Jefferies Insights

JULY 2019

Our Promise to Jefferies Clients

Dear Clients (and employee-partners),

Jefferies' investment banking revenues have grown at a compounded annual growth rate of nearly 20% since we entered this business 29 years ago and we are approaching a $2 billion annual run rate. Our sales and trading growth rate has been nearly 10% over the same period since 1990. This is entirely a result of the trust, partnership and loyalty of our most important constituency: you, our valued clients. Many firms in our industry are caught up in individual transactions, specific trades, processing deals, or being a counterparty or product purveyor. For this quarter's note, we thought it would be worthwhile to remind ourselves and all of you of what we believe our compact is with each of you, our Jefferies clients. You are the ones who have enabled us to build our firm, and every one of us at Jefferies is extremely grateful.

The Jefferies Promise to our clients:

1. We will always put our clients first at Jefferies. This is an easy thing to say and live by 95% of the time because things are generally straightforward and true conflicts are not an everyday occurrence. However, it is that other 5% of the time when the rubber meets the road. Those are the times when the tough calls need to be made, and the firm must rally together and prove that we truly think and act "long term." For us at Jefferies, it is these critical minority of situations where we have the chance to truly distinguish ourselves in the eyes, minds and hearts of our clients.
2. We will always prioritize, protect and improve the culture of Jefferies. We do this not only because this is the way we want to live our daily lives, but because this is the best way for us to truly serve our clients. A culture based on honesty, transparency and integrity means that our clients never have to worry if we mean what we say. We have no agenda besides what is best for you and our clients can trust our words and intent. Additionally, when our culture is healthy and strong, it means that we are truly collaborative and only then can we deliver the best of what Jefferies has to offer. This means that, when you work with any individual at Jefferies, that person is committed to and capable of delivering the entire firm for the client's benefit. No fiefdoms, no political games, and no fighting over credit or fees. Our goal is to always act as one firm and to deliver the firm in its entirety to our clients. Every resource, every idea, every option and every capability must be efficiently and effectively delivered to you, our clients.

IN THIS ISSUE

3. We are committed to constantly invest throughout the Jefferies platform so we can best support our clients in an ever-changing world. This requires discipline, long term commitment and the will to invest. For the first half of this year, we have hired over 350 new professionals into Jefferies, which represents nearly 10% of our end of 2018 headcount. They joined across the firm in all areas where we touch clients or need support to effectively execute for you. We have found unique candidates in research, where others are paring back. We have continued our broad buildout in Europe and Asia, where markets are challenging. We have spent a great deal of money on technology, whether it is to help with better trading execution or to make our investment bankers more effective in addressing our clients' needs. Our clients' worlds are changing rapidly and we are committed to investing our time and capital to make sure we are prepared to best help our clients thrive.

4. We are committed to excellence at Jefferies. This means our people must have the right industry expertise, they must fully understand all the nuances of every product and service that can be provided, and they must be up to the minute on every aspect of the financial markets on a global basis. There can be no holes in our performance or weak links in our chain of execution. We need to provide the right perspective and advice and then we have to achieve the optimal execution, every single time. We must prove ourselves and earn your trust every single time we work together. You trust us with your most important opportunities and needs, and we won't let you down.

5. We are committed as permanent partners. As we stated upfront, we don't view what we do with our clients as trades, transactions or deals. We are not a counterparty or product purveyor. We will be your loyal confidant, alter ego and partner for as long as you will allow us. Nearly 80 percent of our investment banking revenues today represent repeat business from existing clients. This means that we will be with you when you are doing exceptionally well, as well as when you experience the inevitable setback, no matter how bad it may appear or feel. It also means we will be with you not only when the markets are healthy, embracing, and easy, but also when the world is upside down and nothing appears to be working. We have proven this to our clients these past three decades, but we still must prove it going forward each and every day. We fully recognize that past accomplishments are nice, but all that truly matters to our clients is today and tomorrow.

This mid-year note is not just a reminder of our promise to our clients, but a sincere "thank you" for all you have done for us. All of us at Jefferies feel very privileged to share our promises with all of you. The reason is simple, you have all done the same for us for a very long time by showing your loyalty and commitment to us. We look forward to working together in the second half of 2019 and into the decades that will follow.

With great appreciation and our promises extended,

Rich and Brian

RICH HANDLER
CEO, Jefferies Financial Group
1.212.284.2555
rhandler@jefferies.com
@handlerrich Twitter | Instagram

BRIAN FRIEDMAN
President, Jefferies Financial Group
1.212.284.1701
bfriedman@jefferies.com

Economics and Strategy

Fed Policy vs Trade Policy: It's Not Even a Contest

It's so depressing to watch the world of mainstream economic punditry try to blame its epic 2019 forecasting failures on trade policy changes. The number of high-profile folks who were in the 3.5% to 4% 10-year note camp, as well as the three-to-four rate-hike camp, for 2019 who have now become trade-warmongering uber-doves is actually shocking. Just to be clear, so far $200 billion of goods from China, representing about 1% of U.S. GDP, are subject to a 25% tariff. And that's supposed to topple the $20 trillion U.S. economy?? Pullleaasee.

