. Issuers are addressing these concerns by bringing quick-turnaround loan transactions to market. Toward this end, since the presidential election, 36 loan deals for over $33 billion have been launched and priced within one week, thereby avoiding the risks of typical longer marketing periods. This volume of quick-to-market deals has been largely comprised of both incremental loans, many of which were to fund dividends, and repricings which have tightened existing spreads by an average of 50 basis points.

MERGERS AND ACQUISITIONS

Record Chinese Outbound M&A Volume Driven by High P/E Multiples and Chinese Bank Financing

Chinese outbound M&A this year stands at $236 billion through the end of November, already making it the biggest year on record. Several factors are driving this trend, but two of the more notable are the following:

First, the P/E arbitrage between Chinese companies and their comparable U.S. and European targets is enormous, as shown below. This is having two significant effects on the acquisition appetite of Chinese buyers and their willingness to be preemptive buyers. First it has made the cost of equity financing extremely attractive for Chinese corporates, and second it has made acquisitions highly accretive to their equity valuations, even at high acquisition multiples.

Forward 2017 P/E	Mainland China	U.S.	Europe
Consumer	54.5x	23.6x	21.8x
Healthcare	52.8x	30.6x	30.3x
Industrials	55.2x	21.8x	20.5x
Technology	65.7x	28.5x	25.7x

Second, local Chinese lenders, encouraged by the Chinese provincial governments, are providing most of the financing. State-owned lenders have arranged almost 70% of the syndicated loan financing backing this year's overseas Chinese deals, which has enabled Chinese acquirers to target larger companies in a broader array of industries.

Surge in Automotive Industry M&A Driven by Technology Disruption

Digitization, increasing automation, and new business models are giving rise to four disruptive technology-driven trends in the automotive sector: (1) diverse mobility, (2) autonomous driving, (3) electrification, and (4) connectivity. Technology already accounts for over one-third of vehicle costs and is expected to rise dramatically over the next 10 years.

Automotive companies are not strategically positioned to develop technological innovations as quickly as consumer-oriented technology companies like Google, Tesla, Apple and Samsung. However technology companies do not have the ability to mass produce automobiles. This has led to a perfect storm for partnerships and consolidation, and as a result, a growing number of companies have begun strategically targeting various categories within the automotive ecosystem.

Over the next five years, Jefferies expects to see significant M&A activity by both technology and automotive OEMs / suppliers in: assisted driving/autonomous software; driver safety tools; connected vehicle/driving data; fleet telematics; vehicle-to-vehicle communication; and auto cybersecurity.

U.K. Inbound Acquisition Activity Up Over 400% Since Brexit

The into-U.K. M&A market has always been the most open to foreign transactions compared to other European countries, in part as a result of the regulatory and investor openness towards foreign takeovers. Following Brexit, the value of sterling has fallen to levels not seen since the crash in the early 1980s. With sterling down since Brexit over 14% versus the U.S. dollar, and 9% versus the Euro, there is a tremendous opportunity for foreign companies to capitalize on this significant increase in buying power relative to U.K. companies. This has been evidenced in Q3, with announced inbound M&A activity into the U.K. rising to U.S. $49 billion, 450% ahead of Q2 2016 of U.S. $9 billion, and this momentum is continuing into Q4 with more than U.S. $30 billion announced.

RESTRUCTURING AND RECAPITALIZATION

The Restructuring Dual-Track Strategy

In an analogous manner to the IPO/Sale dual track, a distressed company can simultaneously pursue the sale of its business, while negotiating with creditors to convert some or all their debt to equity. The results of the M&A process may either be used to effectuate the restructuring or to provide invaluable market data regarding the valuation of the business to serve as a benchmark for the conversion of debt to equity.

The dual-track strategy offers several benefits including: (1) the opportunity to value the business with a control premium through a sale process; (2) valuable market data for companies in bondholder discussions, as the valuation level that can be achieved in a sale will drive the negotiating leverage of the bondholders; (3) the ability to sell parts of the business to satisfy creditor demands in a restructuring through partial debt pay-down or to enhance liquidity; and (4) providing the Board with multiple restructuring alternatives and the opportunity to leverage firm offers for the entire business against creditor valuations and views on debt capacity.

