Jefferies Insights
APRIL 2022

A Path in the Storm

Dear Clients, Jefferies Employee-Partners and Friends,

We often write to you about the importance of separating out the noise, focusing on the right critical path priorities, building a culture based on empathy and inclusion, and achieving long-term versus short-term objectives. Today, we find ourselves in a world dominated by a full-fledged brutal war that is transparently playing out in real-time before our very eyes. But this is sadly one of many serious issues confronting us today. We also have to cope with our exhaustion and frustration from a more than two-year global pandemic and the harsh reality that, while we are learning to live with it, the virus is far from done with us, and there will surely be unwanted and unfortunate twists in the road ahead. Next, there is this issue of potentially persistent inflation and the accompanying anticipation of central bank actions, which may ultimately lead to a higher universal cost of capital. Finally, while we are at it, let's throw in the supply chain issues and the uncertainty around China's strategic direction, which could bring on a whole new set of macro concerns and implications.

The reality is that not one of these real issues can be categorized as "noise." None are easily explained, understood or quickly solved. Each in its own way causes uncertainty, volatility, heartache and, in certain circumstances, outcomes that none of us ever want to acknowledge or verbalize. With all this said, the critical issue that we at Jefferies are proactively confronting is: <u>how to most directly, effectively and empathetically help our Jefferies team best continue forward with all the important responsibilities for which our clients and shareholders depend upon us. Additionally, how do we best help each other to be present and healthy enough to help our families, friends and loved ones manage through this challenging period?</u> If we had concrete answers that would solve even one of the major issues facing the world today, we would happily share them. Instead, for this moment, we will share our thoughts on what we are trying to do to best help each other navigate this period, with the hope that perhaps even one of you finds something in our thought process that may be helpful:

1. <u>Honesty</u>. In a period of time when everyone is looking for answers and as leaders we are used to quickly and succinctly providing them, today this does not feel possible or credible. Acknowledging that there is a broad array of outcomes for many of these problems and knowing that the very worst-case scenarios remain incredibly and extremely remote, is probably the best we can do. The most seasoned of us have been through the gauntlet of truly uncertain and challenging times, but even we have not seen the confluence of craziness that exists in the world today. It is understandable for all of us to sometimes find ourselves in more than a funk throughout the day and sometimes into the night, and accepting that reinforces that we are human.

IN THIS ISSUE

2. Doing Something Good. The worst part of living through any crisis is feeling helpless to ease the pain felt by the innocent. We pride ourselves on being a group of people who are “doers.” Unfortunately, the distance, complexity and magnitude of some of these problems can make us feel that there is absolutely no way to make things better. By now most of you know that everyone at Jefferies came together with our remarkable clients and shareholders and donated an incredible $14-plus million that went immediately to Ukrainian humanitarian aid. On the one hand, one can easily conclude that this vast amount will provide barely 15 minutes of help given the magnitude of what is occurring. It is easy to come to the conclusion, “Why bother?” On the other hand, we know for sure that because of all that we did there are five new bullet proof vans each transporting more than 25 children a day from bunkers under destroyed cities to safety in Poland. Once in Poland, collectively we are responsible for renting large warehouses and making sure they are stocked with desperately needed supplies for the refugees. We also know that some of these children and adult refugees made it to the border because we funded brave doctors to train local aid workers in real time emergency triage skills. We are not patting each other on our backs and know many have done far more. We also know the real heroes are the ones in the trenches executing the plans to use our money to save lives. However, individually and collectively, each one of us is a very small part of making things better and that makes the feeling of helplessness just a little less unbearable. Of course, there is much good to be done far closer to our respective homes and that is just as important and effective during these times. It doesn’t matter where you do good or how much, as long as you do something. The important point is that in times of upheaval, encouraging our teams and giving them the flexibility to give back in ways that are most personally meaningful to them is one of the best ways we know to maintain a modicum of sanity during a period of grave uncertainty.