Now, I know that indirect effects on business sentiment and retaliatory effects on exports COULD add to further deterioration. And of course there are more serious escalation risks as trade policy looks to weaponize for noneconomic purposes, as in regard to Mexico. But none of this has really happened yet. And even if we did go down that darker path, the largest indirect effect from additional actual and potential trade policy shifts is something far more powerful in the POSITIVE direction: Fed policy changes.

In recent weeks we have heard Powell, Clarida, and Evans all basically say the same thing: they are monitoring economic developments closely, and they will act accordingly if conditions deteriorate. Of course, Bullard has gone a step farther to speak of immediate cuts given the inflation target misses of the last seven years - but that's just a repeat of his long-standing (and in my opinion correct) view. The new story here is that the powerbase of the FOMC brought our beloved spoo put strike right into viewing distance. And it's this same put, which has crushed the haters at every turn of the recovery for the last 10 years, that will no doubt demolish this exiguous threat from trade.

On Monday, June 3, prior to all the Fed speeches at the framework change conference in Chicago, I put forward some possible put strike levels. And after wading through all these new communications, I had no reason to change those {x,y,z} strike levels of {2625,2500,2375}. I believed (and still do) that they had just told us that if we go down ~10% from the all-time highs of around 2950, then the lift-off turns into a nosedive. It's that simple. And the haters best get out of the way as that nosediving rate missile is headed right for their short-biased risk asset portfolios. Now, two weeks later here we sit right back at ~2950, making new highs.

All of this said, I do want to make one other very important point on this whole trade saga flip-flop by the mainstream economic forecasting mob. In my opinion, the modest slowing that began in late 2018 has come from those standard, well-established, long and variable lags associated with the monetary tightening. Over the last two years the Fed has taken policy rates up over 200 basis points and executed $800 billion in QT. And I would argue this balance sheet move is easily worth ~100 basis points of rate tightening. It was this LARGE tightening, and the hawkish Powell communication errors in Q4, which led to the economic and financial-market jitters we have seen in recent quarters. Trade has been a VERY minor factor, and arguably one that can be EASILY offset by the appropriate application of modest doses of monetary stimulus. To see sell-side, academic, and central bank economic forecasters fall back on trade concerns to cover their mistakes is just pathetic. These folks thought neutral rates were 4%. These folks thought end-of-cycle inflation spikes were coming. And these folks thought the Fed was going to overshoot on policy-rate tightening moves. They were wrong about neutrality, wrong about inflation, and wrong about their calls for both rates and risk assets. To try to blame that failure on a few tweets and some modest tariff moves is disgraceful.

Anyway, enough on that. Spoos are right back at all-time highs. Imagine if they went full Bullard and decided to actually initiate the nosedive in rates from here. We would be at new all-time highs in a heartbeat, even if all $565 billion of Chinese imports went under a 25% tariff and the Mexican tariffs went into effect. Oh yeah, and if trade issues escalate any further, and folks worry that the Fed will run out of ammo, don't forget that the balance sheet is ready, willing, and able to head right back to its highs of $4.6 trillion or even well beyond. Spoos, blues, and seagulls all feel just fine.

— David Zervos, Chief Market Strategist

Risk Aversion Overwhelms Fundamentals

Global equities experienced a rollercoaster ride as sentiment shifts on the US-China trade dispute collided with a stream of Dovish commentary from central bankers. Risk aversion was a key theme last quarter as investors sold equities and poured cash into money market funds and US treasuries at a rate similar to that seen last December and during the 2008 Global Financial Crisis. Worries over a U.S. recession, deteriorating global trade and soft economic data led some EM central banks to break with convention and ease before the Fed.

Conviction levels among global equity investors is low, and this has been reflected not only in fund flows away from shares but also investors ignoring extremely attractive valuations. Furthermore, while economic data has reversed, there are no signs that the world is heading into a deflationary abyss with 1Q19 European wage data the best since 2009. Moreover, the drop in negative nominal yields has meant that real interest rates are extremely accommodative for financial markets, especially for equities.

One of the dichotomies confusing investors presently is the divergence between manufacturing and services data releases. The former has seen poorer announcements which disproportionately effect earnings estimates while the latter is experiencing ongoing expansion but there are few pure listed service companies. We expect equity investors to 'capitulate' and switch from cash to equities as earnings revisions become "less bad" over the next quarter. Valuations are very attractive in Europe, EM and within the S&P 500 energy, materials and industrials.

— Sean Darby, Global Equity Strategist

U.S. Outlook – U.S. Inflation in a Globalized World

The increased reliance on imports of manufactured goods over the past few decades has changed the underlying dynamics of U.S. inflation. Headline inflation has become heavily influenced by the behavior of import prices which, in turn, are very sensitive to global economic conditions and commodity prices.

U.S. inflation, as measured by the year-over-year change in the headline CPI, has averaged 1.5% since the beginning of 2015, which marked the end of the second deflation wave of this cycle. In April 2015, the year-over-year change in the headline CPI was running at -0.2% due to a strong disinflationary wave in the second half of 2014. After the disinflationary effects abated, the headline CPI accelerated to as high as 2.9% in June and July of 2018 before again decelerating to as low as 1.5% year-over-year in February of this year.

