Equity Research

Interview preparation summary · IB track

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INT.BR.1.a · How equity research works

Explain what a sell-side analyst does, who reads the research, how the role differs from the buy-side, and how a bank is paid for research.

A sell-side equity research analyst works inside a bank and covers a sector and a list of listed companies. The analyst builds a financial model, forms a view, and publishes it as notes, estimates, a rating and a price target. The readers are mostly buy-side institutions, such as long-only asset managers and hedge funds, and the bank's own salespeople and traders, who carry the view to clients. A buy-side analyst works for one investor, keeps the work private and is judged on the returns of the portfolio. A typical week mixes model updates, results, management meetings, writing and client calls. The bank is paid for research indirectly: through trading commission from clients who value it, through corporate access to management, through the franchise it builds, and in some regimes through explicit payment for research. The companies covered do not pay for the notes, and research is not funded from banking fees. Interviewers test whether you understand the audience and the economics. The usual mistakes are to say research is free, to say the analyst sells shares, or to confuse the role with investment banking advice.

WORKED EXAMPLE: DOES A RESEARCH TEAM PAY FOR ITSELF?

Fenwick Securities (invented) runs a research team of 8 analysts. Each analyst costs 0.55m a year in pay and support, and data and shared services cost a further 1.6m. In the year, 60 institutional clients paid the bank 38.0m of commission, and in their broker votes they attributed 22% of that commission to research. Conventions: annual figures, ignore tax, and treat the attributed share as the revenue that pays for research.

Answer: The team costs 6.0m and is credited with 8.36m of commission, a cover of 1.39 times. If the same clients paid 5.5m directly, cover falls to 91.7% and one analyst's coverage would have to go. Start with who reads the work and how the commission link pays for it, then show the cost cover, then say banking fees do not enter.

> **Interview tip:** Say the audience first (buy-side clients and the bank's sales and trading desks), then the indirect payment, and always state that the covered companies and banking deals do not pay for the research.

INT.BR.1.b · How equity research works

Explain how a rating scale, a price target, estimates and consensus fit together, which note types exist, and how a note is signed off before publication.

Initiating coverage means the analyst starts publishing on a company with a full note: a model, a valuation, a rating and a price target. A rating scale is either relative, where buy, hold and sell compare the stock with its sector or a benchmark, or absolute, where each rating is tied to a band of expected total return. The price target is the value the analyst expects the shares to reach over a stated period, typically twelve months, and it comes from the valuation. Upside is the target over the current price, minus one, and total return adds the dividend yield. Estimates are the analyst's forecasts, such as earnings per share. Consensus is the average or median of analysts' estimates, gathered by a data provider. The common note types are initiation, results, update and thematic. Before release, a note typically goes through editing, compliance review of disclosures and facts, and supervisory or committee sign-off, and then reaches all clients at the same time. The usual mistakes are to mix up the scales, quote upside with no horizon, treat consensus as fact, and move a target without saying why.

WORKED EXAMPLE: FROM TARGET TO UPSIDE TO RATING

Calderbrook Foods (invented) trades at 480p. The analyst's 12-month target is 576p and the expected dividend is 15p. The absolute scale reads: Buy if total return is above 15%, Hold from 0% to 15%, Sell below 0%. The relative scale reads: Overweight if the expected total return is more than 5 points above the sector's, which is 12%. Five analysts forecast next year's earnings per share of 38p, 40p, 41p, 43p and 45p, and ours is 46p. Conventions: dividend received within twelve months, no tax.

Answer: Upside is 20.0% and total return 23.1%, so Buy on the absolute scale and Overweight on the relative scale. Our 46p is 11.1% above the 41.4p consensus. After a 10% rise the same target gives 11.9% total return and a Hold. Say the formula, the rating, the comparison with consensus, and what would move the rating.

> **Interview tip:** Give upside and total return as two separate numbers, name the scale you are using, and say that a rating can change because of price alone.

INT.BR.1.c · How equity research works

Explain how research is kept independent of investment banking, including wall-crossing, restricted lists, disclosures, quiet periods and personal dealing, and how to handle pressure over a rating.

