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New York, NY – Last week, the NASDAQ OMX stock exchange group entered into an agreement with Morningstar, an independent Chicago-based stock and mutual fund research provider, to provide equity research profiles on the exchanges’ more than 3,600 listed companies. The deal between NASDAQ and Morningstar marks the third such arrangement in the past four months between a major stock exchange and independent research providers to provide some form of research coverage to member firms. The basic rationale for the three deals is similar – to help mid to small cap companies that have seen their research coverage evaporate in recent years as sell-side firms have seen their research budgets be squeezed.

Morningstar / NASDAQ Deal

According to a press release, the deal between NASDAQ and Morningstar will provide all NASDAQ OMX companies with basic research coverage at no cost to the issuer. The Morningstar Profile Report, which will be produced under the terms of this agreement, will include a lengthy company profile, comprehensive data about the company and its industry, and industry context written by a Morningstar analyst. This report, however, will not include detailed analyst research on the company, a Morningstar Rating, or a Buy/Sell/Hold recommendation.

Morningstar expect to begin publishing the Morningstar Profile Reports by the third quarter for both NASDAQ-and Nordic-listed companies. The Morningstar Profile Reports will be updated daily and be available on NASDAQ OMX’s Web sites, NASDAQ Online and through Nasdaq.com as well as in most of Morningstar’s key platforms, including Morningstar.com, its Web site for individual investors; Morningstar Advisor Workstation, its Web-based investment research platform for financial advisors; and Morningstar Direct, its Web-based investment research platform for institutions.

NYSE Euronext and LSE Deals

The Morningstar NASDAQ arrangement is only the latest such tie up between an exchange and an independent research firm to provide research coverage for the exchange’s members. On May 28th, the NYSE Euronext announced they initiated a project to produce independent research of NYSE- And NYSE Amex-listed companies. Under the arrangement, independent research provider, Virtua Research, will offer research coverage for an initial group of NYSE- and NYSE Amex-listed companies.

Relying on publicly available information, Virtua Research’s 200 analysts will develop financial models providing a company’s revenues, earnings, earnings per share and a range of comparative analytics. Unlike traditional sell-side research, Virtua Research will not provide detailed qualitative analysis or “Buy”, “Sell” or “Hold” recommendations. These research reports will be accessible from the NYSE Euronext and [Virtua Research](#)’s websites, as well as Capital IQ, and TheMarkets.com.

On March 18th, the London Stock Exchange and the AIM announced the formation of PSQ Analytics, an initiative to provide high quality independent research coverage from three independent research providers to member firms of the exchanges. The research firms included in this venture include New York-based Argus Research, London-based Independent International Investment Research Plc, and Chicago-based Pipal Research.

PSQ Analytics will randomly select one of the partners to produce research for a member firm who wishes

to purchase coverage for £10,000 per annum. The research reports produced by the participating research providers will include detailed fundamental research, based on in-person management interviews and site visits conducted by experienced analysts. In addition, all research reports will be based on a common template and will provide an earnings model and EPS forecasts. PSQ Analytics research reports do not include Buy/Sell/Hold ratings. The professional investor community will be able to access the research via Bloomberg, Thomson Reuters, Proquote, FactSet, Capital IQ, and other market data terminals. The service is free of charge for investors.

Rationale for these Deals

Despite the differences behind the research offerings of the three exchanges, the business rationale for these three ventures is essentially the same. In the past few years, sell-side research coverage for many public companies – particularly mid-cap and small-cap firms – has declined sharply.

Today, in the United States, at least 1,400 public companies have no research coverage at all, while at least 75% of all firms are under covered (defined as having less than 3 analysts covering these companies). As a result, these public companies suffer a discount in their stock price that can directly be attributed to their lack of research coverage.

Unfortunately, given the economics of the small cap equity market, combined with the pressure most investment banks and brokerage firms are facing today, it is highly unlikely that micro-cap, small-cap, and even some mid-cap companies will find it easier to get sell-side research coverage in the future. This is why the NYSE Euronext, NASDAQ, and the LSE have all decided to facilitate the provision of some form of research coverage for their members. Ultimately, these exchanges have realized that increased research coverage will create more active trading and increased liquidity in the stocks on their platforms.

Shane Smith, the CEO of London-based Independent International Investment Research Plc (and a member of the LSE's PSQ initiative), explained the business rationale of the recent deals between exchanges and independent research providers.

“But the real news here is that leading global exchanges, partly to maintain the efficiency of their markets and partly to enhance their own competitive positions, have announced their intentions to step into the gap left by a long structural decline in sell-side research which has sharply accelerated as the downturn has forced many brokers to scale back their operations globally, creating a growing problem of un-covered companies that are effectively invisible to investors. Exchanges are embracing their responsibility and are stepping in, whether in a lightweight or heavyweight capacity, to address the problem. In the changing landscape of the markets, the Exchanges have a role to play in research and are here to stay”.

Integrity's Assessment

As research coverage for micro-cap, small-cap, and even mid-cap companies disappears, the team at Integrity suspects that a growing number of exchanges, ECNs and ATS' will try to come up with ways to help these companies effectively communicate their stories to potential investors.

Some of these ventures will undoubtedly include partnering with independent research providers to produce and distribute high quality information or traditional investment research to both retail and institutional investors. We suspect these endeavors will boost demand for independent research – a development that will be welcomed by many as the Global Research Analyst Settlement comes to an end.

However, we also think some exchanges, ECNs and ATS' will look for more innovative approaches to facilitate communication between company management and potential investors, thereby enhancing the liquidity and volume of the stocks that trade on their platforms.

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