

## FIRST ROUND PREPARATION: VALUATION & STRATEGIC CLIENT REVIEW

### Handout 1: Initial Industry Research ◀

Handout 2: Company Research

Handout 3: Valuation Analysis

Handout 4: Strategic Analysis

Handout 5: Corporate Finance Advice

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*This handout & video tutorial compiles instructions provided to junior analysts and associates at investment banks on evaluating corporate finance opportunities in a new sector. Analysts should aim to work through the steps in this handout in 1-2 days and provide a high-level interim update on key characteristics within a sector.*

### A. Research Process

*Notes: The below points show key topics listed in order of priority which are discussed in more detail in this and future guides; the list is not exhaustive but should be sufficient to form an initial view on potential transactions in the space.*

*Importantly, research tasks are separated into 'Primary' and 'Secondary Research' to indicate which items should be prioritized and are often more readily available.*

#### Company Research

- Stock performance
- Key valuation metrics
- Recent news & earnings
- Strategy and trends
- Background/history
- Operating performance
- Analyst recommendations
- Corporate financing activity
- Shareholder base
- Main competitors
- Customers
- Suppliers

#### Industry Research

- Key players
- Trends
- History
- Sector index performance
- Competition
- Operating margins
- Customers
- Suppliers
- Corporate finance activity  
*IPOs, LBOs, M&As, capital raising, restructuring*

## B. Information Sources

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Notes: The following list summarizes the most useful information sources for initial industry & company research.

For quantitative information, please note the source documents in brackets behind the respective piece of information (where possible) and/or in a separate list of links so reviewers can easily check for accuracy; please send around key information sources used with your research (analyst reports, company presentations, online links).

Please always double-check all quantitative information at least once before sharing it internally or externally; if for any reason you don't have time to check information before sending it internally, please clearly note in your email that you haven't checked it and/or put it in [square brackets] if it likely requires updating (this should be an exception, however).

Note if a sector is completely new, it's generally recommended to start the research process by taking notes from a handful of good and comprehensive information sources identified, rather than spending time on finding all the pieces of information you think might be useful. Once a base level understanding has been created, targeted searches for relevant information gaps can be identified and filled with targeted research rather than full reviews of new documents.

### Critical Information Sources

Notes: To start the research process, download the following materials and perform a high-level review in parallel (a more detailed review often makes sense once a few information sources have been sampled):

- 1. Initiating Coverage Reports:** Search for 2-3 initiating coverage reports with large number of pages (ideally from known brokers if available) [Thomson]
  - o A comprehensive initiating coverage report can often provide 80-90% of the required information
  - o Typically includes breakdown by segment / asset as well as financial model output and assumptions at end
  - o Save equity research material for research team to review using logical file names such as "SpecificCompany-Broker-Report Type-Date"
- 2. Research Updates:** 3 most recent research notes from 2 different brokers (6 in total) [Thomson]
- 3. Company Guidance:** Latest investor presentation [company website], company news releases and last four earnings conference calls [company website, Google]
- 4. Recent General News:** Review significant news over the last [2] years [Google Finance as starting point as well as Bloomberg ('CN'), Marketwire and Google Search]
- 5. Annual Reports:** Glance through entire annual report including SG&A and Notes to Financials noting down any critical items [Cap IQ, company website, SEDAR, EDGAR (highly improved user interface)]
- 6. Excel Downloads:** The below data is usually readily available from data service providers which are constantly expanding the list of information available [Cap IQ, Bloomberg, Annual Report, Initiating Coverage Report]
  - o Financials: Revenues, Operating Expenses, EBITDA, Capex (growth and maintenance), cash balance, capital assets, long-term debt (historical and at least 3-year forecast)
  - o Corporate Finance Transactions: Recent debt and equity issuances, M&A activity, IPOs
  - o Shareholder Structure: Major shareholders of company
  - o Stock Charts and Ratios: Operating and valuation metrics are typically readily available but you should filter the most relevant ones and come back to others as required
- 7. Key Documentation:** Rating reports, loan documentation and feasibilities studies [SEDAR, EDGAR, Google, Company Website]
- 8. Industry Reports:** Industry information is found in a variety of sources such as industry reports [S&P Industry Survey and Reports, McKinsey Global Institute, Industry Associations (online)], primers by research analysts [Thomson], large companies in the space [Investor Presentations Company Websites] and public sources [Google, Wikipedia (follow source)]
- 9. Search Strategies:** When looking for specific information, employ the 'Search' function before even skimming through document to save time [ctrl+f]

## C) Initial Industry Research (Primary)

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Notes: The below outline lists key information required to understand the environment a company operates in in the context to analyzing potential corporate finance opportunities. The outline is not intended for a comprehensive analysis of a sector for purposes of publishing investment research.

Some of the required information will not be as readily available in standard information sources and but is also unlikely to be distributed externally in any detail; hence the accuracy and verifiability of information is less important and a wider set of information sources can be consulted. However, it should be noted where information is anecdotal or difficult to verify.

The best ways to understand an industry is to call a research analyst or coverage banker in that sector and walk through the below topics. That said, you will likely face some Chinese Wall restrictions when speaking to research analysts and coverage bankers may have limited capacity to educate you on a sector. As such, please do your homework in advance. Use the provided Excel templates and charts to help store and summarize the below information.