3. Perspective. The world keeps turning. It really does. Today’s impossible problems become tomorrow’s ancient history and then of course new challenges emerge. That is what we call “life.” The older you get, the clearer this becomes. Doing everything in our power to convey this to our team, especially our younger partners, is critical to getting through this. We need to remember that it is not healthy or productive to be consumed by guilt about the pain in the world while many of us are doing fine. Because we are okay means we can help. Doing our part to compartmentalize a complex world is one way of making it through and frees us up to do our jobs, and also help those in need. Making sure that everyone remembers how important our day jobs are to the many teammates and clients who so mightily depend on them will empower each of us to not only get through each day but make the most of every one of them. Reinforcing to everyone that maintaining their mental and physical health during periods like these ensures they will have the proper body armor that will allow all of us to continue to do our important jobs and be there for our families. Maintaining a culture of respect and ensuring that everyone on the team is looking out for and supporting each other (especially those having the toughest time) will make every one of us stronger. If we are strong, our firm is strong. If our firm is strong, our clients are strong. If we are all strong, together we can help the world advance to a better place. This is what we must and will do together.

In closing, we want to thank each of you for your partnership, trust, loyalty and friendship. Our own strength draws from knowing we are so heavily connected with our 4,808 employee-partners and each of you, our invaluable clients and friends.

Always trying to maintain an honest perspective so we can all do good together,

Sincerely,

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Economics and Strategy

Expectations for Monetary Tightening Ratcheting Higher, but the Outlook for Near-Term Growth and Stock Prices Remains Favorable

Chief Financial Economist Aneta Markowska believes the seven-hike base case depicted in the FOMC's latest Summary of Economic Projections was merely a floor, and risks for rates skew to the upside. Her new base case calls for 50 basis point rate hikes at both the May and June FOMC meetings, followed by 25 basis point rate hikes at the remaining meetings in 2022. Collectively these would be equivalent to a total of nine 25 basis point hikes for the year and would put the target range for the Fed Funds rate at 2.25-2.50% by year end. With the U.S. unemployment rate likely to fall to 3% by the end of the year, Aneta expects wage growth to accelerate to approximately 6%, which would be consistent with inflation in the 3-3.5% range. This wage growth makes it unlikely that inflation will fully self-correct, suggesting the last 1-1.5 percentage points will have to be actively squeezed by the Fed in order to hit their inflation target. As a result, her base case also calls for four more hikes, which would put the Fed Funds rate roughly 100 basis points above the neutral rate. Despite these rate increases, Aneta continues to see 2022 U.S. GDP growth ahead of consensus at 4%, with 2023 GDP growth then slowing to just 2%. Based on the health of household and private sector balance sheets, she believes the risk of a recession is low for now.

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Reiterating his view that the current environment does not mirror the 1970s, Chief Market Strategist David Zervos believes the Fed still has its hard-earned inflation-fighting credibility. He sees the Fed as having taken a calculated and well thought out risk with inflation in 2021 to try to reverse the massive COVID job losses. While one could argue that after the inflation surge in 2Q21 the Fed should have pivoted hawkishly, their decision to bet that inflation would cool, especially after the experiences of the last three decades, seemed perfectly reasonable to David. Regarding the most recent FOMC meeting, he thinks the Fed delivered, with the pivot on rates far more hawkish than market expectations and a suggestion that we could see much earlier balance sheet reduction than expected. As a result, David thinks market participants expecting excessive overshoots in the front end will be disappointed and the balance sheet will do the heavy lifting for accommodation removal after the first 4-6 rate hikes. He also highlights that equity market returns from 1979-82, when then-Fed Chair Paul Volcker announced new policy measures, look surprisingly good.

Global Head of Equity Strategy Christopher Wood highlights that, while the flattening U.S. yield curve signals a growing risk of an economic slowdown, the Fed had no choice but to start raising rates in March due to the latest inflation data. The war in Ukraine and related commodity price surge have also made it likely that inflation will stay higher for longer. Financial markets remain in a classic stagflationary scare, the likes of which have not been seen since the OPEC oil embargos of the 1970s. However, Christopher continues to believe the U.S. economy will be more resilient than Europe’s given the much stronger labor market and continues to prefer cyclical stocks over growth. Still, he believes it should be noted that the more monetary tightening proceeds, the more it raises risk to the growth outlook, which at some point will be a definite negative for cyclicals.

