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Unbundling Research Coverage

How IR teams can make today's fast-changing research landscape work in their favour

Research Reinvented

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WELCOME TO

Unbundling Research Coverage

The onset of more stringent regulations, coupled with growing investor demand for greater transparency and objectivity, are forcing a rethink of the way investment research is sourced and produced.

How will this sector-wide evolution impact the realm of corporate coverage?

A definitive answer still seems out of reach for investor relations (IR) professionals at this point. But by keeping their finger on the pulse, they can be better equipped to navigate this fast-changing landscape.

In conjunction with the launch of Smartkarma Corporate Solutions for C-Suite and IR teams, we present a mix of diverse viewpoints to help shed light on what's relevant for those soliciting coverage in this day and age.

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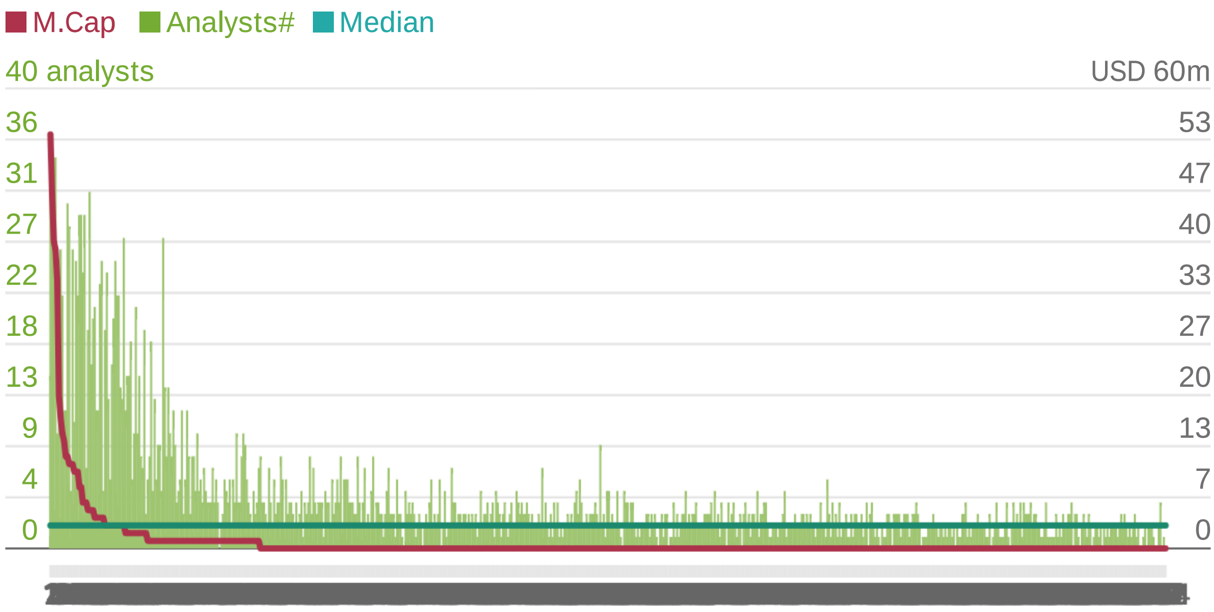
Why Most Listed Companies Are Unlikely to Get Bank Research Coverage

In most cases, the sell-side's pragmatic need to maximise profit still governs selection.

Market Cap versus Analyst Coverage



Smartkarma Chartbuilder 1.0

Data: Smartkarma Corporate Solutions Analysis

Setting the Stage: This conversation centres on the graph shown above, which highlights 93 percent of the companies listed on the Singapore Stock Exchange (SGX). They have been mapped out based on market cap and analyst coverage.

What Stands Out?

The larger a company's market capitalisation, the greater the analyst coverage.

Why Does This Trend Persist?

Historically, only sell-side analysts covered listed companies. Independent and boutique investment research houses only cropped up around 20 years ago (around the time scandals such as Enron came to light) to offer unbiased opinions about companies and their underlying value.

