JEFFERIES GROUP INC /DE/
Form 10-Q
October 07, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended August 31, 2011

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ____________ to ____________

Commission file number 1-14947

JEFFERIES GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	95-4719745
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
520 Madison Avenue, 10th Floor, New York, New York	10022
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (212) 284-2550

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. 199,716,925 shares as of the close of business on September 28, 2011.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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AUGUST 31, 2011

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)
(Dollars in thousands, except per share amounts)

	August 31, 2011	November 30, 2010
ASSETS		
Cash and cash equivalents (including $283,968 in 2011 and $202,565 in 2010, from VIEs)	$ 2,014,950	$ 2,188,998
Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	5,321,012	1,636,755
Financial instruments owned, at fair value, including securities pledged of $14,035,813 and $12,338,728 in 2011 and 2010, respectively:		
Corporate equity securities (including $79,927 in 2011 and $120,606 in 2010 from VIEs)	1,676,598	1,565,793
Corporate debt securities (including $300,652 in 2011 and $462,462 in 2010 from VIEs)	4,213,249	3,630,616
Government, federal agency and other sovereign obligations	5,531,554	5,191,973
Mortgage- and asset-backed securities (including $38,629 in 2011 and $43,355 in 2010 from VIEs)	4,787,608	4,921,565
Loans and other receivables (including $372,105 in 2011 and $362,465 in 2010 from VIEs)	528,681	434,573
Derivatives (including $5,147 in 2011 and $7,579 in 2010 from VIEs)	916,142	119,268
Investments, at fair value (including $1,621 in 2011 and $15,612 in 2010 from VIEs)	116,833	77,784
Physical commodities	369,281	
Total financial instruments owned, at fair value (including $798,081 in 2011 and $1,012,079 in 2010 from VIEs)	18,139,946	15,941,572
Investments in managed funds	73,900	131,585
Other investments	572,764	220,323
Securities borrowed	7,815,663	8,152,678
Securities purchased under agreements to resell	4,505,358	3,252,322
Securities received as collateral	40,401	48,616
Receivables:		
Brokers, dealers and clearing organizations (including $177,793 in 2011 and $195,485 in 2010 from VIEs)	3,743,143	2,550,234
Customers	1,319,664	1,328,365
Fees, interest and other (including $6,763 in 2011 and $127 in 2010 from VIEs)	224,545	165,603
Premises and equipment	170,501	142,729
Goodwill	366,823	364,964
Other assets (including $446 in 2011 and $370 in 2010 from VIEs)	816,573	601,799
Total assets (including $1,267,051 in 2011 and $1,410,626 in 2010 from VIEs)	$ 45,125,243	$ 36,726,543

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED) CONTINUED
(Dollars in thousands, except per share amounts)

	August 31, 2011	November 30, 2010
LIABILITIES AND STOCKHOLDERS EQUITY		
Short-term borrowing	$ 353,000	$
Financial instruments sold, not yet purchased, at fair value:		
Corporate equity securities (including $19,341 in 2011 and $2,708 in 2010 from VIEs)	1,736,221	1,638,372
Corporate debt securities (including $202,037 in 2011 and $443,100 in 2010 from VIEs)	2,472,045	2,375,925
Government, federal agency and other sovereign obligations (including $15,605 in 2011 and $0 in 2010 from VIEs)	5,278,235	4,735,288
Mortgage- and asset-backed securities	82,072	129,384
Loans (including $142,645 in 2011 and $150,100 in 2010 from VIEs)	155,646	171,278
Derivatives (including $1,241 in 2011 and $136 in 2010 from VIEs)	595,942	59,552
Total financial instruments sold, not yet purchased, at fair value (including $380,869 in 2011 and $596,044 in 2010 from VIEs)	10,320,161	9,109,799
Securities loaned	3,338,391	3,108,977
Securities sold under agreements to repurchase	10,935,811	10,684,056
Obligation to return securities received as collateral	40,401	48,616
Payables:		
Brokers, dealers and clearing organizations (including $134,477 in 2011 and $157,134 in 2010 from VIEs)	2,754,164	1,885,357
Customers	7,708,390	3,716,357
Accrued expenses and other liabilities (including $7,411 in 2011 and $94,402 in 2010 from VIEs)	1,164,164	1,142,850
Long-term debt	4,580,978	3,778,681
Mandatorily redeemable convertible preferred stock	125,000	125,000
Mandatorily redeemable preferred interest of consolidated subsidiaries (including $313,095 in 2011 and $315,885 in 2010 from VIEs)	313,095	315,885
Total liabilities (including $835,852 in 2011 and $1,163,465 in 2010 from VIEs)	41,633,555	33,915,578
STOCKHOLDERS EQUITY		
Common stock, $.0001 par value. Authorized 500,000,000 shares; issued 203,525,528 shares in 2011 and 200,301,656 shares in 2010	20	20
Additional paid-in capital	2,227,985	2,218,123
Retained earnings	1,036,879	850,654
Less:		
Treasury stock, at cost, 3,211,223 shares in 2011 and 28,607,510 shares in 2010	(56,102)	(539,530)
Accumulated other comprehensive loss:		
Currency translation adjustments	(25,628)	(42,859)
Additional minimum pension liability	(8,419)	(8,419)

Total accumulated other comprehensive loss	(34,047)	(51,278)
Total common stockholders equity	3,174,735	2,477,989
Noncontrolling interests	316,953	332,976
Total stockholders equity	3,491,688	2,810,965
Total liabilities and stockholders equity	$ 45,125,243	$ 36,726,543

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)
(In thousands, except per share amounts)

	Three Months Ended August 31, 2011	Three Months Ended August 31, 2010	Nine Months Ended August 31, 2011	Eight Months Ended August 31, 2010
Revenues:				
Commissions	$ 154,896	$ 118,571	$ 404,108	$ 347,527
Principal transactions	(74,003)	71,044	391,464	317,686
Investment banking	293,750	246,193	861,230	598,450
Asset management fees and investment income from managed funds	3,086	786	37,501	11,804
Interest	353,006	239,557	930,647	625,725
Other	63,369	16,879	105,948	44,240
Total revenues	794,104	693,030	2,730,898	1,945,432
Interest expense	284,822	175,761	736,068	432,995
Net revenues	509,282	517,269	1,994,830	1,512,437
Interest on mandatorily redeemable preferred interest of consolidated subsidiaries	(14,671)	(2,537)	6,183	(26)
Net revenues, less mandatorily redeemable preferred interest	523,953	519,806	1,988,647	1,512,463
Non-interest expenses:				
Compensation and benefits	299,640	308,797	1,174,468	877,204
Floor brokerage and clearing fees	32,959	30,111	92,475	84,199
Technology and communications	60,039	46,135	153,563	114,189
Occupancy and equipment rental	22,581	18,433	60,997	49,448
Business development	21,853	17,420	64,248	42,405
Professional services	19,061	13,008	48,437	34,702
Other	12,582	9,404	45,805	37,222
Total non-interest expenses	468,715	443,308	1,639,993	1,239,369
Earnings before income taxes	55,238	76,498	348,654	273,094
Income tax expense	1,228	33,873	107,899	110,277
Net earnings	54,010	42,625	240,755	162,817
Net (loss) earnings to noncontrolling interests	(14,265)	(2,129)	4,523	1,865
Net earnings to common shareholders	$ 68,275	$ 44,754	$ 236,232	$ 160,952

Earnings per common share:								
Basic	$	0.30	$	0.22	$	1.07	$	0.79
Diluted	$	0.30	$	0.22	$	1.07	$	0.79
Weighted average common shares:								
Basic		218,426		195,601		209,544		196,943
Diluted		222,541		195,612		213,661		201,062

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)
(Dollars in thousands, except per share amounts)

	Nine Months Ended August 31, 2011	Eleven Months Ended November 30, 2010
Common stock, par value $0.0001 per share		
Balance, beginning of period	$ 20	$ 19
Issued	1	1
Retired	(1)	
Balance, end of period	20	20
Additional paid-in capital		
Balance, beginning of period	2,218,123	2,036,087
Benefit plan share activity (1)	29,281	19,230
Share-based expense, net of forfeitures and clawbacks	46,484	149,799
Proceeds from exercise of stock options	95	108
Acquisitions and contingent consideration	419	419
Tax benefit for issuance of share-based awards	31,619	2,965
Dividend equivalents on share-based plans	6,590	9,515
Issuance of treasury stock	97,773	
Retirement of treasury stock	(202,399)	
Balance, end of period	2,227,985	2,218,123
Retained earnings		
Balance, beginning of period	850,654	688,039
Net earnings to common shareholders	236,232	223,666
Dividends	(50,007)	(61,051)
Balance, end of period	1,036,879	850,654
Treasury stock, at cost		
Balance, beginning of period	(539,530)	(384,379)
Purchases	(96,929)	(140,071)
Returns / forfeitures	(19,165)	(15,080)
Issued	397,122	
Retirement of treasury stock	202,400	
Balance, end of period	(56,102)	(539,530)

Accumulated other comprehensive (loss) income		
Balance, beginning of period	(51,278)	(41,626)
Currency adjustment	17,231	(8,490)
Pension adjustment, net of tax		(1,162)
Balance, end of period	(34,047)	(51,278)
Total common stockholders equity	3,174,735	2,477,989
Noncontrolling interests		
Balance, beginning of period	332,976	321,538
Net earnings to noncontrolling interests	4,523	16,601
Contributions	1,713	12,433
Distributions	(22,056)	(15,177)
Deconsolidation of asset management entity	(203)	(5,477)
Adoption of accounting changes to ASC 810		3,058
Balance, end of period	316,953	332,976
Total stockholders equity	$ 3,491,688	$ 2,810,965

(1) Includes grants related to the Incentive Plan, Deferred Compensation Plan and Directors Plan.

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(Dollars in thousands)

	Three Months Ended		Nine Months Ended	Eight Months Ended
	August 31, 2011	August 31, 2010	August 31, 2011	August 31, 2010
Net earnings to common shareholders	$ 68,275	$ 44,754	$ 236,232	$ 160,952
Other comprehensive income:				
Currency translation adjustments	(6,266)	17,381	17,231	(13,602)
Total other comprehensive (loss) income (1)	(6,266)	17,381	17,231	(13,602)
Comprehensive income	$ 62,009	$ 62,135	$ 253,463	$ 147,350

(1) Total other comprehensive income, net of tax, is attributable to common shareholders. No other comprehensive income is attributable to noncontrolling interests.