Global Equity Strategist Sean Darby suggests it would be an understatement to say that global equities tried to climb the proverbial wall of worry last quarter. Higher long and short-term U.S. interest rates, hawkish global central banks, a sudden invasion of Ukraine by Russia, oil prices touching $130.00 per barrel and a sharp sell-off in China tech shares all rocked sentiment. To date, the sell-off has not been accompanied by any signs of financial distress nor significant poor macro data, leaving some room for share prices to rally, especially as cash levels remain high. A turnaround in China policy could also act as a catalyst, as well as a decline in U.S. inflation.

Actionable Ideas for Companies and Sponsors

MERGERS AND ACQUISITIONS

Opportunities in the Post-SPAC Merger Domain

In an uncertain and volatile world, actionable M&A themes become scarce. That said, the post-merger SPAC domain presents numerous opportunities across the spectrum of M&A and financing solutions.

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Since January 1, 2020, 913 SPACs were raised in the IPO market. Since then, 291 SPACs completed mergers. Of those that completed mergers, 53, or 18%, are trading above $10.00 per share (the SPAC IPO price). Of those trading below the $10.00 IPO threshold, nearly 55% are trading at or greater than a 40% discount (i.e., below $6.00 per share). These companies may now face the misfortunes associated with limited float and trading volume as well as waning institutional coverage and focus. As such, many may face an uphill battle in recovering lost market capitalization.

Regardless of the reasons for this predicament, these companies will likely need to consider myriad strategic actions to improve their market positioning. These range from considering stock-for-stock combinations with similar sized counterparties to enhance critical mass, potential going private transactions with private equity firms, sales to larger companies, and seeking balance sheet liquidity solutions, likely through debt issuance or structured equity issuance. The latter may provide an interesting corridor for private equity players to take sizeable minority ownership positions.

In addition, for larger SPAC-related companies, likely those with market capitalizations greater than $1.0 billion, poor trading performance may attract activist interest in prompting a sale or exploration of strategic initiatives. While boards of directors of these companies may be reticent to transact at a discount to the IPO price, the passage of time and a potentially worsening economic outlook can moderate or mitigate these concerns.

Recent transactions which fall into the aforementioned categories include:

- PAE Incorporated’s purchase by Amentum Government Services Holdings in late October 2021 in an all-cash transaction valued at $1.9 billion. Previously, PAE had completed a merger with Gores Holdings III in February 2020. PAE was acquired for $10.05 per share, representing a premium of 70% to the unaffected trading price of $5.91 prior to announcement.

- The November 2021 merger of Metromile and Lemonade after Metromile completed a SPAC merger with INSU Acquisition Corp II in February of 2021. In this transaction, Lemonade effected a stock-for-stock merger with Metromile at an 18.8 % premium valued at $464 million. Metromile's stock price immediately prior to announcement of the merger was $3.66.

- On March 9, 2022 activist investor Third Point disclosed a 6.4% stake in Cano Health, a senior care facility operator, which had completed a merger with Jaws Acquisition Corp in June 2021. Prior to the disclosure of Third Point's stake, Cano was trading at $4.56 per share and jumped approximately 40% after the activist called for a sale of the company. Interestingly, Third Point had invested in a PIPE in Cano when the merger was announced.

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Emerging Trend Among Activist Funds to Own Portfolio Companies Outright

Over the past two years, the lines between activists and traditional private equity have continued to blur, with more private equity investors adopting a combined strategy encompassing traditional activist value-enhancing tactics as well as the buyout capital characteristics for which private equity is well known. A similar trend is also now on the rise where activist hedge funds make outright bids to own their portfolio companies versus merely putting them in play for a separate PE "white knight" to acquire.

