



INTEGRITY
RESEARCHFOCUSSM

FORENSIC ACCOUNTING, EARNINGS QUALITY,
SHORT IDEAS

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Executive Summary

Forensic Accounting, Earnings Quality and Short Ideas research is a fast-growing, dynamic segment of the alternative research industry. For institutional investors, this type of research offers a commodity in scarce supply, namely high quality short recommendations. In the current environment of market crisis, interest in forensic research has surged. Over the past decade, the number of firms categorized as forensic accounting, quality of earnings or short ideas research specialists has more than quadrupled. This sector has now evolved to support a wide range of investors from small cap investors to long-only mutual funds to long / short hedge funds. At the same time, forensic research firms have developed innovative analytic approaches, new quantitative models, different delivery methods, and customizable forensic data and tools. Additionally, a number of firms have been expanding their research to cover global markets.

For investors, the competitiveness of the forensic research/short recommendations segments is generally a good thing. It is fostering tremendous innovation, and developing research products tailored to every investment need. It is also keeping a lid on fees—even the most premium priced services in this sector are significantly cheaper than the fees in other, less competitive areas of research. The main downside of the increased competition is that finding good ideas has gotten harder, and the shelf life of those ideas has gotten shorter. The research providers have responded in a variety of ways, including email updates and other alert services to keep investors apprised of emerging ideas, or up-to-date on previous ideas.

This Integrity **ResearchFocusSM** report is intended to help investors sift through the many choices to find those research firms which are best suited to their investment requirements. As part of this analysis, Integrity Research has interviewed analysts and management at the research firms; we have reviewed each provider's research products; we have examined their performance —where relevant and available; and, we have conducted a client survey of buy-side users of forensic / short ideas research. Each of these aspects of our analysis have enabled us to further understand the value proposition provided by the various research firms in this space, client demand for this type of research, the future of the sector, and institutional investors' perceptions of the key research providers in the industry.

Sector Definitions

Earnings Quality analysis is a research methodology that seeks to determine if a company's reported earnings are likely to persist, grow, or decline in the future. Because earnings are among the most important variables that determine the market valuation of a company, this form of analysis can be extremely valuable for investors. Analysis is largely based on close examination of a company's accruals- the accounts on a balance sheet that are not associated with immediate cash transfers.

While earnings quality analysis tends to focus on the value of the accounts in the financial statements, **Forensic Accounting** analysis examines the financial statements paying close attention to specifics such as options valuations, off-balance-sheet financings, capitalization of expenses, and goodwill amortization. Forensic accounting can also include evaluation of earnings quality as well as analysis of qualitative factors (i.e. reliability of management's disclosures or discussions in the financial statements).

In practice, most research providers in this space combine elements of earnings quality and forensic analysis in their research process. Many companies that began as earnings quality providers now use forensic accounting techniques, and vice versa.

Short Recommendations firms often draw upon earnings quality and forensic accounting analysis along with other forms of fundamental company research in order to identify securities with significant downside potential. While both earnings quality and forensic analysis highlight firms which should be avoided because of high accruals or dubious accounting methods, short ideas providers go the extra distance to research other factors such as valuation and competitive dynamics.

Investors who are looking for stocks to short or reviewing their portfolios to cull potential 'torpedo stocks' could look to any of the firms we've included in this report. Thus, for the purpose of this report, we have combined the forensic accounting, earnings quality, and short recommendations sectors.

Overview of Research Firms

When Integrity published our initial report on this industry in 2007, we featured nineteen research firms with total revenue of approximately \$60 million. Today there are twenty-one providers in the forensic accounting, earnings quality and short ideas space with estimated total annual revenue of between \$70 million and \$80 million. This marks a 17% increase in revenue.

Although currently in a bear market, we expect that by 2012, total revenue will increase. In our global survey among buy-side 33% of respondents indicated that in the coming year, they plan to increase usage of forensic research.

From one-man shops in Muskego, Wisconsin to research firms with a 40+ analytical team and offices across the globe, each provider offers unique research that helps institutional investors generate investment ideas. Below is a list of the firms included in the 2009 Integrity **ResearchFocusSM** report on the Forensic Accounting, Quality of Earnings, and Short Ideas research industry.

