EL PASO ELECTRIC CO /TX/
Form 10-Q
November 07, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2013

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 001-14206
El Paso Electric Company
(Exact name of registrant as specified in its charter)

Texas	74-0607870
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Stanton Tower, 100 North Stanton, El Paso, Texas	79901
(Address of principal executive offices)	(Zip Code)

(915) 543-5711
(Registrant's telephone number, including area code)

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 x NO o

Indicate by check mark whether the registrant 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 x 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	x	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 x

As of October 31, 2013, there were 40,257,265 shares of the Company's no par value common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EL PASO ELECTRIC COMPANY AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
(In thousands)		
Utility plant:		
Electric plant in service	$3,044,963	$2,857,913
Less accumulated depreciation and amortization	(1,204,872)	(1,162,483)
Net plant in service	1,840,091	1,695,430
Construction work in progress	251,125	287,358
Nuclear fuel; includes fuel in process of $37,294 and $56,129, respectively	195,317	189,921
Less accumulated amortization	(85,992)	(70,366)
Net nuclear fuel	109,325	119,555
Net utility plant	2,200,541	2,102,343
Current assets:		
Cash and cash equivalents	61,948	111,057
Accounts receivable, principally trade, net of allowance for doubtful accounts of $2,799 and $2,906, respectively	97,997	62,900
Accumulated deferred income taxes	14,149	20,292
Inventories, at cost	47,091	42,358
Undercollection of fuel revenues	6,605	—
Prepayments and other	8,990	9,627
Total current assets	236,780	246,234
Deferred charges and other assets:		
Decommissioning trust funds	202,907	187,053
Regulatory assets	103,503	101,590
Other	33,661	31,830
Total deferred charges and other assets	340,071	320,473
Total assets	$2,777,392	$2,669,050

See accompanying notes to consolidated financial statements.

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EL PASO ELECTRIC COMPANY AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS (Continued)

	September 30, 2013 (Unaudited)	December 31, 2012
CAPITALIZATION AND LIABILITIES		
(In thousands except for share data)		
Capitalization:		
Common stock, stated value $1 per share, 100,000,000 shares authorized, 65,625,339 and 65,520,551 shares issued, and 121,363 and 84,446 restricted shares, respectively	$65,747	$65,605
Capital in excess of stated value	313,616	310,994
Retained earnings	995,144	939,131
Accumulated other comprehensive loss, net of tax	(56,162)	(66,084)
	1,318,345	1,249,646
Treasury stock, 25,492,919 shares at cost	(424,647)	(424,647)
Common stock equity	893,698	824,999
Long-term debt	999,598	999,535
Total capitalization	1,893,296	1,824,534
Current liabilities:		
Short-term borrowings under the revolving credit facility	15,491	22,155
Accounts payable, principally trade	47,103	61,581
Taxes accrued	31,849	29,248
Interest accrued	14,370	12,127
Overcollection of fuel revenues	2,886	4,643
Other	29,405	21,995
Total current liabilities	141,104	151,749
Deferred credits and other liabilities:		
Accumulated deferred income taxes	405,331	358,674
Accrued pension liability	113,842	125,690
Accrued postretirement benefit liability	101,864	99,170
Asset retirement obligation	67,169	62,784
Regulatory liabilities	26,495	22,179
Other	28,291	24,270
Total deferred credits and other liabilities	742,992	692,767
Commitments and contingencies		
Total capitalization and liabilities	$2,777,392	$2,669,050

See accompanying notes to consolidated financial statements.

EL PASO ELECTRIC COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands except for share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Operating revenues	$282,661	$267,249	$700,065	$664,079
Energy expenses:				
Fuel	69,268	56,332	175,097	145,132
Purchased and interchanged power	17,395	16,223	46,185	43,304
	86,663	72,555	221,282	188,436
Operating revenues net of energy expenses	195,998	194,694	478,783	475,643
Other operating expenses:				
Other operations	58,810	60,906	173,810	174,128
Maintenance	12,723	12,831	41,260	43,605
Depreciation and amortization	20,416	19,208	59,346	59,329
Taxes other than income taxes	18,153	15,353	44,782	43,631
	110,102	108,298	319,198	320,693
Operating income	85,896	86,396	159,585	154,950
Other income (deductions):				
Allowance for equity funds used during construction	2,287	2,419	7,465	6,589
Investment and interest income, net	2,086	1,833	5,151	3,711
Miscellaneous non-operating income	12	1,182	14	1,383
Miscellaneous non-operating deductions	(537)	(591)	(2,641)	(1,494)
	3,848	4,843	9,989	10,189
Interest charges (credits):				
Interest on long-term debt and revolving credit facility	14,623	13,659	43,829	40,827
Other interest	153	387	456	865
Capitalized interest	(1,302)	(1,324)	(3,911)	(3,992)
Allowance for borrowed funds used during construction	(1,379)	(1,431)	(4,520)	(3,894)
	12,095	11,291	35,854	33,806
Income before income taxes	77,649	79,948	133,720	131,333
Income tax expense	27,084	28,159	46,328	45,306
Net income	$50,565	$51,789	$87,392	$86,027
Basic earnings per share	$1.26	$1.29	$2.17	$2.15
Diluted earnings per share	$1.26	$1.29	$2.17	$2.14
Dividends declared per share of common stock	$0.265	$0.25	$0.78	$0.72
Weighted average number of shares outstanding	40,132,250	40,009,866	40,107,555	39,959,866
Weighted average number of shares and dilutive potential shares outstanding	40,132,250	40,091,625	40,123,626	40,044,154

See accompanying notes to consolidated financial statements.

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EL PASO ELECTRIC COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands except for share data)

	Twelve Months Ended September 30,	
	2013	2012
Operating revenues	$888,867	$855,742
Energy expenses:		
Fuel	221,041	191,528
Purchased and interchanged power	63,132	57,837
	284,173	249,365
Operating revenues net of energy expenses	604,694	606,377
Other operating expenses:		
Other operations	236,240	235,550
Maintenance	57,994	63,937
Depreciation and amortization	78,573	79,885
Taxes other than income taxes	58,594	56,061
	431,401	435,433
Operating income	173,293	170,944
Other income (deductions):		
Allowance for equity funds used during construction	10,303	8,309
Investment and interest income, net	6,715	4,782
Miscellaneous non-operating income	46	1,884
Miscellaneous non-operating deductions	(3,160)	(2,620)
	13,904	12,355
Interest charges (credits):		
Interest on long-term debt and revolving credit facility	57,634	54,347
Other interest	781	1,077
Capitalized interest	(5,231)	(5,305)
Allowance for borrowed funds used during construction	(6,199)	(4,905)
	46,985	45,214
Income before income taxes	140,212	138,085
Income tax expense	48,001	46,605
Net income	$92,211	$91,480
Basic earnings per share	$2.29	$2.28
Diluted earnings per share	$2.29	$2.27
Dividends declared per share of common stock	$1.03	$0.94
Weighted average number of shares outstanding	40,084,525	39,959,034
Weighted average number of shares and dilutive potential shares outstanding	40,114,921	40,085,516

See accompanying notes to consolidated financial statements.

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EL PASO ELECTRIC COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE OPERATIONS
(Unaudited)
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,		Twelve Months Ended September 30,	
	2013	2012	2013	2012	2013	2012
Net income	$50,565	$51,789	$87,392	$86,027	$92,211	$91,480
Other comprehensive income (loss):						
Unrecognized pension and postretirement benefit costs:						
Net loss arising during period	—	—	—	—	(2,109)	(77,678)
Reclassification adjustments included in net income for amortization of:						
Prior service benefit	(1,369)	(1,441)	(4,169)	(4,321)	(5,610)	(5,775)
Net loss	2,903	2,993	8,323	8,978	11,316	10,605
Net unrealized gains/losses on marketable securities:						
Net holding gains arising during period	4,300	6,169	8,861	11,986	6,802	18,470
Reclassification adjustments for net losses (gains) included in net income	(199)	(318)	(287)	916	(161)	1,193
Net losses on cash flow hedges:						
Reclassification adjustment for interest expense included in net income	104	97	306	286	405	378
Total other comprehensive income (loss) before income taxes	5,739	7,500	13,034	17,845	10,643	(52,807)
Income tax benefit (expense) related to items of other comprehensive income (loss):						
Unrecognized pension and postretirement benefit costs	(469)	(591)	(1,550)	(1,687)	(1,327)	28,643
Net unrealized gains on marketable securities	(796)	(1,201)	(1,433)	(2,571)	(1,300)	(3,788)
Losses on cash flow hedges	(39)	(36)	(129)	(117)	(143)	(219)
Total income tax benefit (expense)	(1,304)	(1,828)	(3,112)	(4,375)	(2,770)	24,636
Other comprehensive income (loss), net of tax	4,435	5,672	9,922	13,470	7,873	(28,171)
Comprehensive income	$55,000	$57,461	$97,314	$99,497	$100,084	$63,309

See accompanying notes to consolidated financial statements.