Core measures of U.S. inflation have been significantly more stable than headline measures. The year-over-year change in the core CPI went as low as 1.6% in January 2015 but accelerated to as high as 2.4% in July 2018 before decelerating again to as low as 2% in March of this year. Core CPI inflation has averaged 2% since the beginning of 2015.

The moderate behavior of core inflation relative to headline inflation is primarily a function of the behavior of service inflation relative to manufactured-goods inflation. Service inflation is primarily a function of domestic conditions. Service inflation has gradually and erratically accelerated this cycle from the historic lows. Service inflation in the CPI has averaged 2.7% since the beginning of 2015, ranging from 2.1% to 3.1%, and remains moderate by historical standards with relative stability.

Intuitively, it makes sense that service inflation would accelerate during a 10-year expansion in an economy that is overwhelmingly dominated by the service sector. More than 86% of private sector payrolls are involved in the service sector of the U.S. economy, which is also very domestically oriented. Service exports averaged a modest $69 billion per month in 2018, and imports averaged a very moderate $46 billion per month. Consequently, U.S. service prices tend to be domestically determined.

This domestically-oriented determination of U.S. service prices contrasts sharply with the determination of U.S. manufactured-goods prices. The good-producing sector of the U.S. economy has declined substantially as a share of economic activity. While the share of service sector payrolls has risen from roughly 60% to more than 86% in the U.S., the goods-producing share of private sector payrolls has declined from roughly 40% of payrolls to about 14%. The decline in the U.S. goods-producing sector was primarily a function of the decline in U.S. manufacturing activity during this era of globalization. The U.S. effectively outsourced a significant portion of U.S. manufacturing activity. This outsourcing of manufacturing activity has both had effects on the nature of U.S. growth and has caused growth to be slower but more prolonged.

The decline in the U.S. goods-producing sector has also changed the inflation dynamics related to manufacture goods prices for the simple reason that the U.S. imports of manufactured-goods have increased massively—averaging $214 billion per month during 2018, the U.S. imported more than $2.5 trillion of manufactured-goods from overseas last year.

As U.S. imports of manufactured-goods have risen, there have been two important changes. First, the effect of import prices on U.S. inflation has also increased substantially. Second, inflation in the U.S. has become more volatile due to the increased importance of global economic conditions on import prices. As a result, the magnitude of the oscillations in U.S. manufactured-goods inflation during the era of globalization has increased significantly, and the frequency of these oscillations has also increased.

The movement in U.S. manufactured-goods inflation is very highly correlated with import prices, and the correlation is strong whether energy prices are included or not. Import prices, in turn, tend to be sensitive to global economic conditions, which is why import prices tend to move with commodity prices.

The bottom line is that U.S. headline inflation will follow import prices which, in turn will follow commodity prices. Manufactured-goods inflation reflects the change in the structure of the U.S. economy during this era of globalization and tends to be dictated by global economic conditions because a massive amount of the goods that are consumed in the U.S. are imported from overseas.

— *Ward McCarthy, Chief Financial Economist*

European Outlook – Can the ECB and the BoE Wrestle Back Control of Monetary Policy?

In a performance that summed-up his term at the ECB, Mario Draghi delivered something for everyone at the June press conference. The ECB's overall stance remains cautious, reflecting uncertainties over the state of the domestic economy, uncomfortably low inflation and global trade tensions. In response, Draghi reiterated that the ECB has plenty left in its arsenal to support the economy if it becomes necessary, including restarting QE and cutting rates. At the same time, the ECB's task of setting policy to reflect the needs of the euro area is being made harder by the U.S. Fed's dithering over its direction of travel and the markets projecting expectations of imminent rate cuts in the U.S. onto the European yield curve (a frustration shared by the Bank of England).

As the clock ticks down on his time as the ECB President, however, attention is increasingly turning to life after Draghi. The European Elections didn't produce the political earthquake some had feared. Nonetheless, the two main political parties did significantly worse than in 2014, and the next step in the process is to choose who will replace Jean-Claude Juncker as President of the European Commission. The frontrunner for the job under the process of Spitzenkandidat is the German politician Manfred Weber. But if he is asked to step aside in the coming weeks in favor of another candidate (as suggested by Emmanuel Macron), then Angela Merkel could focus on the top ECB job and the nomination of Jens Weidmann.

At the moment there is widespread skepticism that the ECB would ever be in a position to hike rates or to start unwinding QE. That said, away from the hysteria surrounding inflation expectations and weak manufacturing PMIs, the ECB is nudging the markets to start focusing on a broader set of economic variables. Inflation dynamics should not be judged narrowly by the latest core inflation print but by a wider basket of indicators including what's happening to unemployment and wages, profit margins and the GDP deflator, super-core inflation and the weight of the Harmonized Index of Consumer Prices (HICP) items in deflation.