MUNICIPAL FINANCE

Impact of the Incoming Administration on the Municipal Market

The municipal market has seen bonds cheapen in the post-election period to levels not seen since the post taper-tantrum period in 2013. This dynamic has created opportunities for investors, as well as challenges for issuers regarding timing to market. While much of the recent post-election sell-off in municipals can be attributed to inflation concerns around pro-growth policies and increases in Treasury rates, there are some municipal market-specific concerns largely focused on the following:

- Infrastructure Spending – Some investors are concerned that the administration's goal of spending up to $1 trillion on infrastructure projects over the next ten years would create a glut of supply in the municipal market. Jefferies view is that the municipal market has seen new money supply contract at an average annual rate of 1.2% over the last decade. Accordingly, we view any incremental portion of the Trump infrastructure spending plan that gets earmarked for traditional municipal market financing as constructive for our market.
- Tax Reform – Some investors are concerned that lower marginal tax rates will reduce demand for tax-exempt municipal bonds. Jefferies view is that there is limited historical correlation between changes in federal income tax rates and municipal bond demand. We do not believe that the proposed reduction in the personal income tax rate will have a materially deleterious effect on municipal bond demand. The effects of a reduction in the corporate tax rate, however, are less certain.
- Healthcare – With hospital bonds constituting approximately 10% of the municipal market, the new administration's pledge to repeal "Obamacare" in the first 100 days of his Presidency has materially impacted hospital bond prices. Jefferies believes a symbolic repeal of some of the linchpin provisions of the Affordable Care Act is the most likely outcome and that Congress will consider a three-to-four year transition period before repeal is implemented.

Best Research Ideas

AMERICAS

Research Rundown: U.S. Franchise Picks, Key Themes, Focus Stocks

Jefferies released a new research report that revisited the Franchise Picks, introduced a new Jefferies Focus list, and offered slides on some of the firm's most compelling themes. The constituents of the list were left unchanged, with significant outperformance continuing vs. the S&P 500 since inception in December 2013. Jefferies aims to include stocks with differentiated analysis, where risk reward skews compelling, and analyst conviction is high. The 24 stocks currently on the Franchise Pick list are: ABBV, ATVI, ALLY, GOOGL, BLL, BA, COH, CSC, DISH, FLT, HAIN, HAL, IR, KEY, MUSA, NFG, NVDA, NWL, OC, PYPL, RRC, SRCL, TMUS and URBN. FULL REPORT

— *Jefferies U.S. Equity Research*

U.S. Banks: Another New "Normal," and Post-Election Framework Suggests More Potential Upside

Jefferies conducted an analysis assessing the additional upside potential to U.S. bank stocks based on the tax policy and rate scenarios being contemplated by the market. The analysis suggests there could still be meaningful upside despite the recent post-election rally. The report includes a revised earnings model, with the bull case earnings scenario implying a 20% potential lift to 2018 EPS on average across the firm's coverage of banks. This analysis factors in +50 basis points in Fed rate hikes, a 10% cut in tax rates and modest incremental growth in loans and fees. If the tax rate cut goes to 15%, the lift could be in the 30-35% range. Based on price targets, Jefferies sees upside in the upper single digits on average across covered stocks, and the report includes several upgrades and downgrades. FULL REPORT

— *Ken Usdin, Equity Research Analyst, Banks*

Make Mine an AMG: Consumer Implications from Lower U.S. Income Taxes

Jefferies analyzed Donald Trump's proposed income tax brackets in order to understand the impact on consumer stocks. Higher earners seem to be particularly well positioned, depending on eventual offsets, such as reduced deductions. Electronics, home improvement, building products, jewelry, power sports, apparel, consumer finance, aftermarket auto and convenience stores were all highlighted by Jefferies analysts as likely net beneficiaries of lower income taxes. The report notes that when examining the two personal income tax cuts enacted since 2001, discretionary outperformed both times by an average of 14%. FULL REPORT

— *Jefferies U.S. Equity Research*

EMEA

European Franchise Picks List: 12 High Conviction Ideas

The Jefferies European Franchise Picks is a new product containing high conviction, buy-rated ideas from the European Research Team. The initial list includes: Novartis, Smith & Nephew, AB InBev, British American Tobacco, Bouygues, Just Eat, AP Moeller-Maersk, Airbus, Fiat Chrysler, Credit Agricole, Danske Bank and Aviva. The report provides a one-pager on each stock, identifies the basis for the firm's conviction behind each call, and offers various investment themes and styles captured in the selections. Stocks will be added to the list as new opportunities arise. FULL REPORT

— Jefferies European Equity Research

Some of the Parts: Initiating on European Auto Suppliers and Global Tire Makers

Jefferies sees continued structural growth for European suppliers driven by the evolution of the value of cars, but sentiment is tempered by a more competitive industry structure and challenging environment for operating leverage. The firm expects global auto production growth to slow to 1% in 2017, and while long term growth is undoubted, 2016 may have seen the peak of excitement on electrification and advanced driver assistance systems. Jefferies believes investors should focus attention on traditional & even sometimes “legacy” businesses that have been excessively de-rated. On tires, Jefferies forecasts 5% annual profit growth mid-term despite reversal of some of the net pricing tailwind. Conti, Faurecia, Goodyear and Autoliv are rated Buys, with Valeo and Michelin as Underperforms. FULL REPORT