EL PASO ELECTRIC COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended September 30, 2013		2012	
Cash flows from operating activities:				
Net income	$87,392		$86,027	
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of electric plant in service	59,346		59,329	
Amortization of nuclear fuel	33,621		33,278	
Deferred income taxes, net	45,479		43,818	
Allowance for equity funds used during construction	(7,465	)	(6,589	)
Other amortization and accretion	12,345		10,904	
Gain on sale of assets	—		(1,346	)
Other operating activities	(484	)	782	
Change in:				
Accounts receivable	(35,097	)		

Bank Credit. As of September 30, 2007, we had outstanding guarantees of $56.0 million relating to bank credit obligations ($38.4 million of which is undrawn) of associated investment vehicles in which we have an interest. Also, we have provided a guarantee to a third-party bank in connection with the bank s extension of 500 million Japanese yen (approximately $4.4 million) to

Jefferies (Japan) Limited.

Equity Commitments. On October 7, 2004, we entered into an agreement with Babson Capital and MassMutual to form Jefferies Finance LLC, a joint venture entity created for the purpose of offering senior loans to middle market and growth companies. In February 2006, we and MassMutual reached an agreement to double our equity commitments to Jefferies Finance LLC. With an incremental $125 million from each partner, the new total committed equity capitalization of Jefferies Finance LLC is $500 million. Loans are originated primarily through the investment banking efforts of Jefferies & Company, Inc. with Babson Capital providing primary credit analytics and portfolio management services. As of September 30, 2007, we have funded $55.0 million of our aggregate $250.0 million commitment leaving $195.0 million unfunded.

As of September 30, 2007, we have an aggregate commitment to invest in Babson-Jefferies Loan Opportunity CLO, Ltd. of approximately $25.0 million.

As of September 30, 2007, we have an aggregate commitment to invest in Jefferies Capital Partners IV L.P. and its related parallel fund of approximately $30.0 million.

As of September 30, 2007, we have funded approximately $350.0 million of our aggregate commitment in JHYH leaving approximately $250.0 million unfunded (see note 20 of the Notes to Consolidated Financial Statements for more information related to our commitment to invest in JHYH).

As of September 30, 2007, we had other equity commitments to invest up to $11.5 million in various other investments.

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

Derivative Contracts. In accordance with FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45), we disclose certain derivative contracts meeting the FIN 45 definition of a guarantee. Such derivative contracts include credit default swaps (whereby a default or significant change in the credit quality of the underlying financial instrument may obligate us to make a payment) and written equity put options. At September 30, 2007, the maximum payout value of derivative contracts deemed to meet the FIN 45 definition of a guarantee was approximately $609.5 million. For purposes of determining maximum payout, notional values are used; however, we believe the fair value of these contracts is a more relevant measure of these obligations because we believe the notional amounts greatly overstate our expected payout. At September 30, 2007, the fair value of such derivative contracts approximated $9.7 million. In addition, the derivative contracts deemed to meet the FIN 45 definition of a guarantee are before consideration of hedging transactions. We substantially mitigate our risk on these contracts through hedges, such as other derivative contracts and/or cash instruments. We manage risk associated with derivative guarantees consistent with our risk management policies.

High Yield Loan Commitments. From time to time we make commitments to extend credit to investment-banking clients in loan syndication and acquisition-finance transactions. These commitments and any related drawdowns of these facilities typically have fixed maturity dates and are contingent on certain representations, warranties and contractual conditions applicable to the borrower. We define high yield (non-investment grade) as debt securities or loan commitments to companies rated BB+ or lower or equivalent ratings by recognized credit rating agencies, as well as non-rated securities or loans that, in management s opinion, are non-investment grade. We did not have any commitments outstanding to non-investment grade borrowers as of September 30, 2007.

Jefferies Financial Products, LLC. In July 2004, JFP entered into a credit intermediation facility with an AA -rated European bank (the Bank). This facility allows JFP customers that require a counterparty with a high credit rating for commodity index transactions to transact with the Bank. The Bank simultaneously enters into a back-to-back transaction with JFP and receives a fee from JFP for providing credit support. Subject to the terms of the agreement between JFP and the Bank, JFP is responsible to the Bank for the performance of JFP s customers. We guarantee the performance of JFP to the Bank under the credit intermediation facility. JFP will also provide commodity index pricing to the Bank s customers and JFP will earn revenue from the Bank s hedging of its customer transactions with JFP. Also, we guarantee the performance of JFP to its trading counterparties and various banks and other entities, which provide clearing and credit services to JFP.

Other Guarantees. In the normal course of business we provide guarantees to securities clearinghouses and exchanges. These guarantees generally are required under the standard membership agreements, such that members are required to guarantee the performance of other members. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. Our obligations under such guarantees could exceed the collateral amounts posted; however, the potential for us to be required to make payments under such guarantees is deemed remote. Also, we have guaranteed obligations of Jefferies International Limited (JIL) to various banks which provide clearing and credit services to JIL and to counterparties of JIL.

Note 16. Segment Reporting

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

Beginning in the second quarter of 2007, our international convertible bond funds are included within the results of the Asset Management segment. Previously, operations from our international convertible bond funds were included in the Capital Markets segment. Prior period disclosures have been adjusted to conform to the current quarter s presentation. The above change was made in order to reflect the manner in which these segments are currently managed.

The Capital Markets reportable segment includes our traditional securities brokerage, including the results of our recently reorganized high yield secondary market trading activities and investment banking activities. The Capital Markets reportable segment is managed as a single operating segment that provides the sales, trading and origination effort for various fixed income, equity and advisory products and services. The Capital Markets segment comprises many divisions, with interactions among each. In addition, we choose to voluntarily disclose the Asset Management segment even though it is currently an immaterial non-reportable segment as defined by FASB 131, *Disclosures about Segments of an Enterprise and Related Information*.

Our reportable business segment information is prepared using the following methodologies:

- Net revenues and expenses directly associated with each reportable business segment are included in determining earnings before taxes.

- Net revenues and expenses not directly associated with specific reportable business segments are allocated based on the most relevant measures applicable, including each reportable business segment s net revenues, headcount and other factors.

- Reportable business segment assets include an allocation of indirect corporate assets that have been fully allocated to our reportable business segments, generally based on each reportable business segment s capital utilization.

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

Our net revenues, expenses, income before income taxes and total assets by segment are summarized below (amounts in millions):

	Capital Markets	Asset Management	Total
Three months ended September 30, 2007			
Net revenues	$ 342.0	$ (7.6)	$ 334.4
Expenses	274.5	4.6	279.1
Earnings before income taxes, minority interest and cumulative effect of change in accounting principle	$ 67.5	$ (12.2)	$ 55.3
Nine months ended September 30, 2007			
Net revenues	$ 1,193.0	$ 25.7	$ 1,218.7
Expenses	905.2	26.3	931.5
Earnings before income taxes, minority interest and cumulative effect of change in accounting principle	$ 287.8	$ (0.6)	$ 287.2
Segment assets	$31,306.3	$ 296.1	$31,602.4
Three months ended September 30, 2006			
Net revenues	$ 330.4	$ 10.2	$ 340.6
Expenses	249.9	14.4	264.3
Earnings before income taxes, minority interest and cumulative effect of change in accounting principle	$ 80.5	$ (4.2)	$ 76.3
Nine months ended September 30, 2006			
Net revenues	$ 1,041.9	$ 41.5	$ 1,083.4
Expenses	785.4	43.5	828.9
Earnings before income taxes, minority interest and cumulative effect of change in accounting principle	$ 256.5	$ (2.0)	$ 254.5
Segment assets	$15,270.7	$ 214.0	$15,484.7

Note 17. Goodwill

We acquired LongAcre Partners Limited in May 2007. The LongAcre Partners Limited acquisition contained a five-year contingency for additional consideration to the selling owners, based on future revenues.

We acquired Putnam Lovell Investment banking business (Putnam) in July 2007. The purchase price of the Putnam acquisition was $14.7 million in cash and the acquisition did not contain any contingencies related to additional consideration.

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

The following is a summary of goodwill activity for the period ended September 30, 2007 (in thousands of dollars):

	Nine Months Ended Sept. 30, 2007
Balance, at December 31, 2006	$ 257,321
Add: Acquisition(s)	44,244
Add: Accrued contingent consideration	29,129
Balance, at September 30, 2007	$ 330,694

The acquisitions of LongAcre Partners Limited, Helix Associates, Randall & Dewey, and Quarterdeck Investment Partners, LLC all contained a five-year contingency for additional consideration to the selling owners, based on future revenues. This additional consideration is paid in cash annually. There is no contractual dollar limit to the potential of additional consideration. During the quarter ended June 30, 2007, the Broadview International LLC contingency for additional consideration was modified and all remaining contingencies have been accrued for as of June 30, 2007. During the nine month period ended September 30, 2007, we paid approximately $25.7 million in cash related to contingent consideration that had been earned during the current nine month period or prior periods.

None of the acquisitions listed above were considered material based on the small percentage each represents of our total assets, equity, revenues and net earnings.

Note 18. Quarterly Dividends

The only restrictions on our present ability to pay dividends on our common stock are the dividend preference terms of our Series A convertible preferred stock and the governing provisions of the Delaware General Corporation Law.

