Introduction to Business Valuation and Restructuring

Learning Problems and Discussions

Online Discussion

**Problem: CFA Research Standards**

1. Hanna Jacobson is an equity analyst covering Delta Ltd. for Shuswap Investments. She visits Delta’s CEO regularly, along with analysts from other firms, to discuss company affairs. Jacobson’s airfare and hotel charges are paid for by Delta. Her husband was recently hired by Delta’s regional office near her home.
2. Jon Dreyfuss is an equity analyst for a major investment firm. He just completed a research report for Tungsten Inc. and found the company to be a strong buy. He and his spouse bought 10,000 shares of Tungsten before issuing the report to clients. They sold their shares for a large profit two weeks later.
3. Harrison Investments’ compliance department recently issued a policy requiring all equity analysts to report their personal stock holdings each quarter along with their weekly trades which must be approved in advance. A restricted period is also enforced for specified securities.
4. Shannon Willington is an equity analyst at Chelsea Investments. Willington prepared a research report on Excalibur Enterprises, one of the firm’s corporate finance clients, and gave it a strong buy. She attended an investment seminar to pitch the company to a group of retail investors on her employer’s behalf. She did not mention that her compensation is linked to the success of a recent secondary issue by Excalibur.
5. Mary Jenkins is an equity analyst at Hoboken Ltd. She took a research report from another firm, made minor changes, listed herself as the author, and then issued it to the company’s clients.
6. John Williams is an equity analyst in the research unit of Aloha Securities. Rebound Inc. hired the firm’s investment banking unit to price and distribute a new secondary share offering. Williams was asked to prepare a research report. In addition to his base salary, Williams received 10,000 stock options in Rebound. The research unit reports to the head of the investment banking unit. Williams was told to keep the head of that unit informed about the contents of the report and to get their approval before issuing it. Williams must also take part in a “roadshow” to promote the offer.
7. Heather Baxter is an equity analyst who follows Great Plains Manufacturing for Glacier Bay Securities. After a recent meeting with analysts to discuss a negative earnings announcement that was previously made public in a press release through SEDAR, the company’s CEO Betty Weston talked alone with Baxter about a new product the company was developing that had not yet been made public.
8. Tanya Thomas is researching Mandalay Pharmaceuticals who is currently developing a new treatment for diabetes. To learn more, Thomas arranged a meeting with a well-known industry expert through a placement service. The expert indicated that the new treatment was revolutionary and would eliminate the need for insulin injections in the future. The placement service confirmed that they provide training to all experts about the importance of not disclosing material, non-public information and that the expert does not or has not worked for Mandalay.
9. U.S. Global Investments uses “firewalls” to prevent the movement of information between its investment banking and research units.
10. Ranson Securities decided to stop covering Klondike Industries and will not issue any new research reports.
11. Catherine Toews was part of a group of five analysts who completed a research report on Agassi Enterprises. Toews asked her supervisor to exclude her name from the report as she did not agree with the recommendation.
12. Debra Bracken has just issued a research report for Mendoza Industries with a buy recommendation. She based her analysis on a careful review of the company’s financial filings, conference calls with executives, several company visits, and interviews with several industry experts, suppliers, bankers, and creditors. Bracken accepts no gifts from any subject companies and pays her own travel expenses. She does own shares in the companies she recommends but only purchases them after her clients have had an opportunity to trade.
13. Mary Patel is an equity analyst with CCR Investments. She just completed a research report for Quesnel Ltd. and gave a strong buy recommendation. Patel decided to leave CCR and start an independent research firm with a number of her college classmates. The new firm immediately initiated coverage of Quesnel and Patel issued a new research report.
14. Howard Dove is preparing a research report for Big Pit Mines. Dove determined its newest mine had reserves of one million ounces of gold using core samples provided by the company. In his report, Dove stated that the company was a strong buy based on its proven reserves.
15. Nancy Mantel took over coverage of Smithson Ltd. from a colleague who went on maternity leave. She used a business valuation model from her colleague’s last report which contained future cash flow estimates based on a best-case scenario that she did not fully understand.
16. Tom Willow recently completed his first research report on Savona Enterprises which was distributed to the firm’s clients after a quick review by his supervisor. The report is based on a valuation model Willow claims to have developed but that he found in an older research report from another firm. He adjusted the model to exclude a key variable that increased the value of Savona to the level the firm’s investment banking unit wanted. Savona’s net income for the coming year was reported to be CAD 753 million. It was CAD 573 million due to a transposition error but Willow decided not to correct it as he did not want his clients or supervisor to think he was careless. In the report, Willow wrote he had been a leading equity analyst for the last 15 years and generated returns for his clients that far exceeded their S&P TSX index benchmark. Willow had worked in the firm’s mutual funds sales department.
