Jefferies Insights
APRIL 2023

# Normalcy Returns Faster Than You'd Think After Financial Crises

## Dear Clients, Jefferies Employee-Partners and Friends,

With the end of the first calendar quarter of 2023 complete, once again the financial world feels "on fire." Interest rates are still rising, inflation remains unchecked, two top 20 U.S. banks were put into receivership and auctioned off, and we just witnessed an emergency "shotgun wedding" to protect the world from the imminent demise of a systemically critical global bank. The financial news is dominated by discussions about asset/liability mismatches due to rapidly rising interest rates and the resulting mark to market losses, protecting consumer deposits above the federally mandated $250,000, and which large bank could be next to stumble. It is almost enough to make one forget that there is a European war going on "real time." Though we can NEVER FORGET the Ukrainian war because the unprovoked attack on innocent people makes the financial calamity pale in comparison, but you get our point.

So how do all of us put this new financial crisis into perspective as we focus on our day-to-day responsibilities as we manage our businesses, investment portfolios, co-workers, families and friends? It is very easy to get sucked into the abyss and focus on the day-to-day minutiae of putting out fires caused by the second and third level effects that emanate from the serious financial issues we have just mentioned. In times like these, nothing enables us to see the big picture better than stepping back from the immediate fires (yes, we still need to put them out hourly) and taking a look at the very big picture over a widely extended time horizon.

For that reason, we prepared the slide below that shows the periods of economic and market challenge the two of us have experienced these past three plus decades:

## IN THIS ISSUE

## Historical Financial Crises Over Last Three and a Half Decades

| | Crisis | Causes of Crisis | Government Responses / Solutions | 3-Year Impact: Dow Jones Industrial Average | 3-Year Impact: S&P 500 | 3-Year Impact: CPI Inflation[1] | 3-Year Impact: Unemployment Rate[2] | 5-Year Impact: Dow Jones Industrial Average | 5-Year Impact: S&P 500 | 5-Year Impact: CPI Inflation[1] | 5-Year Impact: Unemployment Rate[2] |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1987** | *Stock Market Crash* | ▪ 5-year sustained bull market<br>▪ Fear of higher rates<br>▪ Persian Gulf hostilities<br>▪ Introduction of programmed trading | ▪ Federal Reserve cut interest rates and provided liquidity via repurchase agreements | 41% | 36% | 1.8% | 6.2% | 83% | 85% | (1.2%) | 7.4% |
| **1990** | *Savings & Loan Crises / Drexel Bankruptcy* | ▪ S&L bankruptcies and seizures due to excess leverage and asset/liabilities mismatch<br>▪ Drexel bankruptcy<br>▪ Rising oil from Kuwait invasion | ▪ Passage of the Financial Reform, Recovery and Enforcement Act to reform banking system<br>▪ Resolution Trust Corporation for organized liquidation of assets | 52% | 56% | (3.6%) | 6.6% | 101% | 97% | (3.8%) | 5.6% |
| **1994** | *Rapid Interest Rate Increases* | ▪ Seven rapid-fire rate hikes to tame inflation | ▪ Cessation of interest rate increases | 80% | 71% | (0.1%) | 4.9% | 178% | 201% | (0.3%) | 4.2% |
| **1998** | *Russian Sovereign Crisis / LTCM* | ▪ Russian Ruble lost over 67% of its value in 3 weeks leading to default on public and private debt<br>▪ Collapse of Long-Term Capital Management | ▪ Sovereign debt restructuring and multi-billion dollar IMF loan helped Russia to regain access to financial markets<br>▪ Recapitalization of LTCM by 14 financial institutions, supervised by the Federal Reserve | 32% | 18% | 1.0% | 5.0% | 25% | 5% | 0.8% | 6.1% |
| **2000** | *Tech Meltdown* | ▪ Bubble of outrageous valuations popped for ".com" companies causing market crash | ▪ Aggressive rate cuts by the Federal Reserve | 11% | 4% | (0.3%) | 5.6% | 18% | 19% | 0.8% | 4.6% |
| **2001** | *9/11 Attack* | ▪ Terrorist attack on America | ▪ Swift, temporary cuts in Fed Funds rate<br>▪ Liquidity provided by Federal Reserve via discount window, Treasury purchase program | 23% | 15% | 0.6% | 5.5% | 40% | 36% | (1.2%) | 4.4% |
| **2008** | *Financial Industry Collapse / Great Recession* | ▪ Global financial crisis bringing systemic risk to the entire banking system and world's economy | ▪ Global central banks reduce rates to zero and introduce massive stimulus and quantitative easing<br>▪ TARP funds issued to banks; forced bank mergers<br>▪ Conversion of largest broker-dealers to bank holding companies<br>▪ Global banking regulation results in significant improvements in capitalization of banking system | 97% | 102% | 2.7% | 8.2% | 151% | 177% | 2.5% | 6.2% |
| **2011** | *European Sovereign Debt Crisis* | ▪ Potential defaults from Portugal, Italy, Ireland, Spain and Greece threatening the entire Eurozone | ▪ European Union, ECB and IMF-led rescue packages offered to Greece, Spain and other nations<br>▪ Struggling nations implement severe austerity measures and other financial reforms | 55% | 58% | 0.2% | 7.2% | 83% | 102% | (1.1%) | 5.1% |
| **2020** | *COVID-19 Pandemic* | ▪ Global health risk forcing shutdowns and isolation around the world | ▪ Global central banks reduce rates and pursue quantitative easing; Federal governments issue significant fiscal stimulus<br>▪ Unprecedented vaccine rollout to quell impact of pandemic | 73% | 76% | 4.4% | 3.6% | TBD | TBD | TBD | TBD |
| **2022 / 2023** | *Russia-Ukraine War / Regional Bank Crisis / Credit Suisse Rescue* | ▪ Unprovoked European war<br>▪ Mismatch on assets and liabilities in regional banks in the face of relentless and unprecedented large rate increases<br>▪ Loss of confidence from years of mistakes | ▪ Western nations coordinate severe sanctions on Russia, support Ukraine financially and militarily<br>▪ FDIC seizes troubled banks, guarantees deposits of struggling institutions to stabilize system<br>▪ Swiss regulators coordinate sale of CS to UBS, offering downside protection to UBS | TBD | TBD | TBD | TBD | TBD | TBD | TBD | TBD |