Dividends per Common Share (declared and paid):

	1st Quarter	2nd Quarter	3rd Quarter
2007	$ 0.125	$ 0.125	$ 0.125
2006	$ 0.075	$ 0.125	$ 0.125

On April 18, 2006, we declared a 2-for-1 stock split of all outstanding shares of common stock. The stock split was paid May 15, 2006 to stockholders of record as of April 28, 2006 and was effected as a stock dividend of one share of common stock for each one share outstanding on the record date. We also announced an increase to our quarterly dividend to $0.125 per post-split share, which at the time represented a 67% increase from the previous dividend of $0.075 per post split share.

Note 19. Variable Interest Entities (VIEs)

Jefferies High Yield Holdings

Under the provisions of FIN 46(R) we determined that Jefferies High Yield Holdings (JHYH) and Jefferies Employees Special Opportunities Partners (JESOP) meet the definition of a VIE. We are the primary beneficiary of JHYH, and we and our employees (related parties) are the primary beneficiaries of JESOP. Therefore, we consolidate both JHYH and JESOP.

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

Managed CLO s

We also own significant variable interests in various managed CLO s and for which are we are not the primary beneficiary and therefore do not consolidate these entities. In aggregate, these variable interest entities have assets approximating $1.4 billion as of September 30, 2007. Our exposure to loss is limited to our capital contributions. The carrying value of our aggregate investment in these variable interest entities is $18.7 million at September 30, 2007 and is included in Investments in Managed Funds on our Consolidated Statements of Financial Condition.

Third Party Managed Warehouse/Special Purpose Entity

We own a significant variable interest in Babson-Jefferies Loan Opportunity CLO, Ltd., a third party managed warehouse/special purpose entity, in which we have a 33% direct economic interest for which we are not the primary beneficiary and therefore do not consolidate this entity. This variable interest entity has assets of approximately $357.8 million as of September 30, 2007. Our exposure to loss is limited to our capital contributions. The carrying value of our investment in this variable interest entity is $27.5 million at September 30, 2007 and is included in Financial Instruments Owned on our Consolidated Statements of Financial Condition.

Note 20. High Yield Secondary Market Trading

In January 2000, we created three broker-dealer entities that employed a trading and investment strategy substantially similar to that historically employed by our High Yield division. Two of these entities, the Jefferies Partners Opportunity Fund and the Jefferies Partners Opportunity Fund II, were principally capitalized with equity contributions from institutional and high net worth investors. The third fund, Jefferies Employees Opportunity Fund (and collectively with the two Jefferies Partners Opportunity Funds, referred to as the High Yield Funds), was principally capitalized with equity investments from our employees and was therefore consolidated into our consolidated financial statements. The High Yield division and each of the funds shared gains or losses on trading and investment activities of the High Yield division on the basis of a pre-established sharing arrangement related to the amount of capital each had committed.

On April 2, 2007 we reorganized Jefferies High Yield Trading, LLC (JHYT) to conduct the secondary market trading activities previously performed by the High Yield division of Jefferies and the High Yield Funds. The activities of JHYT are overseen by Richard Handler, our Chief Executive Officer, and the same long-standing team previously responsible for these trading activities. JHYT is a registered broker-dealer engaged in the secondary sales and trading of high yield securities and special situation securities, including bank debt, post-reorganization equity, public and private equity, equity derivatives, credit default swaps and other financial instruments. JHYT makes markets in high yield and distressed securities and provides research coverage on these types of securities. JHYT is a wholly-owned subsidiary of Jefferies High Yield Holdings, LLC (JHYH).

We and Leucadia National Corporation (Leucadia) expect to increase our respective investments in JHYH to $600 million each over time. We and Leucadia each have the right to nominate two of a total of four directors to JHYH s board of directors, and each respectively own 50% of the voting securities of JHYH. JHYH provides the opportunity for additional capital investments over time from third party investors through two funds managed by us, Jefferies Special Opportunities Fund (JSOP) and Jefferies Employees Special Opportunities Fund (JESOP). The term of the arrangement is for six years, with an option to extend.

Under the provisions of FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, we determined that JHYH meets the definition of a variable interest entity. We are the primary beneficiary and consolidate JHYH. Assets of JHYH were $1.3 billion as of September 30, 2007. JHYH s net revenue and formula-determined non-interest expenses for the three month period ended September 30, 2007 amounted to $0.0 million and $8.8 million, respectively. JHYH s net revenue and formula-determined non-interest expenses for the six month period ended September 30, 2007 (April 2, 2007 to September 30, 2007) amounted to $41.0 million and $19.7 million, respectively. These formula-determined non-interest expenses do not necessarily reflect the actual expenses of operating JHYH.

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

Note 21. Stock Based Compensation

Incentive Plans

We sponsor the following share based employee incentive plans:

We have an Incentive Compensation Plan (Incentive Plan) which allows awards in the form of incentive stock options (within the meaning of Section 422 of the Internal Revenue Code), nonqualified stock options, stock appreciation rights, restricted stock, unrestricted stock, performance awards, dividend equivalents or other stock based awards. The plan imposes a limit on the number of shares of our common stock that may be subject to awards. An award relating to shares may be granted if the aggregate number of shares subject to then-outstanding awards plus the number of shares subject to the award being granted do not exceed 30% of the number of shares issued and outstanding immediately prior to the grant.

Restricted Stock/Restricted Stock Units. The Incentive Plan allows for grants of restricted stock awards, whereby employees are granted restricted shares of common stock subject to forfeiture until the requisite service has been provided. Grants of restricted stock are generally subject to annual ratable vesting over a five year period (i.e., 20% of the number of shares granted vests each year for a five year award) with provisions related to retirement eligibility. In addition, vested shares are subject to transferability restrictions that lapse at the end of the award term. With certain exceptions, the employee must remain with us for a period of years after the date of grant to receive the full number of shares granted. The Incentive Plan also allows for grants of restricted stock units. Restricted stock units give a participant the right to receive fully vested shares at the end of a specified deferral period. Restricted stock units are generally subject to forfeiture conditions similar to those of our restricted stock awards. One advantage of restricted stock units, as compared to restricted stock, is that the period during which the award is deferred as to settlement can be extended past the date the award becomes non-forfeitable, allowing a participant to hold an interest tied to common stock on a tax deferred basis. Prior to settlement, restricted stock units carry no voting or dividend rights associated with the stock ownership, but dividend equivalents are paid or accrued.

Director Plan. We also have a Directors Stock Compensation Plan (Directors Plan) which provides for an annual grant to each non-employee director of $100,000 of restricted stock or deferred shares. These grants are made automatically on the date directors are elected or reelected at our annual shareholders meeting. These grants vest three years after the date of grant and are expensed over the vesting period.

Additionally, the Directors Plan permits each non-employee director to elect to be paid annual retainer fees, meeting fees and fees for service as chairman of a Board committee in the form of cash, deferred cash or deferred shares. If deferred cash is elected, interest is credited to such deferred cash at the prime interest rate in effect at the date of each annual meeting of stockholders. If deferred shares are elected, dividend equivalents equal to dividends declared and paid on our common stock are credited to a Director s account and reinvested as additional deferred shares.

Employee Stock Purchase Plan. We also have an Employee Stock Purchase Plan (ESPP). All regular full-time employees and employees who work part-time over 20 hours per week are eligible for the ESPP. Annual employee contributions are limited to $21,250, are voluntary and are made via payroll deduction. The employee contributions are used to purchase our common stock. The stock price used is 95% of the closing price of our common stock on the last day of the applicable session (monthly).

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

Deferred Compensation Plan. We also have a Deferred Compensation Plan which was established in 2001. In 2006, 2005, and 2004, employees with annual compensation of $200,000 or more were eligible to defer compensation and to invest at a 10% discount in deferred shares of our stock (DCP deferred shares), stock options (prior to 2004) and other alternatives on a pre-tax basis through the plan. The compensation deferred by our employees is expensed in the period earned. In addition, the compensation cost related to the discount on the DCP deferred shares provided by the plan was $157,000 and $327,000, for the three-month period ended September 30, 2007 and 2006, respectively, and $1,372,000 and $1,261,000, for the nine-month period ended September 30, 2007 and 2006, respectively.

Profit Sharing Plan. We have a profit sharing plan, covering substantially all employees, which includes a salary reduction feature designed to qualify under Section 401(k) of the Internal Revenue Code. The compensation cost related to this plan was $1,760,000 and $741,000, for the three-month period ended September 30, 2007 and 2006, respectively, and $7,658,000 and $3,189,000, for the nine-month period ended September 30, 2007 and 2006, respectively.

Adoption of FASB 123R

We adopted the fair value recognition provisions for share based awards pursuant to FASB 123R effective January 1, 2006. See Note 1 Summary of Significant Accounting Policies for a further discussion. The following disclosures are also being provided pursuant to the requirements of FASB 123R.

Prior to the adoption of FASB 123R, we presented all tax benefits resulting from share based compensation as cash flows from operating activities in the consolidated statements of cash flows. FASB 123R requires cash flows resulting from tax deductions in excess of the grant-date fair value of share based awards to be included in cash flows from financing activities. Accordingly, we reflected the excess tax benefit of $38.3 million and $17.7 million related to share based compensation in cash flows from financing activities in the first nine months of 2007 and 2006, respectively.

