
Truth Creates Light

The Edison Group

The Future of Equity
Research





Neil Shah, Director of Research Edison

Neil Shah is the Director of Research at Edison Investment Research, one of the largest independent research firms, with offices in London, New York, Frankfurt, Sydney and Wellington. Neil joined Edison in January 2005. Neil started his career at Price Waterhouse in 1997 in the banking, capital markets and treasury tax team. In 1997 he joined the pan European research team at Goldman Sachs covering construction & building materials. He left Goldman Sachs in 2003 to set up Tusker Capital, a long-short hedge fund. Neil graduated from the LSE with a BSc in economics.



Agenda

1. Introduction to Edison and the Future of Equity Research white paper
2. The importance of equity research for issuers
3. Key changes in the equity research landscape: introduction to MIFID 2
4. Global nature of the changes
5. Key changes we predict(ed) to the landscape

EDISON INVESTMENT RESEARCH

Equity research service

- Award winning
- Read in 100+ countries
- Top ranked on Google
- InvestorTrack® - readership tracking



Buy-side services*

- Expert speaker events
- Sector briefings
- White papers and sector reports
- Regular contact with funds



*All provided at Edison's expense



Compliance wall

Deep Sector Expertise



80 Analysts

EDISON ADVISORS

Investor relations

- Full service IR
- Investor marketing
 - Investor targeting
 - Roadshows
 - Market feedback



Consulting

- Project based
 - Due diligence
 - Fair valuations
 - Financial modelling
- Transaction based
 - M&A support
 - In/out-licensing





The importance of equity research

1. Price formation and the evaluation of the cost of capital by:
 - a. Establishing market context
 - b. Context allows for relative valuations
 - c. Capturing operating leverage
2. New issuance and capital formation
 - a. Market efficiency
 - b. Liquidity
 - c. Valuation and lower cost of capital
3. Public/policy awareness of capital markets' function

Means of assessing impact:

Assistant Professor Mark Kirkpatrick

Determinants and consequence of paid-for analyst research, 2011



MIFID 2: Significant changes to the equity research landscape

“Member states shall ensure that the provision of research by third parties providing portfolio management and other investment or ancillary services to shall not be regarded as an inducement if it is received in return for any of the following:

(a) direct payments by the investment firm out of its own resources

(b) Payments from a separate research payment account controlled by the investment firm, provided the following conditions relating to the operation of the account are met....

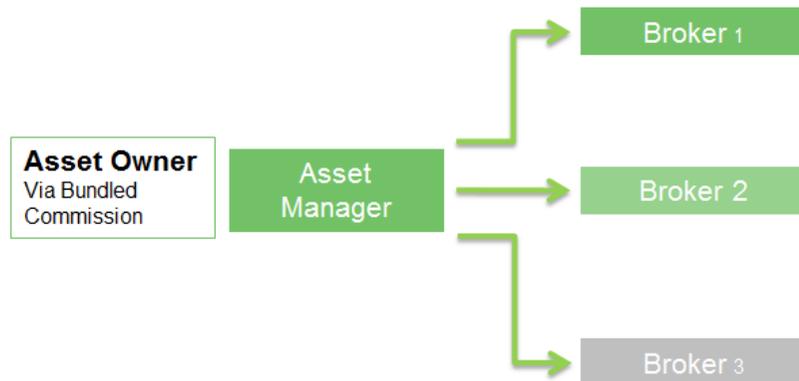
Article 13, Delegated Directive

Written material from a third party commissioned and paid for by the corporate issuer to promote a new issuance by the company, provided the material contains appropriate disclosures and is made available to any investment firm wishing to receive it or to the general public, is also a minor and non-monetary benefit.

