CHARTA LEARNING · INTERVIEW PREPARATION

Hedge Fund Stock Pitches

Interview preparation summary · HF track

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INT.HP.1.a · Pitch Structure and Idea Selection

Structure a stock pitch in three minutes: the call and target, thesis, why now, valuation, risks and exit.

A hedge fund pitch is a short argument, not a company profile. A sound order is the call first (long or short, the target price and the time frame), then the thesis in two or three points, then why now, then valuation, then the main risks, then what would make you exit or change your mind. Spend almost no time on what the company does, since the interviewer can ask. The thesis should say what the market is missing, the why now should name something that will close the gap, and the exit should be stated before you buy: a target reached, a thesis broken, or a better use of the capital. Practise it aloud against a clock, because a pitch that overruns hides its best points. Format varies by fund, so ask how long you have. Interview point: lead with the call and the target, then defend it.

WORKED EXAMPLE: FIXING A PITCH THAT OPENS WITH COMPANY HISTORY

Prompt: pitch Halden Packaging, a listed food packaging maker at £40 a share, as a long in three minutes. Facts: two grocery chains signed supply contracts that forecasts do not yet include, a new plant opens in six months, the shares trade at 9 times EBITDA against 11 times for peers, and resin prices are the main risk. Conventions: EBITDA £100m, net debt £100m, 20m shares. Build the answer in stages, starting with the weak first attempt.

Answer: I am long Halden at £40 with a target of £52.50 within about 18 months, roughly 31% upside, because contract wins and a new plant are missing from forecasts, and I exit if volumes miss for two quarters.

> **Interview tip:** Say the call and the target in your first sentence, then give two reasons, then the exit. The interviewer listens for whether you reach a recommendation with a number in the first fifteen seconds.

INT.HP.1.b · Pitch Structure and Idea Selection

Choose a long idea and test it for edge, variant perception, catalysts, quality and downside.

A good long idea starts with an edge: a better read of information, a longer time horizon than most holders, or a structural reason why others cannot own the stock. From that comes variant perception, a reasoned view that differs from what the price implies on something that matters to value, so you must be able to say what the market expects. Then test it: is there a catalyst, is the business of acceptable quality, and what is the downside if you are wrong? A cheap stock is not an idea, since cheapness may reflect falling earnings or heavy debt. Look for the reason a stock has moved before pitching it, and write the strongest case against yourself. Candidates are often asked what they would need to see to change their view. Interview point: say what the market believes, and why you disagree.

WORKED EXAMPLE: FROM 'IT LOOKS CHEAP' TO A LONG IDEA

Prompt: Brightwell Retail trades at £24, 8 times last year's earnings per share of £3.00, after falling 30% on a profit warning. A colleague says it is cheap, so it is a long. Build the answer in stages, starting with the weak version. Conventions: the warning cut expected EPS to £2.40, and the market pays 10 times for earnings it trusts.

Answer: The market prices Brightwell as if the £0.60 earnings cut is permanent; I think it is one-off, which would be worth £30, 25% above the price, against a 20% loss if I am wrong.

> **Interview tip:** Say what the market believes in one sentence before you say why you disagree, then give the catalyst and the downside. The interviewer listens for a stated market view, not the word cheap.

INT.HP.2.a · Valuation and Catalysts

Value a pitch with multiples, free cash flow yield and upside and downside scenarios, and show the margin of safety.

Valuation in a pitch is usually a simple check rather than a full model. Common tools are an earnings multiple, enterprise value to EBITDA (remember to bridge from enterprise value to equity by subtracting net debt), and free cash flow yield, which is free cash flow to equity divided by market capitalisation. Build three cases, upside, base and downside, give each a probability, and compute the expected value against the current price. The margin of safety is the gap between the price and a conservative estimate of value, which leaves room for error. Also compare reward to risk: a gain of 30% against a loss of 20% needs the idea to be right at least 40% of the time to break even. State the multiples you assume and why they are reasonable. Interview point: show the downside as clearly as the upside.

