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Transparency in forecasts has disappeared

In the investment world, before MiFID II, essentially every institution talked to every broker, and the whole, professional market could see every research note and the forecasts in detail. This was the 'Age of Consensus'. Everyone had the same information (well, everyone except retail investors), and this transparency helped share price formation and liquidity.

Today is very different. Company managements may not appreciate that institutions have typically halved their broker list. As management, you may feel comfortable that you have, for example, eight analysts writing about you – you should feel less so if many of them are not visible to anyone! This article shows how transparency in forecasts has disappeared. Our work shows that, for a typical company with eight analysts, only four forecasts are visible. This demonstrates the risk of confusing coverage with distribution.

MiFID II changes everything, including broker reach

Many brokers have seen their reach go from universal to 'tight'

Most of what has been written about the new environment for investment research has centred on the number of analysts per stock. Indeed, Hardman & Co has been at the forefront of exploring this impact and any consequent effect on liquidity with our own *MiFID II Monitor*. But the more crushing, and far less appreciated, outcome has been on the broker relationship with institutional clients. Many brokers have seen their reach go from universal to 'tight'.

Quantity and quality of research

Volume doesn't necessarily equal value

Some commentators wonder whether the quality of research has gone down. One way to assess this would be to examine the data for the number of pages published collectively in 2018 versus 2017. Recognising that volume doesn't necessarily equal value, if, say, we found that, on average, the figure had halved, then that would be a strong indicator. Unfortunately, these data do not seem to be available.

We have some qualitative evidence, though. The Quoted Companies Alliance recently published its 'Mid and Small-Cap Investor Survey'[1] . 62% of institutions surveyed thought there was less research in 2018, compared with 48% that held that view in 2017. What is particularly interesting is that only 28% of companies have noticed that there is less research. Look forward to the next 12 months and the survey shows 71% of institutions think there will be less research, but only 32% of companies share that view.

Distribution of broker research is key…

Two points should be made about these data.

- Firstly, they are restricted to mid- and small-cap coverage, although there is no reason to believe the large-cap landscape is any different.
- Secondly, there is a significant variance between the views of institutions and companies. Of the two, we would pay more attention to institutions, since they are the audience at which research is targeted. In fact, the difference may be

[1] PP 22 and 33, 'Mid and Small-Cap Investor Survey 2019: MiFID II - The Search for Research', QCA/Peel Hunt, February 2019

explained by distribution. If you have cut the number of brokers you deal with, of course you’re going to see less research.

Companies may not realise this change in broker distribution. In fact, 42% of institutions surveyed would recommend companies change to brokers whose research is more widely distributed[2]. When asked, ‘what are the most important questions mid- and small-cap companies should be asking of their brokers or investors in relation to MiFID II’, 38% of investors answered, ‘How widely does my broker distribute research?’[3]

The QCA/Peel Hunt survey also focused directly on quality. 37% of institutions felt the quality of research had declined and 35% thought it would get worse in 2019[4].

Of course, simply measuring the number of analysts is crude – it does not address the issue of length and depth of analysis. Company A might have 10 analysts who wrote a total of 40 pages about it in 2018 – i.e. the notes were largely a cut and paste of the results statements – while company B had only five analysts with a total page count of 100. This suggests that the analysts of B put in more effort to help investors understand the investment case and went beyond repetition. It would be entirely possible that more activity was generated in Company B as a result. Whether or not this is the case, the point is that looking only at the number of analysts might not be a good enough measure.

