Jefferies Insights
JULY 2018

Dear Clients,

We wrote this letter today to our employee-partners with each of you in mind. As you strive to build your respective organizations, perhaps some of what we say may resonate with you and your own employee-partners.

Thank you.

Please “Disrespect” Your Senior Management Team!

“I didn’t want to trouble you, as I didn’t think you could help, but it looks like I might have been wrong.”

“I assume you are very busy and I didn’t want to elevate this problem to you because it is complicated and a big distraction, and now it is worse.”

“This didn’t seem important enough to involve you at such an early stage, and now it’s too late.”

“It’s my job to handle this and I thought I was doing a good enough job on my own, but I guess I wasn’t.”

“It would have been a pain in the neck to get to this client meeting and I didn’t want to impose on you, and now I wish I did.”

“We screwed this up and I just wanted to fix it myself, and now it’s unfixable.”

“I was sure I could recruit this star on my own because I have a great relationship, but it obviously wasn’t enough and I wish I knew that you knew her too — that may have been the difference maker.”

“I had never been in this situation before and I assumed nobody else had either — I wish I asked.”

“It was a long shot and I didn’t want to look foolish in front of you, but in hindsight you probably could have been the difference maker.”

“I wanted to prove I could do it all myself, and I guess I couldn’t.”

Dear Jefferies Employee-Partners,

We all live in a demanding world with constant pressures, cross currents, challenges and opportunities pulling us in often conflicting directions. For many of us, our job description is not as clear or straightforward as it once was. Juniors find it increasingly difficult to get attention and help from the more senior folks, who in turn feel constant pressure to produce against greater challenges. Often as one navigates the path to

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become more senior, it is all too easy to fall into the trap that asking for help is a sign of weakness. We would like to share with you in this letter one principle that we believe can help everyone at Jefferies deal with this reality: Our entire firm would be better if we collectively purged ourselves of the concept of undue and excessive respect for seniority.

To be specific, we are suggesting you should start disrespecting the CEO, then direct your energy towards the President, and then focus on the entire leadership team of our firm. You should then go to every single other person at Jefferies who manages, oversees, or is otherwise responsible for anyone beyond themselves. The premise is very simple. We believe the job of every leader at Jefferies is to constantly push responsibility down and empower every single person that works for us to allow them to best accomplish their specific jobs. This means our leaders must ensure that all of their direct reports have all the information, support, knowledge, perspective, experience, skills and latitude to do their job well. This is the only way we know to attract and keep the best people in our industry. Winners want to be empowered to accomplish objectives that are truly important and valuable. It only seems natural that if we are going to constantly push out all these responsibilities across our firm to empower every one of our people, sometimes (maybe often) our people will need help. The point we are raising in this note is that we need every single person at Jefferies to accept and embrace the reality that it is a sign of smarts, savvy and commitment to enlist every senior person necessary for help whenever needed. We must stomp out the misperception that any of our senior folks are "too busy," "too important" or "too anything" to help our people accomplish what needs to get done.

Clearly, we are not saying that all of our people should be delegating their responsibilities upward while they coast through their day. We have way too much respect for our team and know there is zero chance of that ever happening. What we are saying is that there will often be times that sharing one's problems or issues, soliciting feedback on strategies or leveraging experience or relationships of someone more senior, will be the deciding factor between success and failure. We believe that to achieve this comfort level of having our more junior people embrace the idea of proudly and confidently asking for help when needed, our senior people need to live by three simple rules:

1. You have to eliminate all artificial barriers that can be used to insulate yourself from the real world. You need to remember you were junior once, and perhaps not that long ago. You need to respond to emails and calls in real-time and be blind to the seniority or title of the person reaching out. You need to maintain a body language that never says, "I'm too busy and important, what do you want?" Approachability is as important as competence. Ego is the enemy, pride in title hierarchy is pathetic and taking satisfaction in mentoring the next generation of good leaders is the most worthy of objectives.

2. You need to stay engaged in the trenches regardless of your length of service, history of success or job title. You can't be of help to anyone in the firm if your skills are not current, your relationships are not maintained and expanded, and you are not learning and growing outside of your historical comfort zone daily. These may be the last things someone who has been very successful wants to hear, especially later in one's career, but there is truly the finest of lines between being super senior and no longer relevant. Never forget this.

3. You need to have the best interests of the entire firm in mind, and not just prioritize your own career. It may appear contrary to common sense or sound too folksy or idealistic to be true, but in our careers we have witnessed the incontrovertible truth that if you act in the long-term interest of your business, you will undoubtedly get more responsibility, more cumulative compensation, more promotions and, most importantly, more satisfaction. Yes there may be short periods of time when more selfish behavior will appear the faster path to some success, but it is illusory and temporary. It is also very lonely.

