

Sell side analyst expertise and performance in a changing regulatory environment

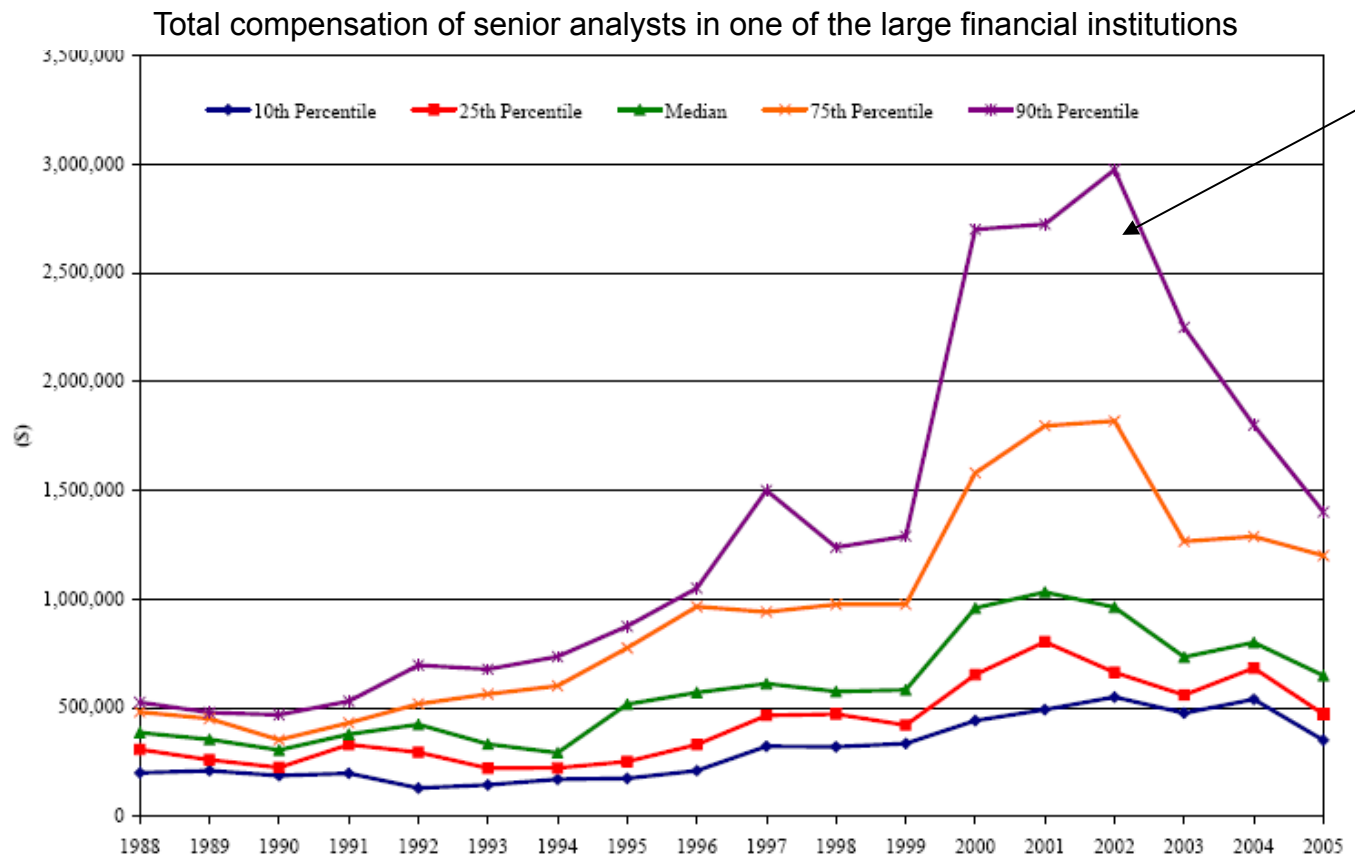
Prof.dr. Philip JOOS - keynote

What do we know about sell side analysts?

- Sell-side financial analysts have a prominent role in
 - analyzing
 - interpreting
 - disseminatinginformation to capital market participants.
- Sell side analysts: both supply and demand of firm information – financial and non-financial
- Interest for academic research:
 - ➔ the “**black box**” of analysts’ decision processes

Analysts and information processing

- What are incentives of financial analysts?