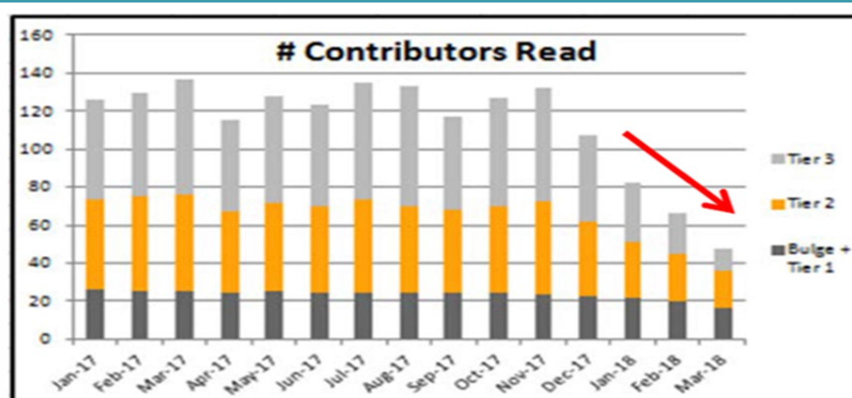
Collapsing distribution of broker research

...and ignoring this can produce misleading conclusions

Ignoring the distribution of broker research can produce misleading conclusions. We have heard many company managements refer to the number of analysts following them and feeling comforted by this. But if it turned out, for example, that of the eight analysts covering a stock, only four had wide distribution, that management confidence would be misplaced.

So how can we judge distribution? One way is to simply ask a broker who pays for the broker’s research. Some brokers seem too shy to answer this question. One way to reach an approximate answer is to consider a chart Thomson Reuters Eikon published last summer (see below).

Thomson Reuters: decline in entitled sell-side contributors



Source: Thomson Reuters Eikon

[2] PP 27, ‘Mid and Small-Cap Investor Survey 2019: MiFID II - The Search for Research’, QCA/Peel Hunt, February 2019
[3] PP 28, ‘Mid and Small-Cap Investor Survey 2019: MiFID II - The Search for Research’, QCA/Peel Hunt, February 2019
[4] PP 24, ‘Mid and Small-Cap Investor Survey 2019: MiFID II - The Search for Research’, QCA/Peel Hunt, February 2019

Briefly explained, this shows that the average top 12 institutional clients of Thomson Reuters Eikon had access to the research and forecasts of 130 brokers (on a pan-European basis) before MiFID II, and that list has been cut by those institutions to about 50. This confirms the dramatic change in the audience for broker research.

Forecasts in the ‘Age of Consensus’

Before MiFID II, all professional investors saw the same number

Another way to judge the decline of distribution is to look at forecasts. This report focuses on this as a way of demonstrating that looking at the number of analysts per company on its own will be misleading.

Before MiFID II came into force, institutional brokers and investment banks bombarded professional investors with research, forecasts and service. Institutions were happy to receive all of this because it was free! Well, not quite. In return, institutions dealt with their favourite brokers (who might even be the ones that produced the best research, the most accurate forecasts and the best service). The commission on that dealing came from the institutions’ underlying clients – perhaps the pensioners and unit trust holders. It certainly didn’t come from the pocket of the fund manager. The only problem an institutional fund manager had was coping with the volume of calls and the massive post bag.

In terms of forecasts, it meant that these fund managers were all looking at the same screen. Every professional could see every forecast for every company, including the date the analyst’s forecast was made, whether it had gone up or down, and how it compared with the peer group, i.e. the consensus. More than that, clever investors realised a forecast made six months ago was not as valid as one made yesterday, and that not all analysts were created equal. A few analysts built reputations for being the most accurate forecasters on a particular stock or sector, while others were always too optimistic or pessimistic. Good fund managers knew that analyst A was brilliant at identifying investment themes early, but hopeless at forecasting profits, while analyst B was good on forecasts, but always got the recommendation wrong. There were even services launched to monitor forecasts, to scientifically prove who was always looking at a glass half full, for example.

The new world of non-consensus

End of transparency…

MiFID II has destroyed the concept of a common consensus. Institutions can now see only the research that they have paid for (with two exceptions). If they have not paid for that research, they will be committing an offence to receive it or even talk about it with the broker. Generally, the compliance officers of institutions have taken that to mean stopping seeing everything from a broker with whom they don’t have a commercial relationship, including viewing the broker’s forecasts. This means, for example, that the forecasts Fidelity can see might be completely different from those seen by BlackRock. The average of these forecasts could be different too. Thus, there is no longer a consensus. We have seen a growth in ’hidden forecasts’, i.e. forecasts that only a select few can see.