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

	Nine Months Ended August 31, 2011	Eight Months Ended August 31, 2010
Cash flows from operating activities:		
Net earnings	$ 240,755	$ 162,817
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	53,786	27,490
Bargain purchase gain	(52,509)	
Fees related to assigned management agreements	(2,728)	(2,589)
Interest on mandatorily redeemable preferred interests of consolidated subsidiaries	6,183	(26)
Accruals related to various benefit plans and stock issuances, net of estimated forfeitures	56,601	30,821
Increase in cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	(555,008)	(248,032)
(Increase) decrease in receivables:		
Brokers, dealers and clearing organizations	(840,670)	226,379
Customers	185,110	(216,894)
Fees, interest and other	(56,909)	7,625
Decrease in securities borrowed	375,677	283,616
Increase in financial instruments owned	(1,124,290)	(4,687,754)
(Increase) decrease in other investments	(353,053)	22,359
Decrease (increase) in investments in managed funds	57,685	(9,672)
(Increase) decrease in securities purchased under agreements to resell	(1,229,802)	324,488
Increase in other assets	(153,776)	(118,625)
Increase (decrease) in payables:		
Brokers, dealers and clearing organizations	810,130	816,626
Customers	610,233	(75,927)
Increase (decrease) in securities loaned	197,357	(408,214)
Increase in financial instruments sold, not yet purchased	797,320	2,429,942
Increase in securities sold under agreements to repurchase	219,933	1,361,466
Decrease in accrued expenses and other liabilities	(251,027)	(18,579)
Net cash used in operating activities	(1,009,002)	(92,683)
Cash flows from investing activities:		
Net payments on premises and equipment	(60,275)	(24,678)
Cash paid for acquisition during the period, net of cash acquired	(318,196)	
Cash received from contingent consideration	2,733	1,927
Cash paid for contingent consideration	(754)	(8,101)

Net cash used in investing activities	(376,492)	(30,852)

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS CONTINUED (Unaudited)
(Dollars in thousands)

	Nine Months Ended August 31, 2011	Eight Months Ended August 31, 2010
Cash flows from financing activities:		
Excess tax benefits from the issuance of share-based awards	$ 33,311	$ 2,148
Gross proceeds from short-term borrowings	2,881,000	2,296,000
Gross payments on short-term borrowings	(2,829,027)	(2,296,000)
Net proceeds from (payments on):		
Issuance of common shares	494,895	
Issuance of senior notes, net of issuance costs	794,587	543,510
Mandatorily redeemable preferred interest of consolidated subsidiaries	(8,973)	(17,077)
Noncontrolling interest	(20,343)	(12,577)
Repurchase of common stock	(96,929)	(114,893)
Dividends	(43,417)	(38,709)
Exercise of stock options, not including tax benefits	95	108
Net cash provided by financing activities	1,205,199	362,510
Effect of foreign currency translation on cash and cash equivalents	6,247	(2,202)
Net (decrease) increase in cash and cash equivalents	(174,048)	236,773
Cash and cash equivalents at beginning of period	2,188,998	1,853,167
Cash and cash equivalents at end of period	$ 2,014,950	$ 2,089,940
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	$ 667,376	$ 428,903
Income taxes, net	143,058	180,420
Acquisitions:		
Fair value of assets acquired	$ 4,703,533	
Liabilities assumed	(4,229,011)	
Bargain purchase gain	(52,509)	
Total purchase price	422,013	
Anticipated cash payment for acquisition subsequent to August 31, 2011	(2,474)	
Cash acquired	(101,343)	
Cash paid for acquisition during the period, net of cash acquired	$ 318,196	

See accompanying unaudited notes to consolidated financial statements.

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(Unaudited)
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JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

Note 1. Organization and Basis of Presentation

Organization

The accompanying unaudited Consolidated Financial Statements include the accounts of Jefferies Group, Inc. and all its subsidiaries (together, we or us), including Jefferies & Company, Inc. (Jefferies), Jefferies Execution Services, Inc. (Jefferies Execution), Jefferies Bache, LLC, Jefferies International Limited, Jefferies Bache, Limited, Jefferies Hong Kong Limited, Jefferies Asset Management, LLC, Jefferies Financial Products, LLC, Jefferies Bache Financial Services, Inc. and all other entities in which we have a controlling financial interest or are the primary beneficiary, including Jefferies High Yield Holdings, LLC (JHYH), Jefferies Special Opportunities Partners, LLC (JSOP) and Jefferies Employees Special Opportunities Partners, LLC (JESOP).

We operate in two business segments, Capital Markets and Asset Management. Capital Markets includes our securities, commodities, futures and foreign exchange trading (including the results of our indirectly partially owned subsidiary, Jefferies High Yield Trading, LLC) and investment banking activities, which provides the research, sales, trading and origination effort for various equity, fixed income and advisory products and services. Asset Management provides investment management services to various private investment funds, separate accounts and mutual funds.

On July 1, 2011, we acquired Prudential Bache s Global Commodities Group (Global Commodities Group or Jefferies Bache) from Prudential Finanacial Inc. (Prudential). Total cash payments made as consideration for the acquisition were $422.0 million. The Global Commodities Group provides execution and clearing services (including sales and trading activities) covering a wide variety of commodity, financial and foreign exchange futures, swaps and forward contracts to an institutional client base. See Note 3, Acquisition of the Global Commodities Group.

Change in Year End

On April 19, 2010, our Board of Directors approved a change to our fiscal year end from a calendar year basis to a fiscal year ending on November 30. As such, the current period represents the three and nine months ended August 31, 2011 and has been reported on the basis of the new fiscal year beginning as of December 1, 2010. Our prior year period consisted of the three and eight months ended August 31, 2010 and is reported on the basis of the previous calendar year cycle beginning as of January 1, 2010.

Basis of Presentation

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in Jefferies Group, Inc. s Transition Report on Form 10-K for the eleven months ended November 30, 2010. All adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included.

We have made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with GAAP. The most significant of these estimates and assumptions relate to fair value measurements, compensation and benefits, legal reserves and the realizability of deferred tax assets. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.

Consolidation

Our policy is to consolidate all entities in which we own more than 50% of the outstanding voting stock and have control. In addition, we consolidate entities which lack characteristics of an operating entity or business for which we

JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

are the primary beneficiary. The primary beneficiary is the party who has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and who has an obligation to absorb losses of the entity or a right to receive benefits from the entity that could potentially be significant to the entity. In situations where we have significant influence but not control of an entity that does not qualify as a variable interest entity, we apply the equity method of accounting or fair value accounting. We also have formed nonconsolidated investment vehicles with third-party investors that are typically organized as partnerships or limited liability companies. We act as general partner or managing member for these investment vehicles and have generally provided the third-party investors with termination or kick-out rights.

Intercompany accounts and transactions are eliminated in consolidation.

Immaterial Restatements

As indicated in our Transition Report on Form 10-K for the eleven months ended November 30, 2010 (hereafter in this Note referred to as adjustments), we made correcting adjustments to our financial statements for the three and eight months ended August 31, 2010 relating to the netting of interest income and interest expense, differences with our former clearing bank, and certain other immaterial adjustments. We do not believe that these adjustments are material to our financial statements for these periods. For additional information on these adjustments, see Note 1, Organization and Basis of Presentation, and Note 23, Selected Quarterly Financial Data (Unaudited), of the Consolidated Financial Statements of our Transition Report on Form 10-K for the eleven months ended November 30, 2010.

The following table sets forth the effects of the adjustments on Net earnings, on an after tax basis, for the three and eight months ended August 31, 2010 (in thousands):

Decrease in Net earnings to common shareholders

	Three Months Ended August 31, 2010	Eight Months Ended August 31, 2010
Previously reported Net earnings to common shareholders	$ 46,256	$ 164,795
Netting of interest revenues and expense		
Differences with clearing bank	(1,738)	(3,453)
Other items (1)	236	(390)
Total adjustments	(1,502)	(3,843)
Adjusted Net earnings to common shareholders	$ 44,754	$ 160,952

(1) Other items Includes the effect of certain other immaterial adjustments.

The following table sets forth the effects of the adjustments on major caption items within our Consolidated Statement of Earnings for the three and eight months ended August 31, 2010 (in thousands, except per share amounts):

JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

	Three Months Ended August 31, 2010		Eight Months Ended August 31, 2010	
	As Previously Reported	Adjusted	As Previously Reported	Adjusted
Principal transactions	$ 74,282	$ 71,044	$ 324,037	$ 317,686
Interest	152,546	239,557	430,902	625,725
Total revenues	609,257	693,030	1,756,961	1,945,432
Interest expense	89,159	175,761	237,493	432,995
Net revenues	520,098	517,269	1,519,468	1,512,437
Net revenues, less mandatorily redeemable perferred interest	522,635	519,806	1,519,494	1,512,463
Floor brokerage and clearing fees	30,244	30,111	84,702	84,199
Total non-interest expenses	443,441	443,308	1,239,874	1,239,369
Earnings before income taxes	79,194	76,498	279,620	273,094
Income tax expense	35,067	33,873	112,960	110,277
Net earnings	44,127	42,625	166,660	162,817
Net earnings to common shareholders	46,256	44,754	164,795	160,952
Earnings per common share:				
Basic	$ 0.23	$ 0.22	$ 0.81	$ 0.79
Diluted	$ 0.23	$ 0.22	$ 0.81	$ 0.79

These adjustments affected certain line items within cash flows from operating activities on the Consolidated Statement of Cash Flows for the eight months ended August 31, 2010, with no net effect on net cash used in operating activities. In addition, supplemental disclosures for cash paid for interest were also adjusted.

Note 2. Summary of Significant Accounting Policies

Revenue Recognition Policies

Commissions. All customer transactions are reported on the Consolidated Statements of Financial Condition on a settlement date basis with related income reported on a trade-date basis. We permit institutional customers to allocate a portion of their gross commissions to pay for research products and other services provided by third parties. The amounts allocated for those purposes are commonly referred to as soft dollar arrangements. Soft dollar expenses amounted to $14.1 million and $8.7 million for the three months ended August 31, 2011 and 2010, respectively, and $36.4 million and $25.8 million for the nine months ended August 31, 2011 and eight months ended August 31, 2010, respectively. We account for the cost of these arrangements on an accrual basis. As we are not the primary obligor for these arrangements, expenses relating to soft dollars are netted against commission revenues. The commissions and related expenses on client transactions executed by Jefferies Bache, LLC, a futures commission merchant, are recorded on a half turn basis.

Principal Transactions. Financial instruments owned and Financial instruments sold, but not yet purchased (all of which are recorded on a trade-date basis) are carried at fair value with gains and losses reflected in Principal transactions in the Consolidated Statements of Earnings on a trade date basis.

Investment Banking. Underwriting revenues and fees from mergers and acquisitions, restructuring and other investment banking advisory assignments or engagements are recorded when the services related to the underlying transactions are completed under the terms of the assignment or engagement. Expenses associated with such assignments are deferred until reimbursed by the client, the related revenue is recognized or the engagement is otherwise concluded. Out-of-pocket expenses are recorded net of client reimbursements. Revenues are presented net

JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   CONTINUED
(Unaudited)

of related out-of-pocket unreimbursed expenses. Unreimbursed out-of-pocket expenses with no related revenues are included in Business development and Professional services expenses in the Consolidated Statements of Earnings.

Asset Management Fees and Investment Income From Managed Funds. Asset management fees and investment income from managed funds include revenues we earn from management, administrative and performance fees from funds managed by us, revenues from management and performance fees we earn from related-party managed funds and investment income from our investments in these funds. We earn fees in connection with management and investment advisory services performed for various funds and managed accounts. These fees are based on assets under management or an agreed upon notional amount and may include performance fees based upon the performance of the funds. Management and administrative fees are generally recognized over the period that the related service is provided. Generally, performance fees are earned when the return on assets under management exceeds certain benchmark returns, high-water marks or other performance targets. Performance fees are accrued (or reversed) on a monthly basis based on measuring performance to date versus any relevant benchmark return hurdles stated in the investment management agreement. Performance fees are not subject to adjustment once the measurement period ends (generally annual periods) and the performance fees have been realized.