Groysberg, Healy & Maber, Sep 2011, "What drives sell-side analyst compensation at high status investment banks"
Journal of Accounting Research, vol.49 n.4, pp.969-1000

Analysts and information processing

- What are performance metrics?
 1. Firm/sector performance determines size of bonus pool
 2. Input metrics
 - Analyst experience
 - Homegrown versus externally hired
 - Size and trading activity for covered stocks *
 3. Process metrics
 - Number of earnings forecasts made during a year
 - Number of initiations
 - Number of phone calls
 4. Output metrics
 - Investment banking business generated from firms FA covers
 - Stock recommendation performance
 - Earnings forecast accuracy * (affects dismissal, not compensation)
 - “All Star” recognition by buy-side client votes *
- Traders seem to appreciate analysts’ access to management, and responsiveness to feedback (see *Institutional Investor* annual poll among traders and sales force)

Groysberg, Healy & Maber, “What drives sell-side analyst compensation at high status investment banks”
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Analysts and information processing

Brown, Call, Clement & Sharp, 2015, “Inside the black box of sell side financial analysts”
Journal of Accounting Research, vol.53 n.1, March 2015

Survey of 365 sell-side analysts & 18 in depth interviews (Jan-Feb 2013)

What are key input for sell- side analysts

- private communication with management is a more important input to analysts' earnings forecasts and stock recommendations than primary research, recent earnings performance, and recent 10-K and 10-Q reports.

Credibility of the analyst

- issuing earnings forecasts and stock recommendations that are well below the consensus often leads to an *increase* in analysts' credibility with their investing clients.

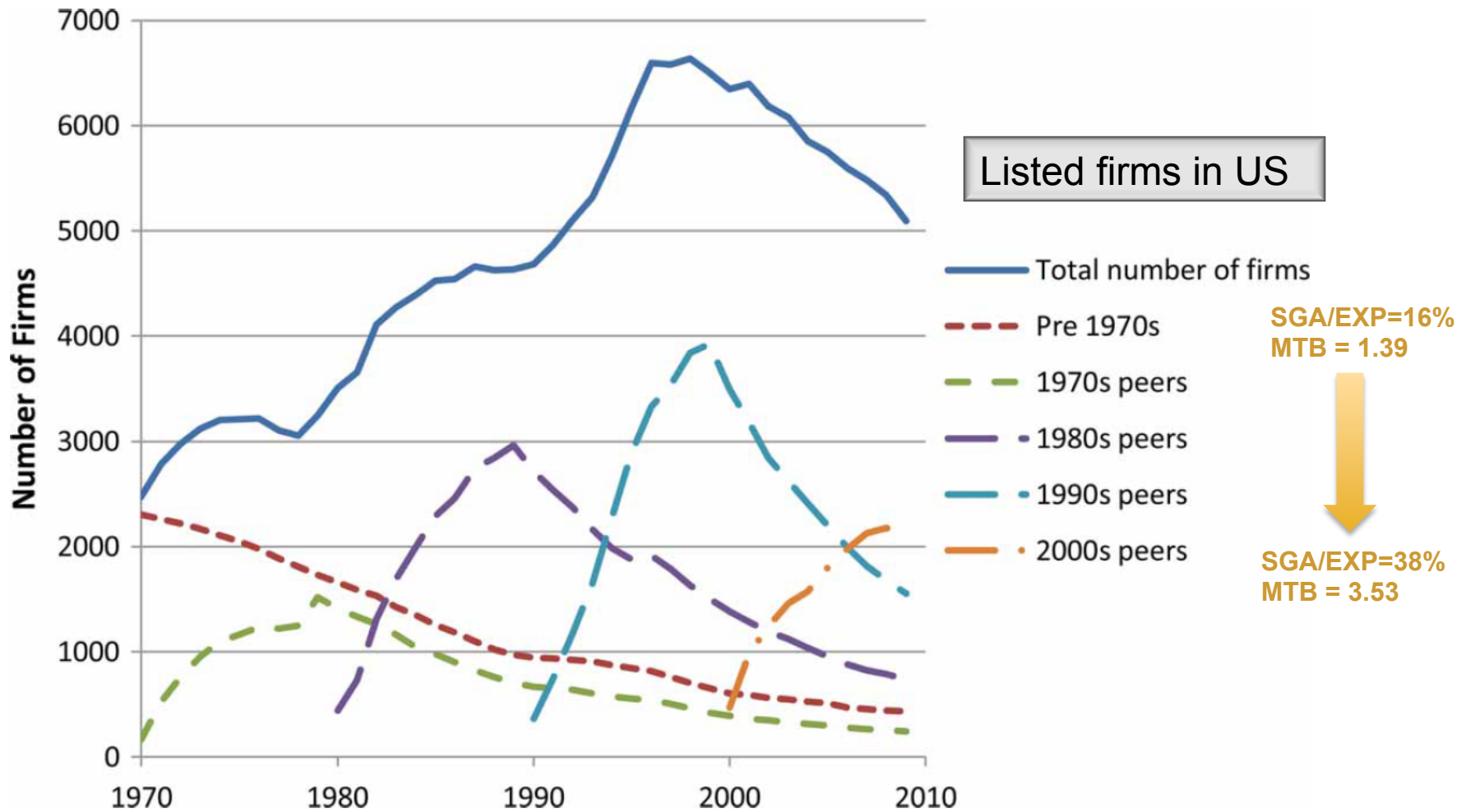
Analysts and information processing

- Hirshleifer, Lim & Teoh (Oct 2009) Journal of Finance
“Driven to distraction: extraneous events and underreaction to earnings news”
 - Limited attention causes underreaction to earnings releases (opposite to instantaneous market efficiency)
 - Distraction hypothesis: immediate price and volume reaction to earnings news is weaker when a greater number of same-day earnings releases are made by other firms.