— Ashik Kurian, Equity Research Analyst, Auto Parts

ASIA

India Equity Strategy: Challenges Beyond the Cash Crunch

Jefferies believes the recent demonetization move is part of a process to fight corruption and unaccounted wealth, with several more moves likely to come. However, the implications for the listed universe aren't too rosy, at least in the near term. Wealth destruction and risk aversion mean growth will slow, primarily in consumer discretionary. Banks will hurt more from a growth slowdown and asset quality issues than they benefit from higher CASA and rate cuts. Low end consumption might be the lone bright spot. Jefferies set an updated Nifty target of 7500. FULL REPORT

— Govindarajan Chellappa, India Equity Strategist and Head of India Equity Research

China Telecom Services: Shareholder-Unfriendly Policy Focus Drives Steep Downside

After multiple rounds of fund raising and restructuring, Jefferies believes that China's telecom industry will likely be increasingly used as a tool to spur the growth of other sectors, supporting China's Internet+ and “Made in China 2025” initiatives. In the firm's view, the government will likely continue pressing for lower prices, rapid coverage expansion and technology and data speed upgrades. Jefferies believes that this will translate into top line pressure and stubbornly high capital expenditures for all three telecom operators. The firm maintains Underperform ratings on China Mobile, China Telecom and China Unicom, seeing between 17% to 20% downside to shares. FULL REPORT

— Edison Lee, Equity Research Analyst, China Telecom Services

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NOTABLE RECENT TRANSACTIONS

Healthcare | December 2016 | Pending
Lonza
$5,500,000,000
Acquisition of **Capsugel S.A.**
Joint Financial Advisor

Industrials | November 2016
Dometic Group
SEK 5,100,000,000
Common Stock Offering
Joint Book-runner

Energy | October 2016 | Pending
SilverHill Energy Partners
$2,400,000,000
Sale to **RSP Permian, Inc.**
Sole Financial Advisor

Consumer | October 2016
Landry's — Dining • Hospitality • Entertainment • Gaming
$1,500,000,000
Credit Facility
Joint Lead Arranger

Real Estate | October 2016
Tritax Big Box
£350,000,000
Common Stock Offering
Sole Bookrunner

Power | October 2016
Sithe Global
$2,100,000,000
Sale of stake in **GNPower** coal plants to **Aboitiz Power Corp.**
Joint Financial Advisor

Automotive Aftermarket | November 2016
IXS — Mark of Innovation
$428,000,000
Credit Facility
Joint Lead Arranger

Energy | December 2016 | Pending
Brigham Resources
$2,430,000,000
Sale of Delaware Basin assets to **Diamondback Energy, Inc.**
Sole Financial Advisor

Public Finance | December 2016
City of New York
$804,000,000
General Obligation Refunding Bonds
Sole Bookrunner

Metals & Mining | December 2016
Moly-Cop
$775,000,000
Senior Secured Note Offering
Joint Bookrunner

Consumer | November 2016
Too Faced Cosmetics
$1,450,000,000
Sale to **The Estée Lauder Companies Inc.**
Joint Financial Advisor

Real Estate | November 2016 | Pending
CNL Lifestyle Properties, Inc.
$830,000,000
Sale of Ski and Attractions Portfolio to **EPR Properties** and **Och-Ziff Real Estate**
Sole Financial Advisor

Technology | November 2016
CommScope
$658,000,000
Common Stock Offering
Joint Bookrunner

Healthcare | December 2106 | Pending
Claris
$625,000,000
Sale of Claris Injectables Limited to **Baxter International Inc.**
Joint Financial Advisor

Automotive Aftermarket | October 2016
Transamerican Auto Parts
$665,000,000
Sale to **Polaris Industries Inc.**
Lead Financial Advisor

Energy | October 2016
QStar LLC
$1,600,000,000
Sale of West Texas assets to **SM Energy Company**
Sole Financial Advisor

Healthcare | October 2016 | Pending
Lilly
$885,000,000
Acquisition of U.S. vaccines portfolio of **Boehringer Ingelheim Vetmedica, Inc.**
Sole Financial Advisor

Energy | October 2016
RSP Permian
$1,006,000,000
Common Stock Offering
Joint Bookrunner

Healthcare | November 2016
Johns Hopkins Medicine — Johns Hopkins Health System
$500,000,000
Taxable Bonds
Sole Bookrunner

Technology | December 2016
Kronos
$3,400,000,000
Credit Facility
Joint Lead Arranger

Consumer | November 2016
Peacock foods — we engineer trust
$748,000,000
Sale to **Greencore Group plc**
Lead Financial Advisor

Healthcare | October 2016
BioClinica — See more clearly
$705,000,000
Credit Facility to Finance Acquisition by **Cinven Ltd.**
Sole Lead Arranger

Industrials | November 2016
Kissner
$400,000,000
Senior Secured Notes Offering
Sole Bookrunner

Consumer | November 2016
Serta Simmons Bedding
$2,625,000,000
Credit Facility
Joint Lead Arranger

JEFFERIES KEY FACTS & STATISTICS

(as of 11/30/2016)

Founded: 1962

Total Long-Term Capital: $10.5 billion

Number of Employees: 3,329

Companies under Global Equity Research Coverage: 2,000+

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