On the other side of the equation, the more junior people who may be looking for help from those more senior should strive to live by the following objectives:

1. <u>Do everything in your power to never waste people's time</u>. You need to know when it is appropriate to reach out for help and when it is not. You need to fully understand what you are asking for, who the most appropriate person is to approach and when is the right time to reach out. You must learn from every experience and learn from the assistance you received, so perhaps next time it is unnecessary. Cogent, succinct, and smart requests are appreciated. Rambling musings without the relevant facts laid out will drive people nuts.

2. <u>Follow the advice you receive or, if something new is learned that may change things, go back to the senior person before improvising</u>. There are few things more frustrating than helping or spelling out a strategy, and then finding out that it was not implemented properly. Leaders who spend the time to help you, want to see you achieve our objectives. Follow their advice. Also, it is always appreciated if you share the feedback of what happened and the current status of the situation.

3. <u>Start doing the exact same to people who are more junior than you</u>. Nothing makes someone want to help you more than when they see you exhibiting the same behavior with people who look up to or need you. It becomes a wonderful cycle of operating leverage, connectivity, information sharing and productivity. If you don't exhibit positive leadership behaviors to the people junior to you, why should anyone waste time advising you, introducing you or going to meetings with you?

It really is this straightforward. If you are relatively new in your career or even in the middle and find yourself with a challenge or opportunity that can be helped by enlisting someone with more experience, please:

1. Pick up the phone early
2. Send a succinct email for advice, history or perspective
3. Ask for help if someone knows the client well
4. Seek additional help in recruiting the people we need
5. Ask the right person to accompany you to the client meeting

None of us are too busy. None of us are too important. We all "have the time." All of us will benefit if together we live by these very simple rules. Just in case there is ever any doubt, all 3,438 of you should feel free to reach out to either of the two of us whenever it is important, timely, and we can be of assistance. We believe the greatest form of respect you can show us is by disrespecting the thought that we may be too busy or too important to help you get the job done for our clients.

(Dis)Respectfully Yours,

Rich and Brian

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P.S. One more thought on disrespecting senior management that is worthy of its own separate letter: If you have a strong conviction that senior management is missing some of the facts, are off base on assumptions, don't know the individuals involved as well as you do, or you just believe what we are saying or doing is simply wrong---<u>PLEASE TELL US</u>! Nobody is infallible, none of us have all the facts, and every one of us can use help. We welcome healthy debate and only want to find the right decisions/conclusions for all.

Economics and Strategy

Goldilocks Just Keeps Kicking the Phillips Curvers in the Teeth

The U.S. unemployment rate released on June 1 hit a cycle low of 3.8%, a level that was last seen in April 2000, at the very end of the Goldilocks era. Prior to that you would have to go all the way back to the "golden age" of the late 1960s in order to find rates this low. But that said, the comparison today with April 2000, or the late 1960s, breaks down quite quickly once we consider current inflation levels.

In April 2000 CPI inflation was 3.1% – 60 basis points higher than it is today. And during the February 1966 - January 1970 period, when the unemployment rate had a 3 handle for all but one month, the average inflation rate was 3.9%. In fact, it was only in April 1967 that an employment rate of 3.8% or less coincided with an inflation rate of 2.5% or less. So what we witnessed last week in terms of inflation and unemployment combinations is one of the most unusual phenomena in modern economic history. But more importantly, it continues a more general pattern of violently contradicting the primary tenet of modern Keynesian economic theory, the Phillips Curve.

The concept that inflation will rise as unemployment falls is preprogrammed into every major central bank and street economic model. And it is like a disease that can cause policy makers and portfolio managers to make serious mistakes. As I have argued for quite some time in these notes, there are powerful drivers of disinflation affecting the U.S. economy. And these have been, and will likely continue to be, dominating the fatuous partial-equilibrium storyline that the Phillips Curve brings to the table. Focusing on the positive supply-side drivers of technological advance, corporate tax reform, and deregulation, along with the negative demand-side driver of demographics, will lead to a much better understanding of both the economy and financial markets.

One can only hope that with the U.S. unemployment rate at 3.8%, average hourly earnings growth at 2.7%, and CPI inflation at 2.5%, the leaders of central banks won't fall prey to the deeply entrenched Keynesian interests of their staff or street economists. These folks have built up a cabal over many decades that principally aims to keep their misguided Keynesian human capital relevant (and compensated). The sooner one figures that out the better.