Interest Revenue and Expense. We recognize contractual interest on Financial instruments owned and Financial instruments sold, but not yet purchased, on an accrual basis as a component of interest revenue and expense. Interest flows on derivative trading transactions and dividends are included as part of the fair valuation of these contracts in Principal transactions in the Consolidated Statements of Earnings and are not recognized as a component of interest revenue or expense. We account for our short-term, long-term borrowings and our mandatorily redeemable convertible preferred stock on an accrual basis with related interest recorded as interest expense. In addition, we recognize interest revenue related to our securities borrowed and securities purchased under agreements to resell activities and interest expense related to our securities loaned and securities sold under agreements to repurchase activities on an accrual basis.

Cash Equivalents

Cash equivalents include highly liquid investments, including money market funds, not held for resale with original maturities of three months or less.

Cash and Securities Segregated and on Deposit for Regulatory Purposes or Deposited With Clearing and Depository Organizations

In accordance with Rule 15c3-3 of the Securities Exchange Act of 1934, Jefferies as a broker-dealer carrying client accounts, is subject to requirements related to maintaining cash or qualified securities in a segregated reserve account for the exclusive benefit of its clients. In addition, certain financial instruments used for initial and variation margin purposes with clearing and depository organizations are recorded in this caption. Jefferies Bache, LLC, as a futures commission merchant, is obligated by rules mandated by the Commodities Futures Trading Commission under the Commodities Exchange Act, to segregate or set aside cash or qualified securities to satisfy such regulations, which regulations have been promulgated to protect customer assets.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries having non-U.S. dollar functional currencies are translated at exchange rates at the end of a period. Revenues and expenses are translated at average exchange rates during the period. The gains or losses resulting from translating foreign currency financial statements into U.S. Dollars, net of hedging gains or losses and taxes, if any, are included in Other comprehensive income. Gains or losses resulting from foreign currency transactions are included in Principal transactions in the Consolidated Statements of Earnings.

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Financial Instruments

Financial instruments owned and Financial instruments sold, not yet purchased are recorded at fair value, either as required by accounting pronouncements or through the fair value option election. These instruments primarily represent our trading activities and include both cash and derivative products. Gains and losses are recognized in Principal transactions in our Consolidated Statements of Earnings. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price).

Fair Value Hierarchy

In determining fair value, we maximize the use of observable inputs and minimize the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect our assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. We apply a hierarchy to categorize our fair value measurements broken down into three levels based on the transparency of inputs as follows:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level 2: Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these financial instruments include cash instruments for which quoted prices are available but traded less frequently, derivative instruments whose fair value have been derived using a model where inputs to the model are directly observable in the market, or can be derived principally from or corroborated by observable market data, and instruments that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level 3: Instruments that have little to no pricing observability as of the reported date. These financial instruments are measured using management s best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The availability of observable inputs can vary and is affected by a wide variety of factors, including, for example, the type of financial instrument and market conditions. To the extent that valuation is based on models or input that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised in determining fair value is greatest for instruments categorized in Level 3.

We use prices and inputs that are current as of the measurement date. As the observability of prices and inputs may change for a financial instrument from period to period, this condition may cause a transfer of an instrument among the fair value hierarchy levels. Transfers among the levels are recognized at the beginning of each period.

Valuation Process for Financial Instruments

Financial instruments are valued at quoted market prices, if available. Certain financial instruments have bid and ask prices that can be observed in the marketplace. For financial instruments whose inputs are based on bid-ask prices, we allow for mid-market pricing and adjust to the point within the bid-ask range that meets our best estimate of fair value. For offsetting positions in the same financial instrument, the same price within the bid-ask spread is used to measure both the long and short positions.

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For financial instruments that do not have readily determinable fair values using quoted market prices, the determination of fair value is based upon consideration of available information, including types of financial instruments, current financial information, restrictions on dispositions, fair values of underlying financial instruments and quotations for similar instruments. The valuation process for financial instruments may include the use of valuation models and other techniques. Adjustments to valuations (such as counterparty, credit, concentration or liquidity) derived from valuation models may be made when, in management s judgment, either the size of the position in the financial instrument in a nonactive market or other features of the financial instrument such as its complexity, or the market in which the financial instrument is traded require that an adjustment be made to the value derived from the models. An adjustment may be made if a financial instrument is subject to sales restrictions that would result in a price less than the quoted market price. Adjustments from the price derived from a valuation model reflect management s judgment that other participants in the market for the financial instrument being measured at fair value would also consider in valuing that same financial instrument and are adjusted for assumptions about risk uncertainties and market conditions. Results from valuation models and valuation techniques in one period may not be indicative of future period fair value measurements.

See Note 5, Financial Instruments, for a description of valuation techniques applied to the classes of financial instruments at fair value.

Investments in Managed Funds

Investments in managed funds include our investments in funds managed by us and our investments in related-party managed funds in which we are entitled to a portion of the management and/or performance fees. Investments in nonconsolidated managed funds are accounted for on the equity method or fair value. Gains or losses on our investments in managed funds are included in Asset management fees and investment income from managed funds in the Consolidated Statements of Earnings.

Other Investments

Other investments includes investments and loans entered into where we exercise significant influence over operating and capital decisions in private equity and other operating entities in connection with our capital market activities and loans issued in connection with such activities. Other investments are accounted for on the equity method or at cost, as appropriate. Revenues on Other investments are included in Other income in the Consolidated Statement of Earnings.

Receivable from, and Payable to, Customers

Receivable from and payable to customers includes amounts receivable and payable on cash and margin transactions. Securities owned by customers and held as collateral for these receivables are not reflected in the accompanying consolidated financial statements. Receivable from officers and directors included within this financial statement line item represents balances arising from their individual security transactions. These transactions are subject to the same regulations as customer transactions and are provided on substantially the same terms.

Securities Borrowed and Securities Loaned

Securities borrowed and securities loaned are carried at the amounts of cash collateral advanced and received in connection with the transactions and accounted for as collateralized financing transactions. In connection with both trading and brokerage activities, we borrow securities to cover short sales and to complete transactions in which customers have failed to deliver securities by the required settlement date, and lend securities to other brokers and dealers for similar purposes. We have an active securities borrowed and lending matched book business in which we borrow securities from one party and lend them to another party. When we borrow securities, we generally provide cash to the lender as collateral, which is reflected in our Consolidated Statements of Financial Condition as Securities borrowed. We earn interest revenues on this cash collateral. Similarly, when we lend securities to another party, that party provides cash to us as collateral, which is reflected in our Consolidated Statements of Financial Condition as

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Securities loaned. We pay interest expense on the cash collateral received from the party borrowing the securities. The initial collateral advanced or received approximates or is greater than the fair value of the securities borrowed or loaned. We monitor the fair value of the securities borrowed and loaned on a daily basis and request additional collateral or return excess collateral, as appropriate.

Securities Purchased Under Agreements to Resell and Securities Sold Under Agreements to Repurchase

Securities purchased under agreements to resell and Securities sold under agreements to repurchase (collectively repos) are accounted for as collateralized financing transactions and are recorded at their contracted repurchase amount. We earn and incur interest from this activity which is reflected in our Consolidated Statements of Earnings. We monitor the fair value of the underlying securities daily versus the related receivable or payable balances. Should the fair value of the underlying securities decline or increase, additional collateral is requested or excess collateral is returned, as appropriate. We carry repos on a net basis by counterparty when appropriate.

Premises and Equipment

Premises and equipment are depreciated using the straight-line method over the estimated useful lives of the related assets (generally three to ten years). Leasehold improvements are amortized using the straight-line method over the term of the related leases or the estimated useful lives of the assets, whichever is shorter.

Goodwill and Intangible Assets

Goodwill. At least annually, and more frequently if warranted, we assess whether goodwill has been impaired by comparing the estimated fair value of each reporting unit with its estimated net book value. Periodically estimating the fair value of a reporting unit requires significant judgment and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant effect on whether or not an impairment charge is recorded and the magnitude of such a charge. We completed our annual assessment of goodwill as of June 1, 2011 and no impairment was identified. (Refer to Note 10, Goodwill and Other Intangible Assets, for further details on our annual assessment of goodwill.)

Intangible Assets. Intangible assets deemed to have finite lives are amortized on a straight line basis over their estimated useful lives, where the useful life is the period over which the asset is expected to contribute directly, or indirectly, to our future cash flows. Intangible assets are reviewed for impairment on an interim basis when certain events or circumstances exist. For amortizable intangible assets, impairment exists when the carrying amount of the intangible asset exceeds its fair value. At least annually, the remaining useful life is evaluated.

An intangible asset with an indefinite useful life is not amortized but assessed annually, or more frequently when certain events or circumstances exist, for impairment. Impairment exists when the carrying amount exceeds its fair value.

For both goodwill and intangible assets, to the extent an impairment loss is recognized, the loss establishes the new cost basis of the asset. Subsequent reversal of impairment losses is not permitted. For amortizable intangible assets, the new cost basis is amortized over the remaining useful life of that asset. Adverse market or economic events could result in impairment charges in future periods.

Income Taxes

We file a consolidated U.S. federal income tax return, which includes all of our qualifying subsidiaries. We also are subject to income tax in various states and municipalities and those foreign jurisdictions in which we operate. Amounts provided for income taxes are based on income reported for financial statement purposes and do not necessarily represent amounts currently payable. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and for tax loss carry-forwards. Deferred tax assets and liabilities are

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measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income taxes are provided for temporary differences in reporting certain items, principally, share-based compensation, deferred compensation, unrealized gains and losses on investments and tax amortization on intangible assets. The realization of deferred tax assets is assessed and a valuation allowance is recorded to the extent that it is more likely than not that any portion of the deferred tax asset will not be realized.

The tax benefit related to dividends and dividend equivalents paid on nonvested share based payment awards and outstanding equity options is recognized as an increase to Additional paid in capital. These amounts are included in tax benefits for issuance of share-based awards on the Consolidated Statement of Changes in Stockholders Equity.

Legal Reserves

In the normal course of business, we have been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with our activities as a global securities and investment banking firm. We are also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding our businesses, certain of which may result in judgments, settlements, fines, penalties or other injunctions.

We recognize a liability for a contingency in Accrued expenses and other liabilities when it is probable that a liability has been incurred and when the amount of loss can be reasonably estimated. When a range of probable loss can be estimated, we accrue the most likely amount of such loss, and if such amount is not determinable, then we accrue the minimum of the range of probable loss. The determination of the outcome and loss estimates requires significant judgment on the part of management.

In many instances, it is not possible to determine whether any loss is probable or even possible or to estimate the amount of any loss or the size of any range of loss. We believe that, in the aggregate, the pending legal actions or proceedings should not have a material adverse effect on our consolidated results of operations, cash flows or financial condition. In addition, we believe that any amount that could be reasonably estimated of potential loss or range of potential loss in excess of what has been provided in the consolidated financial statements is not material.