The twenty-one providers can be broadly classified into three categories based on their methodological research approach. Firms that primarily rely on analysts are categorized as **qualitative** firms; research providers that use proprietary computer models to supply research are defined as **quantitative** firms; firms that offer both qualitative and quantitative research products are considered **hybrid** research firms. Of the providers featured in this report, slightly less than half of the firms are classified as qualitative firms, less than 40% employ a hybrid research process, and slightly more than 10% are primarily quantitative in nature.

Recent and Near Term Demand

In the first quarter of 2009, we conducted a global survey of buy-side analysts and portfolio managers across Europe, Asia, and North America in order to gain a better understanding of the trends and usage of forensic accounting, earnings quality, and short ideas research.

- 184 hedge fund and mutual fund analysts and portfolio managers were interviewed.
- More than forty percent of the participants were current users of forensic research. The remainder indicated that they had not used third-party forensic research in the past year.
- Approximately three-quarters of the total participants were based in the United States, one-fifth in Europe and the remainder in Asia.
- Among users of forensic accounting, earnings quality and short ideas research, close to two-thirds of the participants were based in United States, approximately one-quarter in Europe and the remainder in Asia.

The survey revealed extensive information on the buy-side's changes in research usage; perceived value of forensic research; and the most and least important components of this type

of research. The results were compared across fund types and regions. Below is a summary of our key findings.

Trends in Usage and Value Across Fund Type

	Hedge Funds	Mutual Funds
Relative Importance of FA, EQ, SI Research	Medium	High
Value of Short Ideas	High	Medium
Change in Usage for 2009	More than one-quarter plan to increase usage	More than one-third plan to increase usage
Most Common Reason for not Using FA, EQ, SI research	Not Applicable to Research Process	Done Internally & Not Applicable
Most Valued Components of Research	Comprehensive Research Reports	Comprehensive Research Reports
Least Valued Components	Institutional Sales Coverage	Exclusivity

FA (Forensic Accounting), EQ (Earnings Quality), SI (Short Ideas)
Source: Integrity Research 2009 Forensic Survey

Trends in Usage and Value Across Regions

	North America	Europe	Asia
Relative Importance of FA, EQ, SI Research	Medium-High	Medium	High
Change in Usage for 2009	Increase	Increase	Increase
Value of Short Ideas	High	Medium-High	Medium-Low
Most Valued Components of Research	Comprehensive Research Reports	Comprehensive Research Reports	Comprehensive Research Reports
Least Valued Components of Research	Institutional Sales Coverage	Institutional Sales Coverage	Access to Proprietary Models

FA (Forensic Accounting), EQ (Earnings Quality), SI (Short Ideas)
Source: Integrity Research 2009 Forensic Survey

Frontrunners in the Space

As in the 2007 Integrity **ResearchFocusSM** report, all twenty-one firms were cross-compared based on their methodological style, analytic resources, fees, coverage, and other factors of interest to potential clients. The global survey however, allowed us to take our analysis one step further.

Survey participants rated firms across twelve different metrics: Access to Analysts; Analyst Expertise; Overall Satisfaction with the Firm; Sales Coverage; Responsiveness to Client Requests; Comprehensiveness of Coverage; Cost of Service; Depth of Research; Performance of Recommendations; Quality of Insights / Ideas; Quantity of Actionable Ideas and Timeliness of Ideas. We received sufficient client feedback to evaluate thirteen research firms in each of these categories.

Although Integrity's Top Picks reveal the research providers that should have the broadest general appeal, there are many other gems in the forensic research and short recommendations segments. The best specific research firm for any investor depends on each investor's specific selection criteria and research process. The 2009 Integrity **ResearchFocusSM** report on this segment provides a significant amount of detail on how other buy-side analysts and portfolio managers rate the entire universe of key providers on a wide range of the most important criteria used to select research vendors.

To help investors narrow their choices and find the most interesting forensic/short recommendations firms, Integrity has also included in this report company profiles on all twenty-one firms identified as belonging in this group, outlining the main products and services and key specific advantages and disadvantages for each firm. We also include a review on the field of deception training. Although it is not categorized under forensic research, this type of research focuses on using different tools to determine when company management is being 'economical with the truth'. It is Integrity's view that investors typically use deception analysis to uncover areas for further investigation in instances when company management has shown stress discussing specific topics. Additionally, this report includes a discussion of forensic accounting usage and trends in Europe and sources to consider for European short ideas.

We invite readers of this report to contact us if they wish to discuss further any of the firms or our comments on them.