What Is the Motivation for Sell-side Analysts to Cover Companies in the First Place?

As the name suggests, they "sell", but do not sell research per se. Bank analysts provide research:

1. To buy-side/investors for no fee - hoping that research would lead to (buy/sell) trades through the bank's brokerage, which would earn them commission dollars for trades executed (a dying model in today's post-MiFID II environment)
2. On companies - hoping that when these firms seek to raise capital, the covered companies would come to their investment banking division to run the deal, which would earn them book-running fees

Why Does Market Capitalisation Matter to Sell-side Analysts?

Companies with larger market capitalisation:

1. Are more liquid and therefore can be traded more often, potentially offering more commissions to the bank
2. Run a higher probability of raising capital and hiring an investment bank to do the deal

What Does This Mean?

Small- and mid-cap companies are typically excluded from sell-side coverage by nature of these market forces.

How Does This Apply to Listed Companies on the SGX?

Smartkarma studied 654 companies on the SGX (around 92 percent of the total) for which we have data (sourced from Capital IQ).

The data shows a majority of those reviewed fall under the umbrella of small- and mid-caps. And of this group, more than 70 percent have fewer than five analysts covering them - 26 companies (all small-caps) do not even have coverage.

A couple of interesting outliers:

- 36 mid-cap companies have more than 10 analysts covering them
- 68 small-cap companies have five or more analysts covering them

What's so Important About Analyst Coverage?

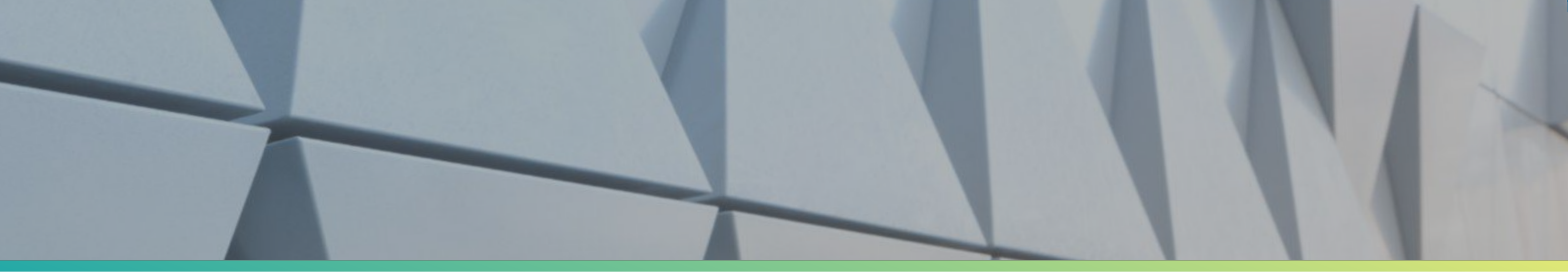
Analyst (sell-side or independent) coverage is meant to provide investors (the buy-side) with "unbiased" research on an entity that they might be interested to invest in.

More often than not, an investor is ready to invest in a listed company, but also wants some external research to further validate what the company tells them.

In light of the pragmatic reasons governing sell-side coverage, it could lead to selection biases where large-caps continue to gain investor interest, neglecting small- and mid-cap companies.

In summary, research coverage of a company should not be determined by its market capitalisation, but by the value it can contribute to the investment community.

Market Cap	> USD 5 bn	USD 1 bn - USD 5 bn	< USD 1 bn	
Analyst Coverage	Large Cap	Mid Cap	Small Cap	Total
Less than 5	0	2	507	509
5 - 9	2	17	64	83
10 - 19	6	23	4	33
More than 19	16	13	0	29
Total	24	55	575	**654**



The Importance of Independent Analysts to Corporates

A true and fair assessment is always within reach in the absence of bias

Corporate Investor Relations teams are continuously looking to engage existing and potential shareholders. They often reach out to sell-side analysts for coverage, with the goal of helping their companies garner interest from the buy-side.