Share-based Compensation

Share-based awards are measured based on the grant-date fair value of the award and recognized over the period from the service inception date through the date the employee is no longer required to provide service to earn the award. Expected forfeitures are included in determining share-based compensation expense.

Earnings per Common Share

Basic earnings per share (EPS) is computed by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding and certain other shares committed to be, but not yet issued. Net earnings available to common shareholders represent net earnings to common shareholders reduced by the allocation of earnings to participating securities. Losses are not allocated to participating securities. Common shares outstanding and certain other shares committed to be, but not yet issued, include restricted stock and restricted stock units for which no future service is required. Diluted EPS is computed by dividing net earnings available to common shareholders plus dividends on dilutive mandatorily redeemable convertible preferred stock by the weighted average number of common shares outstanding and certain other shares committed to be, but not yet issued, plus all dilutive common stock equivalents outstanding during the period.

Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and, therefore, are included in the earnings allocation in computing earnings per share under the two-class method of earning per share. We grant restricted stock and restricted stock

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units as part of our share-based compensation that contain nonforfeitable rights to dividends and dividend equivalents, respectively, and therefore, prior to the requisite service being rendered for the right to retain the award, restricted stock and restricted stock units meet the definition of a participating security. As such, we calculate Basic and Diluted earnings per share under the two-class method.

Securitization Activities

We engage in securitization activities related to commercial mortgage loans and mortgage-backed and other asset-backed securities. Such transfers of financial assets are generally accounted for as sales when we have relinquished control over the transferred assets. The gain or loss on sale of such financial assets depends, in part, on the previous carrying amount of the assets involved in the transfer allocated between the assets sold and the retained interests, if any, based upon their respective fair values at the date of sale. We may retain interests in the securitized financial assets as one or more tranches of the securitization. These retained interests are included within Financial instruments owned in the Consolidated Statement of Financial Condition at fair value. Any changes in the fair value of such retained interests are recognized within Principal transactions revenues in the Consolidated Statement of Earnings.

When a transfer of assets does not meet the criteria of a sale, that transfer is treated as a secured borrowing. We continue to recognize the assets of a secured borrowing in Financial instruments owned and recognize the associated financing in Other liabilities in the Consolidated Statements of Financial Condition.

New Accounting Developments

Testing Goodwill for Impairment . In September 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) Testing Goodwill for Impairment (ASU 2011-08) to Topic 350, Intangibles Goodwill and Other. The update outlines amendments to the two step goodwill impairment test permitting an entity to first assess qualitative factors, as described in the ASU 2011-08, in determining whether the fair value of a reporting unit is less than its carrying amount. We do not believe that the adoption of this guidance will have an impact on our financial condition, or results of operation.

Fair Value Measurements and Disclosures. In May 2011, the FASB issued accounting updates to ASC 820, Fair Value Measurements Topic Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, which provide clarifying guidance on how to measure fair value and additional disclosure requirements. The amendments prohibit the use of blockage factors at all levels of the fair value hierarchy and provide guidance on measuring financial instruments that are managed on a net portfolio basis. Additional disclosure requirements include transfers between Levels 1 and 2; and for Level 3 fair value measurements, a description of our valuation processes and additional information about unobservable inputs impacting Level 3 measurements. The updates are effective March 1, 2012 and will be applied prospectively. We are currently evaluating the impact, if any, that these updates will have on our financial condition, results of operations or cash flows.

Reconsideration of Effective Control for Repurchase Agreements. In April 2011, the FASB issued accounting guidance that removes the requirement to consider whether sufficient collateral is held when determining whether to account for repurchase agreements and other agreements that both entitle and obligate the transferor to repurchase or redeem financial assets before their maturity as sales or as secured financings. The guidance is effective prospectively for transactions beginning on January 1, 2012. We do not believe that the adoption of this guidance will have an impact on our financial condition, results of operations or cash flows.

Note 3. Acquisition of the Global Commodities Group

On July 1, 2011, we acquired Prudential Bache s Global Commodities Group from Prudential. Total cash payments made as consideration for the acquisition were $422.0 million (a cash payment of $419.5 million was made on July 1, 2011 and an additional payment of $2.5 million is anticipated). The acquisition included 100% of the equity interests in Prudential Bache Commodities LLC, a US-based full-service futures commission merchant; Prudential Bache Securities LLC, a US-based registered broker dealer; Bache Commodities Limited, a UK-based global commodities

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and financial derivatives broker; Prudential Bache Asset Management, Inc., a US-based registered investment advisor and commodity trading advisor, Prudential Bache Financial Services, Inc., a global over-the-counter commodities dealer; and Bache Commodities (Hong Kong) Ltd., a Hong Kong-based licensed futures dealer. In addition, we acquired related information technology assets and related contracts used by the Global Commodities Group.

The Global Commodities Group provides sales, trading, clearing and execution services covering a wide variety of commodity, financial and foreign exchange futures, swaps and forward contracts to an institutional client base. The acquisition of the Global Commodities Group will allow us to offer clients globally an increased range of products, including exchange-traded futures and over-the-counter trading in energy, metals and agricultural markets.

In connection with the acquisition of the Global Commodities Group on July 1, 2011, certain acquired entities entered into a $1.0 billion credit facility agreement with Prudential that was terminated by us on September 16, 2011. For further details, see Note 11, Short-Term Borrowings. On August 26, 2011, Jefferies Bache Financial Services, Inc., Jefferies Bache, LLC and Jefferies Bache Limited, as borrowers, entered into a senior secured revolving credit facility in aggregate totaling $950.0 million with a group of commercial banks. See Note 12, Long-Term Borrowings for further information.

We accounted for the acquisition under the purchase method of accounting. Accordingly, the assets acquired, including identifiable intangible assets, and liabilities assumed were recorded at their respective fair values as of the date of acquisition.

The fair values of the net assets acquired, including identifiable intangible assets, was approximately $474.5 million, which exceeded the purchase price of $422.0 million, resulting in a bargain purchase gain of approximately $52.5 million. The bargain purchase gain is included within Other income in the Consolidated Statements of Earnings, is not taxable and is presented within the Capital Market Business Segment. The business of the Global Commodities Group are included within the Capital Market Business Segment.

We believe we were able to acquire the Global Commodities Group for less than the fair value of its assets as the business activities of the Global Commodities Group were not a core business for Prudential and therefore Prudential was willing to exit the commodities trading business at such a price.

Approximately $18.3 million was recognized as the fair value of intangible assets. Of this amount, $5.8 million represents the fair value of customer relationships, $11.2 million represents the fair value of exchange and clearing organization membership interests and registrations and $1.3 million represents the fair value of the Bache trade name. See Note 10, Goodwill and Other Intangible Assets for further details. Additionally, we recognized in the acquisition approximately $6.3 million of internally developed software that is recorded within Premises and equipment on the Consolidated Statements of Financial Condition.

Condensed statement of net assets acquired

The following reflects the fair value of assets acquired and liabilities assumed, by major class, on July 1, 2011 (in thousands):

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Assets acquired:	
Cash and cash equivalents	$ 101,343
Cash and securities segregated	3,130,586
Financial instruments owned, at fair value	918,598
Securities purchased under agreements to resell	1,489
Receivables:	
Brokers, dealers and clearing organizations	313,939
Customers	173,477
Fees, interest and other	122
Premises and equipment	13,584
Indefinite-lived intangible exchange memberships and licences (1)	11,219
Finite-lived intangible customer relationships (1)(2)	5,800
Trade names (1)(3)	1,300
Other assets	32,076
Total assets	$ 4,703,533
Liabilities assumed:	
Short-term borrowings	$ 301,027
Financial instruments sold, not yet purchased, at fair value	267,200
Payables:	
Brokers, dealers and clearing organizations	43,588
Customers	3,384,263
Accrued expenses and other liabilities	232,933
Total liabilities	$ 4,229,011
Fair value of net assets acquired	$ 474,522
Purchase price:	
Cash	$ 422,013
Total purchase price	$ 422,013
Bargain purchase gain	$ 52,509

(1) Intangible assets are recorded within Other assets on the Consolidated Statements of Financial Condition.

(2) The fair value of the finite-lived customer relationships will be amortized on a straight line basis over a weighted-average useful life of approximately 9.6 years.

(3) The fair value of the Bache trade name will be amortized on a straight line basis over a useful life of 1.5 years.

Unaudited pro forma condensed combined financial information

Our third quarter results of operation include the operations of the acquired entities for the period from July 1, 2011 to August 31, 2011. The Consolidated Statement of Earnings for the three months ended August 31, 2011, include $43.5 million of Net revenues and $6.4 million of Net earnings contributed by the Global Commodities Group.

Set forth below are unaudited pro forma combined financial information as they may have appeared if the acquisition had been completed on January 1, 2010 taking into account certain adjustments described below, including the exclusion of the bargain purchase gain of $52.5 million related to the acquisition. The unaudited pro forma combined financial information includes the Global Commodities Group s actual results from January 1, 2010 to August 31, 2010 and December 1, 2010 to August 31, 2011.

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(in millions, except per share data)	Three months ended August 31, 2011	Three months ended August 31, 2010	Nine months ended August 31, 2011	Eight months ended August 31, 2010
Total net revenues	$ 473.3	$ 566.7	$ 2,079.7	$ 1,703.0
Net earnings to common shareholders	$ 16.7	$ 37.6	$ 198.4	$ 210.8
Earnings per common share:				
Basic	$ 0.07	$ 0.18	$ 0.90	$ 1.03
Diluted	$ 0.07	$ 0.18	$ 0.90	$ 1.03
Weighted average common shares:				
Basic	218,426	195,601	209,544	196,943
Diluted (1)	218,431	195,612	213,661	201,062

(1) The conversion of our mandatorily redeemable convertible preferred stock was considered anti-dilutive for the purposes of the pro forma calculation for the three months ended August 31, 2011.

The unaudited pro forma combined financial information is presented for illustrative purposes only and does not purport to be indicative of the financial results we would have achieved had the acquisition been completed as of January 1, 2010, nor is it indicative of the results of operations in future periods.

The pro forma information was derived from historical financial information for 2011 and 2010 adjusted to give effect for events directly attributable to the acquisition and factually supportable and expected to have a continuing impact on the combined results. The adjustments include:

a) the bargain purchase gain of $52.5 million has been excluded from Net revenues and Net earnings for the periods ended August 31, 2011 and included in Net revenues and Net earnings for the eight months ended August 31, 2010;

b) an adjustment to reflect Global Commodities Group s physical commodities at market value;

c) acquisition costs totaling $4.4 million recognized in Professional services has been excluded from the periods ended August 31, 2011 and included in the eight months ended August 31, 2010;

d) additional amortization expense on the acquired intangible assets and internally developed software of $0.2 million and $1.6 million for the three month and nine month periods ended August 31, 2011 and $.07 million and $1.9 million for the three and eight month periods ended August 31, 2010;

e) the recording of income tax expense resulting from the pro forma adjustments before tax at an effective rate of 44.9% and 36.5% for the three month and nine month periods ended August 31, 2011 and 45.4% and 33.8% for the three and eight month periods ended August 31, 2010.