Research is only useful if it can say what it thinks, so banks separate it from investment banking. Typically, analyst pay is not tied to specific banking deals, the analyst does not attend pitches for banking mandates, and bankers cannot approve or change a research view. Information barriers keep confidential information on each side. When an analyst is brought across the wall to advise on a live deal, compliance controls and records it, and the analyst then becomes restricted. A restricted list stops publication and often dealing in companies where the bank holds inside information, while a watch list is used for monitoring. Published research carries disclosures of interests, such as banking fees, holdings or market making in the shares. Around an offering, a quiet period typically limits what the bank's analysts publish. Personal dealing is restricted, usually with pre-clearance and no trading ahead of one's own notes, and often covering the household. If a company or a banker pushes for a better rating, the analyst declines, records the contact and tells compliance. The usual mistakes are to negotiate, to trade a rating for access, and to say nothing.

WORKED EXAMPLE: A COMPANY ASKS FOR A BUY BEFORE ITS OFFERING

Harbourline Retail (invented) trades at 380p. The analyst rates it Hold with a target of 410p and next-year earnings per share of 32p. The bank is joint bookrunner on a 150m follow-on with a gross spread of 2.5%. The finance director asks for a Buy before pricing. The absolute scale gives Buy only if total return is above 15%, and the analysis assumes no dividend. Conventions: twelve-month horizon, quiet period of 10 days after pricing, pricing on day 0.

Answer: A Buy would need a target of 437p, which is 13.7 times earnings against 12.8 times now, and nothing in the evidence has changed. The analyst keeps the Hold, declines to bargain, records the call and tells compliance. Say the principle first, then show the multiple that proves the request is not analysis, then the process.

> **Interview tip:** Do not argue with the company or hint that a better rating is possible. Say you would decline, document the call, escalate to compliance and keep the view the analysis supports.

INT.BR.2.a · Building the view

Build an earnings forecast from volume, price and mix through margins and the bridge to earnings per share, then test it with sensitivities and a discipline check against history and consensus.

The earnings model is the base of every sell-side view, and an interviewer asks about it to see whether you forecast drivers or just extend a growth rate. Split revenue into volume, price and mix, because each has its own evidence and its own drop-through to profit. Price falls to profit almost in full, whereas volume brings variable cost with it. Then separate fixed from variable costs. Operating leverage means a small change in revenue moves operating profit by a larger percentage. Next bridge from operating profit to earnings per share. Deduct net interest, deduct tax at an explicit rate, and divide by the weighted diluted share count, remembering buybacks, options and one-off items. Run sensitivities on the two or three drivers that matter most and state the earnings change per point. Finally apply discipline: compare each assumption with history, with peers and with company guidance, and explain any gap to consensus in one sentence. The usual mistakes are forecasting margins as a flat percentage, ignoring the share count, and building a forecast that is more optimistic than every datapoint behind it.

WORKED EXAMPLE: FROM VOLUME AND PRICE TO EARNINGS PER SHARE

Harbrook Packaging plc (invented) had revenue of 500m last year. Variable costs were 250m, fixed costs were 190m, net interest was 12m, tax is 25% and there are 100m shares. For next year you assume volume up 6%, price and mix up 4%, variable cost per unit up 2%, fixed costs up 3%, and net interest, tax rate and share count unchanged. Consensus earnings per share is 52.0p, and the operating margin has ranged from 11.0% to 14.0% over five years. Build the forecast and test it.

Answer: Earnings per share of 54.9p next year, up from 36.0p, from revenue up 10.2% and operating profit up 42.0%. Price and mix is worth about 4.0p a point and volume about 2.0p. The forecast is 5.6% above consensus and relies on a margin above the five-year range, so a cautious case of 50.9p belongs in the note.

> **Interview tip:** Say the bridge in order: drivers, costs, interest, tax, shares. Then name the one assumption that matters most and what it is worth per point.

INT.BR.2.b · Building the view

Derive a target price from a justified multiple, cross-check it with a second method, choose and defend the peer group, and set a rating from the expected return.

The target price is the analyst's estimate of where the shares should trade in about twelve months, and the rating follows from the gap to the current price. Price to earnings suits stable, profitable companies with similar balance sheets. EV/EBITDA is better when leverage, depreciation or tax differ, because it is struck before financing, and equity value comes after deducting net debt and other claims. A DCF values the cash flows directly but leans on the discount rate and terminal value, so show a sensitivity. Sum of the parts values each division on the multiple of its own peers and suits groups of unlike businesses. Choose peers by business mix, growth, margins, returns and risk, not by the sector label, and justify any premium or discount in a sentence. Cross-check one method against another, and ask what the current price implies about growth or margins. Then compute the expected return, including the dividend, and apply the house rating scale. A common mistake is to pick the multiple that delivers the rating you want, or to apply a peer multiple to peak earnings.