Changing reporting environment

1. Changing type of firms
2. Increasing complexity of financial reporting regulation (GAAP)
3. Greater importance of non-financial information integrated in reporting

1. Changing type of firms



1. Changing type of firms

- Nature of the firm is changing:
 - intangible intensive
 - human capital - creativity
 - high volatility – shorter life
- Less collateral (fixed assets), “movable” human capital (wet ware): less debt financing
- More flexible accounting (simple) needed
 - Pro forma (non-GAAP) numbers
 - More principle based (eg: IFRS SME)

2. Increasing complexity of GAAP

- IFRS is becoming
 - world-standard – question about speed + US GAAP
 - Increasingly complex and more rules based
- RESEARCH: Beuselinck, Joos & Van der Meulen (2015)

How is the relative forecast performance of sell side analysts affected by a change in the accounting system (intro IFRS - 2005)?

➔ 19 EU countries look at 2 years before and after IFRS adoption

 - more general experienced analysts perform worse than less experienced colleagues who follow the same firm
 - large brokers improve relative forecast performance after IFRS
 - sector specialists perform much better after IFRS
 - country specialists perform better before IFRS, but worse after IFRS
 - small (*large*) brokers follow less (*more*) new firms in the same industry

3. More non-financials integrated in reporting

- Three classes of benefits

1. Internal benefits

- better internal resource allocation
- Greater engagement with shareholders/other stakeholders
- Lower reputational risk

2. External market benefits

- meeting needs of investors who want ESG info
- part of sustainable indices (on stock exchanges)

3. Managing regulatory risk

prepared for a likely wave of global regulation
responding to requests from stock exchanges
influence regulation

3. More non-financials integrated in reporting

REGULATORY CHANGES

- From 2017 the EU will require 6000 large EU corporations to annually disclose important environmental, social and governance (ESG) information in combination with their financial statements.
- The requirement, the *Barnier Addendum*, amends the 2013 EU Accounting Directive and is a new step in the harmonization and broadening of company reporting in the EU.
- Goal of the EU regulation is that harmonizing and improving integrated reporting will lead to better
 - (a) corporate management
 - (b) corporate performance
 - (c) increases in investor, corporate stakeholder and consumer trust
 - (d) lower financing cost (both for equity and debt) and labor market improvements.

3. More non-financials integrated in reporting

Wolfsburg, 2015-09-11

Volkswagen is world's most sustainable automotive group

- Pole position in Dow Jones Sustainability Index
- Industry Group Leader in the Automobiles & Components sector
- Winterkorn acknowledges "great success for entire team"



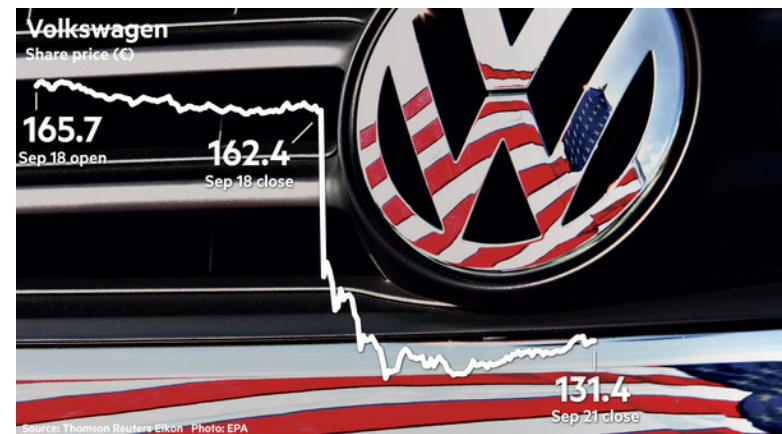
The Volkswagen Group has again been listed as the most sustainable automaker in the world's leading sustainability ranking. As in 2013, RobecoSAM AG again classed the company as the Industry Group Leader in the automotive sector in this year's review of the Dow Jones Sustainability Indices (DJSI). Volkswagen is thus one of only two automakers to be listed in both DJSI World and DJSI Europe.