What are the two exceptions referred to above, when research can be received for free?

- The first is a trial period: an institution can have one three-month free trial period in any 12-month period.
- The second is research that has already been paid for by the company that is being written about. This is covered by clause 12.3 of MiFID II, and such research is considered a ‘minor, non-monetary benefit in the hands of the recipient’; generally, this covers research written by the house broker and by a sponsored research house, such as Hardman & Co.

Why does this matter?

...leading to weakening in broker relationship with institutions

The end of the transparency that existed in the Age of Consensus is important for two reasons.

- First, it means that investors have to make decisions with different sets of data. This undermines investor confidence and, ultimately, that impacts liquidity.
- The second effect is on companies themselves. Yes, weakened investor confidence and lower liquidity are unhelpful. But, more importantly, the loss of visibility of analyst forecasts is one outcome of the weakening in the broker relationship with institutions.

Today, brokers do not have the universal distribution among institutions that they had before MiFID II. A company management may comfort itself that it has eight brokers covering it, but if, on average, institutions can see only four forecasts, the reality is that the effective analyst count is four.

And retail investors never saw consensus, anyway

With MiFID II, playing field between retail and professional investor has been levelled

Before MiFID II came into force, professional investors enjoyed a massive information advantage over retail investors. While an institution could see all research, and every forecast, the retail investor was a second-class citizen. He was not allowed to receive institutional research, he didn't get badgered for a meeting with the analyst, and nor did anyone bother to call him. No, the retail investor had to rely on bulletin boards, blogs and chatrooms, and the crumbs from the institutional table – such as when the *Evening Standard* might report that JPMorgan had upgraded its forecast, or moved to a Buy rating on a stock. The only research and forecasts to which he had access came from sponsored research houses, such as Hardman & Co.

One of the unlikely outcomes of MiFID II is that the playing field between retail and professional investor has been levelled in two ways. First, the professional can't access research for free and generally has less of it and, second, more companies are using sponsored research houses. Historically, sponsored research houses published only on small companies, but, today, the more respected ones, such as Hardman & Co and Edison, are retained by very large companies. For example, Hardman & Co's largest client has a market cap approaching £4bn, with several more over £1bn.

Plenty of companies with absolutely no research or forecasts

Let us not forget that there are a number of companies where there are no forecasts. The table below shows that many companies live in a lonely world without any analysts.

LSE quoted companies with no analyst coverage at December 2018

Mkt. cap. band (£m)	No. of companies	No. with coverage	No. with no coverage	% with no coverage
0-100	947	381	566	59.8%
100-200	208	125	83	39.9%
200-400	211	128	83	39.3%
400-1,000	213	153	60	28.2%
1,000-2,000	113	90	23	20.4%
2,000-5,000	85	80	5	5.9%
>5,000	83	82	1	1.2%
Total	**1,860**	**1,039**	**821**	**44.1%**

Note: List includes investment companies
Source: Thomson Reuters Eikon, Hardman & Co Research

The smaller the market cap, the greater the likelihood that no analyst publishes

It will be no surprise to readers that the smaller the market cap, the greater the likelihood that no analyst publishes (not even the house analyst!). But it is more common up the market cap scale than you might expect. Partly, this is explained by the inclusion of investment companies/trusts, for most of which earnings forecasts aren’t relevant. We even have one constituent with a market cap above £5bn with no coverage – Scottish Mortgage, an investment trust.