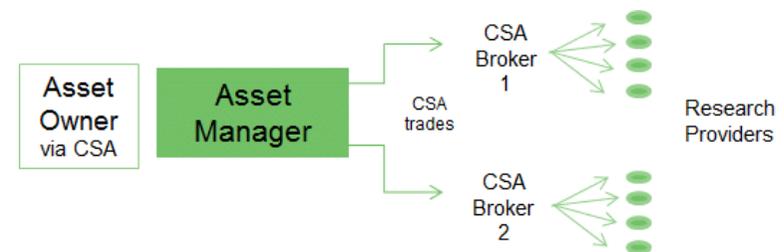
Article 12 (3), Delegated Directive

MIFID 2 in a nutshell: Making research spend accountable

Old way: Bundled commission model



Current model: CSA model



What MIFID 2 requires

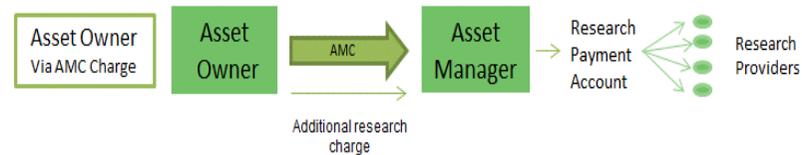
- Recognition that the broker vote system does not meet the requirements of MIFID 2
 - Not specific enough – does not relate to products being paid for – led to unconsumed products being paid for
 - Does not align to assets under management and investment mandates
- MIFID 2 requires:
 - A written policy for valuing research
 - A written policy for how a manager fairly allocates costs to different clients

MIFID 2 in a nutshell: Three ways of operating in the future

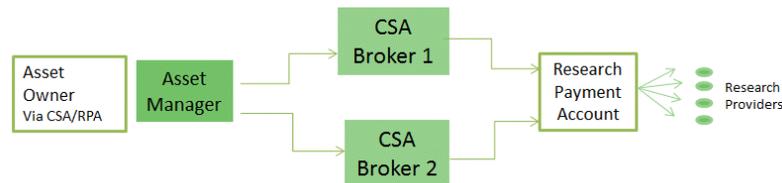
Model 1: Payment from own P&L



Model 2: The “Swedish Model” – ask asset owners for payments to procure research



Model 3: Creation of a Research Payment Account (RPA)



MIFID 2: An easy way of understanding it



MIFID 2: An easy way of understanding it





MIFID 2: Buy side responses we are seeing

1. A sense of urgency to be compliant – FCA thematic visits expected
2. Review of how inputs are procured
 - a. Leading to a cut in the number of providers fund managers are prepared to pay for by c.50%
 - b. A cut in the total commissions paid for research by c.30%
3. Building of in house analyst teams
4. Sourcing new inputs outside of the sell side
5. Firewalls starting to be put up – demonstrate that PMs not being induced
6. Decisions on how to pay for research: RPA or own P&L
7. Direct engagement with corporates



MIFID 2: Sell side responses we are seeing

1. Pricing strategies:
 - a. Take it or leave it – typically bulge bracket
 - b. Aspirational pricing
 - c. Price takers
2. Business model/strategy changes
 - a. Market share gains
 - b. Adoption of models compliant with Article 12(3)
 - c. Head in the sand
3. Threat of cutting of buy side in not being enforced
4. Making it harder to access research and withdrawal from consensus
5. Looking for new revenue streams/clients through aggregators e.g
ResearchTree



MIFID 2: Considerations for corporates/IROs

1. What was once free is no longer – analogy of newspapers
2. Buy-side is going to be less supported
3. Make it easy to follow/understand your company
 - a. Elevator pitch/investment thesis
 - b. IR website/presentations
 - c. Discovery presentations
 - d. Downloadable models
 - e. Accounting policies
4. Where do you focus your time – firewalled analysts
5. Role of the corporate broker and their business model
6. New stakeholders for IR communications – buy side/consultants
7. Feeding consensus estimates
8. Investor targeting
9. Feedback from investors



MIFID 2: Has a global impact

Why does a European piece of legislation have impact in the US?

1. Harmonization of operational procedures at global managers.
2. Need to treat clients equally/manage to the most conservative compliance geography in which the firm operates.
3. Shifting expectations of asset owners – *they increasingly understand the impact of research costs on returns*