Now to be sure, the data have been highly uncooperative with the cabal view for a while now. But these folks are persistent, and they have twisted and shifted the Phillips Curve in every possible way to try to salvage their junkyard of ideas. But after last week the jig may finally be up. A 3.8% unemployment rate with no sign of material inflation risk developing is a near fatal blow. Goldilocks has surely arrived in 2018. And while the Phillips Curvers are all lying beaten on the ground whining about inflation risks with their last dying gasps, she just keeps kicking them harder and harder. Go get 'em Goldilocks! Good luck trading.

— David Zervos, Chief Market Strategist

Divergent Performance

If 2016-2017 was the year of elections, 2018 is turning out to be the revenge of the macro with the whole gamut of yield curve shapes, inflation, volatility and now a strengthening dollar and high oil price to contend with. Over the past quarter, global equity markets have displayed divergent share price performance, conflicting sentiment as well as contradictory central bank policies. Equally, there have been the usual geopolitical worries (Italy, Germany), election surprises (Malaysia) and ongoing trade tensions. Nevertheless, global growth is holding up well while the baton of growth has broadened into a capital expenditure cycle.

Underlying equity markets were driven by three factors in 2Q: the U.S. 10-year government bond yield flirting with 3%, firm oil prices and a resilient U.S. dollar. Since mid-April, a typical emerging markets (EM) cycle has begun to unfold in which concern over the strength of the dollar and higher U.S. rate expectations has caused outflows from EM local fixed income markets, which in turn undermines their currencies and raises imported energy costs. Some EM central banks had deferred rate hikes to encourage growth or had believed inflation pressures would remain benign, but the firm oil price seems to have dented this view.

Hence, equity market performance is diverging with the ‘earnings growth’ story leading investors into the U.S. while the ‘inflation’ tightening pressures in parts of EM is forcing liquidation. Perhaps the easiest way to look at the cycle is very simply from the point of earnings growth. The U.S. is set for double-teen growth while the rest of the world will be satisfied with low-teen and single digit growth in 2018.

Meanwile, Japanese companies continue to report labor shortages and capacity constraints while monetary policy remains loose. A similar picture has been observed in the U.S. with companies raising prices and tight labor markets. To date this should be good for equities in both markets, but a keen eye will need to be kept on margins. Away from the politics, European growth is still holding up, and once again companies are optimistic. We also found UK companies exhibiting reasonable earnings and greater resilience coming into the final round of Brexit negotiations.

Jefferies expects 3Q to show further divergence between developed and emerging markets. This ought to mean a fair amount of fund flow rotation given that positioning for the past two years has been pro EM.

— Sean Darby, Global Head of Equity Strategy

U.S. Outlook – Fed Sets Steady and Gradual Course for Policy Normalization

At the outset of the second half of the year, the Federal Open Market Committee (FOMC) has signaled that policymakers expect to raise rates two more times this year for a total of four rate hikes. The rate normalization process will continue at a gradual pace of one rate hike per quarter against the backdrop of balance sheet normalization that is also an ongoing process. By the end of the year, the top of the target fed funds rate range will be 2.5%.

Balance sheet normalization has also continued to be a gradual process. As of the week ended June 27, Fed balance sheet holdings of Treasury had declined $87.2 billion since the beginning of balance sheet normalization in Q4 of last year. MBS and agency debt holdings had declined $51.2 billion over the same time period.

The balance sheet normalization process will continue to accelerate as the year progresses, however. Based on the Caps laid out in the Policy Normalization Principles and Plans, Treasury rolloffs will increase to as much as $24 billion per month in Q3 from $18 billion in Q2. MBS rolloffs will increase to as much as $16 billion per month in Q3 from $12 billion in Q2. In Q4, Treasury rolloffs will increase to as much as $30 billion per month, with MBS rolloffs being as much as $20 billion per month.

Jefferies estimates the fiscal accommodation provided by the corporate and individual tax cuts, as well as the very expansionary federal budget passed this year, will provide a boost to U.S. GDP of approximately 0.5% in 2018 and 2019. The FOMC views this fiscal accommodation as providing a window of opportunity to pursue monetary policy normalization without undo downside risk to the economy at a time when the U.S. economy is the strongest that it has been in decades.

The Fed is comfortable pursuing policy normalization because policymakers are also comfortable that both of the “Dual Mandate” objectives of maximum employment and stable inflation have been achieved. The 3.8% unemployment rate is the lowest since April 2000; the unemployment rate has not been sustained at a lower level since 1969. The PCE Deflator has finally met the Fed's 2% objective and is likely to continue to do so for at least a few more months ahead.

The biggest downside risk to the U.S. economy continues to be the multiple possible negative ramifications of the ill-advised U.S. trade policy that has led to the threat of a trade war. The Fed will remain sensitive to trade tensions and possible negative consequences for the financial markets. Were trade tensions to spin out of control into an outright trade war with severe negative consequences for the U.S. economy and financial markets, the FOMC would respond as needed. The primary lesson from the financial market volatility of earlier this year is that the Fed has greater tolerance for financial market volatility than was the case earlier this cycle.