This strategy is not foreign to some of the more prolific hedge funds, like Elliott Management, which has submitted several of their own unsolicited bids in the past, including their $7 billion all cash takeover attempt of athenahealth in 2018, and their successful acquisition of Cubic in 2020. With record amounts of dry powder in the industry, this tactic is now possible for smaller, less-established hedge funds as well.

Last year, hedge fund Donerail Group submitted an unsolicited bid to acquire Turtle Beach. The situation remains ongoing, and Donerail has formally nominated a full slate of six director candidates to the Board ahead of the June 2022 AGM. Also finally completed was Standard General's takeover of Tegna following a years-long proxy battle to instill directors to the media giant's Board (Standard General was able to settle for one seat despite losing at the vote in 2019).

Most recently, hedge fund Chatham Asset Management completed its $2.7 billion take-private of media company R.R. Donnelley and Sons, with Jefferies acting as sole financial advisor to Chatham as the acquiror. Chatham's initial unsolicited bid led to a bidding war amongst multiple parties, and Chatham ultimately prevailed.

As activist hedge funds increasingly adopt an investment strategy to own portfolio companies, a new trend may be emerging in the M&A world.

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DEBT CAPITAL MARKETS

Strength in the Private Debt Market

The private debt market continues to show increasing strength as capital raising within the asset class remains strong and lenders' mandates become more flexible. The magnitude of fundraising that has occurred over the last several years, paired with relatively low liquidity resulting in few secondary opportunities, has created remarkably resilient market fundamentals. In January 2022, Jefferies acted as Joint Lead Arranger on the unrated $240 million Senior Secured Credit Facility to finance the dividend recapitalization of AirX Climate Solutions. The transaction demonstrates the Jefferies Private Debt Finance and Advisory team's ability to execute a flexible dividend recapitalization. Jefferies' sector expertise also enabled the firm to effectively position the company for the best execution. Additionally, Jefferies is currently in market raising both an unrated senior term loan and a junior preferred equity tranche for a sponsor-backed acquisition within the Aerospace and Defense industry. This transaction has generated a tremendous amount of interest among credit investors as they seek to deploy capital that has been raised with increasingly flexible mandates and strategies that straddle both debt and equity, further exemplifying the depth of Jefferies' broader investor relationships.

Significant fundraising over the last several years, paired with relatively low liquidity, has resulted in few secondary opportunities and resilient market fundamentals.

Incremental High Yield and Leveraged Loan Issuances for M&A and Dividend Transactions

The high yield and leveraged loan markets remain quiet, with geopolitical tension and inflationary concerns presenting a challenge for both new and incremental issuances. Despite this, incremental transactions for M&A and dividends remain available for higher quality, well-known credits, although potentially at wider yields. Two representative transactions include:

- On March 3, 2022, LSB Industries Inc., an industrial chemicals manufacturer, issued a $200 million add-on to its 6.250% Senior Secured Notes due October 2028, with net proceeds for strategic acquisitions, organic growth, and GCP. Jefferies led this transaction and was able to upsize it by $25 million and priced the deal at par.
- On March 17, 2022, Belfor Holdings Inc., an industrial and residential damage recovery provider, issued a $235 million incremental to its existing L+400 First Lien Term Loan with proceeds to fund a dividend to American Securities. The transaction ultimately priced at S+425, 0.50% Floor, at 97.0 OID.

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EQUITY CAPITAL MARKETS

Increased Share Repurchase Activity in Current Market Environment

U.S. and European corporations are increasingly looking at alternative share repurchase strategies to return excess capital to shareholders in the most efficient manner given recent market volatility. Share repurchases are generally a more investor-friendly method to return capital versus taxable dividends. With falling stock prices, despite relatively attractive business performance, share repurchases in the U.S. are expected to be up more than 10% compared to 2021.

The pace of share repurchase authorizations in the U.S. is up more than 10% YTD compared to 2021.