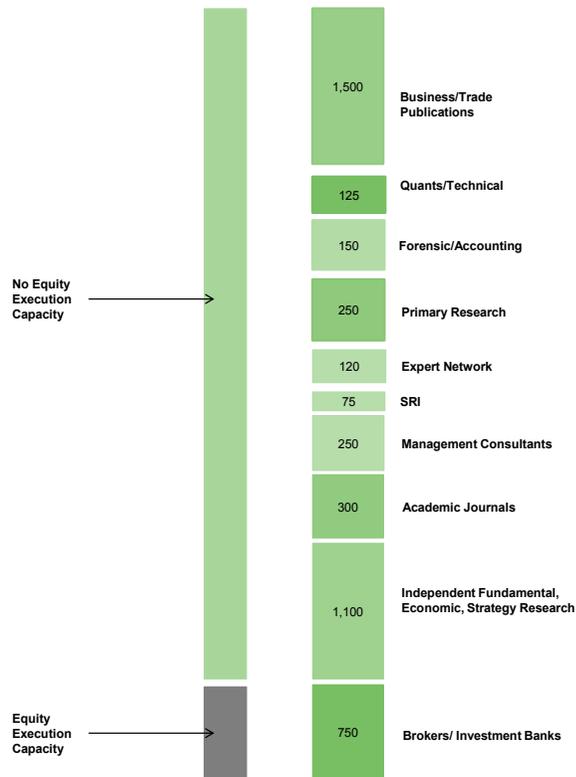
Near term changes expected

1. Continued separation between trading generated revenues and research service revenues – UK ahead of continental Europe
2. Opening up of the content universe – growth of IRPs
3. Shift from unpriced to priced research environment – welcome by asset managers despite implications for implementation
4. Shrinkage in the overall payments for research from asset managers
5. Reallocation of spend amongst research providers
6. Consolidation on the buy and sell side – organic and acquisition led



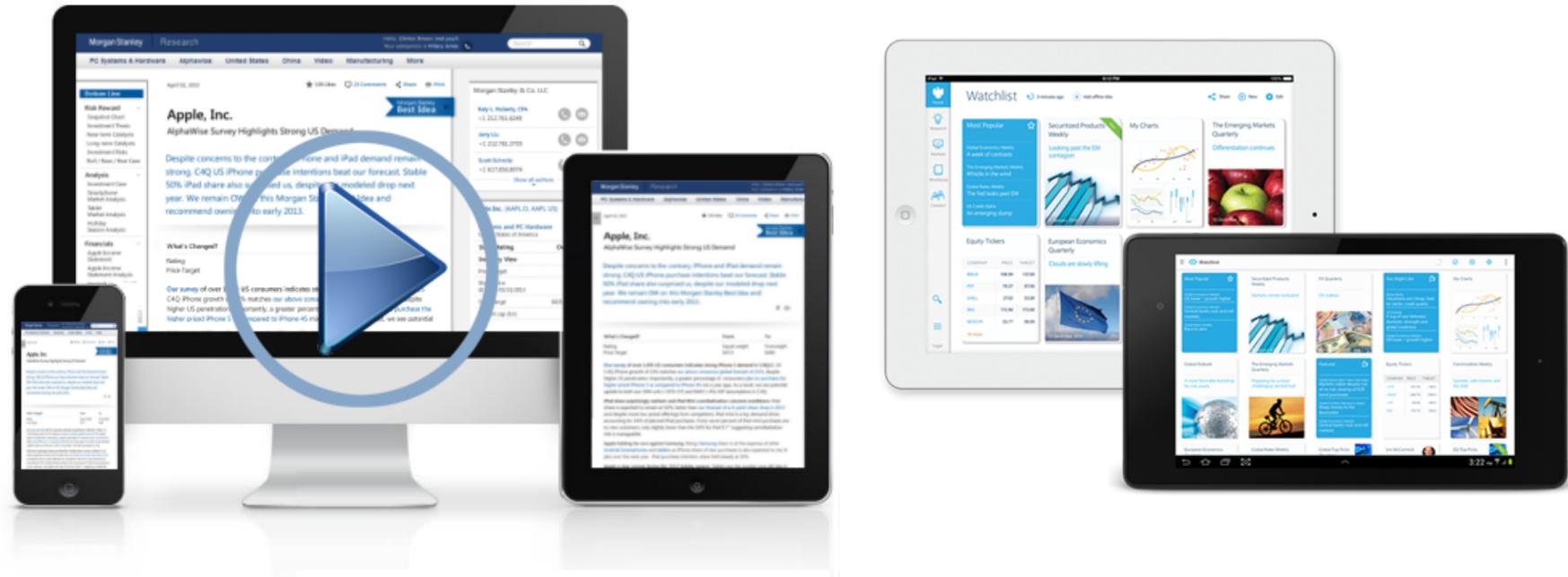
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Six key changes we envisage: 1. A network on new research inputs



The reference to substantive research in the *rule* on use of dealing commission (*COBS 11.6.3R*) is not confined to *investment research* as defined in the *Glossary*. **The FCA's view is that Substantive research can potentially be or include, for example, the goods or services encompassed by *investment research*, but this is not part of the criteria under *COBS 11.6.5E*, provided that they are directly relevant to and are used to assist in the management of investments on behalf of *customers*.** In addition, any goods or services that relate to the provision of research that the FCA regards as not acceptable under *COBS 11.6.6G* or *COBS 11.7.6R 11.6.7G* or *COBS 11.6.8G* should be viewed as not meeting the requirements of *COBS 11.6.3R(2)*, notwithstanding that their content might qualify as *investment research*.