WORKED EXAMPLE: THREE-CASE VALUATION WITH FREE CASH FLOW YIELD

Prompt: a stock trades at £50 with 20m shares. Free cash flow to equity is £80m now. Next year you see 105m, 90m or 70m in the upside, base and downside cases, with probabilities 25%, 50% and 25%. Value each case at a 7.5% free cash flow yield, but 10% in the downside because the market would worry more. Is this a good idea? One-year view, ignore dividends and tax.

Answer: The probability-weighted value is £56.25 against a price of 50, an expected gain of 12.5%, with 40% upside and 30% downside, so the idea works if I am right more than about 43% of the time.

> **Interview tip:** Give the three values, the probabilities, the weighted answer and the downside in that order. The interviewer listens for the downside being stated as clearly as the upside.

INT.HP.2.b · Valuation and Catalysts

Identify catalysts and match the time horizon of an idea to how quickly a return arrives.

A catalyst is a specific, identifiable event or change in information that is likely to make the market revalue the stock within your holding period. Examples are an earnings report that shows a trend, a disposal, a change of management, a regulatory decision or the end of a one-off cost. Cheapness alone is not a catalyst. Time matters because returns are judged per year: a 30% gain in six months is far better than the same gain in twenty-four months, so slippage in timing erodes the annualised return even when the call is right. Check also whether the catalyst is already widely expected and priced in, and whether the idea fits the fund, since a fund with frequent redemptions cannot wait three years. Interview point: name the event, the date or window, and what the stock does if it slips.

WORKED EXAMPLE: ANNUALISING THE RETURN FROM A CATALYST

Prompt: you pitch Orrin Components as a long. You expect a 21% gain once a division sale completes, and the catalyst is that sale. What is the annualised return if it completes in 6, 12 or 24 months, and what do you say about timing? Convention: annual compounding, ignore dividends and costs.

Answer: A 21% gain is worth 46.4% a year if the sale completes in 6 months, 21.0% in 12 months and 10.0% in 24 months, so timing slippage cuts the return sharply.

> **Interview tip:** Name the event, the window and what happens if it slips, with the annualised figures. The interviewer listens for whether you know that a late catalyst erodes the return even when the call is right.

INT.HP.3.a · Short Ideas and Idea Types

Pitch a short idea and explain what makes a good short, borrow cost, squeeze risk, catalysts and why shorts are harder.

A good short combines an expensive or deteriorating business with a reason the problem will be recognised, such as falling margins, aggressive accounting, a failing product or a balance sheet that cannot cope. Expensive alone is not enough, since an overvalued stock can rise further. Shorts are harder because the gain is capped at 100% while the loss is unlimited, the position grows as the price rises, you pay a borrow fee and any dividends, and time is against you. Check the borrow cost, the short interest as a share of the float, days to cover (short interest divided by average daily volume), and the chance of a squeeze or recall of the shares. Keep the position small and set a clear exit. Interview point: a short pitch needs a catalyst and a view on borrow and squeeze risk.

WORKED EXAMPLE: TURNING 'IT IS EXPENSIVE' INTO A SHORT PITCH

Prompt: pitch Pellam Devices as a short. Price £80, 25 times earnings. Operating margin has fallen from 18% to 12% in two years while inventory is up 40% against sales up 5%, and a debt covenant test falls in nine months. Borrow costs 6% a year. Short interest is 12m shares of a 60m share float and average daily volume is 1.5m shares. Target £50 in 12 months. No dividend.

Answer: I am short Pellam at £80 targeting £50, a 37.5% gain or 31.5% after borrow, with the covenant test as catalyst, a 20% short interest and 8 days to cover calling for a small position.

Interview tip: Give the catalyst and the borrow and squeeze view in the same breath as the target. The interviewer listens for whether you know a short needs a reason the problem will be recognised, not just a high valuation.

INT.HP.3.b · Short Ideas and Idea Types

Describe long-short, market-neutral and event-driven idea types in outline, including net and gross exposure.