17. Rita Dolson is a partner in a small investment firm. The company does not have sufficient resources to write its own research reports so its purchases them from a financial information services provider. The reports are reformatted, modified slightly, and the firm’s logo placed at the top of each page but no reference is made to their source. In one report, Dolson did not understand the methodology used to value the company but her firm still distributed it and added wording that above-market returns were guaranteed.
18. Radisson Wealth Management introduced a policy that all equity analysts must act independently and objectively. The research unit cannot report to the investment banking unit and no equity analyst can collaborate with them, participate in any marketing activities, or be compensated in any manner other than the quality of their research.
19. Janice Riley follows Harness Industries for Satellite Investments and values the firm using the average P/E, P/BV, and P/S market multiples for a group of five comparable companies. Riley began using the income approach based on FCFF and calculated the cost of capital using the build-up method. In her most recent report, she only informed clients that she used a proprietary valuation model and had recently updated it to better serve clients.
20. Abby Crawford was hired by the investor relations department of Churchill Industries. Churchill is not currently covered by any investment firm, so it commissioned a research report to promote its upcoming equity offering. Crawford was told to give a strong buy recommendation and write the report so potential investors thought it was written by a major investment firm. She was paid a flat fee plus a bonus based on the funds raised.
21. Henry Pascal is a diamond mining analyst for Holmstrom Financial covering Sparkling Ltd. He recently visited three of the company’s diamond mines in the Northwest Territories as part of a tour organized by their investor relations department. Sparkling provided a chartered flight to each of the sites plus lodgings in employee bunkhouses at their expense.
22. Rubin Meadows is employed in the investment banking unit at Skylark Investments. He promised a prospective client that the firm’s research unit would initiate coverage of the company and provide a strong buy recommendation if Skylark was hired to manage its IPO.
23. Stanley Robbins is a research analyst who sits on the board of Dolson Industries. He does not own shares in the company but his spouse and her five siblings own 40% of the business as part of a family trust established by their late grandmother. The trust decided to sell some of its Dolson shares to diversify its holdings. Robbins convinced his firm to begin covering Dolson and Robbins gave a strong buy recommendation in its first research report.
24. Selma Investments requires all its employee to provide a summary of their investment holdings and those of their immediate family members each quarter. Personal transactions must be prescreened by the compliance department and the employee must provide a trade confirmation. It maintains a restricted list of all companies for which it issued a recommendation in the last 21 days or has insider information.
25. Oscar Willobey was having difficulty submitting a research report on time. While sitting in the kitchen at the family cottage, Willobey collected background data about Twilight from a Wiki site, scanned several blogs that discussed industry trends, and found EPS estimates from Yahoo Finance. Using this information, he wrote the research report where he recommended Twilight as a strong buy.
26. Dessy Ramos is considering a job offer with Rosemary Capital but she has several concerns. Ramos manages the retirement funds of her elderly parents and several of her aunts and uncles as fee-paying clients. She is concerned that she will have to give her firm’s regular clients preference over her family members and have to spend an onerous amount of time pre-clearing all their transactions, filing trade confirmations, and disclosing their holdings each quarter. The firm also has a defined contribution pension plan and each employee must make monthly contributions. The fund invests primarily in large well-diversified equity and fixed-income funds, but Ramos fears reporting all these transactions will be very time-consuming.
27. Kathleen Trembley is the CEO of Portsmouth Investments. She discovered that two members of the investor relations department at Waterloo Industries were found guilty of insider trading and tipping after a recent negative earnings announcement. An analyst at Portsmouth who follows Waterloo was investigated by regulators but not convicted. Trembley met with the analyst who said she sold a large number of shares just before the announcement, but it was based on other public information. Trembley accepted the analyst’s explanation and took no further action as it would have been embarrassing to the firm. Portsmouth currently does not have a compliance officer and only relies on its supervisors to monitor analysts for any wrongdoing.
28. Hanna Wexler is the Chief Compliance Officer for Augusta Investments.  She is reviewing three management practices at the firm:

**Practice 1** Research analysts must invest in the companies they recommend to better align their financial interests with those of investors.  Analysts purchase shares before issuing research reports relating to all initial or secondary share offerings.

**Practice 2** The research unit is separate from the investment banking unit and it reports to a different manager.  Research analysts frequently verify information about the companies they are following with the investment banking unit.  All contacts with the investment banking unit are documented and overseen by the compliance department.

**Practice 3** Research analysts regularly speak about the companies they recommend at investment conferences commencing 30 days after the research reports are issued relating to initial and secondary offerings.

1. Robert Evans is an equity analyst with the research unit at Reese Investments and is preparing a report for Braxton Enterprises.  The research unit reports directly to Reese’s CEO.  Reese’s investment banking unit is working with Braxton to prepare a major secondary equity offering.  Evans along with a group of analysts from other investment companies visit Braxton’s headquarters at their own expense which includes a discussion with their CFO and COO.  At this meeting, they announce a new product launch and Braxton immediately follows this up with a press release on SEDAR.

Reese Investments requires that analysts purchase shares in all the companies they recommend but not for at least 10 business days after the secondary offering is first issued so their clients have time to trade.  Also, all shares purchased must be held for at least 60 days by the analyst unless an extreme case of financial hardship can be proven.

The secondary offering at Braxton is unsuccessful, so Reese Investments is terminated as its investment banker.  Reese Investments immediately discontinues coverage of Braxton and re-assigns Evans to a new company.

1. Trudy Walsh is a sell-side analyst for Skylar Investments.  She works for the firm’s research department preparing investment reports for several public companies.  As part of her duties, she speaks about these companies at investor forums and in media interviews.  During these appearances, she provides investors with a copy of the research report or a website link at no cost.  She makes it clear that she works for Skylar’s research unit and that all recommendations have a reasonable and adequate basis and are approved by the firm’s investment review committee.  She stresses that the firm’s investment banking unit or the subject company does not influence the committee’s findings in any way.  Research analysts cannot issue any new research reports or recommendations within 30 days of an initial or secondary offering managed by the firm’s investment banking unit.

Walsh indicates that she must continually disclose all her personal stock holdings to Skylar and that she cannot buy or sell shares in any company that Skylar has an investment banking relationship with until an initial or secondary offering is complete.  Walsh must hold all shares purchased in a firm that Skylar covers for at least 60 days, cannot trade in derivatives relating to its shares, and must trade per the firm’s recommendations.

Walsh is compensated based on the quality of her research, including its accuracy over time, and the success of any initial or secondary stock offerings managed by Skylar’s investment banking unit relating to companies she covers.

**REQUIRED:**

1. Describe how each of the above actions either violates or complies with CFA research standards.

**Discussion: CFA Institute Research Challenge**

The CFA Institute Research Challenge invites finance students from across the globe to compete preparing and presenting company research reports that include a buy, hold, or sell recommendation.

**REQUIRED:**

1. Review the research reports and presentations of the global champions for the last three years found on the CFA Institute website. Select the best team and decide why you chose them. (https://cfainstitute.org/en/societies/challenge/past-champions).
2. Prepare an approximately 200-word submission describing your decision in Part 1. All submissions should be thoroughly researched and carefully written and edited before being posted to the discussion board.
3. Respond to the posts of at least three classmates.