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Note 4. Cash, Cash Equivalents and Short-Term Investments

We generally invest our excess cash in money market funds and other short-term investments. Cash equivalents include highly liquid investments not held for resale with original maturities of three months or less. The following are financial instruments that are cash and cash equivalents that are deemed by us to be generally readily convertible into cash as of August 31, 2011 and November 30, 2010 (in thousands):

	August 31, 2011	November 30, 2010
Cash and cash equivalents:		
Cash in banks	$ 807,414	$ 325,227
Money market investments	1,207,536	1,863,771
Total cash and cash equivalents	$ 2,014,950	$ 2,188,998
Cash and securities segregated (1)	$ 5,321,012	$ 1,636,755

(1) Consists of deposits at exchanges and clearing organizations, as well as deposits in accordance with Rule 15c3-3 of the Securities Exchange Act of 1934, which subjects Jefferies as a broker dealer carrying client accounts, to requirements related to maintaining cash or qualified securities in a segregated reserve account for the exclusive benefit of its clients; and Jefferies Bache, LLC which, as a futures commission merchant, is subject to the segregation requirements pursuant to the Commodity Exchange Act.

Note 5. Financial Instruments

The following is a summary of our financial assets and liabilities that are accounted for at fair value on a recurring basis as of August 31, 2011 and November 30, 2010 by level within the fair value hierarchy (in thousands):

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	As of August 31, 2011				
	Level 1 (3)	Level 2 (3)	Level 3	Counterparty and Cash Collateral Netting (2)	Total
Assets:					
Financial instruments owned:					
Corporate equity securities	$ 1,523,277	$ 141,909	$ 11,412	$	$ 1,676,598
Corporate debt securities	7,438	4,150,581	55,230		4,213,249
Collateralized debt obligations		92,298	96,664		188,962
U.S. government and federal agency securities	1,932,703	230,780			2,163,483
Municipal securities		682,807	686		683,493
Sovereign obligations	1,994,296	690,154	128		2,684,578
Residential mortgage-backed securities		3,787,720	171,519		3,959,239
Commercial mortgage-backed securities		488,196	40,195		528,391
Other asset-backed securities		107,538	3,478		111,016
Loans and other receivables		364,518	164,163		528,681
Derivatives	967,618	1,557,787	155	(1,609,418)	916,142
Investments at fair value		24,405	92,428		116,833
Physical commodities		369,281			369,281
Total financial instruments owned	$ 6,425,332	$ 12,687,974	636,058	$ (1,609,418)	$ 18,139,946
Level 3 assets for which the firm does not bear economic exposure (1)			(68,987)		
Level 3 assets for which the firm bears economic exposure			$ 567,071		
Cash and securities segregated and on deposit for regulatory purposes	$ 407,096	$	$	$	$ 407,096
Securities received as collateral	$ 40,401	$	$	$	$ 40,401
Liabilities:					
Financial instruments sold, not yet purchased:					
Corporate equity securities	$ 1,622,547	$ 113,615	$ 59	$	$ 1,736,221
Corporate debt securities	21,901	2,450,144			2,472,045
	2,381,050	351,749			2,732,799

U.S. government and federal agency securities					
Sovereign obligations	1,830,082	715,354			2,545,436
Residential mortgage-backed securities		81,955			81,955
Commercial mortgage-backed securities		117			117
Loans		144,188	11,458		155,646
Derivatives	674,857	1,836,983	3,601	(1,919,499)	595,942
Total financial instruments sold, not yet purchased	$ 6,530,437	$ 5,694,105	$ 15,118	$ (1,919,499)	$ 10,320,161
Obligation to return securities received as collateral	$ 40,401	$	$	$	$ 40,401

(1) Consists of Level 3 assets attributable to third party or employee noncontrolling interests in certain consolidated entities.

(2) Represents counterparty and cash collateral netting across the levels of the fair value hierarchy for positions with the same counterparty.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
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(3) There were no significant transfers between Level 1 and Level 2 for the three-months and nine-months ended August 31, 2011.

	As of November 30, 2010				
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting (2)	Total
Assets:					
Financial instruments owned:					
Corporate equity securities	$ 1,453,744	$ 89,430	$ 22,619	$	$ 1,565,793
Corporate debt securities	25	3,557,183	73,408		3,630,616
Collateralized debt obligations		27,863	31,121		58,984
U.S. government and federal agency securities	2,322,204	210,422			2,532,626
Municipal securities		477,462	472		477,934
Sovereign obligations	1,600,762	580,651			2,181,413
Residential mortgage-backed securities		3,912,708	132,359		4,045,067
Commercial mortgage-backed securities		524,614	6,004		530,618
Other asset-backed securities		286,329	567		286,896
Loans and other receivables		206,977	227,596		434,573
Derivatives	279,811	176,069		(336,612)	119,268
Investments at fair value			77,784		77,784
Total financial instruments owned	$ 5,656,546	$ 10,049,708	571,930	$ (336,612)	$ 15,941,572
Level 3 assets for which the firm does not bear economic exposure (1)			(204,139)		
Level 3 assets for which the firm bears economic exposure			$ 367,791		
Securities received as collateral	$ 48,616	$	$	$	$ 48,616
Liabilities:					
Financial instruments sold, not yet purchased:					
Corporate equity securities	$ 1,554,489	$ 83,845	$ 38	$	$ 1,638,372
Corporate debt securities		2,375,925			2,375,925
U.S. government and federal agency securities	1,688,684	51,604			1,740,288

Municipal securities		170			170
Sovereign obligations	2,180,667	814,163			2,994,830
Residential mortgage-backed securities		127,547			127,547
Commerical mortgage-backed securities		1,837			1,837
Loans		124,050	47,228		171,278
Derivatives	241,860	240,866	2,346	(425,520)	59,552
Total financial instruments sold, not yet purchased	$ 5,665,700	$ 3,820,007	$ 49,612	$ (425,520)	$ 9,109,799
Obligation to return securities received as collateral	$ 48,616	$	$	$	$ 48,616

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(1) Consists of Level 3 assets which are either financed by nonrecourse secured financings or attributable to third party or employee noncontrolling interests in certain consolidated entities.

(2) Represents counterparty and cash collateral netting across the levels of the fair value hierarchy for positions with the same counterparty.

We elected to apply the fair value option to loans and loan commitments made in connection with our investment banking and sales and trading activities and certain investments held by subsidiaries that are not registered broker-dealers. Loans and investments at fair value are included in Financial instruments owned and loan commitments are included in Financial instruments owned Derivatives and Financial instruments sold, not yet purchased Derivatives on the Consolidated Statements of Financial Condition. The fair value option was elected for loans and loan commitments and investments held by subsidiaries that are not registered broker-dealers because they are risk managed by us on a fair value basis. We have elected to apply the fair value option to certain secured financings that arise in connection with our securitization activities. At August 31, 2011 and November 30, 2010, $-0- million and $85.7 million, respectively, in secured financings, are included within Other liabilities on the Consolidated Statement of Financial Position, are accounted for at fair value and are classified as Level 3 liabilities. Cash and cash equivalents, the cash component of Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations, Receivables Brokers, dealers and clearing organizations, Receivables Customers, Receivables Fees, interest and other, Payables Brokers, dealers and clearing organizations and Payables Customers, are not accounted for at fair value; however, the recorded amounts approximate fair value due to their liquid or short-term nature.

The following is a description of the valuation basis, including valuation techniques and inputs, used in measuring our financial assets and liabilities that are accounted for at fair value on a recurring basis:

Corporate Equity Securities

Exchange Traded Equity Securities: Exchange-traded equity securities are measured based on quoted exchange prices, which are generally obtained from pricing services, and are categorized as Level 1 in the fair value hierarchy.

Non-exchange Traded Equity Securities: Non-exchange traded equity securities are measured primarily using broker quotations, pricing service data from external providers and prices observed for recently executed market transactions and are categorized within Level 2 of the fair value hierarchy. Where such information is not available, non-exchange traded equity securities are categorized as Level 3 financial instruments and measured using valuation techniques involving quoted prices of or market data for comparable companies, similar company ratios and multiples (e.g., price/EBITDA, price/book value), discounted cash flow analyses and transaction prices observed for subsequent financing or capital issuance by the company. When using pricing data of comparable companies, judgment must be applied to adjust the pricing data to account for differences between the measured security and the comparable security (e.g., issuer market capitalization, yield, dividend rate, geographical concentration).

Equity warrants: Non-exchange traded equity warrants are generally classified within Level 3 of the fair value hierarchy and are measured using the Black-Scholes model with key inputs impacting the valuation including the underlying security price, implied volatility, dividend yield, interest rate curve, strike price and maturity date.

Corporate Debt Securities

Corporate Bonds: Corporate bonds are measured primarily using pricing service data from external providers and broker quotations, where available, prices observed for recently executed market transactions of comparable size, and bond spreads or credit default swap spreads of the issuer adjusted for basis differences between the swap curve and the bond curve. Corporate bonds measured using these valuation methods are categorized within Level 2 of the fair value hierarchy. If broker quotes, pricing data or spread data is not available, alternative valuation techniques are used including cash flow models incorporating interest rate curves, single name or index credit default swap curves for comparable issuers and recovery rate assumptions. Corporate bonds measured using alternative valuation techniques are classified within Level 3 of the fair value hierarchy and comprise a limited portion of our corporate bonds.

High Yield Corporate and Convertible Bonds: A significant portion of our high yield corporate and convertible bonds are classified within Level 2 of the fair value hierarchy and are measured primarily using broker quotations and pricing service data from external providers, where available, and prices observed for recently executed market transactions of comparable size. Where pricing data is less observable, valuations are classified in Level 3 and are based on pending transactions involving the issuer or comparable issuers, prices implied from an issuer s subsequent financings or recapitalizations, models incorporating financial ratios and projected cash flows of the issuer and market prices for comparable issuers.

Auction Rate Securities: Auction rate securities (ARS) included within corporate debt securities include ARS backed by pools of student loans and auction rate preferred securities issued by closed end mutual funds. ARS are measured using market data provided by external service providers, as available. The fair value of ARS is also determined by benchmarking to independent market data and adjusting for projected cash flows, level of seniority in the capital structure, leverage, liquidity and credit rating, as appropriate. ARS are classified within Level 3 of the fair value hierarchy based on our assessment of the transparency of the external market data received.

Collateralized Debt Obligations

Collateralized debt obligations are measured based on prices observed for recently executed market transactions or based on valuations received from third party brokers and are classified within Level 2 or Level 3 of the fair value hierarchy depending on the observability of the pricing inputs.

U.S. Government and Federal Agency Securities

U.S. Treasury Securities: U.S. Treasury securities are measured based on quoted market prices and categorized in Level 1 of the fair value hierarchy.

U.S. Agency Issued Debt Securities: Callable and non-callable U.S. agency issued debt securities are measured primarily based on quoted market prices obtained from external pricing services. Non-callable U.S. agency securities are generally classified within Level 1 of the fair value hierarchy and callable U.S. agency securities are classified within Level 2.

Municipal Securities

Municipal securities are measured based on quoted prices obtained from external data providers and generally classified within Level 2 of the fair value hierarchy.