Sources: Federal Reserve, S&P Capital IQ.
Note: 3-Year and 5-Year changes measure change from market trough of each respective period.

1. CPI figures represent change in year-over-year inflation rate vs. year-over-year inflation rate at the market trough of each respective period.
2. Unemployment rate not presented as change; represents unemployment rate 3-years and 5-years post market trough of each respective period.

Jefferies LLC / March 2023

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Click on image to see larger version.

Some observations from this smorgasbord of turmoil:

1. Our world always finds a way forward. In fact, things are usually pretty darn good in a surprisingly short period of time after we avoid often anticipated the "end of the world."

2. Government intervention, while never ideal or desired, can help solve very complicated and broad problems. The goal, though, should be to make much-needed changes in regulation, incentives and culture throughout our system during periods of relative calm to avoid/minimize future problems and reactive intervention.

3. People or institutions that do not have a strong foundation, constitution or character can easily be wiped out at the bottom of the cycle. This has broad implications why the right culture, capital structure, temperament and ego during good times (which always precede bad times) is so important.

4. People or institutions that panic, freeze or flee when times are at their darkest deprive themselves of participating when the sun comes out once again.

5. People or institutions that buckle up, put out the fires, remain calm, encourage their partners to do the same, and stay the course even when it feels like there is no reason or reward to keep marching on, are often the ones who get magnified positive results when the storm passes.

6. The smart, well-fortified, pre-prepared, and forward-looking people or institutions that have the luxury and nerve to play offense during these especially turbulent times can find themselves at another higher level (in almost every aspect) when the sun shines again, if they play their cards properly.

7. The reason why people or institutions who focus on the long term versus the short term always win is because this roller coaster never ends. The twists and turns and ups and downs may always look and feel completely different, but when you step back and look from a distance, there are enough patterns and similarities that will help thoughtful minds make sense of it all.