However, if you're a small- or mid-cap company, those efforts might not always prove fruitful. The sell-side would be less incentivised to conduct research on your company, let alone churn a report.

We touched on this challenge above, in the previous chapter titled, Why Most Listed Companies Are Unlikely to Get Bank Research Coverage.

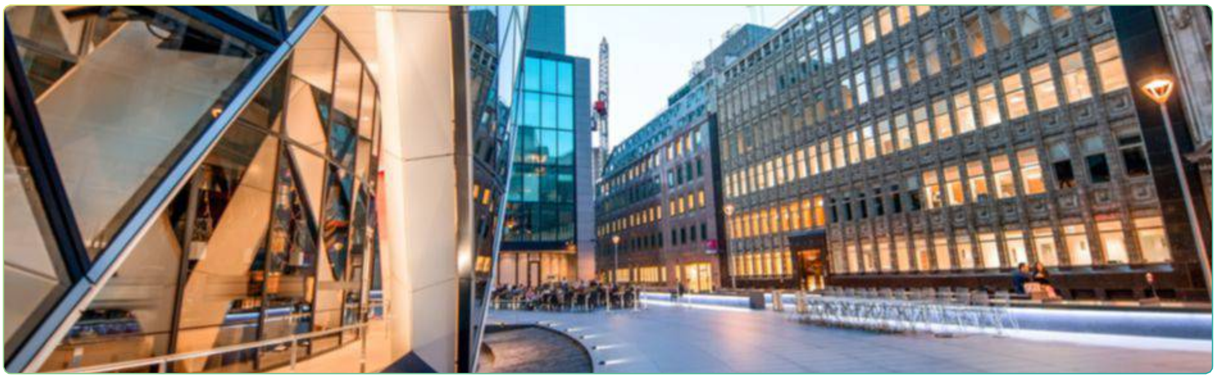
Still, an interest deficit from sell-side analysts does not always have to translate into a coverage deficit for smaller-cap corporations. IR teams can (and should) turn to independent analysts.

Why Are Independent Analysts More Sought After Today?

In the world of investment research, the term "Independent" connotes unbiased and objective viewpoints, free from conflicts of interest and economic incentives. This category of analysts has existed for a long time, but only recently came under the spotlight on the heels of MiFID II and other changing financial regulations.

Often former sell-side analysts, independent analysts set themselves apart by writing insightful and actionable research on a company, rather than focusing on procedural analysis. And they do so frequently through direct and transparent corporate engagement.

The CFA Centre for Financial Market Integrity and National Investor Relations Institute concur with this approach, jointly saying that "only through such dialogue can analysts fully comprehend the information in a company's public disclosure documents."



What Kind of Companies Do Independent Analysts Want to Cover?

1. It's not always about market cap. Independent analysts typically look for companies that bring value to the market and have a story to tell – preferably, a story they want to share with the world.

One such example is Nippon Suisan (1332:JP). Commonly known as "Nissui", the Japanese fishmonger has a relatively modest market cap of around US$2 billion and, according to its website, only three sell-side analysts from established Japanese banks are covering the company - at the time of this writing.

In 2018, US-listed Amarin, a biotech company, released the results of a seven-year, multi-country clinical trial, which has proven to be a game-changer for Nissui's high-purity fish EPA for pharmaceutical products.

This story was covered by SC Capital, an Independent Research Provider publishing on Smartkarma, even before the results came to light. The coverage provided the buy-side with timely insights on the company, creating value for investment managers in the process.

2. Easier ways to have questions answered – independent analysts are always looking to connect with corporate IR teams and management. This is so they can gain more insight on a company they are researching and looking to write about. As a result, it is important for IR teams to be approachable and accessible to these analysts and answer their questions.

Smartkarma has developed an online platform for corporates that's dedicated to facilitating communication between corporate IR teams, the buy-side, and independent analysts.

Why Should Corporate IR Officers Initiate Discussions With Independent Analysts?

An independent analyst might not have come across the company you represent. Reaching out and initiating a discussion or sharing the company's story could bring more visibility to your company.