Sovereign Obligations

G-7 Government and non-G-7 Government Bonds: G-7 government and non-G-7 government bonds are measured based on quoted market prices obtained from external pricing services. G-7 government bonds are categorized within Level 1 of the fair value hierarchy and non-G-7 government bonds are generally categorized within Level 2.

Emerging Market Sovereign Debt Securities: Valuations are primarily based on market price quotations from external data providers, where available, or recently executed independent transactions of comparable size. To the extent market price quotations are not available or recent transactions have not been observed, valuation techniques incorporating foreign currency curves, interest rate yield curves and country spreads for bonds of similar issuers, seniority and maturity are used to determine fair value. Emerging market sovereign debt securities are generally classified within Level 2 of the fair value hierarchy.

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Residential Mortgage-Backed Securities

Agency Residential Mortgage-Backed Securities: Agency residential mortgage-backed securities include mortgage pass-through securities (fixed and adjustable rate), collateralized mortgage obligations, interest-only and principal-only securities and to-be-announced securities and are generally measured using market price quotations from external data providers and categorized within Level 2 of the fair value hierarchy.

Agency Residential Inverse Interest-Only Securities (Agency Inverse IOs): The fair value of agency inverse IOs is estimated using expected future cash flow techniques that incorporate prepayment models and other prepayment assumptions to amortize the underlying mortgage loan collateral. We use prices observed for recently executed transactions to develop market-clearing spread and yield curve assumptions. Valuation inputs with regard to underlying collateral incorporate weighted average coupon, loan-to-value, credit scores, geographic location, maximum and average loan size, originator, servicer, and weighted average loan age. Agency inverse IOs are categorized within Level 2 of the fair value hierarchy. We also use vendor data in developing assumptions, as appropriate.

Non-Agency Residential Mortgage-Backed Securities: Fair values are determined primarily using discounted cash flow methodologies and securities are categorized within Level 2 or Level 3 of the fair value hierarchy based on the observability of the pricing inputs used. Performance attributes of the underlying mortgage loans are evaluated to estimate pricing inputs, such as prepayment rates, default rates and the severity of credit losses. Attributes of the underlying mortgage loans that affect the pricing inputs include, but are not limited to, weighted average coupon; average and maximum loan size; loan-to-value; credit scores; documentation type; geographic location; weighted average loan age; originator; servicer; historical prepayment, default and loss severity experience of the mortgage loan pool; and delinquency rate. Yield curves used in the discounted cash flow models are based on observed market prices for comparable securities and published interest rate data to estimate market yields.

Commercial Mortgage-Backed Securities

Agency Commercial Mortgage-Backed Securities: GNMA project loan bonds and FNMA DUS mortgage-backed securities are generally measured by using prices observed for recently executed market transactions to estimate market-clearing spread levels for purposes of estimating fair value. GNMA project loan bonds and FNMA DUS mortgage-backed securities are categorized within Level 2 of the fair value hierarchy.

Non-Agency Commercial Mortgage-Backed Securities: Non-agency commercial mortgage-backed securities are measured using pricing data obtained from third party services and prices observed for recently executed market transactions and are categorized within Level 2 and Level 3 of the fair value hierarchy.

Other Asset-Backed Securities

Other asset-backed securities include, but are not limited to, securities backed by auto loans, credit card receivables and student loans and are categorized primarily within Level 2 of the fair value hierarchy. Valuations are determined using pricing data obtained from third party services and prices observed for recently executed market transactions.

Loans and Other Receivables

Corporate Loans: Corporate loans categorized within Level 2 of the fair value hierarchy are measured based on market price quotations from external data providers where sufficient observability exists as to the extent of market transaction data supporting the pricing data. Corporate loans categorized within Level 3 are measured based on market price quotations that are considered to be less transparent, market prices for debt securities of the same creditor, and estimates of future cash flow incorporating assumptions regarding creditor default and recovery rates and consideration of the issuer s capital structure.

Participation Certificates in GNMA Project and Construction Loans: Valuations of participation certificates in GNMA project and construction loans are based on observed market prices of recently executed purchases of similar loans which are then used to derive a market implied spread. The market implied spread is used as the

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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primary input in estimating the fair value of loans at the measurement date. The loan participation certificates are categorized within Level 2 of the fair value hierarchy given the observability and volume of recently executed transactions.

Project Loans: Valuation of project loans are based on benchmarks of prices for recently executed transactions of related realized collateralized securities and are classified within Level 2 of the fair value hierarchy.

Escrow and Trade Claim Receivables: Escrow and trade claim receivables are categorized within Level 3 of the fair value hierarchy where fair value is estimated based on reference to market prices and implied yields of debt securities of the same or similar issuers. Escrow and trade claim receivables are categorized within Level 2 where fair value is based on recent trade activity in the same security.

Derivatives

Listed Derivative Contracts: Listed derivative contracts are measured based on quoted exchange prices, which are generally obtained from pricing services, and are categorized as Level 1 in the fair value hierarchy.

OTC Derivative Contracts: OTC derivative contracts are generally valued using models, whose inputs reflect assumptions that we believe market participants would use in valuing the derivative in a current period transaction. Inputs to valuation models are appropriately calibrated to market data. For many OTC derivative contracts, the valuation models do not involve material subjectivity as the methodologies do not entail significant judgment and the inputs to valuation models do not involve a high degree of subjectivity as the valuation model inputs are readily observable or can be derived from actively quoted markets. OTC derivative contracts are primarily categorized in Level 2 of the fair value hierarchy given the observability of the inputs to the valuation models.

OTC options include OTC equity and commodity options measured using Black-Scholes models with key inputs impacting the valuation including the underlying security or commodity price, implied volatility, dividend yield, interest rate curve, strike price and maturity date. Discounted cash flow models are utilized to measure certain OTC derivative contracts including the valuations of our interest rate swaps, which incorporate observable inputs related to interest rate curves, and valuations of our foreign exchange forwards and swaps, which incorporate observable inputs related to foreign currency spot rates and forward curves. Credit defaults swaps include both index and single-name credit default swaps. External prices are available as inputs in measuring index credit default swaps and single-name credit default swaps. For commodity and equity total return swaps, market prices are observable for the underlying asset and used as the basis for measuring the fair value of the derivative contracts. Total return swaps executed on other underlyings are measured based on valuations received from third parties.

Physical Commodities

Physical commodities include crude oil and refined products, natural gas, base and precious metals and agricultural products and are measured using observable inputs including spot prices and published indices. Physical commodities are categorized in Level 2 of the fair value hierarchy.

Investments at Fair Value

Investments at fair value include primarily investments in hedge funds, fund of funds, private equity funds and commodity funds, which are measured based on the net asset value of the funds provided by the fund managers and categorized within Level 2 or Level 3 of the fair value hierarchy. Investments at fair value also include direct equity investments in private companies, which are measured using valuation techniques involving quoted prices of or market data for comparable companies, similar company ratios and multiples (e.g., price/EBITDA, price/book value), discounted cash flow analyses and transaction prices observed for subsequent financing or capital issuance by the company. Direct equity investments in private companies are categorized within Level 3 of the fair value hierarchy. Additionally, investments at fair value include investments in insurance contracts relating to our German defined benefits pension plan and shares in non-US exchanges and clearing houses. Fair value for the insurance contracts is determined using a third party and are categorized in Level 3 of the fair value hierarchy. Fair value for the shares in

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non-US exchanges and clearing houses is determined based on a third party model valuation and are categorized in Level 3 of the fair value hierarchy. The following tables provide further information about our investments in entities that have the characteristics of an investment company at August 31, 2011 and November 30, 2010 (in thousands):

	August 31, 2011		
	Fair Value (f)	Unfunded Commitments	Redemption Frequency (if currently eligible)
Equity Long/Short Hedge Funds [a]	$ 27,282	$	Monthly, Quarterly, Semiannually
High Yield Hedge Funds[b]	993		
Fund of Funds[c]	881	127	Annually
Private Equity Funds[d]	21,198	5,897	
Commodity Funds[e]	14,569		Bi-Monthly
Total[g]	$ 64,923	$ 6,025	

	November 30, 2010		
	Fair Value (f)	Unfunded Commitments	Redemption Frequency (if currently eligible)
Equity Long/Short Hedge Funds [a]	$ 19,865	$	Quarterly, Semiannually
High Yield Hedge Funds[b]	1,561		
Fund of Funds[c]	2,622	131	Annually
Private Equity Funds[d]	26,567	6,792	
Other Investments[h]	287		At Will
Total[g]	$ 50,902	$ 6,923	

(a) This category includes investments in hedge funds that invest in both long and short equity securities in domestic and international markets in both public and private sectors. At August 31, 2011 and November 30, 2010, investments representing approximately 98% and 67%, respectively, of the fair value in this category are redeemable with 30 - 90 days prior written notice. At November 30, 2010, investments representing approximately 30% of fair value cannot be redeemed until the lock-up period expired on December 31, 2010. At August 31, 2011 and November 30, 2010, investments representing approximately 2% and 3% respectively, of fair value cannot be redeemed as they are in liquidation and distributions will be received through the liquidation of the underlying assets of the funds. We are unable to estimate when the underlying assets will be liquidated. At August 31, 2011 and November 30, 2010, an investment representing less than 1% of fair value has no redemption provisions; distributions are received through the liquidation of the underlying assets of the fund which is estimated to be within one to two years.

(b) This category includes investments in funds that invest in domestic and international public high yield debt, private high yield investments, senior bank loans, public leveraged equities, distressed debt, and private equity investments. There are no redemption provisions and distributions are received through the liquidation of the underlying assets of the funds. At August 31, 2011 and November 30, 2010, these investments are currently in liquidation and we are unable to estimate when the underlying assets will be fully liquidated.

(c) This category includes investments in fund of funds that invest in various private equity funds. At August 31, 2011 and November 30, 2010, approximately 95% and 41%, respectively, of the fair value of investments in this category is managed by us and has no redemption provisions. Distributions are received through the liquidation of the underlying assets of the fund of funds, which are estimated to be liquidated in one to three years. At August 31, 2011 we requested redemption for investments representing approximately 5% of fair value at August 31, 2011, however we are unable to estimate when these funds will be returned. At November 30, 2010, investments representing approximately 59% of the fair value were approved for redemption and the funds net asset values were received in the first quarter of 2011.

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(d) At August 31, 2011 and November 30, 2010, investments representing approximately 81% and 74% respectively, include investments in private equity funds that invest in the equity of various private companies in the energy, technology, internet service and telecommunication service industries including acquired or restructured companies. These investments cannot be redeemed; distributions are received through the liquidation of the underlying assets of the funds and are expected to liquidate in one to ten years. At August 31, 2011, a fund that invests in Croatian companies represents approximately 19% of the total investment in private equity funds. At November 30, 2010, funds that invest in Croatian and Vietnamese companies represent approximately 26% of the total investment in private equity funds.

(e) At August 31, 2011, this category included investments in funds that invest in various commodity futures contracts on futures exchanges and forward contracts, exchange-traded options on futures contracts and other commodity-related or commodity-linked financial instruments. These investments can be redeemed on the fifteenth and last calendar day of each month with prior written notice within five business days.

(f) Fair value has been estimated using the net asset value derived from each of the funds partner capital statements.

