



Why Credible Company-Sponsored Research is Needed Today

Background

Over the past 15+ years, obtaining research has become increasingly difficult for smaller capitalization, less liquid securities. Industry dynamics have made it uneconomical (in part due to increased regulation) for high quality securities research firms to publish on these companies. Moreover, small and microcap companies (collectively “SmallCaps”) often fail to attract the attention of the plethora of other information sources available today (e.g., Bloomberg, CNBC, Seeking Alpha) that frequently fill the void for mid-to-large cap equities. Accordingly, many SmallCaps have effectively become “orphaned,” with no credible independent means of communicating their investment theses to the investment community. The result has been lower trading volumes/liquidity, inefficient pricing and a lack of institutional investor support for SmallCap securities.

Notwithstanding the above, institutional investors, high-net-worth individuals, family offices and retail investors still value credible securities research as SmallCaps are frequently an excellent source of “alpha.” In fact, the growing numbers of “quant funds” (comprising a significant portion of trading today) need well-informed revenue and earnings estimates from trusted, independent sources, to attempt to capture this “alpha” through their trading algorithms. Unfortunately, these investors have few places to turn for such independent, trustworthy information.

Sidoti’s Solution

Sidoti & Company, LLC (“Sidoti”) believes that like the debt markets, where issuers pay agencies like S&P and Moody’s to rate their securities, companies will begin to compensate high quality, non-conflicted securities research firms to provide trusted, independent analyses of their businesses. The evolution of the brokerage industry since the turn of the century helps explain Sidoti’s view.

Specifically, over the past 20 years, the entire SmallCap community has become aware that (i) technology has led to better, more pervasive and often instantaneous information flow; (ii) the massive inroads made by low-fee exchange-traded funds and other passively managed vehicles have significantly reduced the fees earned by the active money managers that utilize securities research; (iii) trading commissions have been squeezed to pennies per share, especially as execution costs have become more transparent and (iv) regulatory changes have made it impossible for investment banking and securities research departments to work in tandem to generate revenue. These factors have made it more difficult for institutional investors to “compensate” brokerage houses for providing securities research through the traditional means (i.e, trading commissions) and for the brokerages to “subsidize” their research efforts via investment banking fees. Given these dynamics, Sidoti believes that the “company-sponsored” model may become the most viable means for many SmallCaps to enhance their visibility in the marketplace. Without company-sponsored product, Sidoti believes too many SmallCaps will continue to incur all the costs of being a public company, but reap few of the benefits.

Sidoti's viewpoint about the benefits of company-sponsored research is supported by certain authoritative commentary:

"In order to address the need for more independent research for smaller public companies, we recommend that the Commission...[m]aintain policies that allow company-sponsored research to occur with full disclosure by the research provider as to the nature of the relationship with the company being covered. Entities providing such research should disclose and adhere to a set of ethical standards that ensure quality and transparency and minimize conflicts of interest."

**Final Report of the SEC
Advisory Committee on
Smaller Public Companies
(April 23, 2006) pp. 73-74**

"Our results suggest that paid-for research offers potential benefits to investors in small and mid-cap equity markets where sell-side coverage has declinedCollectively, these results indicate that the recommendations and forecasts supplied by paid-for research firms provide value-relevant information for the buy-and-hold investor, and they affirm the SEC Advisory Committee recommendations, supportive of paid-for research as a means of filling the void left by declining sell-side analyst coverage." (p. 928)

**Bruce K. Billings, et. al., *Worth the Hype? The Relevance of Paid-For Analyst Research for the Buy and Hold Investor*,
The Accounting Review, Vol 89, No. 3 (2014)**

"[W]e fail to find significant differences in the quality of paid-for analyst research relative to matched sell-side analyst research in terms of bias, accuracy, or ability to distinguish favorable from unfavorable future performance." (p. 927)

Sidoti as Preferred Provider of Company-Sponsored Research

Sidoti & Company, LLC is the largest independent provider of research focused on the small-and micro-cap sectors. Its client list includes most of the large institutional money managers on Wall Street. The company has a dedicated institutional sales team of nearly 20. The firm sponsors many non-deal roadshows (NDRS), with upwards of 800 expected in 2016. Over the last two decades, the firm has built one of the most recognized brands known for quality and independence. Sidoti is a broker/dealer registered with the SEC and FINRA. Unlike many other brokerages, in part to avoid conflicts, Sidoti generally does not provide traditional investment banking services.

Sidoti is intent upon offering a highly credible company-sponsored product to companies and investors. To that end:

- To be approved for company-sponsored coverage:
 - A stock selection committee, functioning much like an audit committee, comprised of our compliance officer and at least one "independent" member, vets all company-sponsored research candidates.
 - Our analysts have the final say on whether they wish to cover a stock.
- Sidoti's sponsored offering is identical in virtually every way to its traditional research, except that it does not contain a BUY/NEUTRAL "recommendation;" but it does contain a risk rating. Earnings models and price targets are prominently featured.



- The same analysts who provide our traditional research product, and whose reputations are vital to success with the institutional investor community, are the ones that cover our sponsored companies.
- Our analysts are not directly compensated for providing sponsored research product; they are judged by the same metrics, as applicable, utilized for our traditional product.
- Unlike many sponsored-research houses, Sidoti, as a registered broker dealer, must abide by many regulatory requirements which helps ensure that we operate with the highest standards with respect to quality and independence.
- Sidoti’s relationship with the covered company is fully disclosed, in a manner similar to the footnote below¹.

For More Information

If you are interested in learning more about Sidoti’s company-sponsored research offering, please feel free to contact:

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