WORKED EXAMPLE: FROM A PEER MULTIPLE TO A TARGET PRICE AND A RATING

Pellam Industrial Services plc (invented) has forecast earnings per share of 82.0p and EBITDA of 500m for next year. There are 250m shares, net debt is 350m, the dividend is 30p and the shares trade at 980p. The five peers trade on price to earnings of 12.5x, 13.5x, 14.0x, 15.5x and 16.5x, and on EV/EBITDA of 5.8x, 6.2x, 6.5x, 6.9x and 7.4x. House scale: Buy if the expected total return over twelve months (upside plus dividend yield) is above 15%, Sell if negative, Hold otherwise.

Answer: Target price 1,150p on 14.0x earnings of 82.0p, a Buy with a 20.4% expected total return, confirmed by 6.45x EV/EBITDA against 6.5x for peers. The rating survives a multiple down to 13.4x but not 13.0x, so the multiple choice must be justified and shown.

> **Interview tip:** Give the target price, the upside, the cross-check and the multiple at which the rating flips. That shows you know the rating depends on a judgement, not a formula.

INT.BR.2.c · Building the view

Analyse an industry and a company, choose the KPIs that drive earnings, set out a thesis in three points with catalysts and risks, and state in advance what would change the view.

Industry and company analysis turns a sector into a view. Start with structure: who the customers and suppliers are, how concentrated the competitors are, what stops new entrants, how regulated the industry is and where it stands in its cycle. Then identify what drives demand, price and cost, and the few KPIs that the industry itself reports, such as like-for-like sales, utilisation, churn, backlog or yield. Judge competitive position through the trend in market share, margins and returns relative to peers, and name the source of any advantage: scale, brand, cost, switching costs or regulation. Boil the thesis down to three points a client can remember, each tied to a number in the model. Add dated catalysts, such as results, contract renewals or regulatory decisions, and the main risks with a view on how likely they are. Close with what would change the view: the specific datapoints, set in advance, that would make you cut the rating. The usual mistakes are a list of facts without a view, KPIs that do not drive earnings, and a thesis with no catalyst.

WORKED EXAMPLE: A THESIS FOR A VETERINARY GROUP

Fenwick Vets plc (invented) runs 160 veterinary practices with revenue of 400m. The market is 4,000m and the top three groups hold 38% of it. Like-for-like revenue grew from visits up 2.0% and average spend per visit up 4.0%. Staff costs are 55% of revenue and rising 5% a year, other costs are 30% of revenue and rising 3%, and the operating margin is 15%. Vet attrition is 14% a year against 18% at the nearest peer. Build the industry and company view.

Answer: Fenwick is a 10% share leader in a fragmented market, growing like-for-like by 6.1% against a margin-neutral rate of 4.3%, so margin should rise toward 16.4%. The view breaks if growth falls below 4.3% for two half-years or attrition climbs toward the peer level.

> **Interview tip:** Give the thesis as three numbered points, add one catalyst with a date, and finish with the single number that would make you change your mind.

INT.BR.3.a · In the interview and on the desk

Deliver a two-minute stock pitch, long or short, that gives the recommendation first, then the thesis, valuation, catalysts, risks and what is priced in, and defend it under questions.

A stock pitch is a short argument that ends in an action, so it opens with the recommendation, the target price and the upside, and only then explains why. A good order is recommendation, thesis in two or three points, valuation, catalysts, risks, and what the share price already assumes. The thesis must say where you differ from consensus, because a stock everyone already likes offers no edge. Each point rests on one number the listener can check. Valuation shows the multiple, why you chose it and the earnings it is applied to. Catalysts need dates, such as the next results, because a view without a timetable has no reason to work now. A long pitch asks what must go right. A short pitch asks why the price falls and when, since being early costs money. Interviewers probe the weakest assumption, so know how far the target moves with your key driver and when you would change your mind. The usual mistakes are describing the company for a minute, calling a stock cheap with no reason for the discount, hiding the risks, and defending every point.

WORKED EXAMPLE: A LONG PITCH WITH WHAT IS PRICED IN

Pitch Calderwick Packaging, an invented packaging group. The shares trade at 400p. Consensus earnings per share for next year are 30.0p, and your estimate is 36.0p. Sector peers trade on 14.0x next year's earnings. Conventions: revenue 1,450m, interest 20m, tax 25%, 200m shares, a 12-month target built on next year's earnings, and a target multiple of 13.0x, a discount to peers for smaller scale.

