



## SMALL CAP's MOST VALUABLE "BLACK FRIDAY" BARGAIN

### Company Sponsored Research

#### "What A Bargain!"

The other day, two grizzled Wall Street veterans, were having a holiday lunch: me, a provider of small cap sell side research since 1979, and my buy side colleague who has been investing in the sector for nearly as long. When I told him that many companies were interested in Sidoti's company sponsored research ("CSR") until I revealed the underlying annual \$40,000 price tag, he chuckled, and explained to me why as a shareholder he not only supports CSR, but dubs it a "Black Friday" bargain. He proceeded, on the back of a napkin to lay out the scenario at right and posited the following questions: "Given my experience, supported by all the academic studies that I have read that suggests that research (including sponsored research) by a credible provider leads to: (i) more informed valuations; (ii) enhanced liquidity, and (iii) improved visibility, in a scenario such as this, would I encourage the CFOs of the companies I hold to pay 27% of 1 penny per share (pretax) or 0.0004 of the company's market cap (pretax), to reap those benefits? Or thought of another way, do I believe that CSR will yield me at least \$0.0027 per share of market value on the upside or preserved market value on the downside so I can justify the expense? Of course I would and of course I do! What a bargain!"

Small Cap Co.	
Share Price	\$7.50
Shares Outstanding	15,000,000
Market Capitalization	\$ 112,500,000
Annual Cost of CSR-Pretax	\$ 40,000
Shares Outstanding	15,000,000
Pre-tax cost per share of CSR	\$ 0.0027
Pre-tax cost per share of CSR	40,000
Market capitalization	\$ 112,500,000
Pre-tax cost of CSR/Market Cap	0.0004

#### The Cost of CSR Will Become Even More Compelling In A Post-MiFid II World

My colleague went on to note that his firm has a much harder time looking at small caps without some credible research coverage and that for some prospective holdings, he cannot justify devoting the internal resources to do the work because the size of the position he could accumulate would mean diverting analyst time from an opportunity with more liquidity. He noted that in the post-MiFid II world, where small caps are expected to lose coverage in droves, it will really behoove the C-Suite to reframe its thinking and sharpen its pencils. He thinks buy side institutions will vigorously support CSR, especially since under new regulations, the buy side may otherwise have to pay for securities research out of its own pocket.

#### Companies With Good Stories Tend to Be More Positive About CSR

I discussed with my colleague my anecdotal, unscientific observation that the management teams most partial to CSR were those who foresaw a bright future for their companies in the near-term or believed the world remained uninformed about a great story that already existed. Companies with more lukewarm prospects tended to shy away from the product. He understood why this would be the case, but explained that it was a very short-sighted strategy noting: "Good management can turn a lukewarm story into an exciting one. This usually doesn't happen overnight, but over a period of several quarters. A good analyst starts projecting these turnarounds months before they show up in earnings, prompting new buyers to come in. If a company waits to commission CSR until right before the benefits show up, it is the existing shareholders who benefit, but it is often too late for new shareholders to learn enough about the company and build a big enough position to join the party. I like to buy shares when upside still exists."

#### Tomorrow I Come In With Razor Stubble!

I then asked my colleague why so many companies and their advisors don't support CSR. He looked at me in amazement: "Peter, if someone asked you 15 years ago about CSR, you would have looked at them crossed-eyed. People are slow to change old biases. You still can't stand it when the 30 year old men in your office show up to work without ties and with razor stubble. Guys like you, with backward ideas, are training these young professionals." He is right, the world is slow to adapt, but adapt it must and adapt it will! I guess tomorrow, as a show of progressive thinking, I need to lose the razor.