Module 10 Article

Why Analysts Are Useful

Key Terms

- **Quarterly Report**: Every fiscal quarter, companies release reports on and hold a press conference about new challenges, acquisitions, strategies, and more. Analysts attend companies' quarterly earnings calls to hear and ask questions about executive's explanations of their quarterly results.
- **DCF**: DCF stands for Discounted Cash Flow, which is a valuation technique analysts commonly use. It takes into account a company's future cash flows and discounts them back to the present day to estimate its current value.
- **CFA/CPA**: Many analysts hold CFA(Chartered Financial Analyst) or CPA(Certified Public Accountant) designations. These credentials signify deep knowledge in investment analysis and accounting respectively.

You Can (Sometimes) Take Their Word For It

Analyst reports can be a great resource. They follow companies more closely than many individual investors have the time to, calculate and update valuation metrics, and attend earnings calls and other company press events. Analysts reports typically begin with a "buy", "sell" or "hold" recommendation, followed by a qualitative and quantitative justification. Many analysts hold professional financial certifications, such as a CPA or CFA, or are experts in their fields.

While they are very knowledgeable and generally use reputable raw information used to make their reports, analysts can sometimes provide a skewed view of a company's performance. Before the 1990's there was clear incentive for analysts at investment banks to produce positive reports for companies they had business relationships with.

The repercussions of this became clear with the failure of companies such as Enron which, amid filing for one of the largest bankruptcies in U.S. history, still saw "buy" recommendations from analysts. Since the Enron scandal and others like it, regulation has been passed to help ensure the independence of analyst recommendations, though bias is still present in many recommendations.

So What Do Analysts Do…

Analysts' schedules follow that of the companies they report on. In between earnings seasons, analysts work on estimating the upcoming earnings using financial models, company guidance, and general market news.

During the week(s) that companies report earnings, analysts dial into earnings calls to hear the CEO, CFO and other executives discuss quarterly financial progress. Immediately following this, analysts put together reports that summarize the company's results and compare them to their own estimates.

Within the world of analysts, there are two main types, buy-side and sell-side, which have different goals and procedures. Buy-side analysts work- you guessed it- on the buy side, which includes mutual funds and other asset management firms.

Buy-side analysts may have incentive to base their report on their own decision to buy or sell a stock; therefore, extra-positive buy ratings or negative sell ratings should be read with a grain of salt. On the other side of the industry, sell-side analysts work for brokerages or other firms which sell research to the buy side. Analysts on the sell side cover broader segments than those on the buy-side, sometimes responsible for entire sectors.

The Bottom Line

Analysts reports provide a helpful summary of companies' quarterly and annual progress. The bias in analyst reporting is largely reduced but still present, so always pair their recommendations with your own independent research.