— *Ward McCarthy, Chief Financial Economist*

European Outlook – As the ECB Ends QE, the Focus Turns to Capital Flows, Rate Hikes and Draghi's Successor; Brexit Uncertainty Is Rising, but BoE to Hike Rates in August

Deciding not to delay the decision for another six weeks, the ECB took the plunge at the June meeting and announced a short three-month taper to finish QE at the end of December. Coupled with the more explicit interest rate guidance, this puts the policy debate in the euro area on hold until mid-2019. In a year's time, however, the EU Council may have already appointed Mario Draghi's successor to take over from November 1st, which means that what will likely preoccupy the markets next summer is not whether Draghi manages to squeeze in a deposit rate rise before he departs, but the intentions of his successor.

The ECB's inflation forecasts are certainly bullish enough to justify multiple rate hikes in 2020; and even if wages and inflation remain sluggish, the ECB could adopt the Fed's playbook and normalize policy regardless–something that a Draghi-led ECB has already done to some degree. In the meantime, the ECB could enhance its guidance around QE portfolio size and signal that reinvestments will likely carry on for years into the future (following the BoE lead, for instance, the ECB could say that the size of its QE portfolio won't be reduced until the deposit rate rises to at least 1%).

The ECB could also amend some of the technicalities around its reinvestment activity, smoothing out purchases across the whole year (rather than having some months with large purchases, and other months with very limited flows), and potentially also changing the rules on where reinvestments end up by country. But these are minor tweaks, and the ECB has essentially prepared the markets to expect nothing new or substantial for at least a year. That said, events could still overtake the ECB. The twists around Italian politics remain unpredictable and could easily unsettle the markets once the budget negotiations kick-off after the summer. In terms of global implications, the end of QE-driven capital flows may have a far more significant impact on the U.S. markets than is realized. And, as the BoE recently warned, there are £67 trillion of outstanding derivatives exposed to a disorderly Brexit.

In the UK, the government is still struggling to find a balance between the form of Brexit it prefers, what it can manage to get through a divided Parliament, and what will be acceptable to the rest of EU. In the meantime, the BoE hopes that the UK economy bounces back sufficiently in Q2 to push through a rate hike on August 2nd. Beyond the next few months, however, the outlook for the economy is perhaps more uncertain than at any time since the wobble straight after the EU referendum, with divided politics, the BoE in damage limitation mode, and a clock ticking to March 29, 2019. FULL REPORT

— *David Owen, Chief European Financial Economist*

— *Marchel Alexandrovich, European Financial Economist*

Actionable Ideas for Companies and Sponsors

MERGERS AND ACQUISITIONS

Traditional Institutional Investors Now Embracing Activism

Activist investors have substantially increased their proactive engagement with YTD 2018 activity of approximately 400 campaigns, matching the annual totals for 2013 and 2014 and on pace to exceed 2017's record level. However, growth in activism is not coming solely from the 112 activist funds. In fact, of the 662 public campaigns in 2017, only 24% came from full-time activists.

The real drivers of activism have been traditional investment managers, such as AllianceBernstein and Blackrock, who are now embracing activism as a key responsibility of investment management. These investors are driving shareholder returns by agitating for more thoughtful M&A strategies, divestment of non-core businesses and changes in board composition. Investment managers are leveraging their in-depth investment research and their ongoing engagement with managements and boards – without the aggressive approach employed by the full-time activists – to become mainstream change agents.

Acquisitions of Corporates Carveouts Will Continue to Grow

Following the recent court approval of AT&T's acquisition of Time Warner, a wave of pending and potential vertical mergers across technology, media, healthcare, energy and general industrials are expected, which will create more supply of corporate divestitures to satisfy regulatory requirements or to help with de-leveraging. More generally, corporate divestitures are continuing to grow as companies – rather than allocating investment capital away from non-core businesses and exposing these businesses to long-term risks of under-investment – are instead selling these businesses at premium valuations and driving shareholder value. These trends were recently confirmed in Deloitte's recent annual 2018 survey of corporate executives, where 70% indicated plans to sell units or assets in 2018 and over 50% of respondents from companies with over $1.0 billion in revenue expect an unsolicited offer for one of their non-core business units in 2018.