Press release VW web site Sep 11, 2015

For investors, the Dow Jones Sustainability Index is the most significant benchmark for measuring the development of the world's most sustainable companies. The review analyzed the corporate performance of a total of 33 automotive companies, seven of them from Europe. Volkswagen took pole position with a total of 91 out of 100 possible points. Economic sustainability was awarded 93 points, social sustainability 91 points, and ecological sustainability 89 points.

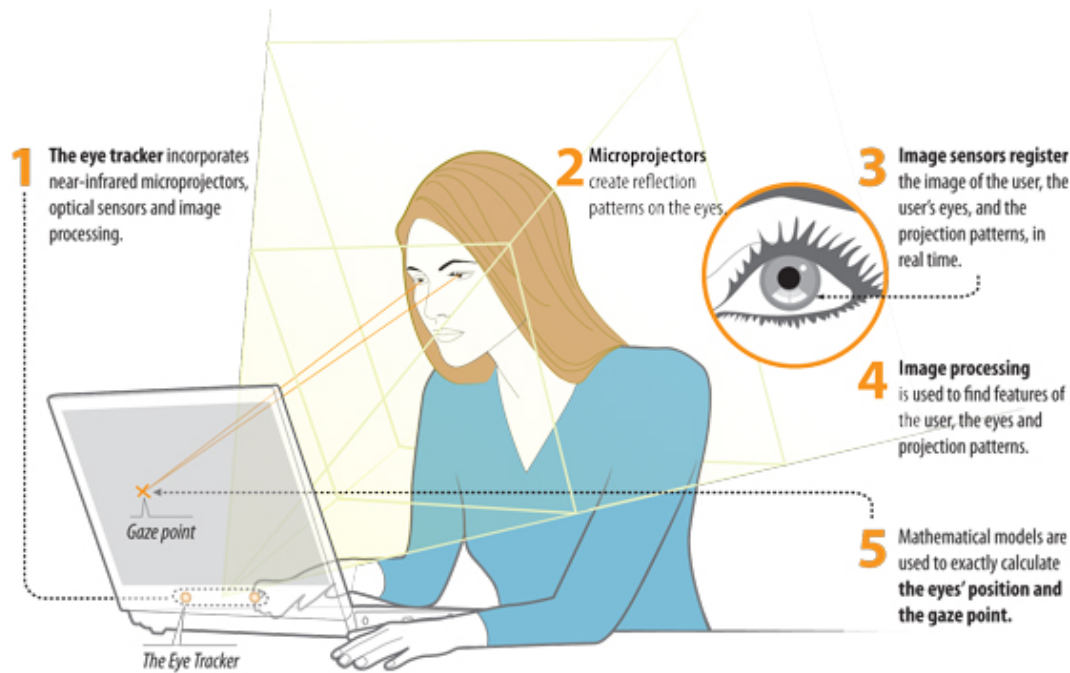
"This distinction is a great success for the entire team. It confirms that the Volkswagen Group is well on the way to establishing itself long term as the world's most sustainable automaker," commented Prof. Dr. Martin Winterkorn, Chairman of Volkswagen Aktiengesellschaft.

Full marks were awarded to Volkswagen in the areas of codes of conduct, compliance and anti-corruption as well as innovation management, climate strategy and life cycle assessment. The Group is also the industry benchmark for supplier management and environmental reporting. Furthermore, significant progress has been made in human capital development, occupational health and safety, tax strategy and talent attraction.



3. More non-financials integrated in reporting

Role for **experimental research methods** to understand sell side analysts quantitative and qualitative information processing



3. More non-financials integrated in reporting

Heat maps using the eye tracking technology



Performance explanation

- Performance will be supported by "aggressive" price policy
- 1.5% of savings in 't1' and benefit from R&D spending
- Production problems to meet order demand continue to hurt the business
- No increase in profitability for t1

Strategy

- Significant cost savings and simplification
- Full support to improve new technologies
- Focussation of R&D spending
- Introduction of new LED lighting products
- Full focus on LED
- The effect of the increase of the manufacturing costs of the policy to lower costs and to improve product quality will benefit the company from Q3 t1

Performance targets

- Ditech confirms its previous expectation to achieve a range of 8 - 10% EBITDA increase in 2010
- Continued continuous operation is expected to be positive
- Ditech confirms its previous expectations on R&D investments to a range of 8 - 10%
- EBITDA is expected to slightly increase

Industry

- New wave of consolidation likely
- Further development of European Markets
- Korean competitors increase production
- Main competitors will start production in Far East

Qualitative information



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Performance targets

	(ACTUAL)	(OLD FORECAST)	(NEW FORECAST)
	£	£	£
Sales	36,002	36,002	36,002
Revenue	36,002	36,002	36,002
EBITDA	21,009	21,009	21,009
Earnings	5,000	5,000	5,000
Cost of sales	21,009	21,009	21,009
EPS	1.55	> 1.50	> 1.50

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Quantitative information

Thank You