

# Equity Research and Advisory

Research is the result of advancing knowledge created in the past. Equity Research is a discipline within the financial services industry. Research is an activity that requires a lot of time and effort. It starts with choosing a company to work on, followed by collecting data and related information such as their financials and the analysis. The more information we have the accurate we get with predicting the value. The help of external sources such as information databases via the internet, research papers, annual reports and published information, company officials are of paramount importance to get at the right information.

Research requires data plus information as the basis for analysis. Information sources can be categorized as either primary or secondary data. Primary data is original data that has been collected by a researcher by whatever means appropriate. Examples of primary data include questionnaires, interviews, e-mails, contacts and surveys. Secondary data is data that has been collected by others for their own purposes, but which may be used by a researcher for his or her different purposes. Examples of secondary data include reference material, books, CD ROMs and financial statements.

Equity Research professionals are known most generally as "Equity Analysts," "Research Analysts," or "Securities Analysts" all the foregoing terms are synonymous. However, there are some analysts who cover all of the securities of a particular issuer, and stocks alike. Equity Analysts are usually further subdivided by industry specialization (or sectors) among the industries.

## Research Function

Analysts are often employed by mutual and pension funds, hedge funds, securities firms, banks, insurance companies, and other businesses, helping these companies or their clients make investment decisions. They read company financial statements and analyze commodity prices, sales, costs, expenses, and tax rates in order to determine a company's value and project future earnings. In any of these various institutions, the Analyst often meets with company officials to gain a better insight into a company's prospects and to determine the company's managerial effectiveness. Usually, Research Analysts study an entire industry, assessing current trends in business practices, products, and industry competition. They must keep abreast of new regulations or policies that may affect the industry, as well as monitor the economy to determine its effect on earnings. Traditionally, analysts use fundamental analysis principles but technical chart analysis and tactical evaluation of the market environment are also routine. Often at the end of the assessment of analyzed securities, an analyst would provide a rating recommending an investment action, e.g. to buy, sell, or hold the security.

The Analyst obtain information by studying public records and filings by the company, as well as by participating in public conference calls where they can ask direct questions to the management. Additional information can be also received in small group or one-on-one meetings with senior members of management teams. They often meet with company officials to gain a better insight into a company's prospects and to determine the company's managerial effectiveness.

## Methodology used in Equity Research

In the broadest terms, Analysts seek to develop, and thereafter communicate to investors, insights regarding the value, risk, and volatility of a covered security, and thus assist investors to decide whether to buy, hold, sell or simply avoid the security in question or derivative securities. To gather the information required to do so, Analysts review periodic financial disclosures of the issuer and other relevant companies, read industry news and use trading history and industry information databases, interview managers and customers of the issuer, and perform their own primary research.

Research analysts produce reports and typically issue a recommendation: buy, hold or sell. These reports can be accessed from a number of sources, and brokerages will often offer the reports free to their customers. They may make presentations to prospective investors about the merits of investing in the new company. Analysts also work in mergers and acquisitions, preparing analyses on the costs and benefits of a proposed merger or takeover.

Research Analysts or Equity Analyst use spreadsheet to analyze financial data, spot trends, and develop forecasts. On the basis of their results, they write reports and make presentations, usually making recommendations to buy or sell a particular investment or security. Senior Analysts may actually make the decision to buy or sell for the company or client if they are the ones responsible for managing the assets. Other analysts use the data to measure the financial risks associated with making a particular investment decision.

Research Analysts collect industry data, financial data mainly balance sheet, income statement and cash flow statements, financial ratios, merger and acquisition history and financial news for their clients. They normally standardize the different companies' data to look uniform and facilitate their clients to do peer analysis. Their main objective is to enable their clients to make better decisions about the investment. They also provide the information on financial ratios calculated from the data that they gather from the financial statements that help clients to read the bottom line of the company. They normally standardize the different companies data to look uniform and facilitate their clients to do peer analysis.

Analyst recommendations on stocks owned by firms employing them may be seen as potentially biased. This may be less of an issue with analysts employed by firms that do not own the recommended stocks.

Since 2002 there has been extra effort to overcome perceived conflicts of interest between the investment part of the firm and the public and client research part of the firm. For example, research firms are sometimes separated into two categories, brokerage and independent. Independent researchers are not part of an investment firm and so don't have the same incentive to issue overly favorable views on companies. But this might not be sufficient to avoid all conflicts of interest. The temptation for analysts to act as stock sellers and to lure investors into "overtrading" could be high. Some consider that it would be sounder if investors had to pay financial research separately and directly to fully independent research firms. Analyst keep Investment Advisors informed with the current market conditions regularly.