Shifting Landscape of Asian Buyers

There has been a significant shift in the foreign acquisition activity of U.S. and European companies. Companies in Japan and Taiwan have become extremely active acquirors across multiple industries in the U.S. and Europe. Deal activity from Japan is 44% higher in 2018 than for all of 2017 and Taiwan has already reached 80% of 2017 total volume. Similarly, Singapore, through their sovereign wealth funds, specifically GIC and Temasek, have been increasingly active in the acquisition market and we expect this trend to continue, based on (i) the strategic shift to more direct investing, (ii) the significant expansion of their direct investment teams, and (iii) the increase in SWFs partnering with both strategic buyers and traditional financial sponsors to acquire businesses.

Quite to the contrary, in the past twelve months, substantial pressure on Chinese acquirors has dried up the pace of Chinese outbound acquisitions. We expect this trend to continue throughout 2018 and 2019, as it is being driven by a number of factors, including (i) the Chinese government imposing stringent foreign investment and foreign exchange limitations, (ii) China's aggressive restructuring of companies that over-extended themselves through acquisitions, and (iii) concerns about national security, privacy rights and intellectual property protection that have caused foreign regulators to block transactions.

DEBT CAPITAL MARKETS

Reverse Yankee Term Loan B and High Yield Issuance

As LIBOR continues to climb, we have seen U.S. issuers with growing European operations increasingly issuing in the European Term Loan B (TLB) and High Yield markets. The switch is being driven by the lower cost on EUR-denominated debt, given negative short term EURIBOR rates (albeit floored at zero for a TLB), combined with an increased willingness by companies to broaden their financing sources into a more resilient market with a deeper investor base. While spreads on a TLB for USD and EUR are approximately equivalent, when three-month base rates are taken into account, the all-in cost can be as much as 200 basis points tighter in EURs. This dynamic extends to the high yield market, with EUR-denominated bonds pricing 175-225 basis points inside the USD equivalent.

Issuers Pursuing More Flexible Terms During Incremental Term Loan Add-ons

Over the last two years, numerous new loan terms and structures have been devised that have greatly increased the flexibility and freedom of the borrower to raise additional debt, make investments, pay dividends and sell assets. The major new terms include (i) various carve-outs from yield protection when arranging incremental loans, (ii) carve-outs to allow incremental loans with maturities inside the base maturity and (iii) leverage based step-downs to limit the required repayment when selling assets. Originally developed for large sponsor-owned businesses, we have seen these new terms show up in non-sponsor-owned and middle-market credit agreements, further engraining these new terms into the loan market. As borrowers with older credit agreements return to market to raise incremental loans, we expect to see an increase in amendment requests to introduce these more flexible terms into their loan documents.

Reemergence of Floating Rate High Yield Notes

In the midst of a rising rate environment, we have seen a reemergence of Floating Rate Notes (FRNs) for high yield Issuers. These products are structured with a variable coupon based on a fixed spread generally over LIBOR, similar to the pricing structure of a term loan. FRNs have been met with high investor demand, both due to their rarity and attractiveness to investors who are protecting themselves against rising interest rates or who would otherwise invest in loans but are interested in exposure to a different part of the capital structure. Although issuers take interest rate risk – which can be easily hedged – it is offset by a much less restrictive call structure, therefore making it cheaper to paydown debt in the future. Recently we saw Albertsons Companies issue a $750 million floating rate note alongside their $1.5 billion asset-based term loan to help fund the company’s acquisition of Rite Aid. These bonds were non-callable for the 1½ years and callable at 102 thereafter, a far more attractive structure than the more standard 3-year non-call period followed by a call price starting at par + 50% of coupon.

EQUITY CAPITAL MARKETS

Concurrent IPOs and Convertible Offerings Provide Access to Increased Proceeds and Unique Sources of Capital

Concurrent IPO and Convertible issuance provides companies with the opportunity to maximize proceeds at the time of the IPO by accessing two distinct sources of capital. It also allows an issuer to take advantage of the current strength in both the IPO and Convertible markets. IPO activity in the U.S. and Europe has increased 20+% over the same period in 2017, and Convertible issuance continues to be a preferred source of financing for companies, as a result of rising interest rates, favorable equity valuations, and issuers actively using Convertibles with record low coupons to refinance floating rate debt and extend maturities. Concurrent IPOs and Convertibles are being well received by investors, and Concurrent Convertibles are averaging approximately 30% of the IPO size. Most recently, AXA Equitable Holdings, the U.S. operations of life insurance and asset management firm AXA SA, successfully raised $750 million through a Convertible bond offering concurrent with its $3.2 billion IPO.

At-The-Market Programs Are Now Being Used Across a Wide Range of Sectors

At-The-Market (ATM) programs are on pace for a record year in 2018. Following more than $40 billion of ATM filings in 2017, ATM programs have become an increasingly common alternative to raise primary equity capital across a wide range of sectors in the U.S. While ATM programs have historically been used primarily by REITs and MLPs, we are seeing broader sector diversification. In 2018, healthcare companies have filed $2.2 billion of ATM programs, media/telecom companies $1.2 billion of programs, FIG companies nearly $600 million of programs and Industrial companies nearly $300 million of programs. Jefferies is active in the ATM market with 50+ programs filed since 2017 totaling $20+ billion in value.