In the UK, will the new Prime Minister be able to renegotiate a deal with the EU and steer his/her version of Brexit through Parliament before October 31? With this outcome extremely unlikely, another extension is almost inevitable, although the decision could come very late in the day with the Parliament potentially on the brink of a no-confidence vote in the government. As this mess unfolds, the calls for another referendum and a new General Election will grow even louder, although neither would be expected to produce a decisive outcome with the electorate as divided (and in some ways arguably more) now as in 2016 or 2017. Against this backdrop, the BoE will be on standby to adjust policy in either direction; but if an orderly Brexit can somehow be delivered or, more likely, Brexit is delayed into next year, the Monetary Policy Committee has a bias to tighten policy and, as in summer 2017, could surprise the markets with its resolve. FULL REPORT

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

Actionable Ideas for Companies and Sponsors

MERGERS AND ACQUISITIONS

Activist Activity Should Increase Due to Continued Uncertainty Around Brexit

Activist activity in the UK has increased significantly over the last five years as the number of activist campaigns in the UK has nearly tripled from 23 to 66. However, the impact of continuing uncertainty surrounding Brexit on the expected growth and margin profile of otherwise attractive UK companies is setting up UK corporates for a record level of shareholder activism. Brexit has resulted in a 25% decline in UK equity valuations over the last 24 months, as well as a significant decline in Sterling exchange rates. In addition, a potential change to a Labour Party government is leading to uncertainty around higher corporate income taxes. Furthermore, private equity and pension funds are significantly limiting their investments in UK corporates. Notwithstanding these factors, there are a large number of UK-domiciled corporates that are competitively strong and well-managed, but whose values have been significantly diminished by Brexit and politics. We believe this confluence of events will drive a significant increase in activist activity, and UK corporate clients should be thinking through strategies to help prevent as well as to address this outcome.

SPACs Continue to be a More Pervasive Buyer of U.S. Businesses

The surge in SPAC M&A activity that started in 2018 has continued unabated in 2019, fueled by 23 SPAC IPOs in 2019 raising over $5 billion and tracking ahead of 2018 records in both number and value. Consistent with this SPAC new issuance activity, the pace and size of SPAC mergers have accelerated as well. In 2019 there have been 11 mergers completed across multiple industries with an average enterprise value of $1.25 billion, 25% higher in average deal value than the 2018 average, and acquisition activity is on pace to exceed the 21 deals in 2018. In addition, there are currently 69 SPACs with $16.5 billion of equity capital looking for acquisitions, of which 10 SPACs with $3.5 billion of capital, will expire in 2019.

Companies considering a sale should focus on SPACs as a legitimate and competitive alternative to strategics or private equity buyers. SPACs are an attractive acquiror because: (i) the seller can participate in the future upside of the business through public equity ownership, while concurrently monetizing a portion of their gain through the SPAC's cash, (ii) future monetization of a seller's equity position is not dependent on other shareholders as is the case when rolling equity in a sale to a sponsor, and (iii) a sale to a SPAC creates an acquisition currency to accelerate a company's growth through further M&A.

Private Equity Becoming An Important Buyer of Venture-Backed Businesses

Venture capital-backed companies are increasingly turning to private equity for exits versus the traditional route of selling to strategic buyers. This is a recent trend being driven by venture-backed companies remaining private for longer time periods and therefore representing more mature targets for private equity, as well as the need for these companies to provide liquidity to early stage investors. In addition, record levels of dry powder and a highly competitive M&A environment are driving private equity firms to be more proactive in pursuing venture-backed companies. Private equity buyers now account for almost 25% of venture-backed exits, and we expect this trend will become a more prominent focus for later-stage growth companies.

DEBT CAPITAL MARKETS

"Loan-to-Value" Debt Financing is Available for High Growth Private Companies

There is increased receptivity from the institutional loan market for "loan-to-value" (LTV) issuers. These LTV issuers are typically high growth companies with very low leverage and minimal or negative cash flow who have achieved strong valuations (>$1 billion) in private capital raises, and typically wouldn't qualify for access to the syndicated debt capital markets using traditional debt-to-EBITDA metrics. However, in today's market, lenders will invest in a traditional syndicated loan issued by these companies, independent of cash flow, due to the substantial (>75%) implied equity cushion beneath the debt to provide credit support. This provides high-growth companies the opportunity to raise non-dilutive capital to fund M&A and for ongoing general corporate needs. Potential issuers include E-commerce and SaaS businesses with strong recurring revenue, and other leading high-growth disruptors across multiple verticals. The recent uptick in IPO volumes also has helped validate private valuations and added additional credibility to the implied equity cushions that support these LTV opportunities.

HoldCo PIK Toggle Notes to Finance Dividend Recaps

With the high yield bond primary market exhibiting great strength, investors recently have shown interest in buying HoldCo PIK Toggle Notes from sponsor-owned companies to fund dividend distributions. These notes are issued at the holding company level, and the PIK Toggle component is issued with a base coupon as well as a slightly increased coupon, the latter which the borrower will have to pay if it elects to defer interest payments. The flexible PIK Toggle structure also allows sponsors to avoid restrictive language in the OpCo bond indentures that prevent dividend distributions. Sponsor portfolio companies with larger EBITDA, whose OpCo bonds are yielding single digits in their non-call period, should consider taking advantage of this current market environment to issue PIK Toggle Notes to finance dividends.