In the U.S., there has been a marked increase from large and small cap companies across multiple industry groups in announced Accelerated Share Repurchases (ASRs), a popular approach that provides several benefits relative to an open market repurchase, including:

- Stronger signal to market given commitment to repurchase shares
- Discounted repurchase price versus VWAP benchmark
- EPS benefit
- Autopilot execution

In Europe, the market has experienced a wider adoption of share buybacks as a complement to dividend distributions, which have historically been the predominant channel to return value to shareholders in the region. The surge in buybacks is led by financial institutions and oil and gas companies, attracted by the flexibility and the enhanced economics. From an execution standpoint, the European approach has been veering toward the U.S. model with programs that typically:

- Include a discount versus the VWAP benchmark or a profit-sharing agreement
- Outsource daily activity to a financial intermediary

U.S. and European Equity-Linked Market Remains Open

The convertible market is coming off two consecutive years of record issuance. While it has slowed with recent market volatility, activity is expected to increase in the coming months. Terms remain attractive as there is a lack of supply, high volatility and relatively low interest rates. The convertible investor base is less exposed to equity returns with hedged investors generally performing well in high volatility. Near-term issuers will also need to have an appropriate technical profile to access the market and attract broad investor interest (e.g., adequate market cap, stock borrow and liquidity).

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Key drivers of activity in the U.S. and Europe will include:

- Refinancing activity to lock-in interest rates ahead of rate increases
- Companies that need to raise capital may pivot to a convertible to mitigate dilution or for greater execution certainty
- Convertible-financed share repurchases

DEBT ADVISORY & RESTRUCTURING

Development of “Hybrid” Capital as a Source of Rescue Financing

With available private equity capital commitments at or near record highs, an increasing number of funds are willing to provide “hybrid” capital to stressed / distressed companies. While this capital can come in many different forms, the most common examples include:

- Junior debt plus warrants
- Preferred / convertible preferred equity
- Minority equity

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The common theme among these various financing options is the creation of a bespoke solution designed to meet the idiosyncratic needs of a company. “Hybrid” capital providers are typically sophisticated investors with flexible mandates that allow them to design “out of the box” solutions, which are unavailable in the broadly syndicated markets.

Highly levered companies should explore “hybrid” capital as a means of refinancing existing debt or extending liquidity runway.

As the high yield and leveraged loan markets navigate a shift in monetary policy and geopolitical uncertainty, highly levered companies should explore “hybrid” capital as a means of refinancing existing debt or extending liquidity runway. Key potential benefits to companies include:

- Reduced cash interest burden due to investor focus on the multiple of invested capital (MOIC) versus current yield
- Flexible structuring, which can limit dilution to existing equity holders
- Negotiating with a single counterparty, which can typically fund the entirety of the capital need
- Alignment of interests and partnership mentality, with funds often willing to assist/fund subsequent value creation opportunities

Best Research Ideas

Global Asset Allocation: An Equity Investor's Guide to Market Corrections

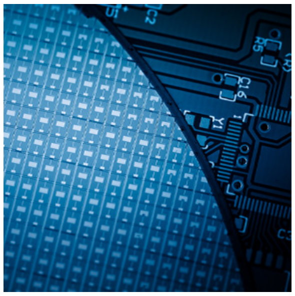
Since the 1990s monetary cycles have ended not through the economy necessarily slowing but as asset prices have fallen or due to concerns over systemic risk. Expectations of a traditional rate tightening cycle might be misplaced since financial conditions are the loosest in modern history and a plethora of asset prices are at record highs. Jefferies believes that volatility is set to be the best asset class in 2022, closely followed by value.

— Sean Darby, Global Equity Strategist, and Kenneth Chan, Quantitative Strategist

U.S. Insights: More Than Clocks Spring Forward in March – Leisure Spending Should Inflect Too

Jefferies published a report focused on leisure spending. With omicron cases falling and weather on the cusp of warming, Jefferies sees opportunity in some of the beaten-down shares of companies with leverage to this type of services spending. From March to July last year, the Pratersonal Consumption Expenditures Services Seasonally Adjusted Annual Rate for the categories related to travel, dining and entertainment jumped $350 billion. While commodity inflation, labor shortages, rising wages and supply chain challenges continue to represent risks, Jefferies analysts highlighted companies expected to have some insulation from these headwinds, especially compared to peers, or outsized exposure to a lift in volumes. The list included: BLMN, BKNG, CZR, DAL, HLT, MGM, PLAY, SIX, WH and XHR.