In accordance with FASB 123R, the fair value of share based awards is estimated on the date of grant based on the market price of our stock less the impact of selling restrictions subsequent to vesting, if any, and is amortized as additional compensation expense on a straight-line basis over the related requisite service periods, which are generally five years. As of September 30, 2007, there was $312.2 million of total unrecognized compensation cost related to nonvested share based awards, which is expected to be recognized over a remaining weighted-average vesting period of approximately 3.5 years. The unrecognized compensation cost related to nonvested share based awards was recorded as unearned compensation in stockholders equity at December 31, 2005 and was a reduction to stockholders equity. As part of the adoption of FASB 123R, the unrecognized compensation cost related to nonvested share based awards granted prior to January 1, 2006 is included as a component of additional paid-in capital.

The total compensation cost of share based awards was $34.7 million and $21.8 million for the three month periods ended September 30, 2007 and 2006, respectively, and $109.0 million and $65.0 million for the nine month periods ended September 30, 2007 and 2006, respectively.

We have historically and generally expect to issue new shares of common stock when satisfying our issuance obligations pursuant to share based awards, as opposed to reissuing common stock from treasury.

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

Restricted Stock and Restricted Stock Units (Share Based Awards   )

The following tables detail the activity of restricted stock and restricted stock units:

	Nine Months Ended September 30, 2007 (Shares in 000s)	Weighted Average Grant Date Fair Value
Restricted stock		
Balance, beginning of year	4,336	$ 19.12
Grants	4,664	$ 28.57
Forfeited	(382)	$ 25.19
Vested	(1,644)	$ 19.91
Balance, end of period	6,974	$ 25.26

	Nine Months Ended September 30, 2007 (Shares in 000s)			Weighted Average Grant Date Fair Value		
	Future Service Required	No Future Service Required		Future Service Required	No Future Service Required	
Restricted stock units						
Balance, beginning of year	14,813	13,905		$ 19.21	$ 7.26	
Grants, includes dividends	3,675	320	(1)	$ 25.13	$	(1)
Deferral expiration		(1,791)		$	$ 12.20	
Forfeited	(400)			$ 20.81	$	
Vested	(3,071)	3,071		$ 17.99	$ 17.99	
Grants related to stock option exercises		509		$	$ 11.69	
Balance, end of period	15,017	16,014		$ 21.01	$ 8.75	

(1) Represents dividend equivalents on restricted stock units declared during the nine month period ending September 30, 2007.

The compensation cost associated with restricted stock and restricted stock units amounted to $34.5 million and $21.0 million for the three-month period ended September 30, 2007 and 2006, respectively, and $107.5 million and $62.6 million for the nine-month period ended September 30, 2007 and 2006, respectively. The average fair value of the vested awards during the first nine months of 2007 was approximately $28.15 per share.

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

Stock Options

The fair value of all option grants for all of our plans are estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for all fixed option grants in 2004: dividend yield of 0.9%; expected volatility of 32.6%; risk-free interest rates of 3.0%; and expected lives of 4.8 years. There were no option grants in 2007 and 2006. A summary of the status of our stock options in all of our stock-based plans as of September 30, 2007 and changes during the nine-month period then ended is presented below:

Dollars and shares in thousands, except per share data	Options	Weighted-Average Exercise Price
Outstanding, December 31, 2006	1,688	$11.02
Granted		
Exercised	(1,303)	$11.18
Canceled		
Outstanding, September 30, 2007	385	$10.28

The total intrinsic value of stock options exercised during the nine months ended September 30, 2007 and 2006 was $6.2 million and $29.5 million, respectively. Cash received from the exercise of stock options during the nine-months ended September 30, 2007 and 2006 totaled $3.7 million and $12.9 million, respectively, and the tax benefit realized from stock options exercised during the nine-months ended September 30, 2007 and 2006 was $2.5 million and $7.1 million, respectively.

The table below provides additional information related to stock options outstanding at September 30, 2007:

Dollars and shares in thousands, except per share data

September 30, 2007	**Outstanding Net of Expected Forfeitures**	**Options Exercisable**
Number of options	385	385
Weighted-average exercise price	$10.28	$10.28
Aggregate intrinsic value	$6,757	$6,757
Weighted-average remaining contractual term, in years	1.82	1.82

At September 30, 2007, the intrinsic value of vested options was approximately $6.8 million for which tax benefits expected to be recognized in equity upon exercise are approximately $2.8 million.

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

Note 22. Subsequent Events

As previously reported, on July 18, 2005, we entered into a Share and Membership Interest Purchase Agreement (Purchase Agreement) with Brian P. Friedman (one of our directors and Chairman, Executive Committee), James L. Luikart, a family partnership controlled by Mr. Friedman and the manager and general partner of Jefferies Capital Partners IV L.P. Jefferies Capital Partners IV L.P., together with its related parallel funds, is a private equity fund managed by a team led by Messrs. Friedman and Luikart.

The closing of the Purchase Agreement occurred on November 1, 2007. In connection with the closing, we and the other parties to the Purchase Agreement entered into Amendment No. 1 to the Share and Membership Interest Purchase Agreement dated as of November 1, 2007 (the Amendment). In the Amendment, the parties (i) confirmed that the aggregate shares of our common stock issuable pursuant to the terms of the Purchase Agreement (after giving effect to the 2-for-1 stock split effected as a stock dividend on May 15, 2006) to Messrs. Friedman and Luikart were 1,040,000 and 260,000, respectively; (ii) agreed that in lieu of the adjustment required to be made to the shares of our common stock issuable under the Purchase Agreement (other than the adjustment giving effect to the 2-for-1 stock split effected as a stock dividend on May 15, 2006), we would pay to Messrs. Friedman and Luikart $156,000 and $39,000, respectively, and agreed that the partial clawback provisions contained in the Purchase Agreement would apply to these cash amounts; (iii) agreed to a funds flow schedule for the various capital commitment transfers required pursuant to the Purchase Agreement; and (iv) agreed on other non-material, technical changes to exhibits to the Purchase Agreement.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This report contains or incorporates by reference forward-looking statements within the meaning of the safe harbor provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements include statements about our future and statements that are not historical facts. These forward-looking statements are usually preceded by the words believe, intend, may, will, or similar expressio Forward-looking statements may contain expectations regarding revenues, earnings, operations and other financial projections, and may include statements of future performance, plans and objectives. Forward-looking statements also include statements pertaining to our strategies for future development of our business and products. Forward-looking statements represent only our belief regarding future events, many of which by their nature are inherently uncertain and outside of our control. It is possible that the actual results may differ, possibly materially, from the anticipated results indicated in these forward-looking statements. Information regarding important factors that could cause actual results to differ, perhaps materially, from those in our forward-looking statements is contained in this report and other documents we file. You should read and interpret any forward-looking statement together with these documents, including the following:

- the description of our business and risk factors contained in our annual report on Form 10-K for the fiscal year ended December 31, 2006 and filed with the SEC on March 1, 2007;
- the discussion of our analysis of financial condition and results of operations contained in this report under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations ;
- the notes to the consolidated financial statements contained in this report; and
- cautionary statements we make in our public documents, reports and announcements.

Any forward-looking statement speaks only as of the date on which that statement is made. We will not update any forward-looking statement to reflect events or circumstances that occur after the date on which the statement is made.

Critical Accounting Policies

The consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles, which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes. Actual results can and will differ from estimates. These differences could be material to the financial statements.

We believe our application of accounting policies and the estimates required therein are reasonable. These accounting policies and estimates are constantly re-evaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

Our management believes our critical accounting policies (policies that are both material to the financial condition and results of operations and require management s most difficult, subjective or complex judgments) are our valuation of financial instruments and our use of estimates related to compensation and benefits during the year.

Fair Value Measurements

JEFFERIES GROUP, INC. AND SUBSIDIARIES

Our financial instruments are primarily recorded at fair value. 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). The use of fair value to measure financial instruments is fundamental to our financial statements and is our most critical accounting policy. Unrealized gains or losses are generally recognized in principal transactions in our Consolidated Statement of Earnings. Financial instruments are valued at quoted market prices, if available. For financial instruments that do not have readily determinable fair values through 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.

We adopted FASB 157 and FASB 159, as of the beginning of 2007. See notes 1 and 4 of the Notes to the Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for further information on FASB 157 and FASB 159, including the impact of adoption.

Level III assets, as defined by FASB 157, increased to approximately 7.4% as of September 30, 2007 of total financial instruments owned and other investments measured at fair value, compared to approximately 5.1% in the trailing quarter. The increase in Level III assets resulted largely from the origination of $148.1 million in bridge loans to investment-banking clients in acquisition-finance transactions.

Compensation and Benefits

The use of estimates is important in determining compensation and benefits expenses for interim and year end periods. A substantial portion of our compensation and benefits represents discretionary bonuses, which are fixed at year end. In addition to the level of net revenues, our overall compensation expense in any given year is influenced by prevailing labor markets, revenue mix and our use of equity-based compensation programs. We believe the most appropriate way to allocate estimated annual discretionary bonuses among interim periods is in proportion to projected net revenues earned. Consequently, we have generally accrued interim compensation and benefits based on annual targeted compensation ratios, taking into account the guidance contained in FASB 123R regarding the timing of expense recognition for non retirement-eligible and retirement-eligible employees.