Incremental First Lien Term Loans to Refinance Second Lien Term Loans

With the flurry of new issue activity that occurred in 2017, a number of second lien term loans have call protection scheduled to sunset in 2019 and 2020, minimizing potential breakage costs. By refinancing these second liens, the issuer can save significantly on interest expense, and investors gain comfort in the shift to first lien leverage from the growth and deleveraging of the business since the original financing. With market technicals remaining strong for issuers, companies can take advantage of this investor interest and issue incremental first lien term loans to refinance existing second lien term loans. Recently, Jefferies was left lead on a $115 million incremental first lien for ABC Financial to repay the Company's second lien term loan. Pro forma for the transaction, the weighted average spread of fund debt decreased from L+556 to L+425. While the Company will pay a 1% prepayment premium on the second lien, the interest premium far outweighs the penalty.

EQUITY CAPITAL MARKETS

Convertible Bonds for Smaller Companies

The strength of the convertible market has created a compelling financing window for smaller, growth-oriented companies that may lack profitability. Investors have become receptive to smaller capital raises—between $75 and $150 million—for issuers with market caps as small as $300 million. These financings provide access to low-coupon, covenant-free debt that allows high-growth companies to maximize strategic and operational flexibility. Jefferies recently acted as sole underwriter on the $80 million convertible bond offering for PAR Technology, which is a $400 million market cap company undergoing a business transformation from a lower margin hardware business to a higher growth software company. The financing was upsized, given significant investor demand, and provided PAR Technology with the growth capital to accelerate its software business transition and to pursue potential tuck-in acquisitions.

Concurrent Offerings Gaining Momentum

Concurrent equity and convertible issuance has accelerated, with year-to-date volume nearly eclipsing full-year 2018 levels. In the U.S., nine transactions have priced raising $15 billion, and in Europe, three deals have priced raising $2 billion. Concurrent equity and convertible offerings allow companies to maximize proceeds by tapping two distinct investor bases and the average concurrent offering size has been $1.4 billion since 2018, representing 25% of market cap. Specific situations where concurrent offerings are applicable include (i) M&A transactions where significant equity is required to maintain ratings or leverage, (ii) the need for both liquidity for existing shareholders (through the equity component) as well as primary capital (through the convertible component), and (iii) issuers with sizable capital or deleveraging needs but dilution sensitivity.

The concurrent structure is also relevant in the IPO context, where an issuer needs to raise a larger amount of equity than is efficiently achievable in the IPO. Companies have used this structure to maximize debt paydown by selling a mandatory convertible, which alongside the IPO achieves 100% equity credit from the ratings agencies. Jefferies recently served as an active bookrunner for Avantor on its concurrent $3.3 billion IPO and $1 billion mandatory convertible.

European Mid-Caps Increasingly Turning to The Equity Markets For M&A and Growth Financing

European companies have issued $40 billion of equity in 2019 and small and mid-cap companies have been the primary beneficiaries, with over 90% of these transactions for companies with a market capitalization of less than $5 billion, and over 80% of these for companies with market caps less than $2.5 billion. As European equity investors generally demand low leverage ratios, we expect this trend of primary issuance to continue, as it provides companies with an important source of growth funding. The issuance activity has been diversified across sectors, but the healthcare (26%), real estate (24%) and TMT (21%) sectors remain the most active.

RESTRUCTURING AND RECAPITALIZATION

Buyers are Increasingly Pursuing Section 363 Asset Purchases

Pursuant to Section 363 of the Bankruptcy Code, a purchaser can acquire all or substantially all the assets of the debtor, free-and-clear of all liens, claims, or other encumbrances. Given the skyrocketing costs of large bankruptcy reorganizations, the use of Section 363 sales is growing, as Section 363 asset purchases can be completed outside the plan of reorganization process at a fraction of the time and cost of traditional restructurings. Recent asset sales have been completed within 45 days of the petition date.

Motivated purchasers in a section 363 purchase often seek to become the “stalking horse” bidder given the protection of a breakup fee. More importantly, the stalking horse bidder’s asset purchase agreement is used as the baseline document that all other interested parties must “bid on”, and the stalking horse bidder also often has an advantage of completing their due diligence first. In addition, the 363 sale process enables secured creditors to place a “credit bid” that is not restricted to making only a cash bid for the assets, as they can opt to bid the amount of debt owed them by the debtor on the loan for which the asset served as collateral.