When we look back at these past three and a half decades at Jefferies, we marvel at our corporate and investing clients who have best navigated the storms along the way. We have seen (and hopefully helped) corporate and private equity clients build amazing world class companies, consolidate industries and create enormous economic and social value. We have seen (and hopefully helped) our investing clients generate exceptional long-term, alpha-based returns for their shareholders and even build large, multi-faceted asset management platforms. Both groups of clients have driven change and created positive economic and social benefits for our society.

That said, having lived through so many financial crises, we are acutely aware of the pain and serious ramifications each one has caused, particularly the hardship of losing a job, a beloved firm you've given a large part of your life to, and the often gut-wrenching personal and societal economic impact that follows. Today is one of those times. But while extremely unsettling and painful (especially to those directly affected), we do not believe the current financial situation compares in systemic magnitude to the other crises we've witnessed and are included in our chart.

To us, the salient takeaway is when we look back at this chart and combine it with our intimate knowledge of our vibrant and impressive client base, it is apparent which characteristics the most successful individuals and companies share. They are all consistent year in and year out. They have a strong foundation both in capital and culture. They share the gift of zero arrogance and while they keenly embrace their current reality, they also have the gift of being able to anticipate change. They strike the right balance of patience and aggressiveness, while remaining calm regardless of circumstances. None of them ever give up, and while they all share a keen sense of urgency, they all prioritize the long term.

We at Jefferies always strive to do the same, and we humbly admit that it is not always easy to do so. We clearly make a lot of mistakes, but on balance our partnership with each of you allows us to minimize them, and stick to what we most enjoy:

**Working to build value with all of you by focusing on the long term, regardless of the current climate, crisis or calamity.**

Once again in the bunker with each of you, but enjoying every moment as we persevere and continue to build together, and knowing that we will all come out together on the other side, sooner than we might expect,

Rich and Brian

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# Economics and Strategy

**Less Risk for the Global Financial System, More Risk for the Main Street Economy**

Jefferies' Economics Team believes fears of contagion spreading within the financial sector will soon fade because banks are facing a liquidity crisis, not a solvency or credit crisis. But once liquidity fears pass, they believe Main Street could be hit by a credit crisis where small businesses soon find their access to credit restrained. For a long time now, Jefferies Economics has forecast a full-blown layoff cycle to begin at the start of the third quarter this year. The recent banking sector developments reinforces the team's view that layoffs are coming soon.

Fears of contagion spreading within the financial sector will soon fade as banks face a liquidity crisis, but once this passes, small businesses and Main Street could be hit by a credit crisis.

Chief Market Strategist David Zervos pointed out that even if market participants had anticipated significant bank failures, most probably wouldn't have correctly guessed the market responses. S&P 500 futures and the High Yield Corporate Bond ETF (HYG) are essentially unchanged, while 2-year Treasury yields have dropped precipitously. Looking through the lens of the rate volatility market this appears to be a global financial style crisis, while risk-assets suggest something like banal summer doldrums. The question is, should we be listening to the rate volatility market? David is sticking with his gut instinct from the immediate aftermath of the Silicon Valley Bank and Signature collapses and new Fed 13(3) funding structures: It might be bumpy in the near term, but savvy institutions will come through this stronger and capitalism will still work.

Global Head of Equity Strategy Christopher Wood says there is growing conviction that the Fed tightening cycle is coming to an end because of the assumption that credit conditions will tighten due to the banking-related stresses. He believes it is almost inevitable that the federal government will have to ultimately guarantee all retail depositors in the U.S. banking system to prevent continued deposit flight from regional banks. He anticipates that the U.S. stock market's initial response to any coming Fed U-turn, and renewed easing cycle, should be positive, just as it will be negative for Treasuries. Nonetheless, Christopher still expects that 2023 will be the year when earnings downgrades hit the stock market if the US recession forecast proves to be accurate.

Global Equity Strategist Sean Darby noted that the recent reverberations in financial markets need to be set against Chinese GDP returning to trend while the European economies led by the Peripherals (Spain) are surprising on the upside. Further, Asian and Emerging Market equities have largely shrugged off the tightening in U.S. financial conditions, suggesting that they are better placed than in the past to deal with external shocks. One of his key tenets for 2023 is that the greater the divergence in central bank policies, the greater the dispersion in equity returns is likely to be. Sean continues to favor Japan, Northern Asia and the European bourses.