Answer: Buy Calderwick Packaging at 400p with a target of 468p, 17.0% upside. The market prices 13.3x consensus earnings of 30.0p, while a margin recovery to 8.0% gives 36.0p. If only consensus is delivered and the multiple falls to 12.0x, the shares are worth 360p, 10.0% below.

> **Interview tip:** Open with the call and the number, show the one assumption that differs from consensus, and finish by naming what would make you wrong and how much it would cost.

INT.BR.3.b · In the interview and on the desk

Judge a results announcement against consensus, separate the quality of a beat or miss, read guidance, and revise estimates and the target price with a clear account of how the shares should react.

On results day the analyst asks four questions in order: what happened against consensus, what was the quality, what did management say about the future, and what changes in the estimates and the target price. Compare with consensus, not last year, because consensus is what the share price already contains. Quality means asking where the surprise came from. A beat from a lower tax rate, a one-off gain or a pension credit is weaker than one from volume, price or margin, and cash conversion shows whether profit is real. Guidance often matters more than the period reported, because shares are priced on future earnings, so look at the second half it implies. Revise estimates for what is lasting, then recompute the target price from the new earnings and a multiple chosen on its merits. The shares can fall on a headline beat if they had already risen on hope, or if guidance disappoints. The usual mistakes are calling a beat on headline earnings per share, ignoring guidance, and changing the multiple to protect the old rating.

WORKED EXAMPLE: A HEADLINE BEAT THAT IS NOT A BEAT

Marlowe Instruments, an invented company, reports half-year earnings per share of 18.4p against consensus of 17.0p. Reported profit before tax is 46.6m and includes a one-off property gain of 1.5m. The tax rate was 21% against the 25% the market assumed, and there are 200m shares. Consensus profit before tax was 45.3m. Consensus for the full year is 36.0p, of which 19.0p is in the second half, and management said wage settlements will cut second-half earnings by about 3%. The target multiple is 14.0x full-year earnings.

Answer: Headline earnings per share beat by 8.2%, but underlying earnings of 16.9p missed consensus by 0.6%. The beat came from a property gain and a lower tax rate. Full-year earnings fall to 35.3p, and the target falls from 504p to 494p.

> **Interview tip:** Give the headline, then the underlying figure, then name the source of the difference, then say what you changed in the estimates and why.

INT.BR.3.c · In the interview and on the desk

Communicate a view clearly in a note and on a call, defend it without rigidity, change it openly when the evidence moves, and keep the published view honest when the data cuts against the house view or the stock has fallen.

Research is only useful if the reader can act on it, so a note opens with the conclusion: the rating, the target price, the one reason that matters and what is new. On a call, lead with the view and one supporting number, then listen for what the client needs. Never hint at a change that is not yet published, because published research reaches every client at the same time. Defend a view with evidence and a sensitivity, concede a fair point, and say what would change your mind. When you are wrong, find out what happened, ask whether the thesis or only the timing broke, recompute estimates and target on their merits, let the rating follow the scale, and say plainly what you got wrong. Do not lift the multiple to rescue a rating. If your analysis cuts against the house view or a company's wishes, the published rating is still your honest view, reviewed through normal sign-off, and pressure is logged and referred to compliance. The usual mistakes are burying the call, going quiet after a bad call, and softening a rating.

WORKED EXAMPLE: AFTER A PROFIT WARNING, WHO DECIDES THE RATING

Harrowgate Foods, an invented food group, is rated Buy at 540p with a target of 630p, which is 14.0x earnings per share of 45.0p. House scale: Buy if the target is more than 15% above the price, Sell if more than 10% below, Hold otherwise. The company warns that input costs are higher. Cost of sales is 900m, costs rise 3%, and only 50% is passed on. The shares fall to 440p. Conventions: operating profit 150m, interest 30m, tax 25%, 200m shares, full-year earnings, a target multiple cut to 13.0x for weaker visibility.

Answer: Earnings fall 11.3% to 39.9p, the target falls to 519p, and upside is 17.9%, so the rating stays Buy. The note states the error and gives a lower target.

> **Interview tip:** Say what you got wrong, show the recomputed number, let the scale decide the rating, and never choose the multiple to keep the rating.

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