An ATM program allows a company to discretely sell primary stock into the market with complete control over timing, price and volume. The only upfront disclosure for an ATM is the filing of a sales agency agreement that includes the maximum dollar amount to be sold under the program, and public disclosure of the primary stock sales occurs in arrears in the company's quarterly financial statements.

Technology IPOs are Experiencing a Major Resurgence After 3-Year Dry Spell

Technology IPOs are experiencing a major resurgence in 2018, on pace to surpass the last 3 years both in volume of new issuance and capital raised, and returning closer to normalized historical levels. Dropbox's IPO in March (where Jefferies acted as bookrunner) set a much-needed positive tone to pave the way for others, with 17 U.S. Technology IPOs since then raising $8 billion to date.

Although headlines focus on high profile unicorns, it is the small and mid-cap technology growth companies that have dominated the slate of successful offerings. Software IPOs, in particular, have comprised more than 50% of IPO issuance and achieved record valuations at pricing – Smartsheet, Pluralsight and Zscaler, all pricing near 7x TEV/Forward Revenues, marking the highest valuations since Atlassian in 2015. Further, they've set a pattern for technology IPOs pricing strategies, filing at relatively conservative ranges, upwardly revising during the roadshow, and then pricing above the range. Technology new issues should continue to perform well, as institutional investors seek diversification away from the concentration risk associated with the large-cap technology companies. A portfolio of this year's class of Technology IPOs thus far has outperformed the large-cap technology stocks (Facebook, Amazon, Apple, Microsoft, Netflix and Alphabet) 78% to 27%.

RESTRUCTURING AND RECAPITALIZATION

Preserving Valuable Tax Attributes in Chapter 11 Reorganizations

For distressed companies with holding company (Holdco) and operating company (Opco) corporate structures, the Holdco frequently accumulates substantial NOLs. Recently, sophisticated investors have taken advantage of the special rules provided by section 382(l)(5) of the bankruptcy code and have successfully reorganized HoldCos in Chapter 11, with the sole purpose of preserving substantial NOLs. Under 382(l)(5), distressed companies can preserve NOLs in Chapter 11 without limitation, so long as "qualified creditors" and historic shareholders receive greater than 50% of the value and voting power of the post Chapter 11 reorganized company.

These companies frequently emerge from Chapter 11 as corporate shells, with their primary asset being NOLs, and a strategy to acquire assets that generate substantial taxable income. A recent example of deploying this strategy in Chapter 11 is the holding company of Washington Mutual, in which investors led by KKR successfully preserved approximately $6 billion of NOLs.

MUNICIPAL FINANCE

Municipal Issuers Should Initiate Tenders Alongside New Issue Financings

The Tax and Jobs Act eliminated the ability of municipal governments to issue tax-exempt bonds for advance refunding of outstanding bonds, thereby limiting an issuer's refinancing options in advance of the optional call date. However, municipal issuers can replace advance refunding flexibility and potentially achieve present value savings by tendering for their outstanding high coupon callable bonds.

We therefore recommend tenders as an add-on to an issuer's anticipated new money or current refunding financing. A tender mimics an advance refunding, because it permits outstanding high coupon tax-exempt callable bonds to be purchased immediately using the proceeds of tax-exempt bonds. A tender can be easily woven into the timetable of a traditional financing, because recently modified regulations permit the tender period for most tenders to be as little as five business days. Current market conditions, a flat yield curve and low long-term rates are attractive for tenders, since they translate into lower tender prices for callable bonds and higher prices for long term bonds issued to fund a tender. Jefferies recently acted as Dealer Manager for a successful tender completed by the City of Indianapolis.

Best Research Ideas

AMERICAS

U.S. Insights – "Powered by Data" Franchise Note Series

Jefferies U.S. Equity Research published a series of reports that seek to elucidate how companies under coverage are leveraging data to generate sales, improve operational efficiencies and ultimately drive profits. Each analyst was asked to examine how companies in their vertical are innovatively using data and to assess whether the market is rewarding companies that excel in using data to drive incremental revenue and earnings. Jefferies Equity Research has published 13 "Powered by Data" notes to-date across the Consumer, Financial, Healthcare, Industrial, REIT and Technology verticals.