Reportable Business Segments

The Capital Markets reportable segment includes our traditional securities brokerage, including the results of our recently reorganized high yield secondary market trading activities and investment banking activities. The Capital Markets reportable segment is managed as a single operating segment that provides the sales, trading and origination effort for various fixed income, equity and advisory products and services. The Capital Markets segment comprises many divisions, with interactions among each. In addition, we choose to voluntarily disclose the Asset Management segment even though it is currently an immaterial non-reportable segment as defined by FASB 131, *Disclosures about Segments of an Enterprise and Related Information.*

For presentation purposes, the remainder of Results of Operations is presented on a detailed product and expense basis rather than on a business segment basis because the Asset Management segment is immaterial as compared to the consolidated Results of Operations.

Our earnings are subject to wide fluctuations since many factors over which we have little or no control, particularly the overall volume of trading, the volatility and general level of market prices, and the number and size of investment banking transactions may significantly affect our operations.

Revenues by Source

JEFFERIES GROUP, INC. AND SUBSIDIARIES

The following provides a breakdown of total revenues by source for the three-month period ended September 30, 2007 and 2006 (in thousands of dollars):

	Three Months Ended			
	September 30, 2007		September 30, 2006	
	Amount	% of Total Revenues	Amount	% of Total Revenues
Equity	$ 140,296	21%	$ 112,635	24%
Fixed income and commodities:				
Fixed income (excluding high yield) and commodities (1)	16,502	2	50,871	11
High yield (2)	(7,387)	(1)	11,188	2
Total	9,115	1	62,059	13
Investment banking	189,780	29	144,763	31
Asset management fees and investment income from managed funds (3):				
Asset management fees	5,369	1	6,345	2
Investment income (loss) from managed funds	(11,652)	(2)	10,438	2
Total	(6,283)	(1)	16,783	4
Interest	334,056	50	132,424	28
Total revenues	$ 666,964	100%	$ 468,664	100%

(1) Fixed income and commodities revenue is primarily comprised of investment grade fixed income, convertible and commodities product revenue.

(2) High yield revenue is comprised of revenue generated by our high yield secondary market trading activities during the third quarter of 2007 and revenue generated by our pari passu share of high yield revenue in the third quarter of 2006. Our economic share of the revenues from high yield secondary market trading was $(3.7) million or 50% of the total high yield revenue for the third quarter ended September 30, 2007. For the prior year period we recorded our pari passu share of our high yield fixed income activities in this caption.

(3) Prior period amounts include asset management revenue from high yield funds. Effective April 2, 2007, with the commencement of our reorganized high yield secondary market trading activities, we do not record asset management revenue associated with these activites.

Consolidated Results of Operations

Revenues

Revenues increased $198.3 million, or 42%, to $667.0 million, compared to $468.7 million for the third quarter of 2006. The increase was primarily due to a $45.0 million, or 31%, increase in investment banking revenues, a $27.7 million, or 25%, increase in equity product revenues, and a $201.6 million, or 152%, increase in interest revenues due to increased securities borrowing activities; partially offset by a $34.4 million, or 68%, decrease in fixed income (excluding high yield) and commodities revenues, an $18.6 million, or 166%, decrease in high yield revenues and a $23.1 million, or 137%, decrease in asset management fees and investment income (loss) from managed funds.

Equity Product Revenue

Equity product revenue is comprised of equity (including principal transaction and commission revenue), correspondent clearing and prime brokerage, and execution product revenues. Equity product revenue was $140.3 million, up 25% from the third quarter of 2006 primarily attributable to strong customer activity in cash equity products driven by volatility in the global equity markets offset by a decrease in block trading and derivative product revenue due to a difficult trading environment.

Fixed Income and Commodities Revenue

JEFFERIES GROUP, INC. AND SUBSIDIARIES

Fixed income and commodities revenue is primarily comprised of high yield secondary market trading activities, investment grade fixed income, convertible and commodities product revenue. Fixed income and commodities revenue was $9.1 million, down 85% over third quarter of 2006. The decrease was driven by an (1) extremely challenging and illiquid U.S. credit markets and (2) difficult trading conditions in a very volatile commodity market.

Investment Banking Product Revenue

	Quarter Ended Sept. 30, 2007	Quarter Ended Sept. 30, 2006	Percentage Change
	(Dollars in Thousands)		
Capital markets	$ 92,256	$ 57,816	60%
Advisory	97,524	86,947	12%
Total	$ 189,780	$ 144,763	31%

Capital markets revenues, which consist primarily of debt, equity and convertible financing services, were $92.3 million, an increase of 60% from the third quarter of 2006. The increase in capital markets revenues was driven by strong conditions for both equity and debt underwritings.

Revenues from advisory activities were $97.5 million, an increase of 12% from the third quarter of 2006. The increase in advisory revenues was led by services rendered on assignments in the technology, energy, media (including our recently acquired LongAcre Partners media group), maritime and aerospace and defense sectors.

Asset Management Fees and Investment Income(Loss) from Managed Funds

Asset management revenue includes revenues from management, administrative and performance fees from funds managed by us, revenues from asset management and performance fees from third-party managed funds, and investment income (loss) from our investments in these funds. Asset management revenues were $(6.3) million, down $23.1 million over the third quarter of 2006. The decrease in asset management revenue was a result of (1) a strong prior period performance from our High Yield Funds, which are no longer included in asset management effective April 2, 2007, (2) weaker operating performances from our equity funds and (3) downward valuation adjustments on our investments in our managed CLOs.

Changes in Assets under Management

In millions	**Three Month Period Ending Sept. 30, 2007**	**Three Month Period Ending Sept. 30, 2006**	**Percent Change**
Balance, beginning of period	$5,491	$4,383	25%
Net cash flow in (out)	227	562	
Net market appreciation	28	73	
	255	635	
Balance, end of period	$5,746	$5,018	15%

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

The net cash inflow during the third quarter of 2007 is partially due to the commencement of the St. James River CLO, Ltd., an actively managed collateralized loan obligation consisting primarily of senior secured loans, offset by redemptions from our convertible bond asset funds.

Net Interest

Interest income increased $201.6 million primarily as a result of increased stock borrowing, securities purchased under agreements to resell activities and increases in interest rates; and interest expense increased by $204.5 million primarily as a result of increased stock lending and securities sold under agreements to repurchase activities, increases in interest rates and the issuance of our $600 million of senior unsecured debentures in June 2007.

Compensation and Benefits

Compensation and benefits decreased $0.9 million, or 1%, relatively consistent with the 2% decrease in net revenues. The ratio of compensation to net revenues was approximately 54.9% for the third quarter of 2007 as compared to 54.1% for the third quarter of 2006. Average employee headcount increased 12% from 2,212 during the third quarter of 2006 to 2,472 during the third quarter of 2007. The growth in headcount is primarily due to increased business activities and growth initiatives, both domestically and internationally.

Non-Personnel Expenses

Non-personnel expense was $95.6 million for the third quarter of 2007 versus $79.9 million for the third quarter of 2006 or 28.6% of net revenues for the third quarter of 2007 versus 23.4% of net revenues for the third quarter of 2006. The increase in non-personnel expenses is consistent with our increase in headcount combined with increased legal, compliance, technology and communications costs as well as increased occupancy related to the expansion of the London and New York offices.

Earnings before Income Taxes, Minority Interest, and Cumulative Effect of Change in Accounting Principle, Net

Earnings before income taxes, minority interest and cumulative effect of change in accounting principle, net, were down $21.0 million, or 28%, to $55.3 million, compared to $76.3 million for the third quarter of 2006. The effective tax rates were approximately 39.1% for the third quarter of 2007 and 39.0% for the third quarter of 2006. Although the effective tax rate was relatively consistent as compared to the prior period, the effective tax rate was impacted by a reduction in JHYH s projected minority interest tax benefit, offset by a decrease in state and local income taxes and return to provision adjustments for amounts previously deemed non-deductible.

Minority Interest

Minority interest was $(5.1) million compared to $0.7 million for the third quarter of 2006. The decrease is primarily due to JHYH s third quarter of 2007 net loss before minority interest of $(8.8) million.

Earnings per Share

Diluted net earnings per share were $0.26 for the third quarter of 2007 on 155,480,000 shares compared to $0.32 in the third quarter of 2006 on 148,908,000 shares. The diluted earnings per share calculation for the third quarter of 2007 includes an addition of $1.0 million to net earnings for preferred dividends.

Basic net earnings per share were $0.27 for the third quarter of 2007 on 142,822,000 shares compared to $0.34 in the third quarter of 2006 on 135,140,000 shares.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

The following provides a breakdown of total revenues by source for the nine-month period ended September 30, 2007 and 2006 (in thousands of dollars):

	Nine Months Ended			
	September 30, 2007		September 30, 2006	
	Amount	% of Total Revenues	Amount	% of Total Revenues
Equity	$ 457,916	22%	$ 386,917	27%
Fixed income and commodities:				
Fixed income (excluding high yield) and commodities (1)	103,073	5	132,206	9
High yield (2)	37,073	2	70,141	5
Total	140,146	7	202,347	14
Investment banking	582,988	28	395,429	27
Asset management fees and investment income from managed funds (3):				
Asset management fees	22,114	1	41,272	3
Investment income from managed funds	7,472	1	38,860	2
Total	29,586	2	80,132	5
Interest	845,957	41	385,035	27
Total revenues	$ 2,056,593	100%	$ 1,449,860	100%

(1) Fixed income and commodities revenue is primarily comprised of investment grade fixed income, convertible and commodities product revenue.

