

Companies | International

Jefferies growth harks back to Wall St of old

BANKS

News analysis

The once-middling investment bank posted record revenues and has doubled its revenues since the crisis, writes **Justin Baer**

Jefferies Group is not quite the last of its kind.

But on a post-crisis Wall Street dominated by the world's largest banks, many within the industry have been ready to declare the independent broker-dealer an endangered species.

Few corners of the financial-services world paid more dearly for their missteps heading into 2008 than the stand-alone securities firms.

Lehman Brothers collapsed. Bear Stearns and Merrill Lynch were swallowed by two of the world's largest banks. Even Goldman Sachs and Morgan Stanley ended the ordeal as bank holding companies.

Their implosions left a belief that the capital markets now belonged to the massive banks, asset managers and hedge funds whose influence has only grown since the start of the crisis.

Jefferies, which reported record quarterly revenues on Tuesday, would like to remind its peers that the New York-based bank is proof that old Wall Street is still alive.

The once-middling investment bank has doubled its revenues since the crisis, thanks to aggressive hiring and a

timely capital raising.

Jefferies reported fiscal first-quarter net income of \$87.3m, or 42 cents a share, up from \$72m, or 35 cents, a year ago. With a market value of about \$4.4bn and less than \$1bn in quarterly revenues, Jefferies will not land on any regulator's list of "systemically important" financial institutions any time soon.

But the breadth of its growth has added some distance between the investment bank and many of the boutiques that sought to capitalise on the same upheaval.

"We may never catch the megabank holding companies," Richard Handler, Jefferies' chief executive, told the Financial Times. "But the boutiques don't have the capital base, diversification or the quality of human capital that we have."

Jefferies is a throwback, in form and in culture, to a time in Wall Street when Lehman, Bear – and Drexel Burnham Lambert and Donaldson Lufkin & Jenrette – still roamed the earth.

Even its fiscal year, which ended on November 30, is a nod to an era many believed had ended in September 2008 (with their conversions to banks, Goldman and Morgan Stanley now report first-quarter results in April).

"If someone started their career at a firm like DLJ, Salomon Brothers or the old Lehman, then he or she is our kind of person," says Brian Friedman, chairman of Jefferies' executive committee.

"It says they are committed to work on the real Wall Street. It's either in you and you join us, or you might be

happier at the big bank."

If this sounds like a recruiting pitch, it may be because Mr Friedman and his colleagues have not stopped making them to disenchanted traders and bankers since the crisis descended on Wall Street.

Staffing at the bank has surged by 38 per cent since the end of 2008.

The bank built out offerings in mortgages and municipal bonds. It won regulatory approval to operate as a primary dealer in the US and Europe, gaining a foothold in government securities, and added hundreds of investment bankers and research analysts.

The hiring spree has raised eyebrows and fuelled rumours that the bank relied on lengthy bonus guarantees to lure talent.

Jefferies executives dismissed the notion that they have overpaid, noting their guarantees have never exceeded the two-year limits that remain widespread.

But they are also quick to note their pay policies have not wavered with the advent of regulatory reform. The investment bank has paid out 58 per cent of net revenues in salary costs, and defers less than half of employees' bonuses.

Consistent pay plans have helped Jefferies retain an entrepreneurial culture the company's executives believe distinguishes it from the big banks. But building out trading desks and banking teams can be an expensive game once confidence fully returns.

"Managing effectively the explosive global expansion

An unlikely bellwether

Jefferies Group, which emerged from the financial crisis as an unlikely bellwether for the securities industry, did its part to build investors' confidence in Wall Street's trading desks.

The investment bank reported trading revenues of \$495m in the fiscal quarter ending in February, up 29 per cent from prior three months.

On a call with analysts, Jefferies executives noted client activity had remained strong throughout the quarter and into March, before the events in Japan and the Middle East gave some investors pause. But by late last week, they said, more clients had returned to the markets.

How the next few weeks unfold may determine whether powerhouses such as Goldman Sachs, Morgan Stanley and JPMorgan Chase can match Jefferies' optimism. All three report quarterly results next month.

"The wild card will be March," wrote Jeff Harte, an analyst with Sandler O'Neill + Partners, wrote.

without disrupting the culture and keeping a watchful eye on risk taking is among Jefferies' biggest challenges," Lauren Smith, an analyst with Keefe, Bruyette & Woods, wrote in a note to clients last week. "We would become concerned if Jefferies was unable to control the comp ratio going forward."