

Three Part Advisors, LLC



The Day in the Life of a Sell-Side Analyst

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Agenda

- Who/what is the sell-side?
- A day in the life of a sell-side analyst
- How sell-side analysts are motivated and compensated
- How sell-side analysts select the companies they cover
- How the sell-side is changing
- What does it mean for investor relations



What is the Sell-Side?

- Broker/ Dealer analysts
- Independent research analysts
- Brokers (retail and institutional), investment bankers





Who are Broker/Dealer Analysts?

- Work for broker dealers/ investment banks
- Subject matter experts – focus on 10 to 15 companies
- Who are they? – Cross between an analyst, broker, investment banker



Who are Broker/Dealer Analysts?

Broker/ Dealer Analysts Types

– Distribution

- Institutional – JP Morgan, CSFB,
- Retail – Merrill Lynch, AG Edwards

– Size

- Bulge Bracket – Goldman Sachs,
- Regional – Stephens, Sanders Morris Harris,
- Boutique – First Dallas,



Who are the Independent Analysts?

- Independent of investment banking
 - Perceived to have no conflicts of interest
- Not as well defined as broker/ dealer analysts
 - Fundamental and/or quantitatively driven
 - Individual investor focused and/or institutional investor focused
 - Varying methods of compensation
- Examples
 - Sanford Bernstein, Sidoti – fundamental, institutional focused
 - Value Line, Zacks - quantitative, large universe, individual focused
 - Farmhouse Equity, Moss Creek Capital – boutique, institutional focused



Side by Side Comparison

Independent	Broker/ Dealer	Buy Side
10 to 200 stocks	10 to 15 stocks	40 to 50 stocks
Independent Research Firm	Broker Dealer/ Investment Bank	Institutional Investment Firm
50% of time spent researching	50% of time spent researching	100% of time spent researching
Generalist/ Subject Matter Experts	Subject Matter Experts	Generalists



Why is the Sell-Side Important?

For companies – Help provide a more efficient market for a company's stock

- Make introductions to their clients
- Increased the number of investors that are exposed to a company
- Publish ongoing estimates to help set the bar for expectations
- Provide third party validation



Why is the Sell-Side Important?

For companies -

- Assist in educating investors about the investment merits and risks of a company
- Overall, the more investors that know about a company's stock, understand its investment merits and risks, the stock will be more liquid, less volatile and achieve higher valuations.



Why is the Sell-Side Important?

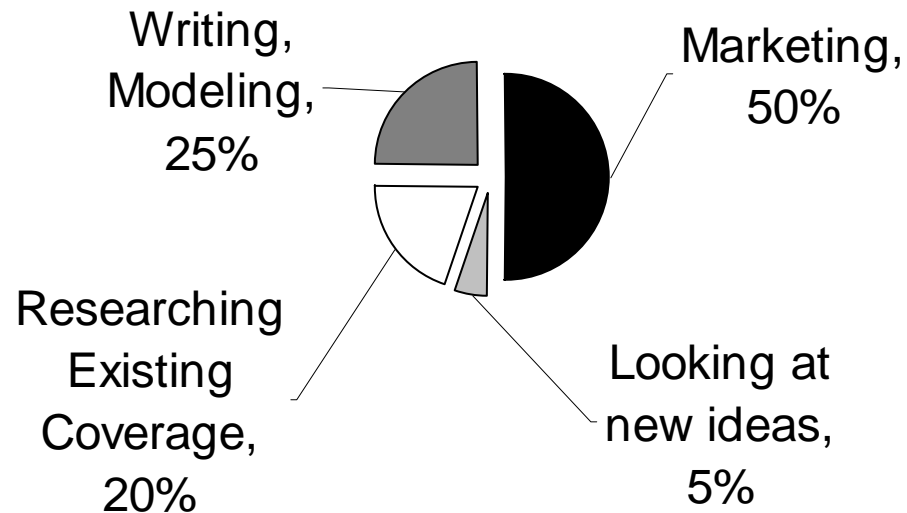
For Investors -

- Decrease the time necessary to research a company
- Provide incremental data flow that can help investors paint a mosaic
- Valuation and Buy/ Sell recommendations are less important



A Day in the Life of a Sell-Side Analyst

- Work about 60 hours a week
- Travel about 2 weeks out of every month





A Day in the Life of a Sell-Side Analyst

Research

- Channel checks
- Industry research, trade shows
- Visiting companies and speaking with management
- Reading SEC filings, press releases, industry publications



A Day in the Life of a Sell-Side Analyst

Marketing Activities

- Sales force morning meetings
- Calls to clients - about 20 calls a day on average.
- Client meetings
- Media



A Day in the Life of a Sell-Side Analyst

Other Activities

- Modeling – earnings, cash flow, valuation
- Writing research reports/ notes
- Compliance



How Sell-Side Analysts are Compensated

	Years of Experience		
	<5 years	5-10 years	10-20 years
2005 Median Compensation	\$130,000	\$185,000	\$315,000
90th Percentile	\$210,000	\$525,000	\$900,000

Source: CFA Institute



How Sell-Side Analysts are Compensated

- 1) Generating commissions
- 2) Investment banking fees?
- 3) Making the right calls
- 4) Other key factors
 - II rating, WSJ Ratings, others



How the Sell-Side Looks at Coverage

- 1) Identify investment themes
- 2) What companies fit within these themes
- 3) Is it profitable for my firm to cover the stock?
 - Are there enough trading commissions to go around
 - Can I differentiate myself
 - Investment banking Fees?
- 4) Do I need to follow it to understand the industry/ investment themes?



Identify Investment Themes

- Identify a trend that is happening in the market place
- What companies will be able to benefit from the trend
- Ideas sources
 - Buy Side
 - Customers, suppliers, industry contacts
 - Management teams

How Much Commission Can be Generated?