MUNICIPAL FINANCE

Higher Education and Healthcare Issuers Should Consider Issuing Century Bonds

Not-for-profit issuers that normally sell tax-exempt bonds, in particular higher education and large, highly rated healthcare issuers, should consider issuing Century Bonds to lock-in committed long-term fixed cost of capital funding. A Century Bond is a taxable fixed rate bond with a 100-year bullet maturity, and although Century Bonds represent a somewhat higher cost of funding than traditional tax-exempt financing, the flexibility of the use of proceeds and the long-term relatively low-cost equity-like funding make Century Bonds particularly attractive for many issuers. Proceeds of Century Bonds have been used for deferred maintenance, working capital, to restructure existing debt, and to fund internal “banks” that take advantage of the long-term committed funds to recycle the proceeds for multiple projects over the 100-year term. Century Bonds price at a spread over the 30-year U.S. Treasury yield and, given current attractive market conditions, they represent an opportunity for low cost ultra-long-term funding.

Best Research Ideas

AMERICAS

U.S. Insights – Gathering What Another Man Spills: Favored by Jefferies, Not by the Street

Jefferies U.S. Research highlighted 13 stocks that the Street generally does not like, based on average Street rating, trajectory of rating and short interest, but which Jefferies favors. The Street’s more negative views on these stocks are often based on end-of-cycle concerns, fears of tech disruption, or both, and better economic data could lead investors back to some of these stock ideas. Notably, since 2011, when quintiling stocks by average Street rating, the second-to-lowest rated quintile of stocks has performed best, likely because these stocks are less crowded and more can go right. The 13 stocks highlighted in the piece include: BWA, COMM, CPRI, DGX, F, FCX, GPS, IVZ, KR, PCAR, RRC, TSLA and WYND. FULL REPORT

— *Jefferies U.S. Equity Research*

Telecom & Networking Equipment – 5G: Why We Don’t Believe in the 5G “Cycle”

Jefferies believes the ROI for 5G investment in the U.S. is significantly less attractive that it was for prior 3G and 4G investments, largely because wireless is more mature, with higher smartphone penetration now relative to history and peaking average revenue per user (ARPU). While some cutover from 4G to 5G is likely, Jefferies does not expect overall capex to grow due to 5G technology availability over the next two years. Further out, applications such as autonomous vehicles should make for a better case for 5G. Jefferies favorite Communication Equipment plays are CIEN and LITE, which are beneficiaries of increasing optical fiber content associated with wireless network deployments. In the semiconductor space, Jefferies views XLNX, LSCC, MRVL and ADI as beneficiaries as they are key suppliers into 5G base stations. FULL REPORT

— *George Notter, Telecom & Networking Equipment*

Amazon (AMZN) – Deep Dive: Still Room to Run

Jefferies sees a roadmap to $3,000 for AMZN shares by 2022E supported by sum-of-the-parts (SOTP) work. The firm's SOTP analysis identifies conservative estimates around both growth, including a deceleration in retail, and valuation multiples for the business segments. The Amazon Web Services, advertising and Third Party Seller segments are all expected to grow faster than the retail business, are accretive to margins and are higher multiple businesses. Additionally, new businesses including Healthcare, where Jefferies expects the company eventually to engage in Rx prescriptions, would be incremental to the current forecasted growth model. FULL REPORT

— *Brent Thill, Internet*

EMEA

Telefonica: Looking More GARP as Spain Advances

In this 50-page note Jefferies restates the view that retail segmentation is restoring Spain to growth. Netflix upsell, O2 retention and weaker wholesale headwinds should benefit 1Q19. Jefferies estimates group organic revenues/OIBDA +1.8%/2.6% in 2019 and normalized free cash flow growing from €3.1bn 2018 to €3.3/3.6 billion 2019/20. Leverage decline from 3.4x to 3.2x/3.1x can be enhanced by ~€2.3 billion proceeds from disposals of CentAm assets and data centres, as well as a material tax rebate. TEF trades on 11.1x/10.3x EV/OpFCF 2019/20 (sector 13.2x/12.5x). FULL REPORT

— *Jerry Dellis, European Telecoms*

The Mortality Mystery

Mortality rates are hardly improving. Life expectancy forecasts are falling fast. At first this was considered an anomaly, then a flu related one-off, now a trend. However, from this tragedy comes an uncomfortable truth: reducing life expectancy forecasts releases hidden value in annuity back books. So much so that Jefferies believes the value release could be worth 3.6% of Prudential, 8.7% of L&G and >11.0% of Aviva. FULL REPORT

— *Philip Kett, European Insurance*

ASIA

Hong Kong | Consumer Gaming – Buying In: Initiate on the Macau Gaming Sector. Top Buy - Sands China

With China the key driver given 73% of total Macau visitations are from China (42% of Chinese visitors from Guangdong), Jefferies believes the combination of tax cuts (VAT and individual) and lowering of China's reserve requirement ratio (RRR) is likely to lead to credit loosening and translate to more spending money for both individuals and state-owned enterprises (SOEs). This fiscal policy mixed with the U.S. Federal Reserve's increasingly dovish stance is expected to place less pressure on RMB. The mass market continues to benefit from strong visitations (4Q18 and 2M19 visitations rose 13.8% and 19.9%, respectively), driven by higher disposable incomes with Jefferies' auto and energy analysts noting another 240 million Chinese residents could reach the crucial RMB3,500/month personal mobility travelling threshold (double the existing number). Ease of travelling via the opening of the HK-Macau-Zhuhai bridge and HSR is a positive driver. Jefferies initiates coverage of Macau gaming stocks with Buy on Sands China (higher mass and non-gaming exposure) and Wynn Macau (strong brand and reputation), but Hold on Galaxy (increasing VIP competition) and MGM China (MGM Cotai recovery already in price). With monthly gaming revenue (GGR) the key driver but expected to bottom in 2Q19 driven by credit easing and tax cuts. FULL REPORT