(2) High yield revenue is comprised of revenue generated by our high yield secondary market trading activities during the second and third quarter of 2007 and revenue generated by our pari passu share of high yield revenue during the first quarter of 2007 and the first nine months of 2006. For the prior year period we recorded 100% of the revenue related to our pari passu share of our high yield revenue.

(3) Prior period amounts include asset management revenue from high yield funds. Effective April 2, 2007, with the commencement of our reorganized high yield secondary market trading activities, we do not record asset management revenue associated with these activities.

Consolidated Results of Operations

Revenues

Revenues increased $606.7 million, or 42%, to $2,056.6 million, compared to $1,449.9 million for the first nine months of 2006. The increase was primarily due to a $187.6 million, or 47%, increase in investment banking revenue, a $71.0 million, or 18%, increase in equity product revenue, and a $460.9 million, or 120%, increase in interest revenue due to increased securities borrowing activities; partially offset by a $29.1 million, or 22%, decrease in fixed income (excluding high yield) and commodities, a $33.1 million, or 47%, decrease in high yield revenues, and a $50.5 million, or 63%, decrease in asset management fees and investment income from managed funds.

Equity Product Revenue

Equity product revenue is comprised of equity (including principal transaction and commission revenue), correspondent clearing and prime brokerage, and execution product revenues. Equity product revenue was $457.9 million, up 18% from the first nine months of 2006 primarily attributable to increased proprietary and block trading activities, as well as strong contributions from our cash equity revenue products.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

Fixed Income and Commodities Revenue

Fixed income and commodities revenue is primarily comprised of high yield secondary market trading activities, investment grade fixed income, convertible and commodities product revenue. Fixed income and commodities revenue was $140.1 million, down 31% over the first nine months of 2006. The decrease was driven by a strong prior period performance in high yield secondary market trading, extremely challenging and illiquid U.S. credit markets and difficult trading conditions in a very volatile commodity market.

Investment Banking Product Revenue

	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Percentage Change
	(Dollars in Thousands)		
Capital markets	$ 318,191	$ 147,748	115%
Advisory	264,797	247,681	7%
Total	$ 582,988	$ 395,429	47%

Capital markets revenues, which consists primarily of debt, equity and convertible financing services, were $318.2 million, an increase of 115% from the first nine months of 2006. The increase in capital markets revenues was led by a strong performance in debt underwritings as well as the expansion of our investment banking activities outside the United States.

Revenues from advisory activities were $264.8 million, an increase of 7% from the first nine months of 2006. The increase in advisory revenues was led by services rendered on assignments in the technology, industrial, energy, media and communications and aerospace and defense sectors.

Asset Management Fees and Investment Income from Managed Funds

Asset management revenue includes revenues from management, administrative and performance fees from funds managed by us, revenues from asset management and performance fees from third-party managed funds, and investment revenue from our investments in these funds. Asset management revenues were $29.6 million, down $50.5 million over the first nine months of 2006. The decrease in asset management revenue was a result of a strong prior period performance from our High Yield Funds, which are no longer included in asset management effective April 2, 2007 and weaker operating performances from our equity funds.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

Changes in Assets under Management

In millions	Nine Month Period Ending Sept. 30, 2007	Nine Month Period Ending Sept. 30, 2006	Percent Change
Balance, beginning of period	$ 5,282	$ 4,031	31%
Net cash flow in	241	687	
Net market appreciation	223	300	
	464	987	
Balance, end of period	$ 5,746	$ 5,018	15%

The increase in net cash inflow during the first nine months of 2007 is primarily due to the commencement of the Clear Lake CLO and St. James River CLO, Ltd., partially offset by the liquidation of our managed high yield funds due to the commencement of our reorganized high yield secondary market trading activities (which are no longer included in assets under management) and the liquidation of the Jefferies Paragon Fund in June 2007.

Net Interest

Interest income increased $460.9 million primarily as a result of increased stock borrowing, securities purchased under agreements to resell activities and increases in interest rates;, and interest expense increased by $471.4 million primarily as a result of increased stock lending and securities sold under agreements to repurchase activities, increases in interest rates and the issuance of our $600 million of senior unsecured debentures in June 2007.

Compensation and Benefits

Compensation and benefits increased $68.9 million, or 12%, consistent with the 12% increase in net revenues. The ratio of compensation to net revenues was approximately 54.4% for the first nine months of 2007 as compared to 54.8% for the first nine months of 2006. Average employee headcount increased 12% from 2,107 during the first nine months of 2006 to 2,352 during the first nine months of 2007. The growth in headcount is primarily due to increased business activities and growth initiatives, both domestically and internationally.

Non-Personnel Expenses

Non-personnel expense was $268.7 million for the first nine months of 2007 versus $235.1 million for the first nine months of 2006 or 22.1% of net revenues for the first nine months of 2007 versus 21.7% of net revenues for the first nine months of 2006. The increase in non-personnel expenses is consistent with our revenue growth and primarily attributable to increased legal, compliance, technology and communications costs as well as increased occupancy related to the expansion of the London and New York offices.

Earnings before Income Taxes, Minority Interest, and Cumulative Effect of Change in Accounting Principle, Net

Earnings before income taxes, minority interest and cumulative effect of change in accounting principle, net, were up $32.7 million, or 12.9%, to $287.2 million, compared to $254.5 million for the first nine months of 2006. The effective tax rates were approximately 37.4% for the first nine months of 2007 and 39.1% for the first nine months of 2006. The lower effective tax rate is due to the minority interest holdings in JHYH which are not taxed at the Jefferies level.

Minority Interest

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

Minority interest was $11.0 million compared to $6.6 million for the first nine months of 2006. The increase is due to the commencement of JHYH. We now consolidate 100% of the operations of JHYH for financial reporting purposes beginning with the second quarter of 2007.

Earnings per Share

Diluted net earnings per share were $1.12 for the first nine months of 2007 on 153,911,000 shares compared to $1.04 in the first nine months of 2006 on 146,502,000 shares. The diluted earnings per share calculation for the first nine months of 2007 includes an addition of $3.0 million to net earnings for preferred dividends.

Basic net earnings per share were $1.19 for the first nine months of 2007 on 141,905,000 shares compared to $1.13 in the first nine months of 2006 on 133,048,000 shares.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

Liquidity, Financial Condition and Capital Resources

Our Chief Financial Officer and Treasurer are responsible for developing and implementing our liquidity, funding and capital management strategies. These policies are determined by the nature of our day to day business operations, business growth possibilities, regulatory obligations, and liquidity requirements.

Our actual level of capital, total assets, and financial leverage are a function of a number of factors, including, asset composition, business initiatives, regulatory requirements and cost availability of both long term and short term funding. We have historically maintained a highly liquid balance sheet, with a substantial portion of our total assets consisting of cash, highly liquid marketable securities and short-term receivables, arising principally from traditional securities brokerage activity. The highly liquid nature of these assets provides us with flexibility in financing and managing our business.

Liquidity

The following are financial instruments that are cash and cash equivalents or are deemed by management to be generally readily convertible into cash, marginable or accessible for liquidity purposes within a relatively short period of time (in thousands of dollars):

	September 30, 2007	December 31, 2006
Cash and cash equivalents:		
Cash in banks	$ 223,528	$ 107,488
Money market investments	297,811	405,553
Total cash and cash equivalents	521,339	513,041
Cash and securities segregated (1)	613,808	508,303
Other (2)	2,251	71,160
	$ 1,137,398	$ 1,092,504

(1) 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.

(2) Items are financial instruments utilized in our overall cash management activities and are readily convertible to cash in normal market conditions.

Bank loans represent short-term borrowings that are payable on demand and generally bear interest at a spread over the fed funds rate. We had no outstanding secured bank loans as of September 30, 2007 and December 31, 2006. Unsecured bank loans are typically overnight loans used to finance financial instruments owned or clearing related balances. We had $399.8 million and $0 of outstanding unsecured bank loans as of September 30, 2007 and December 31, 2006, respectively. Average daily bank loans for the nine-months ended September 30, 2007 and year ended December 31, 2006 were $237.3 million and $12.4 million, respectively.

A substantial portion of our assets are liquid, consisting of cash or assets readily convertible into cash. The majority of securities positions (both long and short) in our trading accounts are readily marketable and actively traded. In addition, receivables from brokers and dealers are primarily current open transactions or securities borrowed transactions, which are typically settled or closed out within a few days. Receivable from customers includes margin balances and amounts due on transactions in the process of settlement. Most of our receivables are secured by marketable securities.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

Our assets are funded by equity capital, senior debt, mandatorily redeemable convertible preferred stock, securities loaned, customer free credit balances, bank loans and other payables. Bank loans represent temporary (usually overnight) secured and unsecured short-term borrowings, which are generally payable on demand. We have arrangements with banks for unsecured financing of up to $877.0 million. Secured bank loans are collateralized by a combination of customer, non-customer and firm securities. We have always been able to obtain necessary short-term borrowings in the past and believe that we will continue to be able to do so in the future. Additionally, we have $258.5 million in letters of credit outstanding as of September 30, 2007, which are used in the normal course of business mostly to satisfy various collateral requirements in lieu of depositing cash or securities.