Average Analyst Compensation	\$250,000
Commission \$ need to cover 10% allocatinon to research	\$2,500,000
Commission per share	0.03
Number of Shares	83,333,333

Divided by Numer of Stocks followed	12
Divided by Number of trading days in a year	250
Number of Shares required to trade per day (per stock)	27,778

XYZ Large Cap company Trading Volume	1,800,000
Number of Analysts that Follow the stock	20
Equal Share of trading volume	90,000

ABC Small Cap Company Trading Volume	26,000
Number of Analysts that Follow the stock	2
Equal Share of trading volume	13,000



Can I Differentiate Myself?

What do the Customers Want

Overall Rank	Attributes
1	Industry knowledge
2	Integrity/ Professionalism
3	Accessibility/ responsiveness
4	Useful & timely calls & visits
5	Management access
6	Independence from corporate finance
7	Special services
8	Written reports
9	Financial models
10	Communication skills
11	Stock Selection
12	Quality fo sales force
13	Earnings estimates
14	Market making execution
15	Primary market services

Source: Institutional Investor Magazine



How Do I Generate My Fair Share of Commissions

- Become an industry expert
 - Industry contacts
 - Channel checks
- Access to management
 - Road show
 - Conference
 - Conference calls

Source: Institutional Investor Magazine



How is the Sell-Side Changing?

Commissions are Shrinking

- Pricing ↓
 - From \$0.125 (1/8) to \$0.02 per share
- Volumes ↓
 - Increase in electronic trading (Instinet, Island, others)
- Reg FD
- Widespread availability of information and analytical tools



How is the Sell-Side Changing?

Investment Banking Fees are Still Important

Background

- Investors' interests were compromised for greater investment banking revenues.
- Analysts were being **DIRECTLY** compensated for helping to generate investment banking revenue



How is the Sell-Side Changing?

Investment Banking Fees are Still Important

New rules separate investment banking from research

- 1) Analysts pay can't be tied directly to **SPECIFIC** investment banking transactions.
- 2) If an analyst's compensation is based on the firm's general investment banking revenues, it must be disclosed in the firm's research reports.
- 3) Research can not be a tool for selling investment banking services



How is the Sell-Side changing? Investment Banking Fees are Still Important

“All of the views expressed in this report accurately reflect the personal views of the responsible analyst(s) about any and all of the subject securities or issuers. No part of the compensation of the responsible analyst(s) is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the responsible analyst(s) in this report.”

“The analyst(s) responsible for preparing this research report received compensation that is based upon various factors, a portion of which are or have been generated by investment banking activities...” of the firm.



How is the Sell-Side changing?

Investment Banking Fees are Still Important

- Can be “Indirectly Compensated”
- Commission versus investment banking fees

\$100,000 investment banking fee

=

Trading commissions of 3.3 million shares

(@ \$0.03 per share)



How is the Sell-Side Changing?

Pay is Decreasing

Years of Experience

<5 years 5-10 years 10-20 years

**2005 Median
Compensation**

\$130,000

\$185,000

\$315,000

**1999 Median
Compensation**

\$110,000

\$260,000

\$497,500

**Change in
Compensation**

18%

-29%

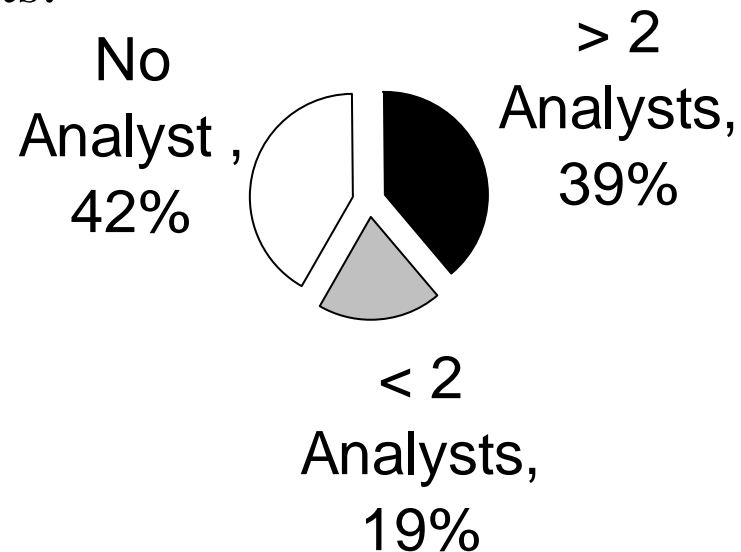
-37%



How is the Sell-Side Changing?

Sell-Side Analysts are Leaving

- Research coverage is down by 35% since 2001
- 60% of the public companies are being covered by less than 2 analysts.



Source: Thomson/ First Call, NASDAQ, Reuters



What Does it Mean for Investor Relations?



What Does it Mean for IR?

- It is important to know the themes of the analysts that follow your industry
 - How does your company fit within the theme
 - Do the analysts that write on your industry have different themes
 - What implications does it have for my messaging and targeting



What Does it Mean for IR?

- Be proactive in establishing relations with the RIGHT sell-side analysts
 - Understand the motivations for why analysts would want to follow your company
 - Target based on distribution, understanding of the industry, influence, consistency with investment themes
 - Ask your major holders about the sell-side



What Does it Mean for IR?

- Understand that “access to management” is a major part of analyst compensation
 - Conferences
 - Road shows
 - Conference calls
 - Allocate accordingly



What Does it Mean for IR?

- Investor relations becomes more important
 - Increasing awareness, educating investors
 - Important to establish direct relationships with the buy side
 - Continue to cultivate sell-side relationships

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