Six key changes we envisage: 2. Unlocking of the PDF

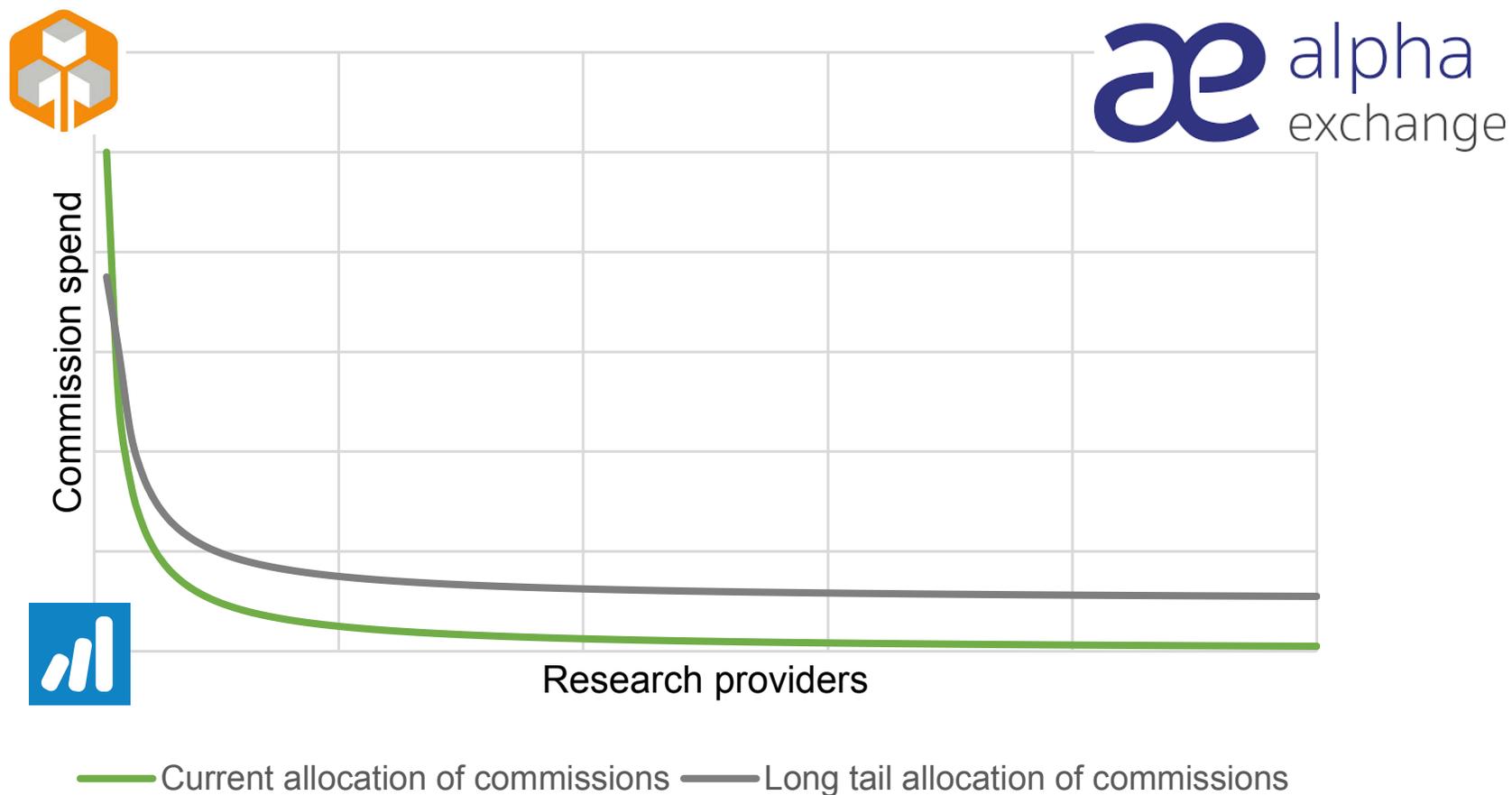




Six key changes we envisage: 3. Changing research content at banks



Six key changes we envisage: 4. Accessing the long tail of research





Six key changes we envisage: 5. Exchanges facilitating research