Excess Liquidity

Our policy is to maintain excess liquidity to cover all expected cash outflows for one year in a stressed liquidity environment. Liquid resources consist of unrestricted cash and unencumbered assets that are readily convertible into cash on a secured basis on short notice. Certain investments are also readily convertible to cash. In addition, we have $877.0 million of unsecured, uncommitted lines of credit with various banks.

Management believes these resources provide sufficient excess liquidity to cover all expected cash outflows for one year during a stressed liquidity environment. Expected cash outflows include:

- The payment of interest expense (including dividends on our mandatorily redeemable convertible preferred stock) on our long term debt;
- The anticipated funding of outstanding investment commitments;
- The anticipated fixed costs over the next 12 months;
- Potential stock repurchases; and
- Certain accrued expenses and other liabilities

Analysis of Financial Condition and Capital Resources

Financial Condition

As previously discussed, we have historically maintained a highly liquid balance sheet, with a substantial portion of our total assets consisting of cash, highly liquid marketable securities and short-term receivables, arising principally from traditional securities brokerage activity. Total assets increased $13,776.9 million, or 77%, from $17,825.5 million at December 31, 2006 to $31,602.4 million at September 30, 2007 primarily due to increased repo activity. Our financial instruments owned, including securities pledged to creditors, increased $2,309.5 million, while our financial instruments sold, not yet purchased increased $476.6 million. Our securities borrowed and securities purchased under agreements to resell increased $10,545.9 million, while our securities loaned and securities sold under agreements to repurchase increased $11,047.4 million.

Level III assets, as defined by FASB 157, increased to approximately 7.4% as of September 30, 2007 of total financial instruments owned and other investments measured at fair value, compared to approximately 5.1% in the trailing quarter. The increase in Level III assets resulted largely from the origination of $148.1 million in bridge loans to investment-banking clients in acquisition-finance transactions.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

The following table sets forth book value, pro forma book value, tangible book value and pro forma tangible book value per share (dollars in thousands, except per share data):

	September 30, 2007	December 31, 2006
Stockholders equity	$ 1,830,752	$ 1,581,087
Less: Goodwill	(330,694)	(257,321)
Tangible stockholders equity	$ 1,500,058	$ 1,323,766
Stockholders equity	$ 1,830,752	$ 1,581,087
Add: Projected tax benefit on vested portion of restricted stock	134,039	130,700
Pro forma stockholders equity	$ 1,964,791	$ 1,711,787
Tangible stockholders equity	$ 1,500,058	$ 1,323,766
Add: Projected tax benefit on vested portion of restricted stock	134,039	130,700
Pro forma tangible stockholders equity	$ 1,634,097	$ 1,454,466
Shares outstanding	125,657,168	119,546,914
Add: Shares not issued, to the extent of related expense amortization	22,433,471	24,139,907
Less: Shares issued, to the extent related expense has not been amortized	(4,442,655)	(1,813,423)
Adjusted shares outstanding	143,647,984	141,873,398
Book value per share (1)	$ 14.57	$ 13.23
Pro forma book value per share (2)	$ 13.68	$ 12.07
Tangible book value per share (3)	$ 11.94	$ 11.07
Pro forma tangible book value per share (4)	$ 11.38	$ 10.25

(1) Book value per share equals stockholders equity divided by common shares outstanding.

(2) Pro forma book value per share equals stockholders equity plus the projected deferred tax benefit on the amortized portion of restricted stock and RSUs divided by common shares outstanding adjusted for shares not yet issued to the extent of the related expense amortization and shares issued to the extent the related expense has not been amortized.

(3) Tangible book value per share equals tangible stockholders equity divided by common shares outstanding.

(4) Pro forma tangible book value per share equals tangible stockholders equity plus the projected deferred tax benefit on the amortized portion of restricted stock and RSUs divided by common shares outstanding adjusted for shares not yet issued to the extent of the related expense amortization and shares issued to the extent the related expense has not been amortized.

Tangible stockholders equity, pro forma book value per share, tangible book value per share and pro forma tangible book value per share are non-GAAP financial measures. A non-GAAP financial measure is a numerical measure of financial performance that includes adjustments to the most directly comparable measure calculated and presented in accordance with GAAP, or for which there is no specific GAAP guidance. We calculate tangible stockholders equity as stockholders equity less intangible assets. We calculate pro forma book value per share as stockholders equity plus the projected deferred tax benefit on the vested portion of restricted stock and RSUs divided by common shares outstanding adjusted for shares not yet issued to the extent of the related expense amortization and shares issued to the extent the related expense has not been amortized. We calculate tangible book value per share by dividing tangible stockholders equity by common stock outstanding. We calculate pro forma tangible book value per share by dividing tangible stockholders equity plus the projected deferred tax benefit on the vested portion of restricted stock and RSUs by common shares outstanding adjusted for shares not yet issued to the extent of the related expense amortization and shares issued to the extent the related expense has not been amortized. We consider these ratios as meaningful measurements of our financial condition and believe they provide investors with additional metrics to comparatively assess the fair value of our stock.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

Capital Resources

We had total long term capital of $3.7 billion and $2.9 billion as of September 30, 2007 and December 31, 2006, respectively, resulting in a long-term debt to total capital ratio of 47% and 41%, respectively. Our total capital base as of September 30, 2007 and December 31, 2006 was as follows (in thousands):

	September 30, 2007	December 31, 2006
Long-Term Debt	$ 1,764,560	$ 1,168,562
Mandatorily Redeemable Convertible Preferred Stock	125,000	125,000
Total Stockholders Equity	1,830,752	1,581,087
Total Capital	$ 3,720,312	$ 2,874,649

Our ability to support increases in total assets is largely a function of our ability to obtain short term secured and unsecured funding, primarily through securities lending, and through our $877.0 million of uncommitted unsecured bank lines. Our ability is further enhanced by the cash proceeds from the $500 million senior unsecured bonds and $125 million in series A preferred stock, both issued in the first quarter of 2006; as well as cash proceeds from our $600 million senior unsecured debt issuance in June 2007.

At September 30, 2007, our senior long-term debt, net of unamortized discount, consisted of contractual principal payments (adjusted for amortization) of $492.3 million, $346.2 million, $348.5 million, $248.3 million and $329.2 million due in 2036, 2027, 2016, 2014 and 2012, respectively.

We rely upon our cash holdings and external sources to finance a significant portion of our day-to-day operations. Access to these external sources, as well as the cost of that financing, is dependent upon various factors, including our debt ratings. Our current debt ratings are dependent upon many factors, including operating results, operating margins, earnings trend and volatility, balance sheet composition, liquidity and liquidity management, our capital structure, our overall risk management, business diversification and our market share and competitive position in the markets in which we operate.

Our long term debt ratings are as follows:

	Rating
Moody s Investors Services	Baa1
Standard and Poor s	BBB+
Fitch Ratings	BBB+

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

Net Capital

Jefferies, Jefferies Execution and Jefferies High Yield Trading are subject to the net capital requirements of the SEC and other regulators, which are designed to measure the general financial soundness and liquidity of broker-dealers. Jefferies, Jefferies Execution and Jefferies High Yield Trading use the alternative method of calculation.

As of September 30, 2007, Jefferies, Jefferies Execution and Jefferies High Yield Trading s net capital and excess net capital were as follows (in thousands of dollars):

	Net Capital	Excess Net Capital
Jefferies	$ 431,661	$ 409,404
Jefferies Execution	$ 24,473	$ 24,223
Jefferies High Yield Trading	$ 555,033	$ 554,783

Guarantees

As of September 30, 2007, we had outstanding guarantees of $20.0 million relating to an undrawn bank credit obligation of an associated investment fund in which we have an interest. In addition, we guarantee up to an aggregate of approximately $36.0 million in bank loans committed to an employee parallel fund of Jefferies Capital Partners IV L.P. (Fund IV).

We have guaranteed the performance of JIL and JFP to their trading counterparties and various banks and other entities, which provide clearing and credit services to JIL and JFP. Also, we have provided a guarantee to a third-party bank in connection with the bank s extension of 500 million Japanese yen (approximately $4.4 million) to Jefferies (Japan) Limited. In addition, as of September 30, 2007, we had commitments to invest up to $511.5 million in various investments, including $195.0 million in Jefferies Finance LLC, $25.0 million in Babson-Jefferies Loan Opportunity CLO, $30.0 million in Fund IV, $250.0 million in JHYH and $11.5 million in other investments.

Leverage Ratios

The following table presents total assets, adjusted assets, and net adjusted assets with the resulting leverage ratios as of September 30, 2007 and December 31, 2006. With respect to leverage ratio, we believe that net adjusted leverage is the most relevant measure, given the low-risk, collateralized nature of our securities borrowed and segregated cash assets.

	September 30, 2007	December 31, 2006
Total assets	$ 31,602,366	$ 17,825,457
Adjusted assets (1)	30,988,558	17,317,154
Net adjusted assets (2)	11,640,096	7,605,260
Leverage ratio (3)	17.3	11.3
Adjusted leverage ratio (4)	16.9	11.0
Net adjusted leverage ratio (5)	6.4	4.8

(1) Adjusted assets are total assets less cash and securities segregated.