LSE quoted companies by listing with no analyst coverage at December 2018

	Main Market			AIM		
Mkt. cap. band (£m)	No. of companies	No. with no coverage	% with no coverage	No. of companies	No. with no coverage	Mkt. cap. band (£m)
0-100	148	102	68.9%	672	337	50.1%
100-200	50	8	16.0%	90	9	10.0%
200-400	92	14	15.2%	53	5	9.4%
400-1,000	114	9	7.9%	45	0	0.0%
1,000-2,000	84	2	2.4%	7	0	0.0%
2,000-5,000	74	1	1.4%	5	0	0.0%
>5,000	82	0	0.0%	0		
Total	**644**	**136**	**21.1%**	**872**	**351**	**40.3%**

Note: List excludes investment companies
Source: Thomson Reuters Eikon, Hardman & Co Research

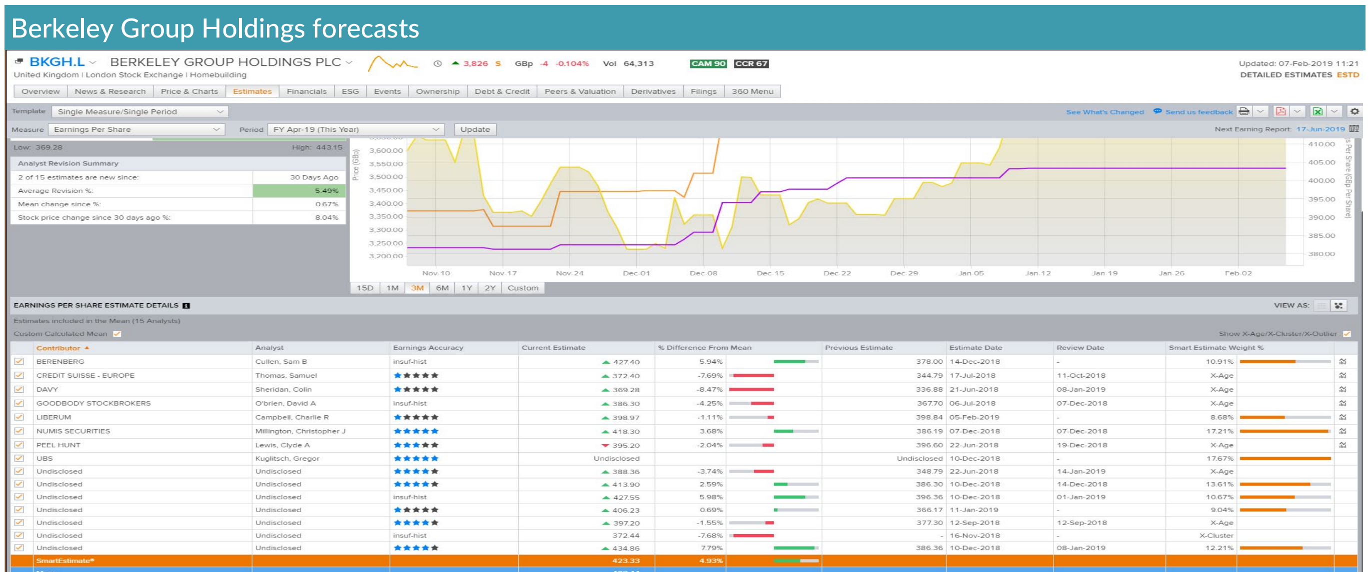
The picture looks dramatically better without investment companies, as the table above shows. Nevertheless, the table does demonstrate the difference in coverage for the same size band companies between Main and AIM. For example, 68.9% of companies in the £0-100m size band on Main have no coverage, compared with 50.1% of AIM-listed. This has always been the case. AIM tends to be attractive to a wider investor audience, such as IHT investors and Venture Capital Trust funds; hence there is more liquidity (for the same size companies) and a better commercial case to write research.

An example of hidden forecasts

How much of a problem is the ‘hidden forecast’?

Ideally, we would carry out a survey of institutions and put together a whole series of snapshots of what they can see to gauge the seriousness of the problem. However, we can’t do that. So perhaps the next best thing is to look at Hardman & Co’s own position. Hardman & Co is a subscriber to the Thomson Reuters Eikon service and, just like institutions and brokers, we have a page of detailed estimates for every company on the market (see example below).