# Actionable Ideas for Companies and Sponsors

## MERGERS AND ACQUISITIONS

### Stock-for-stock transactions as a hedge against volatility and risk

The M&A market remains challenged by dislocation relating to the failure of SVB and the continuing overhang of interest rate uncertainty, the possibility of recession and ongoing geopolitical tensions extending from the Russia/Ukraine conflict to China and North Korea. Any one of these factors alone would have a negative impact on M&A, and this cocktail of concerns has substantially dampened activity; the volume of announced transactions in January 2023 was the lowest in two decades and represented just one-third of the announced transactions in January 2022.

Notwithstanding these headwinds, pockets of activity and structures which can be used to mitigate risk remain. Stock-for-stock transactions remain an effective means of reducing risk and equilibrating valuations in periods of volatility. These transactions tend to take place within industries as valuations and stock prices are likely to move in sync, thus lessening multiple disparities amongst parties. Stock swaps also facilitate substantial transactions without overleveraging balance sheets, and in some cases, result in lower pro forma combined leverage. The combination of increased scale and synergies can be a powerful motivator in otherwise challenging economic conditions for corporations.

Recent examples which underscore the logic of stock-for-stock transactions include two transactions unveiled in late January and early February. In January, Xylem agreed to acquire Evoqua in a $7.5 billion transaction to create a $7.0 billion pro forma revenue company specializing in water technology and treatment. In early February, Newmont Corp made an unsolicited $16.9 billion stock-for-stock offer for Newcrest Mining. While the offer was rejected as inadequate, Newcrest agreed to provide limited non-public information to Newmont potentially to facilitate an improved proposal. These two combinations demonstrate the conviction around industry scale and importance of balance sheet strength. We expect to see more stock-for-stock transactions, albeit dominated by friendly mergers, as the year progresses.

Despite headwinds, pockets of activity and structures which can be used to mitigate risk remain active, including stock-for-stock transactions and stock swaps. The combination of increased scale and synergies can be a powerful motivator in otherwise challenging economic conditions.

## LEVERAGED FINANCE

### Junior Financing Back on the Table

Recent market volatility has re-established Paid-in-Kind Mezzanine (PIK Mezz) financing as a complementary source of long-term capital for highly leveraged companies. PIK Mezz debt is capital that resides between senior debt and common equity and offers leveraged companies additional flexibility within their capital structure. Raising a tranche of junior PIK Mezz debt could allow an issuer to de-lever through the First Lien while achieving higher total leverage.

Additionally, PIK Mezz financings provide the issuer the ability to defer cash interest payments in lieu of increased principal through payment-in-kind interest, potentially benefitting issuers by increasing cash flow to pay down senior debt, invest in working capital, relieve covenant pressure, and accrue cash to strengthen balance sheets.

Recent market volatility has re-established (PIK Mezz) financing as a complementary source of long-term capital for highly leveraged companies, benefitting issuers by increasing cash flow for corporate uses.

## EQUITY CAPITAL MARKETS

### Increasing Structured Share Repurchase Activity

Recent volatility in the equity markets is driving a record pace of share repurchase activity. Companies evaluating a share buyback, often look to signal confidence in their business and balance sheet through an Accelerated Share Repurchase (ASR). The increased volatility also makes ASRs more attractive from a pricing perspective given the resulting higher discount on the repurchase price.

We are also seeing share repurchases in connection with insider sell downs, especially from sponsors. Over the past year, more than 30% of sponsor sell-downs in the U.S. were coupled with a share repurchase from the company. The concurrent repurchase has proven to be an efficient way to enhance the size or pricing of a secondary share offering in an otherwise challenging market. On average, blocks with a share repurchase have priced at tighter discounts and traded better in the aftermarket.

We expect share repurchase and ASR activity to remain robust throughout the year and Jefferies has unique insights into these execution strategies.

Equity market volatility is driving a record pace of share repurchase activity, including Accelerated Share Repurchases. The increased volatility can make ASRs more attractive given the resulting higher discount on the repurchase price.