— *Andrew Lee, China Consumer Gaming*

India Retailers — Online Retail: Love It or Hate It but Don't Ignore It

Jefferies' retail survey of 572 urban online shoppers suggests increasing influence of online retailing across segments, especially in electronics and apparel. The survey also suggests online retail is increasingly becoming a convenience format rather than just a discounting one. The recent steps by the government, coupled with increased preparedness of the physical retailers, will ensure that the incremental impact will be lower. Increasing competition in physical retailers is key to watch in FY20E for apparel and grocery players. Key highlights from the survey: 1) a majority (62%) shopped for apparel online in the past one year; 2) in the past six months, a majority of the shopping for electronics was online (60%), followed by personal care products; 3) incrementally, grocery and personal care saw the highest share of first-time online shoppers; 4) convenience was the key reason for shopping online followed by discounting; and, 5) preference to shop online was highest for electronics and least for jewelry. Given rising competition within grocery and value retailing, stretched valuations and limited margin levers, Jefferies downgrades DMART and VMART to Underperform. FULL REPORT

— *Tanmay Sharma, India Retail*

Japanese Steel Producers — Creation of Value Destruction: Structural Short Thesis on Japanese Steelmakers

Jefferies published a franchise note drawing attention to the fact that steelmakers globally have been destroying value by not earning their cost of capital. Chief among these are Japanese producers with aging equipment and weak negotiation terms with customers. Jefferies believes CY17-18 marked the peak of the steel cycle when robust global macroeconomic growth combined with China's focus on environment limited steel exports. In Japan, demand from the construction segment was robust with an order backlog for the '20 Olympics and redevelopment projects, as well as car OEMs producing a record amount of vehicles. Still, major Japanese steelmakers such as Nippon Steel, JFE Holdings, and Kobe Steel missed their targets due to ongoing plant outages and unplanned blast furnace shutdowns. Smaller accidents in such a large-scale operation is a recurring issue. However, the frequency and magnitude of the Japanese steelmakers' issues are hard to ignore—and competition is heating up. Jefferies shares evidence and introduces a structural short thesis, downgrading Nippon Steel to UNPF, Kobe to Hold, remain UNPF on JFE and Daido, while reiterating Buy ratings on Yamato Kogyo and Tokyo Steel. FULL REPORT

— *Thanh Ha Pham, Japan Steel Producers*

Jefferies Group LLC, the world's only independent full-service global investment banking firm focused on serving clients for over 55 years, is a leader in providing insight, expertise and execution to investors, companies and governments. Our firm provides a full range of investment banking, advisory, sales and trading, research and wealth management services across all products in the Americas, Europe and Asia. Jefferies Group LLC is a wholly-owned subsidiary of Jefferies Financial Group Inc. (NYSE: JEF), a diversified financial services company.

NOTABLE RECENT TRANSACTIONS

Energy — May 2019 Pending Anadarko Petroleum Corporation **$57,000,000,000** Sale to **Occidental Petroleum** Joint Financial Advisor	Finance — May 2019 METRO BANK **£375,000,000** Common Stock Offering Joint Global Coordinator and Joint Bookrunner	Automotive Aftermarket — April 2019 TRUCK HERO **$335,000,000** Senior Secured Notes Offering Sole Bookrunner	Healthcare — May 2019 avantor **$3,333,000,000** Initial Public Offering Joint Bookrunner **$1,035,000,000** Convertible Notes Offering Joint Bookrunner
Healthcare — June 2019 Pending CAPITAL VISION SERVICES myeyedr. **Undisclosed** Sale to **Goldman Sachs Merchant Banking** Sole Financial Advisor	Consumer — May 2019 Lancadia Holdings II, Inc. **$316,000,000** Initial Public Offering Sole Bookrunner	Metals & Mining — April 2019 MISSION COAL COMPANY **$1,415,000,000** Restructuring and Sale of Assets Financial Advisor to the Company	Technology — April 2019 EllieMae **$1,425,000,000** Credit Facilities to Finance Acquisition by **Thoma Bravo** Joint Lead Arranger
Consumer — April 2019 Pending Smart&Final. **$1,119,000,000** Sale to **Apollo Global Management, LLC** Joint Financial Advisor	Finance — May 2019 CNG HOLDINGS, INC. **$310,000,000** Senior Secured Notes Offering Sole Bookrunner	Technology — April 2019 HUYA **$442,000,000** Common Stock Offering Joint Bookrunner	Energy — April 2019 / May 2019 ORYX MIDSTREAM SERVICES **$3,600,000,000** Sale to **Stonepeak Infrastructure Partners** Joint Financial Advisor **$1,650,000,000** Credit Facility to Finance Acquisition by **Stonepeak Infrastructure Partners** Joint Lead Arranger
Healthcare — June 2019 Pending NVA **Undisclosed** Sale to **JAB Investors** Sole Financial Advisor	Industrials — May 2019 CHARTER NEX FILMS **$700,000,000** Credit Facility to Finance Acquisition of **Next Generation Films** Joint Lead Arranger	Technology — May 2019 Pending BLACK MOUNTAIN **Undisclosed** Sale to **Vista Equity Partners** Sole Financial Advisor	Consumer/Technology — June 2019 chewy **$1,023,000,000** Initial Public Offering Joint Bookrunner
Media — May 2019 iHeartMEDIA **$16,200,000,000** Restructuring Financial Advisor to the Official Committee of Unsecured Creditors	Consumer — April 2019 aphria inc. **$350,000,000** Convertible Notes Offering Joint Bookrunner	AeroDefense — May 2019 VISTA GLOBAL HOLDING **$550,000,000** Senior Unsecured Notes Offering Joint Bookrunner	Industrials — June 2019 Pending BCA **£2,100,000,000** Sale to **TDR Capital** Lead Financial Advisor

