

Jefferies Shares Decline as Profit Misses Estimates
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By David Henry

Sept. 22 (Bloomberg) -- Jefferies Group Inc., the first Wall Street firm to release third-quarter results, fell the most in two months in New York trading after reporting earnings that missed analysts' estimates on a drop in trading revenue.

Jefferies declined 5.2 percent on the report, which showed a 46 percent drop in third-quarter net income. Profit for the three months ended Aug. 31 fell to \$46.3 million, or 23 cents a share, from \$86.3 million, or 42 cents, a year earlier, when the quarter ended on Sept. 30, the New York-based company said today in a statement. The average estimate of seven analysts surveyed by Bloomberg was 30 cents a share.

Trading revenue from stocks and bonds slid 51 percent to \$273.1 million at Jefferies, which has relied on stock and bond markets for more than 80 percent of revenue since 2008. Industrywide bond-trading volume declined 12 percent in the period, according to Trace, the bond-price reporting system of the Financial Regulatory Authority. U.S. equity underwriting fell 15 percent, according to data compiled by Bloomberg.

"Trading volumes across the board were painfully slow during the months of June, July and August," Chief Executive Officer Rich Handler, 49, said in the statement. "The normal seasonal slowdown was exacerbated by continued concerns over the state of the global economy."

Jefferies fell \$1.25 to \$23 in composite trading on the New York Stock Exchange at 4:15 p.m., after reaching \$22.47 earlier today. The shares were up 2.2 percent for the year before today.

Banking Revenue

Investment-banking revenue more than doubled to \$246.2 million, including an increase of \$105.9 million in fees from advising on mergers and acquisitions and restructurings.

The investment-banking results got a boost from fees for advising XTO Energy Inc. on its \$35 billion sale, which closed June 28, to Exxon Mobil Corp, company officials said on a conference call today. Jefferies's fee from the deal was \$24 million, according to a proxy statement filed by XTO.

Employee compensation costs were 59 percent of net revenue, compared with 56 percent a year earlier. Jefferies's stated target range for the ratio is 55 percent to 58 percent.

The firm in April changed the end of its fiscal year to November and today compared its results to the 2009 quarter that ended in September. Jefferies now reports earnings a month earlier than most other Wall Street firms.

"Just about everyone is going to have negative comparisons for the quarter," Chris Kotowski, an analyst at Oppenheimer & Co., said in an interview before earnings were released. "It was a really slow summer."

Economic Stall

Concern that the U.S. and global economies were stalling discouraged many investors from buying stocks during the quarter, Handler said on the call. The average estimate for Jefferies earnings for the period declined 12 percent from June 22 through yesterday, according to Bloomberg data.

Jefferies increased its staff 31 percent in 20 months to 2,971 people in a drive to pick up capacity from failed investment banks and profit from a recovery in the financial- services industry. The hiring "has made it highly leveraged to a capital- markets recovery, and we are just not there yet," Steve Stelmach, an Arlington, Virginia-based analyst at FBR Capital Markets, wrote in a Sept. 17 report. Jefferies won't reverse its expansion, Handler said on the call. "We are not rethinking anything that we have done because we have incredible traction with a variety of people and a variety of businesses that we feel great about," Handler said.

Long-Term Value

The company is trying to balance the need for short-term results with the goal of creating long-term value, he said. "We might slow things down if it continues to be as challenging as it is, but really it is a balancing act," Handler said.

Non-compensation expenses increased 26 percent to \$134.6 million on technology and telecommunications costs to support an expansion abroad, the company said. Those costs are unlikely to go down soon, Chief Financial Officer Peregrine "Peg" C. de M. Broadbent said on the call.

Jefferies' expansion will ultimately pay off, Byron Snider, co-founder of West Oak Capital LLC Partners, said in an interview after the report.

'Quite Patient'

"I am quite patient," said Snider, who said Jefferies is his firm's largest position. Low borrowing costs and mounting corporate cash will result in more M&A advisory revenue for investment banks such as Jefferies. "Deals overseas are going to pick up," Snider said. West Oak, based in Westlake Village, California, holds 1.56 million shares, or 0.91 percent of Jefferies, according to data compiled by Bloomberg.

During the three months covered by the earnings report, the Standard & Poor's 500 stock index lost 3.68 percent as average daily trading volume in stocks in the index declined 17 percent from the previous three months, according to Bloomberg data.

Jefferies's earnings are useful as "an imperfect data point" in anticipating trading results to be announced next month by other Wall Street firms, Kotowski

said. The report includes two of the three months that will be covered in other firms' results. Jefferies's mix of business tends to be more domestic and more tied to high-yield bond markets than bigger firms, he said.

Jefferies had \$32 billion of assets at the end of May, placing it between Morgan Stanley, with \$809 billion of assets, and Stifel Financial Corp., an investment bank based in St. Louis, with \$3.37 billion, according to Bloomberg data.

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