(g) Investments at fair value, in the Consolidated Statements of Financial Condition at August 31, 2011 and November 30, 2010 include $51.9 million and $26.9 million, respectively, of direct investments which are not investment companies and therefore are not part of this disclosure table.

(h) Other Investments at November 30, 2010 included investments in closed-ended funds that invested in Vietnamese equity and debt instruments.

At August 31, 2011 and November 30, 2010, our Financial instruments owned and Financial instruments sold, not yet purchased are measured using different valuation basis as follows:

	August 31, 2011		November 30, 2010	
	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased
Exchange closing prices	10%	16%	9%	17%
Recently observed transaction prices	7%	2%	5%	2%
Data providers/pricing services	67%	74%	65%	60%
Broker quotes	1%	1%	12%	19%
Valuation techniques	15%	7%	9%	2%
	100%	100%	100%	100%

Pricing information obtained from external data providers may incorporate a range of market quotes from dealers, recent market transactions and benchmarking model derived prices to quoted market prices and trade data for comparable securities. External pricing data is subject to evaluation for reasonableness using a variety of means including comparisons of prices to those of similar product types, quality and maturities, consideration of the narrowness or wideness of the range of prices obtained, knowledge of recent market transactions and an assessment of the similarity in prices to comparable dealer offerings in a recent time period.

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The following is a summary of changes in fair value of our financial assets and liabilities that have been classified as Level 3 for the three months ended August 31, 2011 (in thousands):

	Three Months Ended August 31, 2011						
	Balance, May 31, 2011	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances, net	Transfers into Level 3	Transfers out of Level 3	Balance, August 31, 2011	Change in unrealized gains/ (losses) relating to instruments still held at August 31, 2011 (1)
Assets:							
Financial instruments owned:							
Corporate equity securities	$ 18,230	$ 1,720	$ 2,631	$ 861	$ (12,030)	$ 11,412	$ (154)
Corporate debt securities	39,688	(4,069)	6,230	14,425	(1,044)	55,230	(7,349)
Collateralized debt obligations	84,046	(3,417)	9,325	19,029	(12,319)	96,664	(5,413)
Municipal securities	858	11	(183)			686	1
Sovereign obligations			128			128	
Residential mortgage-backed securities	206,721	(12,527)	15,276	41,510	(79,461)	171,519	(12,917)
Commercial mortgage-backed securities	33,516	(3,652)	(292)	17,364	(6,741)	40,195	(3,690)
Other asset-backed securities	9,352	(329)	2,773	99	(8,417)	3,478	(329)
Loans and other receivables	261,056	710	(92,362)	27,077	(32,318)	164,163	(116)
Investments at fair value	71,008	2,397	19,045	11	(33)	92,428	(938)
Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	$ 38	$ 21	$	$	$	$ 59	$ 20

Net derivatives (2)	2,739	696			11	3,446	687
Loans	6,398	(230)	5,290			11,458	(230)

(1) Realized and unrealized gains/ losses are reported in Principal transactions in the Consolidated Statements of Earnings.

(2) Net derivatives represent Financial instruments owned Derivatives and Financial instruments sold, not yet purchased Derivatives.

Analysis of Level 3 Assets and Liabilities for the Three Months Ended August 31, 2011

During the three months ended August 31, 2011, transfers of assets of $120.4 million from Level 2 to Level 3 are primarily attributed to:

Non-agency residential mortgage-backed securities, collateralized debt obligations, and commercial mortgage backed securities due to less observable trading activity and vendor quotes that were not corroborated to market transactions;

Loans and other receivables due to lower number of contributors comprising vendor quotes to support classification in Level 2; and

Corporate debt securities due to lack of observable market transactions.

During the three months ended August 31, 2011, transfers of assets of $152.4 million from Level 3 to Level 2 are primarily attributed to:

Non-agency residential mortgage-backed securities, collateralized debt obligations, other asset-backed securities, and commercial mortgage backed securities for which market trades were observed in the period for either identical or similar securities or for which vendor prices were corroborated to actual market transactions;

Loans and other receivables due to greater number of contributors comprising vendor quotes supporting classification into Level 2; and

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Corporate equity securities due to announced market transactions or more observable market data on comparable securities used as a benchmark.

During the three months ended August 31, 2011 there were no transfers of liabilities from Level 2 to Level 3 and $.01 million transfers of liabilities from Level 3 to Level 2.

Net losses on Level 3 assets were $19.2 million and net losses on Level 3 liabilities were $0.5 million for the three months ended August 31, 2011. Net losses on Level 3 assets were primarily due to decreased valuations of various residential mortgage-backed securities, corporate debt, collateralized debt obligations, and commercial mortgage-backed securities, offset by sales of certain investments at fair value, corporate debt, and collateralized debt obligations.

The following is a summary of changes in fair value of our financial assets and liabilities that have been classified as Level 3 for the three months ended August 31, 2010 (in thousands):

	Three Months Ended August 31, 2010						
	Balance, May 31, 2010	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances	Transfers into Level 3	Transfers out of Level 3	Balance, August 31, 2010	Change in unrealized gains/ (losses) relating to instruments still held at August 31, 2010 (1)
Assets:							
Financial instruments owned:							
Corporate equity securities	$ 21,918	$ 1,327	$ 2,751	$	$ (417)	$ 25,579	$ (789)
Corporate debt securities	100,275	(714)	3,149	54	(1,480)	101,284	(813)
Collateralized debt obligations	21,957	(495)	352	4,492		26,306	(615)
U.S. issued municipal securities	436	(7)				429	(7)
Residential mortgage-backed securities	148,833	5,914	(8,770)	23,143	(1,281)	167,839	404
Commercial mortgage-backed securities	1,000		50		(1,000)	50	
Other asset-backed securities	369		(369)				
Loans and other receivables	145,181	(4,735)	(55,105)			85,341	(4,139)
Investments at fair value	72,297	8,060	(3,724)	2,723		79,356	9,145

Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	$ 38	$	$	$ 58	$	$ 96	$
Corporate debt securities	14,365	(1,275)	(13,090)				
Net derivatives (2)	1,271	523			(500)	1,294	523
Loans	68,242		(42,130)			26,112	

(1) Realized and unrealized gains/ losses are reported in Principal transactions in the Consolidated Statements of Earnings.

(3) Net derivatives represent Financial instruments owned derivatives and Financial instruments sold, not yet purchased derivatives.

During the three months ended August 31, 2010, we had transfers of assets of $30.4 million from Level 2 to Level 3, which are primarily attributed to transfers of non-agency mortgage-backed securities for which no recent trade activity was observed for purposes of determining observable inputs. Transfers of assets from Level 3 to Level 2 during the three months ended August 31, 2010 were $4.2 million.

Net gains on Level 3 assets were $9.4 million and net gains on Level 3 liabilities were $0.8 million for the three months ended August 31, 2010. Net gains on Level 3 assets were attributed to sales of residential mortgage-backed securities and due to increased valuations of various alternative investments.

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The following is a summary of changes in fair value of our financial assets and liabilities that have been classified as Level 3 for the nine months ended August 31, 2011 (in thousands):

	Nine Months Ended August 31, 2011						
	Balance, November 30, 2010	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances, net	Transfers into Level 3	Transfers out of Level 3	Balance, August 31, 2011	Change in unrealized gains/ (losses) relating to instruments still held at August 31, 2011 (1)
Assets:							
Financial instruments owned:							
Corporate equity securities	$ 22,619	$ 2,905	$ (3,040)	$ 816	$ (11,888)	$ 11,412	$ (422)
Corporate debt securities	73,408	(487)	(22,533)	6,304	(1,462)	55,230	(5,906)
Collateralized debt obligations	31,121	10,423	54,351	779	(10)	96,664	9,632
Municipal securities	472	89	125			686	78
Sovereign obligations			128			128	
Residential mortgage-backed securities	132,359	(8,354)	64,906	29,901	(47,293)	171,519	(25,284)
Commercial mortgage-backed securities	6,004	1,625	25,574	6,992		40,195	112
Other asset-backed securities	567	(604)	3,156	926	(567)	3,478	(604)
Loans and other receivables	227,596	2,476	(57,473)	9,006	(17,442)	164,163	(1,452)
Investments at fair value	77,784	9,326	8,421		(3,103)	92,428	6,495
Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	$ 38	$ 21	$	$	$	$ 59	$ 20
Net derivatives (2)	2,346	1,100				3,446	1,200

Loans	47,228	(230)	(35,540)			11,458	(230)

(1) Realized and unrealized gains/ losses are reported in Principal transactions in the Consolidated Statements of Earnings.

(2) Net Derivatives represent Financial instruments owned derivatives and Financial instruments sold, not yet purchased Derivatives.

Analysis of Level 3 Assets and Liabilities for the Nine Months Ended August 31, 2011

During the nine months ended August 31, 2011, transfers of assets of $54.7 million from Level 2 to Level 3 are primarily attributed to:

- Non-agency residential mortgage-backed securities and commercial asset backed securities due to a tightening in the historical trading period used for corroborating market data and a greater scrutiny of vendor prices;

- Loans and other receivables due to lower number of contributors comprising vendor quotes to support classification in Level 2; and

- Corporate debt securities due to lack of observable market transactions.

During the nine months ended August 31, 2011, transfers of assets of $81.8 million from Level 3 to Level 2 are primarily attributed to:

- Non-agency residential mortgage-backed securities for which market trades were observed in the period for either identical or similar securities or for which vendor prices were corroborated to actual market transactions;

- Loans and other receivables due to greater number of contributors comprising vendor quotes supporting classification into Level 2; and

- Corporate equity securities due to announced market transactions or more observable market data on comparable securities used as a benchmark.

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During the nine months ended August 31, 2011 there were no transfers of liabilities from Level 2 to Level 3 or from Level 3 to Level 2.

Net gains on Level 3 assets were $17.4 million and net losses on Level 3 liabilities were $0.9 million for the nine months ended August 31, 2011. Net gains on Level 3 assets were primarily due to sales or settlements of various residential mortgage-backed securities, corporate debt securities, loans and other receivables, investments at fair value, and corporate equity securities, increased valuations of certain collateralized debt obligations and investments at fair value, offset by decreased valuations of certain residential mortgage-backed securities and corporate debt securities.

The following is a summary of changes in fair value of our financial assets and liabilities that have been classified as Level 3 for the eight months ended August 31, 2010 (in thousands):

	Eight Months Ended August 31, 2010						
	Balance, December 31, 2009	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances	Transfers into Level 3	Transfers out of Level 3	Balance, August 31, 2010	Change in unrealized gains/ (losses) relating to instruments still held at August 31, 2010 (1)
Assets:							
Financial instruments owned:							
Corporate equity securities	$ 43,042	$ (20,125)	$ 5,467	$ 143	$ (2,948)	$ 25,579	$ (22,524)
Corporate debt securities	116,648	(1,056)	(1,084)	75	(13,299)	101,284	1,060
Collateralized debt obligations	9,570	5,397	4,067	7,272		26,306	4,840
U.S. issued municipal securities	420	9				429	9
Sovereign obligations	196				(196)		
Residential mortgage-backed securities	136,496	21,857	(5,893)	23,435	(8,056)	167,839	6,888
Commercial mortgage-backed securities	3,215	11	(1,241)		(1,935)	50	
Other asset-backed securities	110		(110)				
Loans and other receivables	506,542	38,029	(302,151)		(157,079)	85,341	14,960
	65,564	13,744	(3,991)	4,039		79,356	11,029

Investments at fair value							
Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	$	$	$	$ 96	$	$ 96	$
Corporate debt securities		(2,210)	2,210				
Net derivatives (2)	6,835	(3,585)			(1,956)	1,294	(3,585)
Loans	352,420	(344)	(214,670)		(111,294)	26,112	

(1) Realized and unrealized gains/ losses are reported in Principal transactions in the Consolidated Statements of Earnings.