Banks: Driven by Digital FULL REPORT
Biotechnology: The Exciting Potential and Challenge of Big Data in Biotech FULL REPORT
Consumer Products: Initial Assessment of HPC and Beverage Cos. in Data Analytics FULL REPORT
Consumer: Assessing Who's Winning/Losing the DATA WARS in Retail FULL REPORT
Consumer Finance: How Tech-Based Alternative Data Apps Benefit Cons. Finance FULL REPORT
Cosmetics: Beauty Tech Is Next Natural Evolution for Growing Industry FULL REPORT
Food: The Makings of a Brand Resurgence FULL REPORT
Health Care Facilities: HC Provider Strategy Handbook FULL REPORT
Industrials: Sensors & Analytics – Trends, Opportunities & Threats FULL REPORT
Medical Devices: Data Taking Root in Devices FULL REPORT
Pharmaceutical Services: Outsourcing Insights Part II – How Data Is Powering Trials FULL REPORT
REITs: Self-Storage Performance Increasingly Driven by Data Analytics FULL REPORT
Technology: The Alchemy of Extracting Value from Big Data FULL REPORT

— *Jefferies U.S. Equity Research*

Software: Identity & Access Primer – Materially Underestimated Opportunity

Jefferies published a Franchise Note on Identity and Access management (IAM), identifying it as a market significantly underestimated. In Jefferies' view, industry analysts' 8% growth CAGR does not accurately address the increased relevance of the market due to the use of hyper distributed cloud architectures. Jefferies estimates the market could grow at more than 2x that rate, or a 22% CAGR through 2021, as non-traditional, smaller customers utilize IAM as well. Jefferies believes SAIL is best positioned to benefit from this and believes there could be upside to the Street's 16% license revenue growth in both 2018 and 2019. FULL REPORT

— John DiFucci, Equity Research Analyst, Software

Building Products – Peak Concerns Overblown, But Focused on Highest Conviction Ideas

Jefferies highlighted that the building products group has seen EV/EBITDA multiples compress YTD, largely on concerns over housing, a result of higher rates and peak of cycle fears. Jefferies' analysis found that 30-year mortgage rates have had a weak/positive correlation to home sales, and household formation and consumer confidence are bigger drivers. Housing starts were at 1.2 million in 2017, but Jefferies believes builders need to build 1.5-1.6 million homes a year to keep pace. Millennial home buying will also release pent up demand. As a result of this work, Jefferies highlighted top pick OC, a Franchise Pick, and added MLM to the Franchise Picks list, citing leverage to home construction. As aggregate producers like MLM are eluding to second price increases in 2H18 even as they see little inflation themselves, Jefferies put 2018 and 2019 EPS estimates for MLM ahead of consensus. FULL REPORT

— Phil Ng, Equity Research Analyst, Building Products

EMEA

European Franchise Picks List – Time to Refresh!

Jefferies reviews recent performance and looks to build impetus with nine new stocks added: Anglo American, ArcelorMittal, Burford Capital, Generali, Lonza, Indivior, Sky, Sophos, and Volkswagen. These join Siemens, Meggitt, RDSA, EDF, Maersk, RBS, and Novartis to make up the 16-strong list. Eight names have been removed: Credit Agricole, Bouygues, ThyssenKrupp, S&N, Swisscom, Allianz, Yoox Net-a-Porter, and British American Tobacco, for reasons explained within. FULL REPORT

— Jefferies European Equity Research

Consumer Staples – Why the Model Is Not Broken

The mass market model in staples isn't broken, Jefferies argues. Fragmentation fears are overdone and the 'disruption' thesis around Millennials, digital and channel shifts conflicts with the realities and the evidence. It would be naïve to argue that change isn't occurring. But Jefferies questions whether it's occurring at a rate beyond the adaptive qualities of the best players and stays sanguine. FULL REPORT

— Martin Deboo, Equity Research Analyst, Food and HPC

ASIA

Japan Equity Strategy: Fifth Anniversary of Abenomics – Three Reasons to Buy Japan

Jefferies believes the Japanese stock market remains attractive for three reasons: 1) valuation multiples have barely risen and remain very reasonable; 2) stimulative monetary and fiscal policies; and 3) corporate governance reform should result in a market re-rating over time up to higher multiples. Jefferies expects a rise to a 1.8x PBR multiple may be possible in the coming five years as balance sheet structures are improved and earnings, dividends, share buybacks and ROEs continue to rise. This should result in double-digit annual returns for investors. FULL REPORT

— *Zuhair Khan, Equity Research Analyst, Japan Equity Strategy*

Insurance: Life is Not Risk Free! Initiate Coverage on India Life Insurance

Jefferies believes structural growth opportunity is large and promising, but near-to-medium term risks exist from regulations around product structure and pricing, which could dent profitability. IPRU is the firm's top pick given: 1) lower mix of credit protect and non-linked savings where regulatory risks are an overhang; 2) retail-oriented business mix (>90% of business is individual); and 3) levers for margin improvement. SBILIFE is Jefferies' second pick for its granular, geographically diversified customer franchise and leading distribution capabilities. Conversely, the firm initiates HDFCLIFE at Underperform, believing margins have peaked as competition in the credit life segment intensifies and the mix of ULIP increases. Also, current valuations leave little room for any disappointment. FULL REPORT