## Reports

Research Analysts use all information gathered to prepare Company reports, IPO reports, Sector reports, Daily / Weekly market reports, and Private Placement documents for companies, Introductory documents for the listing of the company while distributing those reports among investors or prospective investors and investment advisors. Generally the components of a company research reports are as follows

- Company Profile
- Financial Performance
- Financial Analysis
- Conclusion

Components of a Daily / Weekly market performance reports as follows

- Market Performance
- Daily / Weekly Market Summary
- Average Daily turnover in a week
- Top Five Contributors for the Day / Week
- Top Five Volume Contributors for the Day / Week
- Company News
- Economic and Money Market news
- Financials
- Dividend Announcements
- Rights Issues
- Share Swaps
- List of Securities on which price band is applicable
- Daily / Weekly Money Market Review and Economic Indicators
- Tourist Arrivals
- Commodity News
- Currency News
- Worldwide News

## Making use of Reports

Research is designed to solve a particular existing problem so there is a much larger audience eager to support research that is likely to be profitable or solve problems of immediate concern. We also must understand how research impacts our decision making. Some People make decisions without gathering information to back them up. They aren't patient enough to put in the effort. Research requires time, effort, and sometimes money to have the information you need to make a sound decision that's why many avoid it. The research reports we do will have impact on your future decisions. Be advised, considering the risks or consequences of making an important decision without inadequate information.

In conclusion research reports are very vital to everyday decision making. It helps you make calculated and informed decisions.

## Research and Investment Advisory

Investment Advisor is a regulated professional who buys and sells shares and other securities through market makers or Agency only firms on behalf of investors. A transaction on a stock exchange must be made between two members of the Exchange. Such an exchange must be done through a broker.

There are three types of stockbroking service.

- Execution-only, which means that the broker will only carry out the client's instructions to buy or sell.
- Advisory dealing, where the broker advises the client on which shares to buy and sell, but leaves the final decision to the investor.
- Discretionary dealing, where the stockbroker ascertains the client's investment objectives and then makes all dealing decisions on the client's behalf.

According to the Colombo Stock Exchange Rules and Regulations an investee can give the broker or the brokering firm discretion which may be complete or within specific limits as to the purchase and sale of securities including selection timing and price. A broker or brokering firm shall not exercise any discretionary authority with respect to a discretionary account unless investee has given prior written authorization to exercise discretion on the account and the member firm has accepted such authority to manage a discretionary account.

Investment Advisers may help their clients invest for both long and short term goals. It is the Investment adviser's duty to determine the clients' goals and risk tolerance and then to recommend appropriate investments.

Business firms or organizations raise funds from investors in the form of equities and debts collectively known as the capital structure and further reinvest it into various investment schemes by carefully analyzing the returns in order to meet out their obligations relating to purchase of assets which provides them long term benefits. An Investment advisory, in financial/investment organizations, is the unit linking the investment professionals in the central asset management unit to the relationship managers and to important clients of the asset management organization. Investment Advisors explain the investment ideas of the experts to their internal or external clientele and propose adequate investment solutions. In turn, they

identify needs and wishes of the clients or the Relationship Managers of their organization and transport them to the central (financial/investment) asset management unit.

Generally, a long time horizon allows for the advisor to recommend more volatile investments with potentially greater risks and rewards. Such investments include direct investment in stocks or through collective investment products such as mutual funds and unit investment trusts/unit trusts.

If the client has short term goals, the adviser should recommend less volatile investments with shorter time spans. Although short-term investments can guard against loss of capital, their value can be eroded by inflation over longer periods of time.

Many Investment Advisers receive a commission payment for the various financial products that the broker, although "fee-based" planning is becoming increasingly popular in the financial services industry around the world.

Investment Advisors also sometimes or exclusively trade on their own behalf, as a principal, speculating that a share or other financial instrument will increase or decline in price.

Investment has different meanings in finance and economics. Finance investment is putting money into something with the expectation of gain that upon thorough analysis has a high degree of security for the principal amount, as well as security of return, within an expected period of time. In contrast putting money into something with an expectation of gain without thorough analysis, without security of principal, and without security of return is speculation or gambling.

To avoid speculation an investment must be either directly backed by the pledge of sufficient collateral or insured by sufficient assets pledged by a third party.

In terms of financial assets, these are often marketable securities such as a company stock (an equity investment) or bonds (a debt investment). At times, the goal of the investment is to produce future cash flows, while at others it may be for the purpose of gaining access to more assets by establishing control or influence over the operation of a second company (the investee). While it should be borne in mind that research reports are prepared with careful analysis and they are subjective and may not necessarily be right. Research and Investment Advisory go hand in hand. Research reports are the tools used to assist investment advisors to equip their clients with information required to make calculated decisions.

Information to research into companies and sectors are carried out using information obtained from financial websites, fact books, Colombo Stock Exchange and financial market reports.

*Source: Taprobane Securities (Pvt) Ltd*