(2) Net derivatives represent Financial instruments owned derivatives and Financial instruments sold, not yet purchased derivatives.

During the eight months ended August 31, 2010, we had transfers of assets of $35.0 million from Level 2 to Level 3, which are primarily attributed to transfers of non-agency mortgage-backed securities for which no recent trade activity was observed for purposes of determining observable inputs. Additionally, transfers of assets from Level 2 to Level 3 are attributed to certain investments at fair value and investments in managed funds, which have little to no transparency as to trade activity. Transfers of assets from Level 3 to Level 2 during the eight months ended August 31, 2010 were $183.5 million primarily attributed to corporate loans, for which we obtained additional market pricing data from third party sources during the quarter that provided additional transparency into the valuation process for these assets; residential mortgage-backed securities, for which market trades were observed in the period for either identical or similar securities; and corporate debt securities, for which market transactions were announced or market data on comparable securities used as a benchmark became more observable.

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Transfers of liabilities from Level 2 to Level 3 were $0.1 million and transfers of liabilities from Level 3 to Level 2 were $113.3 million for the eight months ended August 31, 2010. Transfers of liabilities from Level 3 to Level 2 during the three and eight months ended August 31, 2010 are primarily due to transfers of corporate loans, for which we obtained additional market pricing data from third party sources during the quarter that provided additional transparency into the valuation process for these liabilities.

Net gains on Level 3 assets were $57.9 million and net gains on Level 3 liabilities were $6.1 million for the eight months ended August 31, 2010. Net gains on Level 3 assets were primarily due to increased valuations of various alternative investments, sales of certain corporate loans and improved credit conditions and enhanced recovery estimates for certain residential mortgage-backed securities.

Level 3 cash instruments are frequently hedged with instruments classified within Level 1 and Level 2, and accordingly, gains and losses that have been reported in Level 3 are frequently offset by gains or losses attributable to instruments classified within Level 1 or Level 2 or by gains or losses on derivative contracts classified in Level 3 of the fair value hierarchy.

Note 6. Derivative Financial Instruments

Off-Balance Sheet Risk

We have contractual commitments arising in the ordinary course of business for securities loaned or purchased under agreements to resell, repurchase agreements, future purchases and sales of foreign currencies, securities transactions on a when-issued basis and underwriting. Each of these financial instruments and activities contains varying degrees of off-balance sheet risk whereby the fair values of the securities underlying the financial instruments may be in excess of, or less than, the contract amount. The settlement of these transactions is not expected to have a material effect upon our consolidated financial statements.

Derivative Financial Instruments

Our derivative activities are recorded at fair value in the Consolidated Statements of Financial Condition in Financial Instruments Owned Derivatives and Financial Instruments Sold, Not Yet Purchased Derivatives net of cash paid or received under credit support agreements and on a net counterparty basis when a legal right to offset exists under a master netting agreement. Net realized and unrealized gains and losses are recognized in Principal transactions in the Consolidated Statements of Earnings on a trade date basis and as a component of cash flows from operating activities in the Consolidated Statements of Cash Flows. Acting in a trading capacity, we may enter into derivative transactions to satisfy the needs of our clients and to manage our own exposure to market and credit risks resulting from our trading activities. (See Notes 5 and 19 for additional disclosures about derivative instruments.)

Derivatives are subject to various risks similar to other financial instruments, including market, credit and operational risk. In addition, we may be exposed to legal risks related to derivative activities. The risks of derivatives should not be viewed in isolation, but rather should be considered on an aggregate basis along with our other trading-related activities. We manage the risks associated with derivatives on an aggregate basis along with the risks associated with proprietary trading as part of our firmwide risk management policies. In connection with our derivative activities, we may enter into master netting agreements and collateral arrangements with counterparties. These agreements provide us with the ability to offset a counterparty s rights and obligations, request additional collateral when necessary or liquidate the collateral in the event of counterparty default.

A portion of our derivative activities is performed by Jefferies Financial Products, LLC (JFP), a market maker in commodity index products and a trader in commodity futures and options. JFP maintains credit intermediation facilities with a highly rated European bank (the Bank), which allow JFP customers that require a counterparty with

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a high credit rating for commodity index transactions to transact with the Bank. The Bank simultaneously enters into offsetting transactions with JFP and receives a fee from JFP for providing credit support.

The following table presents the fair value and related number of derivative contracts at August 31, 2011 and November 30, 2010 categorized by predominant risk exposure. The fair value of assets/liabilities related to derivative contracts represents our receivable/payable for derivative financial instruments, gross of counterparty netting and cash collateral received and pledged (dollars in thousands):

	August 31, 2011			
	Assets		Liabilities	
	Fair Value	Number of Contracts	Fair Value	Number of Contracts
Interest rate contracts	$ 417,666	93,251	$ 512,254	134,486
Foreign exchange contracts	501,063	105,139	546,885	109,033
Equity contracts	951,232	2,329,567	665,190	2,090,700
Commodity contracts	595,268	172,621	749,278	181,285
Credit contracts	60,331	85	41,834	58
Total	2,525,560	2,700,663	2,515,441	2,515,562
Counterparty/cash-collateral netting	(1,609,418)		(1,919,499)	
Total per Consolidated Statement of Financial Condition	$ 916,142		$ 595,942	

	November 30, 2010			
	Assets		Liabilities	
	Fair Value	Number of Contracts	Fair Value	Number of Contracts
Interest rate contracts	$ 77,295	41,166	$ 126,281	43,243
Foreign exchange contracts	20,263	1,165	17,004	290
Equity contracts	275,760	1,166,365	249,229	1,133,464
Commodity contracts	62,727	103,562	76,911	35,071
Credit contracts	19,835	18	15,647	15
Total	455,880	1,312,276	485,072	1,212,083
Counterparty/cash-collateral netting	(336,612)		(425,520)	
Total per Consolidated Statement of Financial Condition	$ 119,268		$ 59,552	

The following table presents unrealized and realized gains and losses on derivative contracts for the three months ended August 31, 2011 and 2010, respectively, and the nine and eight months ended August 31, 2011 and 2010, respectively (in thousands):

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	Three Months Ended		Nine Months Ended	Eight Months Ended
	August 31, 2011	August 31, 2010	August 31, 2011	August 31, 2010
	Gain (Loss)	Gain (Loss)	Gain (Loss)	Gain (Loss)
Interest rate contracts	$ (103,572)	$ (90,599)	$ (190,800)	$ (127,358)
Foreign exchange contracts	2,200	(1,185)	(5,981)	(369)
Equity contracts	(74,564)	(14,345)	(178,433)	(61,613)
Commodity contracts	8,512	2,231	41,102	5,963
Credit contracts	11,383	449	17,123	(50,313)
Total	$ (156,041)	$ (103,449)	$ (316,989)	$ (233,690)

The following tables set forth the remaining contract maturity of the fair value of OTC derivative assets and liabilities as of August 31, 2011 (in thousands):

	OTC derivative assets (1) (2) (4)				
	0 - 12 Months	1 - 5 Years	Greater Than 5 Years	Cross-Maturity Netting (3)	Total
Commodity swaps, options and forwards	$ 102,889	$ 11,396	$	$ (782)	$ 113,503
Equity options	17,992				17,992
Credit default swaps	468	33,476	11,381	(263)	45,062
Total return swaps	518	17			535
Foreign currency forwards, swaps and options	191,540	36,420	3	(9,973)	217,990
Fixed income forwards	92				92
Interest rate swaps and caps	46,301	88,646	142,426	(14,560)	262,813
Total	$ 359,800	$ 169,955	$ 153,810	$ (25,578)	657,987
Cross product counterparty netting					(17,588)
Total OTC derivative assets included in Financial instruments owned					$ 640,399

(1) At August 31, 2011, we held exchange traded derivative assets and other credit enhancements of $308.0 million.

(2) OTC derivative assets in the table above are gross of collateral received. OTC derivative assets are recorded net of collateral received on the Consolidated Statements of Financial Condition. At August 31, 2011, cash collateral

received was $32.2 million.

(3) Amounts represent the netting of receivable balances with payable balances within product category for the same counterparty across maturity categories.

(4) Derivative fair values include counterparty netting within product category.

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	OTC derivative liabilities (1)(2)(4)				
	0 - 12 Months	1 - 5 Years	Greater Than 5 Years	Cross-Maturity Netting (3)	Total
Commodity swaps, options and forwards	$ 258,951	$ 15,251	$	$ (782)	$ 273,420
Equity options	11,079	1,895			12,974
Credit default swaps	1,001	23,309		(263)	24,047
Total return swaps		1,443			1,443
Foreign currency forwards, swaps and options	238,109	37,407		(9,973)	265,543
Interest rate swaps and caps	47,157	164,399	167,734	(14,560)	364,730
Total	$ 556,297	$ 243,704	$ 167,734	$ (25,578)	942,157
Cross product counterparty netting					(17,588)
Total OTC derivative liabilities included in Financial instruments sold, not yet purchased					$ 924,569

(1) At August 31, 2011, we held exchange traded derivative liabilities and other credit enhancements of $13.7 million.

(2) OTC derivative liabilities in the table above are gross of collateral pledged. OTC derivative liabilities are recorded net of collateral pledged on the Consolidated Statements of Financial Condition. At August 31, 2011, cash collateral pledged was $342.3 million.

(3) Amounts represent the netting of receivable balances with payable balances within product category for the same counterparty across maturity categories.

(4) Derivative fair values include counterparty netting within product category.

At August 31, 2011, the counterparty credit quality with respect to the fair value of our OTC derivatives assets was as follows (in thousands):

Counterparty credit quality (1):	
A or higher	$ 439,724
B to BBB	185,906
Lower than B	6,982
Unrated	7,787
Total	$ 640,399

(1) We utilize the credit ratings of external rating agencies when available. When external credit ratings are not available, we may utilize internal credit ratings determined by our credit risk management. Credit ratings determined by credit risk management use methodologies that produce ratings generally consistent with those produced by external rating agencies.

Contingent Features

Certain of our derivative instruments contain provisions that require our debt to maintain an investment grade credit rating from each of the major credit rating agencies. If our debt were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on our derivative instruments in liability positions. The aggregate fair value of all derivative instruments with such credit-risk-related contingent features that are in a liability position at August 31, 2011 and November 30, 2010, is $239.0 million and $51.8 million, respectively, for which we have posted collateral of $221.5 million and $44.9 million, respectively, in the normal course of business. If the credit-risk-related contingent features underlying these agreements were triggered on August 31, 2011 and November

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