Berkeley Group Holdings forecasts



EARNINGS PER SHARE ESTIMATE DETAILS

Estimates included in the Mean (15 Analysts)

Contributor	Analyst	Earnings Accuracy	Current Estimate	% Difference From Mean	Previous Estimate	Estimate Date	Review Date	Smart Estimate Weight %
BERENBERG	Cullen, Sam B	insuf-hist	427.40	5.94%	378.00	14-Dec-2018	-	10.91%
CREDIT SUISSE - EUROPE	Thomas, Samuel	★★★★★	372.40	-7.69%	344.79	17-Jul-2018	11-Oct-2018	X-Age
DAVY	Sheridan, Colin	★★★★★	369.28	-8.47%	336.88	21-Jun-2018	08-Jan-2019	X-Age
GOODBODY STOCKBROKERS	O'brien, David A	insuf-hist	386.30	-4.25%	367.70	06-Jul-2018	07-Dec-2018	X-Age
LIBERUM	Campbell, Charlie R	★★★★★	398.97	-1.11%	398.84	05-Feb-2019	-	8.68%
NUMIS SECURITIES	Millington, Christopher J	★★★★★	418.30	3.68%	386.19	07-Dec-2018	07-Dec-2018	17.21%
PEEL HUNT	Lewis, Clyde A	★★★★★	395.20	-2.04%	396.60	22-Jun-2018	19-Dec-2018	X-Age
UBS	Kuglitsch, Gregor	★★★★★	Undisclosed		Undisclosed	10-Dec-2018	-	17.67%
Undisclosed	Undisclosed	★★★★★	388.36	-3.74%	348.79	22-Jun-2018	14-Jan-2019	X-Age
Undisclosed	Undisclosed	★★★★★	413.90	2.59%	386.30	10-Dec-2018	14-Dec-2018	13.61%
Undisclosed	Undisclosed	insuf-hist	427.55	5.98%	396.36	10-Dec-2018	01-Jan-2019	10.67%
Undisclosed	Undisclosed	★★★★★	406.23	0.69%	366.17	11-Jan-2019	-	9.04%
Undisclosed	Undisclosed	★★★★★	397.20	-1.55%	377.30	12-Sep-2018	12-Sep-2018	X-Age
Undisclosed	Undisclosed	insuf-hist	372.44	-7.68%	-	16-Nov-2018	-	X-Cluster
Undisclosed	Undisclosed	★★★★★	434.86	7.79%	386.36	10-Dec-2018	08-Jan-2019	12.21%
SmartEstimate®			423.33	4.93%				
Mean			403.44					

Source: Thomson Reuters Eikon

The above is a typical snapshot of the detailed estimates page from Hardman & Co’s Thomson Reuters Eikon screen. It shows the data for Berkeley Group Holdings, a housebuilder with a market capitalisation of just under £5bn. Hardman & Co is not in the position of an institution. We can see any forecast without paying for it. Even so, our view is restricted. Some brokers have chosen to be anonymous to us, either because they have some mistaken notion that they would otherwise be in breach of MiFID II (the truth is the onus is on the receiver of research, not the provider), or because it is part of a policy of monetising research. Unlike an institution, though, we can see all forecasts – we just don’t know who made them! Institutions will typically see less than Hardman & Co, with only the data for the brokers they have paid for being visible.

You would expect there to be lots of analysts covering Berkeley. You would be right. At the last count, there were 15 estimates. But on Hardman & Co’s screen, seven of them are declared as broker ‘undisclosed’, and, although we know, for example, that UBS follows the company, we cannot see its forecast. This is critical information. What if, historically, the analyst with the best forecasting record is greyed out? Is his forecast 388.36p for the next EPS number, or 434.86p? That is a difference of 46.5p, or 11%. We simply don’t know. Remember, if you are an institution, you would not even know there is a forecast as high as 434.86 – if you were paying the brokers visible on the Hardman & Co screen, you would think the top of the range was 427.40 from Berenberg.

This example demonstrates that, while the management may think that 15 brokers cover Berkeley Group, if Hardman & Co were an institution, in reality, we would think the number was just seven.

