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What Does an Analyst Do?

How do Breakaway Research go about selecting, and then writing up a company?

This month's column follows on from last month's editorial where we discussed bias (or lack of it) in commissioned research, and presented the case that the potential for bias in commissioned research is no different to that in research from other sources, including broking houses.

And you may ask again why all recommendations are "Speculative Buy" recommendations, and no "Sells" are given? This does come down to stock selection – Breakaway Research is not going to write up and make a positive recommendation on a company we do not like or think has the potential to create value for the investors (and of course a company is not going to commission research that will result in a sell recommendation)!

The key question for us when making a company selection is that we will be happy in recommending it to potential investors? The clear answer here is "Yes" – as mentioned in last month's jottings the investor is the key stakeholder here, and analysts have a duty to put the potential investor's interests first, before their own or those of the client company. We also have to truly believe in our recommendations.

However, does this mean that we would happily buy all of the stocks we recommend? The answer here is "No" – different investors have different risk profiles and investment time frames, and thus not all stocks suit all parties. In buying stocks we are just another investor with our own investment requirements; in writing research our target audience has a wide range of investment criteria.

One key point is that will always be discussed in a note is what we consider to be the key risks in the company – this to us is vital, and needs to be taken into account by potential investors. If necessary we will also qualify a recommendation by highlighting events that need to occur for value to be potentially added.

Key areas looked at in selecting companies we would like to research include:

- The potential for value add – vital for potential investors – it is hard to recommend a company that is considered to be fully valued by the market, or has limited scope for value add
- This takes into account why a company may be undervalued by the market, and what is being, or has been done to address this, including, amongst others, the potential of good quality assets having value realised through a change to better management
- Quality of the management and technical team
- Whether the balance sheet is being properly managed – this includes factors, in the case of exploration companies, such as what proportion of money is going into the ground, or is the company being used as a "lifestyle" company by the principals

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- Whether the company has potentially viable and robust projects or prospective exploration ground
- The above point takes into a number of factors including commodities and jurisdictions the company is involved with.

So how do we go about analysing and writing up companies?

Following an initial hook up or meeting with management to get a broad overview of strategy, research then includes a lot of reading – this includes company releases, presentations and other research that has been done, as well as external data. External research includes work on peers, the commodity the company is looking at and the jurisdiction they are operating in. Technical issues include factors such as geology, metallurgy and mining methods. An understanding of these factors is vital in understanding a company's business and chances for success. Talking to independent contacts who know the assets is also a valuable exercise in research – they will often give an unbiased view of the company and its assets and raise issues that otherwise may be overlooked.

A site visit is very valuable, but unfortunately not always possible. Site visits can give important insights that cannot be gained from just talking and reading.

From the background research we then develop an idea of the strengths, weaknesses and risks inherent in the company, and develop the points we would like to stress in the write up (these are the points given on the first page, as well as the "Investment Thesis" section – in effect the selling points of the Company).

This background work also raises further questions, with which we can then go back to the company for clarification.

From this an initial draft will be prepared, which will be then be sent to the company for their comments. Hopefully there won't be too many of these! This can sometimes be a tricky part of the whole process – the company may want to say/stress something that the writer is not prepared to accept – such conflicts can take some negotiation to resolve, however we will stand firm where we believe our analysis is correct!

Issues may also arise where a valuation is concerned – a company may have a different view of a valuation than what comes out of our research (and valuations could be a subject for some future discussions). Again negotiation, with a result acceptable to all will resolve this.

When all parties are happy after toing and froing we will then release the note.

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Just as background, our notes generally have three sections:

- 1.**The cover page – this is in effect a précis of the note, and includes all information required to attract attention to the company (and especially for dealers and their 5 second attention span). A good first page is key.
- 2.**The “Investment Thesis” – up to four or five pages covering what we consider the key points of the company, and fleshing out the points on the cover page. This will also summarise any valuations, and include a discussion of risks.
- 3.**Detailed information – this includes detail on the assets, including geology, resources, detail of any valuations and bios of key personnel. A discussion of the commodity and its market can also be included if warranted – this is the case in commodities that we consider may be poorly understood by potential investors.

In addition there is a section called “Breakaway’s View” lurking within the report – this comprises a few paragraphs summarising the writers view, including positives and negatives. This is a key part of the note, and needs to be read if a party is considering an investment in the company.

As a final comment we try to write a note such that most, if not all reasonable questions a potential investor may have relating to the company are answered (this was stressed to me by an old colleague who had a long career in the markets). However there are certain factors (including commodity price forecasts) that are impossible to definitely quantify. These are generally those covered in the risk and the analysts view sections, and are up to the potential investor to make a final judgement on.

However, if you do have any questions or comments the writers email address and Breakaway’s contact details are included on anything published. We do welcome comments and constructive criticism, and will answer all such input!

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