— *Harshit Toshniwal, Equity Research Analyst, India Financials*

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NOTABLE RECENT TRANSACTIONS

Technology, April 2018, Pending Mitel $2,000,000,000 Sale to Searchlight Capital Partners, L.P. Sole Financial Advisor	Healthcare, April 2018 Heartland Dental $1,285,000,000 Credit Facility to Finance Acquisition of Stake by KKR Joint Lead Arranger $310,000,000 Senior Secured Notes Offering Joint Bookrunner	Energy, April 2018, Pending RMP Rice Midstream Partners $2,400,000,000 Merger with EQT Midstream Partners Sole Financial Advisor to the Conflicts Committee	Finance, May 2018 Virtu Financial $483,000,000 Common Stock Offering Joint Bookrunner
Industrials, April 2018 WSB Titan CAD800,000,000 Sale to Sale to GMS, Inc. Sole Financial Advisor	Energy, April 2018, May 2018 Brazos Midstream $1,750,000,000 Sale to Morgan Stanley Infrastructure Partners Sole Financial Advisor $950,000,000 Credit Facility to Finance Acquisition by Morgan Stanley Infrastructure Partners Joint Lead Arranger	Gaming, April 2018, Pending Tropicana Entertainment $1,210,000,000 Sale of real estate to Gaming and Leisure Properties, Inc. Sole Financial Advisor $640,000,000 Merger of gaming and hotel operations into Eldorado Resorts, Inc. Sole Financial Advisor	Technology, May 2018 Renaissance $1,120,000,000 Credit Facility to Finance Acquisition by Francisco Partners Joint Lead Arranger
Technology, April 2018, Pending Callcredit £1,000,000,000 Sale to TransUnion Co-Lead Financial Advisor	Metals & Mining, May 2018 Real Alloy $470,000,000 Restructuring and Sale to DDJ Capital Management Financial Advisor to the Company	Healthcare, June 2018 dentalcorp $908,000,000 Credit Facility to Finance Acquisition by L Catterton Joint Lead Arranger	Business Services, June 2018, Pending Navigant $470,000,000 Sale of Disputes, Forensics and Legal Technology and its Transaction Advisory Services businesses to Ankura Consulting Group, LLC Sole Financial Advisor
Industrials, April 2018 Airxcel $540,000,000 Credit Facility to Finance Acquisition by L Catterton Joint Lead Arranger	Healthcare, May 2018 Jordan Health Services Great Lakes Caring Home Health Hospice $935,000,000 Credit Facility to Finance Merger by Blue Wolf Capital Partners and Kelso & Company Joint Lead Arranger	Technology, May 2018 SailPoint $461,000,000 Common Stock Offering Joint Bookrunner	Consumer, May 2018 Hearthside Food Solutions $1,295,000,000 Credit Facility to Finance Acquisition by Charlesbank Capital Partners and Partners Group Joint Lead Arranger $350,000,000 Senior Unsecured Notes Offering Joint Bookrunner
Technology, April 2018 Ceridian $531,000,000 Initial Public Offering Joint Bookrunner	Municipals, May 2018 Penna Turnpike Pennsylvania Turnpike Commission $442,000,000 Oil Franchise Tax Revenue Bond Offering Sole Bookrunner	Healthcare, May 2018 Teladoc $288,000,000 Convertible Notes Offering Joint Bookrunner	Industrials, April 2018 Ply Gem $2,875,000,000 Credit Facility to Finance Acquisition by Clayton, Dubilier & Rice Joint Lead Arranger
Healthcare, April 2018, Pending Curo Health Services $1,400,000,000 Sale to Humana Inc., TPG Capital and Welsh, Carson, Anderson & Stowe Sole Financial Advisor	Technology, May 2018 avast £602,000,000 Initial Public Offering Joint Bookrunner	Finance, May 2018 TMX Finance $450,000,000 Senior Secured Notes Offering Sole Bookrunner	Municipals, April 2018 Tobacco Settlement Financing Corporation $3,147,000,000 Tobacco Settlement Bonds, Series 2018 Joint Bookrunner

JEFFERIES KEY FACTS & STATISTICS

(as of May 31, 2018)

Founded: 1962

Total Long-Term Capital: $12.0 billion

Number of Employees: 3,438

Companies under Global Equity Research Coverage: 2,000+

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