The scale of the problem of hidden forecasts

The more analysts that follow a company, the greater the percentage of forecasts is hidden

If we employ the approach used for Berkeley Group for the whole of the market, what do the data show? We have taken a snapshot at 31 December 2018 for every quoted company (less investment companies and international businesses, such as Boeing, where the London quote is a subsidiary one). Our dataset comprises 1,029 companies where there is at least one forecast.

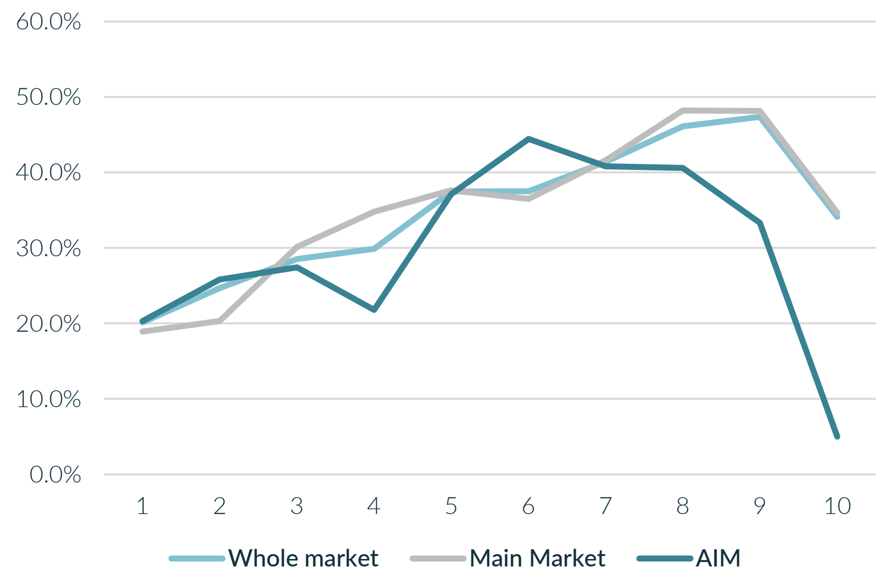
LSE quoted companies by listing with visible analyst coverage at December 2018

Number of analysts	Weighted average of visible estimates				
	Whole market	Main market	No. of companies	AIM	No. of companies
1	0.80	0.81	37	0.80	261
2	1.51	1.59	32	1.48	120
3	2.14	2.10	42	2.18	62
4	2.80	2.61	51	3.13	31
5	3.13	3.12	34	3.14	21
6	3.75	3.81	42	3.33	6
7	4.10	4.09	23	4.14	7
8	4.31	4.14	21	4.75	8
9	4.74	4.67	18	6.00	1
10+	6.59	6.53	208	9.50	4

Source: Hardman & Co Research

The above table shows that, for the typical company with eight analysts showing on the Hardman & Co/Thomson Reuters Eikon screen, only 4.14 forecasts are available for Main-listed companies and 4.75 for AIM.

Percentage of analyst forecasts hidden by number of analysts per company



Source: Thomas Reuters, Hardman & Co Research

The above chart looks at the data another way. It shows what percentage of a company's forecasts are hidden. Broadly, the more analysts that follow a company, the greater the percentage of forecasts is hidden. Some caution should be applied to the figure for 10 analysts, since this includes companies with 10 or more followers. If the chart displayed the results for 11 analysts and above, the chart would peak at 64%.

The conclusion is clear. Managements who are comforted by a reasonable number of analysts covering them, are misleading themselves. The reality for institutional investors is much smaller, often by half.

What can companies do about it?

Managements will have to do more to get investor attention

Company managements are beginning to realise that, in the new world post-MiFID II, they will have to do more for themselves to get the attention of investors. In the case of consensus, there are two practical steps to take:

- Publish the consensus at the time of a trading or results announcement. Even if you just give the middle of the range the night before and the source (e.g. Thomson Reuters Eikon), this improves the market's understanding. Some advisors will be wary that this might end up effectively being a forward-looking forecast; others won't. Seek advice.