Corporations can sometimes get caught up in the rat race of soliciting coverage from established sell-side firms, only to come up short. Independent analysts, on the other hand, have a wider following and might also be the ones potentially willing to cover your company.

Above all, independent analysts are trusted by the buy-side as their opinions are known to be based on the search for truth and value.

Congratulations, Your Company Got Analyst Coverage. But Is It Useful to the Buy-side?

Quality trumps quantity - now more than ever

Analyst coverage is something companies pursue constantly. Why?

C-Suite and Investor Relations of listed companies recognise that the buy-side relies fairly heavily on analyst opinions about a company to make investment decisions.

It's easy for IR teams to find comfort in the fact that they already have analyst coverage. As a result, they become complacent as they feel that they only need to work with the analysts they have already engaged to ensure sustained coverage.

However, here is what those IR teams are missing:

1. Sell-side analysts can stop their coverage as and when they deem fit
2. The quality of research might diminish, providing the buy-side with no added value

Analysing Sell-side Coverage

The following points illustrate how a company typically gets coverage by the sell-side:

1. Company IR personnel/teams engage sell-side analysts and share the company's story, with the goal of enticing them to initiate coverage.
2. If successful, this push results in a lengthy and detailed initiation report, analysing the company from various angles and in depth.
3. Analysts typically absorb new details and update their models once the company releases its results during earnings season. They do so to reflect how things have changed since their last report.
4. This process continues until a sell-side firm decides to cut coverage on a company.

In the past, the reasons for cutting coverage on a company could be based on a few of these scenarios:

1. Lower trading commissions generated by less frequent buy-side trading of that company's stock
2. Failure to run a deal through the bank

Today, that pool of reasons has expanded to include the following:

1. MiFID II causing the sell-side to rethink the economics of their research departments
2. Sell-side reducing their headcount and, thus, their bandwidth to continue coverage of certain companies

Analysing the Quality of Sell-side Coverage

MiFID II's impact across global financial markets has led to a decline in the quality of sell-side coverage, with many of them increasingly resembling auto-generated reports that merely regurgitate broad earnings figures.

Sell-side research is also known to be vulnerable to conflicts of interest, as the bank has other relationships to maintain. And conversely, when running deals, the sell-side might be precluded from covering certain companies going public.

What Should Corporate Investor Relations Teams Do to Change This?

Cast a wider net and engage independent analysts.

What Is the Advantage of Independent Analyst Coverage?

Independent analysts might not provide regular earnings-related updates, which are typical to the sell-side, but are more driven to provide insightful and actionable ideas to the buy-side.

Their coverage might not follow a standard approach, but it will be substantive.

Buy-side's interest in independent analyst coverage has increased against the backdrop of the evolving set-up, pricing, and nature of sell-side coverage.

How to Gain More Coverage

1. Promote your company
2. Share updated investor presentations
3. Keep analysts in the loop on events that might impact your company
4. Be accessible when they come back with questions

Smartkarma has launched a new solution for corporates that allows C-Suite and IR teams to fulfil these critical functions under one roof.

Start your journey to more insightful coverage.

Visit the website to learn more:
www.smartkarma.com/home/corporates

Epilogue

There is a saying by the late Philip Fisher - acclaimed investor and author - that goes: "The stock market is filled with individuals who know the price of everything, but the value of nothing."

Fisher's quote speaks to the importance of corporate coverage and the fundamental role it plays in informing investment decisions.

The content compiled in this ebook evidence the extensive challenges faced by investor relations professionals who undertake the responsibility of acquiring such coverage.

In time, these challenges will only get harder.

Disruption has arrived, and this new reality calls for a makeover of how IR teams approach disclosures, as well as investor and analyst engagements.

Staying a step ahead requires IR teams to first acknowledge the trappings of sticking to the ways of old. That means being open to adopting new strategies and leveraging digital tools where necessary, such as Smartkarma Corporate Solutions.

For without venture, there can be no gain.

Find out more about Smartkarma Corporate Solutions:
www.smartkarma.com/home/corporates

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