## DEBT ADVISORY & RESTRUCTURING

### Rights Offerings Are Effective Financing Tools in Distressed Situations

The use of rights offerings has become an increasingly popular means of acquiring a company in distressed situations, including, without limitation, pursuant to a Plan of Reorganization in a Chapter 11 proceeding. Rights offering provides a debtor and participants with many benefits including (i) providing access to capital, (ii) resolving valuation disputes, (iii) allocating control, and (iv) a potential exemption from registering new securities with the SEC.

In bankruptcy, a rights offering allows a company to offer creditors or equity security holders the right to purchase equity in the post-emergence company, usually at a discount to the assumed value of the reorganized enterprise. Because the new equity is typically sold at a discount to plan value, interested parties often have a strong incentive to participate in the offering to avoid dilution. Moreover, since the capital being raised via the rights offering is necessary to fund the Plan of Reorganization, rights offerings are almost always backstopped by a third party, ensuring that the requisite capital is fully committed. Furthermore, the parties providing the backstop typically receive a fee for providing the commitment; on average, backstop fees range from 3% to 10% of the financing.

Rights offerings also have proven to be an especially effective tool for junior creditors or equity holders to support their position on the value of the debtor due to their willingness to invest new money.

Rights offerings provide both debtors and participants with many benefits in distressed situations.

### Discount Exchange Offers can be an Effective Deleveraging Strategy

Companies with multiple tiers of debt trading at a discount to par often examine ways to repurchase the debt to capture a discount; thereby deleveraging their balance sheet.

Typically, however, these companies lack ready access to capital to fund debt buybacks. In these situations, there may be an opportunity for long-dated maturity or unsecured bondholders to exchange their debt into instruments with collateral, guarantees, shorter maturities or other enhancements to induce holders to participate in the exchange.



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A contemplated discount exchange is often most effective when the issuer faces future uncertainty as to its ability to repay longer dated debt or the capital structure implies significant downside for junior or unsecured creditors in the event of a bankruptcy. In these circumstances, bondholders typically value their existing debt on a yield to workout basis; more specifically, investors estimate a future reorg value, applying the cap structure in order of payment priority and then estimating the recovery to their class. To the extent there is further downside, bondholders may act defensively, allowing issuers to exchange bonds, at a discount, with features (i.e., collateral) that provide downside protection in a reorganization in exchange for existing debt and, in doing so, incrementally reduce debt with little or no upfront cash.

Discount exchange offers give an opportunity for certain bondholders to exchange debt into long-dated maturity or unsecured bondholders to exchange their debt into instruments with collateral, guarantees or shorter maturities.

# Best Research Ideas

### Global Insights – Jefferies' Global Best Ideas List: Introducing Our Top Picks Across Regions

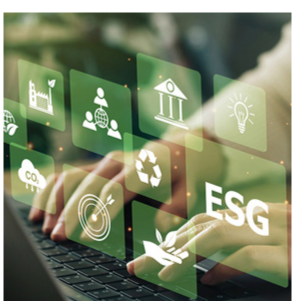
Jefferies introduced the top 15 ideas across the firm's global research platform. These ideas are supported by differentiated analysis, have identified catalysts and substantial potential upside. In addition, Jefferies highlighted key investment themes each idea is aligned with including Secular Innovation & Capex, the Emerging Market Resurgence and Resource Scarcity. Our inaugural list includes: Alibaba, ASML, Boeing, Caterpillar, Dexcom, Estee Lauder, Fuyao Glass, Glencore, Glodon, HSBC, NVIDIA, Prudential, Sony and Shell.

*— Global Equity Research*

### Consumer Finance – Unemployment's Impact on Net Charge-Offs: Then vs Now

The consumer finance research team published a deep dive analysis of the relationship between unemployment and the consumer finance space. This franchise report states that while government stimulus has skewed the relationship between rates of unemployment and consumer loan net charge-offs (NCO), that will prove to be temporary. The report stresses that pre-2020, each 100 basis points increase in UE was associated with a 51 basis points increase in net charge-off rates, but since then the beta has been closer to 35 basis points. Looking forward, the team anticipates net charge-offs peaking in 2024 between 5% and 8% based on an analysis of soft vs hard landing scenarios. In addition, this scenario analysis reinforced OMF and SYF as his preferred picks.