- Appoint a sponsored research house, such as Hardman & Co, to increase the number of forecasts. Importantly, this research will not just be 'available' to every investor, by being posted on a website; it will be actively promulgated. The research and forecasts can be received for free by professional and retail investors alike.

Raising your investor profile in the new world – a tick list

It is worth reiterating the steps companies should be considering in the new world to come to the attention of investors. Again, the QCA/Peel Hunt survey of institutions is helpful:

Source: PP29 of 'Mid and Small-Cap Investor Survey 2019: MiFID II - The Search for Research', QCA/Peel Hunt, February 2019

When thinking about commissioning additional research, either from a sponsored house, such as Hardman & Co, or a second broker, the following issues should be pondered:

- To whom will the research be available, and how does it get to them? Just hosting it on a website, even if retail can read it, is not enough – it needs to be proactively advertised and pushed.
- How good is the analyst?
- How often and how much will be written?
- Is it respected? What sort of other companies does the house have? If you are a £500m financial services business, for example, employing a house that writes about small-cap miners is unlikely to get the profile you want.

Methodology

Source

Hardman & Co is a subscriber to the Thomson Reuters Eikon market data service. This is one of the most popular services for professional investors; its biggest competitor is Bloomberg. Hardman & Co has access to all the publicly available data on broker forecasts through this service. We collected data for this article from Thomson Reuters Eikon on 31 December 2018.

Dataset and exclusions

Our dataset includes every company listed on the London Stock Exchange’s Main and AIM markets. There are approximately 1,937 companies in the complete dataset. However, we decided to exclude two categories of company:

- Investment companies. Forecasts of future earnings are not really that relevant to most of these vehicles; hence, including them would distort the results of our work. There are more than 343 of these excluded from the list.
- Companies whose London listing is very much a secondary one. These are typically overseas companies. For example, Boeing is listed on the London market; looking at the London quotation of the company on Thomson Reuters Eikon for the number of analysts is misleading – you should really look at the US listing.

Excluding the two categories above, we were left with 1,029 companies where there is at least one forecast.

Further research

Hardman & Co has produced a series of research pieces on the impact of MiFID II, the relationship between research coverage and liquidity, and the importance of retail investors for liquidity. Publications include:

- *After the Love Has Gone – Post-IPO liquidity: how bad is it, does it matter and what can companies do about it? (Keith Hiscock and Yingheng Chen, July 2018)*
- *The importance of the retail investor (Keith Hiscock, January 2018)*
- *MiFID II - Impact on research & stock market liquidity (Keith Hiscock – 2017)*
- *Why broker research coverage of non-clients is collapsing (Jason Streets – 2016)*

About the authors

Keith Hiscock is the Chief Executive of Hardman & Co.

He is personally responsible for the firm's relationships with its corporate clients and also for corporate finance. In addition, he is the author of several articles tackling the issues facing companies in today's climate.

Keith has more than 35 years' stockbroking experience and has developed long-standing relationships with many major institutional investors, including Private Client Brokers and Wealth Managers. He started his career at James Capel, at the time the top-ranked research house in London. He was a founding member of Schroder Securities and of Agency Partners, a leading research boutique house, and was a member of the five-man securities board at Evolution. Keith has also advised companies, large and small, on their relationships with the capital markets.

Yingheng Chen is a senior financial analyst at Hardman & Co.

Yingheng has particular experience in the markets for palm oil, cocoa, citrus, coconut, Jatropha and sugar. She worked as a corporate finance analyst at the Agricultural Bank of China, and is fluent in Cantonese and Mandarin. She has a thorough understanding of the Chinese financial and business markets, as well as of those in the UK.

Yingheng joined Hardman & Co in 2008. She holds the Chartered Financial Analyst Level 2 qualification, together with a BSc in Economics from the London School of Economics.

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Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies, legal entities and issuers about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public…'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

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