Long-short equity holds longs and shorts, so returns come from stock selection as well as market direction, and net exposure (longs minus shorts, as a share of capital) shows how much market risk remains. Gross exposure (longs plus shorts) shows the total amount at work. Market-neutral funds aim for close to zero net exposure, and often zero beta, so that returns depend on the spread between longs and shorts. Dollar neutral and beta neutral are different, because a portfolio of higher-beta longs against lower-beta shorts can be dollar neutral yet still carry market risk. Event-driven ideas depend on a corporate event, such as a merger, spin-off or restructuring, rather than the market. In a deal spread, the implied probability of completion comes from the price relative to the offer and the break price. Practice varies by fund. Interview point: know which risk each style is built to take.

WORKED EXAMPLE: NET, GROSS AND BETA EXPOSURE, THEN A DEAL SPREAD

Prompt: a fund has £100m of capital, 90m of longs with average beta 1.2 and 60m of shorts with average beta 0.8. State net and gross exposure and say whether it is market neutral. Then a takeover target trades at £46, the offer is £50 and the price if the deal breaks is £36. What completion probability does the price imply?

Answer: The fund has net exposure of 30% and gross of 150%, but beta-adjusted net of 60%, so it is not market neutral, and the deal price implies a completion probability of about 71.4%.

Interview tip: Give net and gross first, then adjust for beta and say what risk each style is built to take. The interviewer listens for the difference between dollar neutral and market neutral.

INT.HP.4.a · Risk and Defending a Pitch

Size a single idea using a loss limit, stop logic, conviction and liquidity, in outline.

Position size links the idea to the risk the fund is willing to take on it. A common approach is to set the loss you will accept if the idea fails, for example 1% of the fund, and divide it by the loss you expect if the thesis breaks. A 1% loss budget and a 20% downside gives a 5% position. Conviction can raise the size, but liquidity caps it: if you trade at a fifth of daily volume, a large position may take weeks to exit. The tighter of the two limits binds. A stop works best as a prompt to re-examine the thesis, not an automatic sale, and adding to a loser only makes sense if the thesis is intact and the limits allow it. Practice varies. Interview point: name the loss limit and the liquidity limit, and take the smaller size.

WORKED EXAMPLE: SIZING A POSITION FROM LOSS AND LIQUIDITY LIMITS

Prompt: size a new long for a fund of £500m. The fund accepts a loss of 1% of the fund if the thesis breaks, and you expect a 20% fall in that case. The stock trades £10m a day on average, you will trade at most 20% of that, and you want to be able to exit in 5 days. What size do you recommend?

Answer: I would size the position at £10m, 2% of the fund, because liquidity binds before the £25m loss limit, and a 20% fall would cost 0.4% of the fund.

Interview tip: Name the loss limit, the liquidity limit and take the smaller size. The interviewer listens for whether you let liquidity cap conviction.

INT.HP.4.b · Risk and Defending a Pitch

Handle pushback and the follow-up questions an interviewer asks about a pitch.

Interviewers push back to see how you think under challenge, not necessarily because you are wrong. Expect questions such as what the market is missing, what would make you wrong, what the downside is, why now, and why not buy an index. A strong response acknowledges the point, tests it with numbers where possible, and says whether it changes your view. Flex the model out loud: if earnings fall 10% and the multiple falls 10%, the value falls about 19%, not 20%, because the effects multiply. If you do not know something, say so and explain how you would find out, rather than bluffing. Do not fold at the first challenge, and do not defend a point you have just seen disproved. Interview point: update when the facts change, and hold your view when only the tone does.

WORKED EXAMPLE: ANSWERING A FLEX ON EARNINGS AND THE MULTIPLE

Prompt: you pitched a long at £45 with a base value of £60. The interviewer says: what if earnings come in 10% lower and the market also pays a multiple 10% lower? Build the answer in stages, starting with weak responses. Convention: value equals earnings times multiple.

Answer: With earnings and the multiple each 10% lower, value falls 19% to £48.60, still 8% above the price of 45, so the thesis holds but with a thinner margin of safety.

> **Interview tip:** Acknowledge the challenge, work the numbers out loud and end with whether your view changed. The interviewer listens for whether you update on facts and hold on tone.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.