TEL-AVIV STOCK EXCHANGE

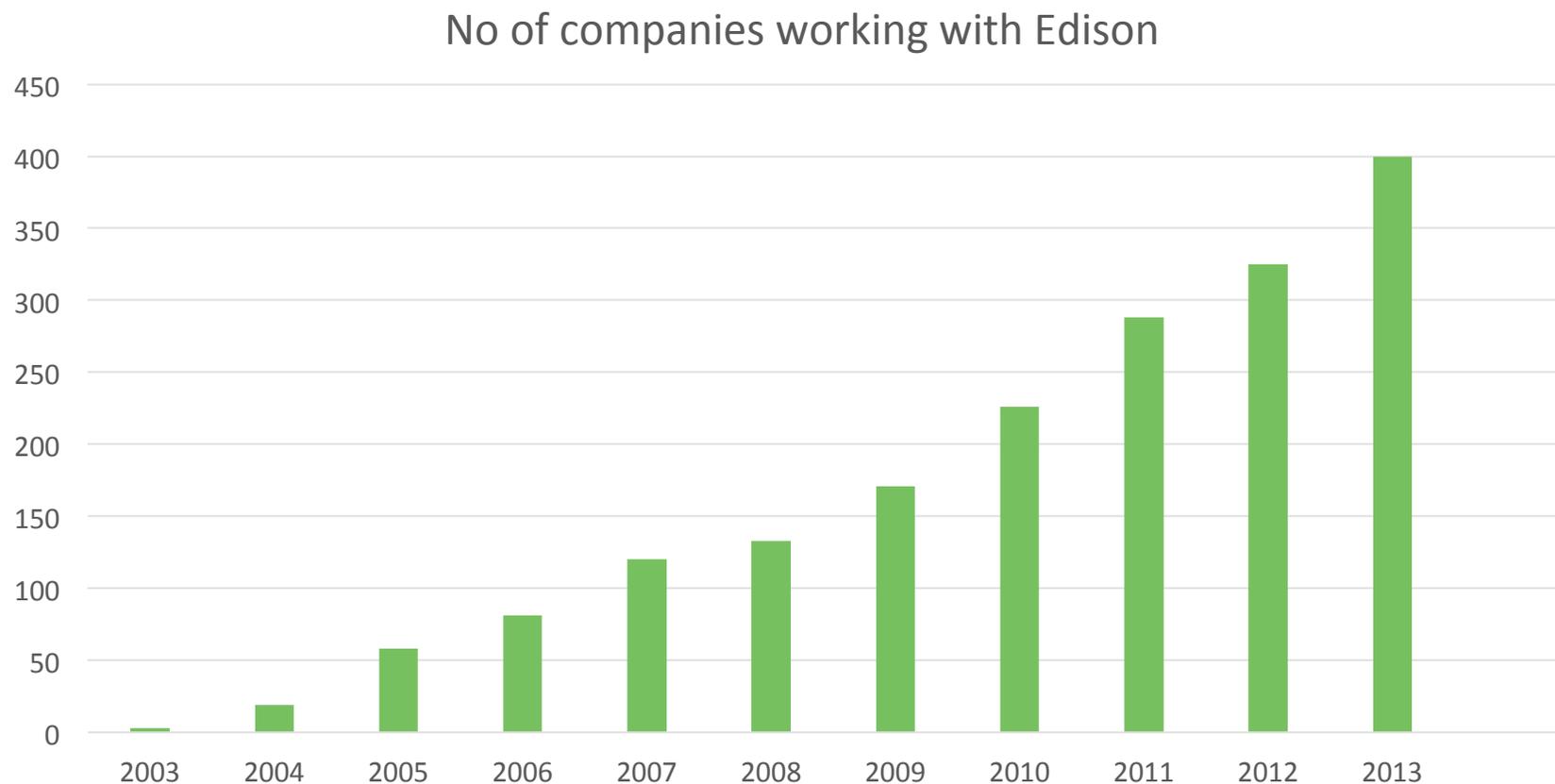


ASX

AUSTRALIAN STOCK EXCHANGE



Six key changes we envisage: 6. Growth in issuer sponsored research





Questions?

Neil Shah

Director of Research, Edison

NShah@edisongroup.com

+44 (0) 20 3077 5715