— Jefferies Equity Research



European Semiconductors: More Short-Term Pain

Jefferies remains negative on the short-term outlook for European semiconductors as the current downcycle decelerates through 2022-23. While demand in 2022 may hold up, weakness is still anticipated into next year alongside an inventory correction. Ahead of that, Jefferies expects stocks to price in future estimate cuts by de-rating further, with related initiations on IFX, STM and MELE at Underperform. Conversely, Jefferies remains positive on ASML, ASMI and AWE with resilience expected.

— Janardan Menon, EMEA Technology Hardware Analyst

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NOTABLE RECENT TRANSACTIONS

Gaming — January 2022
FERTITTA ENTERTAINMENT
$3,800,000,000
Credit Facility
Joint Lead Arranger
$2,250,000,000
Senior Notes Offering
Joint Bookrunner

Healthcare — March 2022 Pending
LHC GROUP
$6,118,000,000
Sale to
UnitedHealth Group
Joint Financial Advisor

Finance — January 2022
SIGNATURE BANK
$739,000,000
Common Stock Offering
Joint Bookrunner

InfoServices — February 2022
rd
$1,125,000,000
Credit Facility to Finance Acquisition by
Chatham Asset Management
Joint Lead Arranger

Energy — January 2022
NAVITAS
$3,250,000,000
Sale to
Enterprise Products Partners L.P.
Sole Financial Advisor

AeroDefense — January 2022
VISTAJET
$1,000,000,000
Senior Unsecured Notes Offering
Joint Bookrunner

Energy — January 2022
LIMETREE BAY REFINING, LLC
$1,950,000,000
Section 363 Sale
Financial Advisor to the Company

Business Services — January 2022
vaco
$740,000,000
Credit Facility
Joint Lead Arranger

Mining — March 2022
QIA جهاز قطر للاستثمار QATAR INVESTMENT AUTHORITY
$1,042,000,000
Common Stock Offering of
Glencore plc
Joint Global Coordinator

Energy — February 2022
REC Rayburn Electric COOPERATIVE
$908,000,000
Winter Storm Uri
Cost Recovery Bonds
Financial Advisor to the Company

Mining — February 2022
Peabody
$320,000,000
Convertible Notes Offering
Joint Bookrunner

Healthcare — February 2022
Collegium PHARMACEUTICAL
$604,000,000
Acquisition of
BioDelivery Sciences International, Inc.
Sole Financial Advisor

Automotive Aftermarket — February 2022
XLerate GROUP
$810,000,000
Credit Facility to Finance Merger with
America's Auto Auction
Joint Lead Arranger

Healthcare — February 2022
AMERIVET VETERINARY PARTNERS
Undisclosed
Sale to
AEA Investors
Sole Financial Advisor

Industrials — February 2022
EM ECOMATERIAL TECHNOLOGIES
$525,000,000
Financing for merger of
Boral Resources and **Green Cement**
Joint Bookrunner

AeroDefense — February 2022
BEHRMAN CAPITAL
$500,000,000
Sale of **Micross Components** to
Behrman Capital Micross CF L.P.
Sole Financial Advisor

Finance — February 2022 Pending
TORA
$325,000,000
Sale to
London Stock Exchange Group
Sole Financial Advisor

Business Services — March 2022
Colibri
$720,000,000
Credit Facility to Finance Acquisition of
Becker Professional Education and
OnCourse Learning
Joint Lead Arranger

Leisure — February 2022
JOURNEY BEYOND
A$600,000,000
Sale to
Hornblower Group
Sole Financial Adviser

Technology — March 2022, January 2022
mobileum
$595,000,000
Credit Facility to Finance Acquisition by
H.I.G. Capital
Joint Lead Arranger
Undisclosed
Sale to
H.I.G. Capital
Sole Financial Advisor

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