*— John Hecht, Consumer Finance*




### ESG Strategy – The American Consensus on ESG

The Jefferies ESG research team published a report analyzing ESG within the current political and regulatory backdrop in the U.S., identifying the areas where there is bipartisan consensus and investable opportunities. The report highlighted four key areas of consensus: 1) the energy transition – including carbon capture and storage (CCS), nuclear and hydrogen; 2) adaptation and resilience; 3) the importance of financial materiality in investment decision-making and 4) increased attention to the working class. Recommendations are for investors to look to nuclear energy, data security, human capital and "green growth." The report also identified key upcoming catalysts, such as antitrust actions, SEC climate disclosure bills and state-level actions.

*— Aniket Shah, Global Head of ESG Strategy*

Jefferies (NYSE: JEF) is a leading global, full-service investment banking and capital markets firm that provides advisory, sales and trading, research and wealth and asset management services. With more than 40 offices around the world, we offer insights and expertise to investors, companies and governments and Asia. Jefferies' Leucadia Asset Management division is a growing alternative asset management platform.

## NOTABLE RECENT TRANSACTIONS

Finance — February 2023 — Pending
FOCUS FINANCIAL PARTNERS
**$7,148,000,000**
Sale to
**Clayton, Dubilier & Rice**
Joint Financial Advisor

Consumer — February 2023
VARSITY BRANDS
**$1,132,000,000**
Amendment and Extension of
Credit Facility
Joint Lead Arranger

Industrials — March 2023
adani
**$1,872,000,000**
Common Stock Offering
Sole Bookrunner

Finance — March 2023
New York Community Bancorp, Inc.
**$38,423,000,000**
**In assets**
Purchase of Assets and Assumption of Liabilities of **Signature Bank**
Lead Financial Advisor

Healthcare — March 2023 — Pending
Polyplus
**€2,400,000,000**
Sale to
**Sartorius Stedim Biotech**
Sole Financial Advisor

Finance — March 2023
York Holdings II Limited
**£2,000,000,000**
Common Stock Offering of
**London Stock Exchange Group plc**
Joint Bookrunner

Consumer — January 2023
savers
**$550,000,000**
Senior Secured Notes Offering
Joint Bookrunner

Metals & Mining — March 2023
TMS INTERNATIONAL
**$450,000,000**
Credit Facility
Joint Lead Arranger

Finance — February 2023
amynta
THE AMYNTA GROUP
**$1,170,000,000**
Credit Facility
Joint Lead Arranger

AeroDefense — March 2023 — Pending
SAIC
**$350,000,000**
Sale of Logistics and Supply Chain Management business to **ASRC Federal**
Sole Financial Advisor

Consumer — February 2023
HILLMAN
**$230,000,000**
Common Stock Offering
Joint Bookrunner

Technology — January 2023
MarkLogic
**$355,000,000**
Sale to
**Progress Software**
Sole Financial Advisor

Energy — March 2023 — Pending
LOTUS MIDSTREAM
**$1,450,000,000**
Sale to
**Energy Transfer LP**
Sole Financial Advisor

Finance — January 2023
לאומי
leumi
**$500,000,000**
Subordinated Notes Offering
Joint Bookrunner

Industrials — February 2023
safetykleen
**€610,000,000**
Amendment and Extension of
Credit Facility
Joint Global Coordinator and
Joint Bookrunner

Healthcare — February 2023
CUREVAC
the RNA people®
**$250,000,000**
Common Stock Offering
Joint Bookrunner

Energy — February 2023
Brazos Midstream
**$800,000,000**
Credit Facility
Joint Lead Arranger

Finance — February 2023 — Pending
nexi
**€350,000,000**
Partnership with
**Banco de Sabadell**
Joint Financial Advisor

Healthcare — February 2023
Collegium PHARMACEUTICAL
**$242,000,000**
Convertible Notes Offering
Sole Bookrunner

Automotive Aftermarket — February 2023
HORIZON GLOBAL
**$425,000,000**
Sale to
**First Brands Group**
Financial Advisor to the Company

## IMPORTANT DISCLOSURES



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