(2) Net adjusted assets are adjusted assets, less securities borrowed.

(3) Leverage ratio equals total assets divided by stockholders equity.

(4) Adjusted leverage ratio equals adjusted assets divided by stockholders equity.

(5) Net adjusted leverage ratio equals net adjusted assets divided by stockholders equity.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We use a number of quantitative tools to manage our exposure to market risk. These tools include:

- inventory position and exposure limits, on a gross and net basis;

- scenario analyses, stress tests and other analytical tools that measure the potential effects on our trading net revenues of various market events, including, but not limited to, a large widening of credit spreads, a substantial decline in equities markets and significant moves in selected emerging markets; and

- risk limits based on a summary measure of risk exposure referred to as Value-at-Risk (VaR).

Value-at Risk

In general, Value-at-Risk (VaR) measures potential loss of trading revenues at a given confidence level over a specified time horizon. We calculate VaR over a one day holding period measured at a 95% confidence level which implies the potential loss of daily trading revenue is expected to be at least as large as the VaR amount on one out of every twenty trading days.

VaR is one measurement of potential loss in trading revenues that may result from adverse market movements over a specified period of time with a selected likelihood of occurrence. As with all measures of VaR, our estimate has substantial limitations due to our reliance on historical performance, which is not necessarily a predictor of the future. Consequently, this VaR estimate is only one of a number of tools we use in our daily risk management activities.

The VaR numbers below are shown separately for interest rate, equity, currency and commodity products, as well as for our overall trading positions, excluding corporate investments in asset management positions, using a historical simulation approach. The aggregated VaR presented here is less than the sum of the individual components (i.e., interest rate risk, foreign exchange rate risk, equity risk and commodity price risk) due to the benefit of diversification among the risk categories. Diversification benefit equals the difference between aggregated VaR and the sum of VaRs for the four risk categories. The following table illustrates the VaR for each component of market risk.

Daily VaR (1)
(in millions)
Value-at-Risk in trading portfolios

	VaR at			Average VaR Three Months Ended		
Risk Categories	**9/30/07**	**6/30/07**	**12/31/06**	**9/30/07**	**6/30/07**	**12/31/06**
Interest Rates	$ 1.48	$ 1.71	$ 1.39	$ 1.78	$ 1.69	$ 1.07
Equity Prices	$ 10.37	$ 8.95	$ 6.37	$ 8.34	$ 7.84	$ 5.44
Currency Rates	$ 0.46	$ 0.45	$ 0.34	$ 0.47	$ 0.29	$ 0.34
Commodity Prices	$ 1.20	$ 1.59	$ 0.80	$ 1.29	$ 1.18	$ 1.41
Diversification Effect (2)	$ (3.39)	$ (3.60)	$ (3.36)	$ (4.03)	$ (2.92)	$ (3.18)
Firmwide	$ 10.12	$ 9.10	$ 5.54	$ 7.85	$ 8.08	$ 5.08

(1) VaR is the potential loss in value of our trading positions due to adverse market movements over a defined time horizon with a specific confidence level. For the VaR numbers reported above, a one-day time horizon and 95% confidence level were used.

(2) Equals the difference between firmwide VaR and the sum of the VaRs by risk categories. This effect is due to the market categories not being perfectly correlated.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

	Daily VaR (1) (in millions) Value-At-Risk Highs and Lows for Three Months Ended					
	09/30/07		06/30/07		12/31/06	
Risk Categories	**High**	**Low**	**High**	**Low**	**High**	**Low**
Interest Rates	$ 2.24	$ 1.37	$ 2.18	$ 1.41	$ 1.50	$ 0.45
Equity Prices	$ 12.40	$ 6.59	$ 10.34	$ 4.94	$ 6.45	$ 4.22
Currency Rates	$ 0.54	$ 0.30	$ 0.55	$ 0.13	$ 0.48	$ 0.24
Commodity Prices	$ 2.36	$ 0.78	$ 2.03	$ 0.40	$ 3.22	$ 0.61
Firmwide	$ 11.35	$ 5.95	$ 11.36	$ 5.31	$ 5.85	$ 4.27

(1) VaR is the potential loss in value of our trading positions due to adverse market movements over a defined time horizon with a specific confidence level. For the VaR numbers reported above, a one-day time horizon and 95% confidence level were used.

Average VaR of $7.85 million during the third quarter of 2007 decreased from the $8.08 million average during the second quarter of 2007 due mainly to an increase in the diversification effect.

The following table presents our daily VaR over the last four quarters:

Daily VaR Trend

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

VaR Back-Testing

The comparison of daily actual revenue fluctuations with the daily VaR estimate is the primary method used to test the efficacy of the VaR model. Back testing is performed at various levels of the trading portfolio, from the holding company level down to specific business lines. A back-testing exception occurs when the daily loss exceeds the daily VaR estimate. Results of the process at the aggregate level demonstrated ten outliers when comparing the 95% one-day VaR with the back-testing profit and loss in the third quarter of 2007. The outliers were driven predominately by exceptionally high market volatility realized during the quarter. A 95% confidence one-day VaR model usually should not have more than twelve (1 out of 20 days) back-testing exceptions on an annual basis. Back-testing profit and loss is a subset of actual trading revenue and includes only the profit and loss effects relevant to the VaR model, excluding fees, commissions and certain provisions. We compare the trading revenue with VaR for back-testing purposes because VaR assesses only the potential change in position value due to overnight movements in financial market variables such as prices, interest rates and volatilities under normal market conditions. The graph below illustrates the relationship between daily back-testing trading profit and loss and daily VaR for us in the third quarter of 2007.

VaR is a model that predicts the future risk based on historical data. We could incur losses greater than the reported VaR because the historical market prices and rates changes may not be an accurate measure of future market events and conditions. In addition, the VaR model measures the risk of a current static position over a one-day horizon and might not predict the future position. When comparing our VaR numbers to those of other firms, it is important to remember that different methodologies could produce significantly different results.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
Daily Trading Net Revenue
($ in millions)

Trading revenue used in the histogram below entitled Third Quarter 2007 vs. Third Quarter 2006 Distribution of Daily Trading Revenue is the actual daily trading revenue which is excluding fees, commissions and certain provisions. The histogram below shows the distribution of daily trading revenue for substantially all of our trading activities.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

Item 4. Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2007. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of September 30, 2007 are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance, however, that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

No change in our internal control over financial reporting occurred during the quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Many aspects of our business involve substantial risks of liability. In the normal course of business, we have been named as defendants or co-defendants in lawsuits involving primarily claims for damages. We are also involved in a number of regulatory matters arising out of the conduct of our business. Our management, based on currently available information, does not believe that any matter will have a material adverse effect on our financial condition, although, depending on our results for a particular period, an adverse determination or settlements could be material for a particular period.

Item 1A. Risk Factors

Information regarding our risk factors appears in Part I, Item 1A. of our annual report on Form 10-K for the fiscal year ended December 31, 2006 filed with the SEC on March 1, 2007. These risk factors describe some of the assumptions, risks, uncertainties and other factors that could adversely affect our business or that could otherwise result in changes that differ materially from our expectations. There have been no material changes from the risk factors previously disclosed in our annual report on Form 10-K.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased (1)	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (2)
July 1 July 31, 2007	543,292	27.02	475,000	5,019,793
August 1 August 31, 2007	526,407	25.58	525,000	4,494,793
September 1 September 30, 2007	40,305	22.29	37,515	4,457,278
Total	1,110,004	26.17	1,037,515	

(1) We repurchased an aggregate of 72,489 shares other than as part of a publicly announced plan or program. We repurchased these securities in connection with our stock compensation plans which allow participants to use shares to pay the exercise price of options exercised and to use shares to satisfy tax liabilities arising from the exercise of options or the vesting of restricted stock. The number above does not include unvested shares forfeited back to us pursuant to the terms of our stock compensation plans.

(2) On July 26, 2005, we issued a press release announcing the authorization by our Board of Directors to repurchase, from time to time, up to an aggregate of 3,000,000 shares of our common stock. After giving effect to the 2-for-1 stock split effected as a stock dividend on May 15, 2006, this authorization increased to 6,000,000 shares.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
Item 6. Exhibits

Exhibits

3.1	Amended and Restated Certificate of Incorporation of Jefferies Group, Inc. is incorporated herein by reference to Exhibit 3 of the Registrant s Form 8-K filed on May 26, 2004.
3.2	Registrant s Certificate of Designations of 3.25% Series A Cumulative Convertible Preferred Stock is incorporated herein by reference to Exhibit 3.1 of the Registrant s Form 8-K filed on February 21, 2006.
3.3	By-Laws of Jefferies Group, Inc are incorporated herein by reference to Exhibit 3.2 of Registrant s Form 10-K filed on March 28, 2003.
31.1*	Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer.
31.2*	Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer.
32*	Rule 13a-14(b)/15d-14(b) and Section 1350 of Title 18 U.S.C. Certification by the Chief Executive Officer and Chief Financial Officer.

* Filed herewith.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

JEFFERIES GROUP, INC.
(Registrant)

Date:	November 8, 2007	By:	/s/	Joseph A. Schenk

Joseph A. Schenk
Chief Financial Officer
(duly authorized officer)