### Quantitative Summary (Columns in Excel Table)

- Total size of market in terms of revenues and other market metrics (please check what analysts use as common metric for volume) [*Initiating Coverage Reports, Sector Research Reports, Industry Associations, Google, Investor Presentations, Wikipedia*]
  - Historic (5-year) and forecasted (3-5 year) CAGR for Revenues
- Top 5-7 main players with market share in brackets either by revenue or volume [*same as previous*]

### Industry Performance Charts

- Historic and forecasted market growth for revenues and / or volume
- Sector index performance relative to some benchmark index (typically S&P and/or other sector)
- Often easier to search for existing charts and don't necessarily need to verify data since only for internal purposes
- Historical and forecasted prices of products (where applicable such as for commodities)

### Qualitative Research

- **Market and Price:** Drivers for historical and forecasted market volume and revenues by region and/or product
  - Drivers of historical and forecasted product price levels (especially applicable for commodities)
  - Sources of supply and demand and expected growth trends
- **Cost Structure:** Capital-intensity of operations (large capital outlays for fixed assets) and split between fixed and variable costs as well as ability to react to changing volume
- **Profitability and Capital Intensity:** Understand operating margins (EBITDA) and ability to recover fixed investments (payback period and return on assets)
- **Volatility:** Volatility of operating and share price performance both during economic cycles (financial crisis) and company lifecycle including development phase, consolidation and diversification
- **Competitive Landscape:** Start by focusing on major players and key competitors (only readily available data and leave rest as secondary research topic)
  - Market share by revenues & volume, high-level strategy and business model
  - Recent & forecasted operating performance (revenues, EBITDA, historic and forecasted growth rates)
  - Valuation metrics (share price performance, enterprise value, market cap, debt, cash)
  - History, ownership and corporate finance transactions
- **Background:** Evolution of industry and current macro themes (review sector reports and note down short-form bullets, will already become apparent from analysis of main players)
- **Capital Structure:** Leverage employed in the industry as well as typical financing options through company lifecycle
  - New Companies: Reliance of on capital from entrepreneurs, venture capital firms, private equity firms, large corporations or listed venture exchange
  - Developer Companies: standalone growth, sale to large company, private equity firm or listed market
  - Mature Companies: Consolidation, vertical integration, leverage
- **Corporate Finance:** Venture Capital, IPOs, LBOs (Private Equity), Acquisitions, Consolidation, Restructuring

## D. Initial Company Research (Primary)

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Notes: The below instructions outline how to perform a quick high-level screen of companies, both to understand the main players in an industry as well as identify potential corporate finance transactions.

Use the Excel template has to help outline the below information and prepare a 'one-pager' summary.

### Quantitative Summary (Columns in Excel Table)

- Revenues and EBITDA
- Historic (5-year) and forecasted (3-5 year) CAGR for Revenues and EBITDA
- EBIDTA Margin
- EV and Market Cap
- Debt / EV
- EV / EBIDTA (shade in light grey to highlight)
- EV / volume metric
  - Check other valuation metrics analysts use for comps valuation
- Major segments, properties or assets [*initiating coverage, annual report*]
- Proportion of revenues from segments / assets [*initiating coverage, annual report*]
- Product pipeline within next 5-10 years [*initiating coverage, investor presentation, website, annual report*]
- WACC [*Bloomberg – beta calculation usually needs to be adjusted*]
- Cost / Current Yield of Debt [*Bloomberg / Cap IQ but need to verify with Annual Report - Notes*]
- Credit Rating [*Bloomberg / Cap IQ*]

### Stock Charts

- 5-year individual stock charts for each company relative to some index (typically S&P and/or sector)
- Use data provider interface to plot multiple charts and paste as pictures into Excel to save time [*Cap IQ, Google Finance, Bloomberg*]
- Quick analysis of shocks, peaks and troughs of stock price

### Qualitative Information

- **Operations:** Understanding of revenues, operating expenses, EBITDA, capex (growth and maintenance), cash balance, capital assets, long-term debt [*Initiating Coverage, Annual Report – Notes*]
- **Trends:** Reasons for underperformance / overperformance relative to peers in past 5 years and over next 3-5 years (as forecasted), focusing on revenues and operating cost drivers as well as capex and debt
- **History:** How companies evolved over past 10 years (would like to understand the basic story behind each of these companies)
- **Volatility:** Volatility of operating and share price performance in particular through the financial crisis and subsequent recovery period
- **Strategy:** Differences in strategy (sometimes driven by major institutional or private shareholders) both with regards to capital structure and operating the business
  - Improvement of existing operations (through revenues growth and/or EBIDTA margin expansion)
  - New developments and capital investments
  - Leverage, refinancing, spin-off, acquisitions and other capital markets operations
- **Competition and Market:** Main competitors as well as size and trajectory of overall market
- **Transactions:** Understand recent and intended corporate finance transactions focusing on operational or financial / valuation benefits and use of proceeds where financing is raised
- **Developments:** Look further into major recent and future developments
- **Key Drivers:** Understand the drivers for each item such as reasons for improving/deteriorating expense margin, increasing/decreasing capex, changing revenue growth