JEFFERIES KEY FACTS & STATISTICS

(as of March 15, 2019)

Founded: 1962

Total Long-Term Capital: $12 billion

Number of Employees: 3,700

Companies under Global Equity Research Coverage: 2,800+

GLOBAL HEADQUARTERS
520 Madison Avenue
New York, NY 10022
1.212.284.2300

EUROPEAN HEADQUARTERS
68 Upper Thames Street
London EC4V 3BJ UK
+44 20 7029 8000

ASIAN HEADQUARTERS
2 Queen's Road Central
Central, Hong Kong China
+852 3743 8000

Jefferies.com

IMPORTANT DISCLOSURES

This material has been prepared by Jefferies LLC, a U.S.-registered broker-dealer, employing appropriate expertise, and in the belief that it is fair and not misleading. Jefferies LLC is headquartered at 520 Madison Avenue, New York, N.Y. 10022. The information upon which this material is based was obtained from sources believed to be reliable, but has not been independently verified; therefore we do not guarantee its accuracy. This is not an offer or solicitation of an offer to buy or sell any security or investment. Any opinion or estimates constitute our best judgment as of this date and are subject to change without notice. Jefferies LLC and Jefferies International Limited and their affiliates and their respective directors, officers and employees may buy or sell securities mentioned herein as agent or principal for their own account.

In the United Kingdom this material is approved by Jefferies International Limited and is intended for use only by persons who have professional experience in matters relating to investments falling within Articles 19(5) and 49(2)(a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended), or by persons to whom it can otherwise be lawfully distributed. In the member states of the European Economic Area, this document is for distribution only to persons who are “qualified investors” within the meaning of Article 2(1)(e) of The Prospectus Directive. For Canadian investors, this document is intended for use only by professional or institutional investors. None of the investments or investment services mentioned or described herein is available to other persons or to anyone in Canada who is not a “Designated Institution” as defined by the Securities Act (Ontario). For investors in the Republic of Singapore, this material is intended for use only by accredited, expert or institutional investors as defined by the Securities and Futures Act and is distributed by Jefferies Singapore Limited, which is regulated by the Monetary Authority of Singapore. Any matters arising from, or in connection with, this material should be brought to the attention of Jefferies Singapore Limited at 80 Raffles Place #15-20, UOB Plaza 2, Singapore 048624, telephone: +65 6551 3950. In Australia this information is issued solely by Jefferies LLC and is directed solely at wholesale clients within the meaning of the Corporations Act 2001 of Australia (the “Act”) in connection with their consideration of any investment or investment service that is the subject of this document. Any offer or issue that is the subject of this document does not require, and this document is not, a disclosure document or product disclosure statement within the meaning of the Act. Jefferies LLC is regulated by the Securities and Exchange Commission and the Financial Industry Regulatory Authority, under the laws of the United States of America, which differ from Australian laws. Jefferies LLC has obtained relief under Australian Securities and Investments Commission Class Order 03/1100, which conditionally exempts it from holding an Australian financial services license under the Act in respect of the provision of certain financial services to wholesale clients. In Japan this material is issued and/or approved for distribution by Jefferies (Japan) Limited to institutional investors only. In Hong Kong, this material is issued and/or approved for distribution by Jefferies Hong Kong Limited and is intended for use only by professional investors as defined in the Hong Kong Securities and Futures Ordinance and its subsidiary legislation. In India this material is issued and/or approved for distribution by Jefferies India Private Limited. Recipients of this commentary in any other jurisdiction should inform themselves about and observe any applicable legal requirements in relation to the receipt of this material. Jefferies International Limited is authorized and regulated in the United Kingdom by the Financial Conduct Authority. Its registered office is at Vintners Place, 68 Upper Thames Street, London EC4V 3BJ; telephone +44 20 7029 8000; facsimile +44 20 7029 8010.

This communication is being provided strictly for informational purposes only. This information is not a solicitation or recommendation to purchase securities of Jefferies and should not be construed as such.