

Research Analyst Qualification Examinations (Series 86 and 87)

CONTENT OUTLINE

Series 86/87

PURPOSE OF THE EXAMS

The Series 86 and 87 exams are designed to assess the competency of entry-level Research Analysts. The Series 86 and 87 exams seek to measure the degree to which each candidate possesses the knowledge, skills and abilities needed to perform the critical functions of a Research Analyst. In order to obtain registration as a Research Analyst, candidates must pass both the Series 86 and 87 exams and a general knowledge co-requisite, the Securities Industry Essentials (SIE) exam. For more information about the activities requiring registration as a Research Analyst, see FINRA Rule 1220(b)(6).

STRUCTURE OF THE EXAMS

The exams consists of two parts: Part I (Series 86) and Part II (Series 87). Part I contains 100 multiple-choice items and Part II consists of 50 multiple-choice items. Each item consists of four answer choices. The allocation of exam items for each major function is as follows:

| Part 1 (Series 86) | | | |
|--------------------|----------------------------------|--------------------------|-----------------|
| Function | Description | Percentage of Exam Items | Number of Items |
| 1 | Information and Data Collection | 10% | 10 |
| 2 | Analysis, Modeling and Valuation | 90% | 90 |
| TOTAL | | 100% | 100 |

| Part 2 (Series 87) | | | |
|--------------------|---------------------------------|--------------------------|-----------------|
| Function | Description | Percentage of Exam Items | Number of Items |
| 3 | Preparation of Research Reports | 64% | 32 |
| 4 | Dissemination of Information | 36% | 18 |
| TOTAL | | 100% | 50 |

ADMINISTRATION OF THE EXAMS

The exams are administered via computer. A tutorial on how to take the exams is provided prior to taking the exams. Each candidate's exam includes additional, unidentified pretest items that do not contribute toward the candidate's score. The pretest items are randomly distributed throughout the exam. The Series 86 exam includes 10 additional pretest items, and the Series 87 exam includes 5 additional pretest items. Therefore, each candidate's Series 86 exam consists of a total of 110 items (100 scored and 10 unscored), and each candidate's Series 87 exam consists of a total of 55 items (50 scored and 5 unscored). There is no penalty for guessing. Therefore, candidates should attempt to answer all items. Candidates will be allowed 4 hours and 30 minutes to complete the Series 86 exam, and 1 hour and 45 minutes to complete the Series 87 exam.

All candidate test scores are placed on a common scale using a statistical adjustment process known as equating. Equating scores to a common scale accounts for the slight variations in difficulty that may exist among the different sets of exam items that candidates receive. This allows for a fair comparison of scores and ensures that every candidate is held to the same passing standard regardless of which set of exam items they received.

Candidates are not permitted to bring reference materials to their testing session. Severe penalties are imposed on candidates who cheat or attempt to cheat on FINRA-administered exams.

Please visit www.finra.org for additional details.

Function 1: Information and Data Collection — Collects Information and Data from Various Sources to Evaluate the Economy, the Industry Sector and the Individual Companies that the Analyst Covers

1.1. Gathers macroeconomic data

Knowledge of:

- Economic indicators, market forces, monetary policy, and government statistics (e.g., consumer confidence, disposable income, unemployment rates, inflation and interest rates, gross domestic product (GDP))
- Short- and long-term trends in the economy, demographic information, domestic and international issues

1.2. Gathers information about the industry sector to identify the industry's market size, cyclical nature, capital intensity, growth rate, product pricing flexibility, products offered, supply curve, potential entry and exit of competing companies and/or products, customer demand, supplier dynamics, and regulatory issues

Knowledge of:

- Attendance at industry conferences, seminars and trade shows
- Gathering information and data about the industry sector by reading industry/trade literature (e.g., trade magazines and journals) and using industry-specific databases
- Liaising with individuals within the industry sector (e.g., suppliers, vendors, buyers, industry associates, competitors, industry expert/consultants, other analysts)
- Regulatory impacts on the industry sector
- Competitors in the industry and/or peripheral industries
- Obtaining supplemental information (e.g., by conducting telephone and/or written/web-based surveys of the industry)

1.3. Gathers information about individual companies to understand the company's financial status, structure, supply chain, costs of production, sources of revenue, sources of economic growth, risk tolerance, quality of management, new product development, business plan, and how the business plan will be implemented

Knowledge of:

- Financial statements published by the subject companies (e.g., Form 10-Ks, Form 10-Qs income statement, balance sheet, statement of sources and uses of cash)
- Meeting with various levels of each company's management (e.g., CEO, chief financial officer (CFO), chief operating officer (COO), board of directors, middle/junior management), as applicable
- Meeting with each company's investor relations staff and corporate communications
- Visiting key facilities, and meeting operating management, salespeople, production/plant employees, and customers, as applicable

1.4. Assesses the relevance and importance of the information gathered to identify the drivers that influence the performance of the industry and/or the subject company

Function 2: Analysis, Modeling and Valuation — Analyzes the Industry Sector’s Key Drivers as Well as the Individual Companies that the Analyst Covers to Develop a Forecast of the Industry Sector, Make Projections about the Subject Company, and Determine the Valuation of the Company’s Stock

2.1 Conducts analysis of the data obtained about industry sector, competition within the industry, and supply and demand in the industry sector

Knowledge of:

- Key economic drivers that impact the industry which may be supplemented and/or confirmed by conducting correlation studies of industry factors (e.g., using statistical techniques such as regression analysis)
- Short- and long-term trends within the industry sector (i.e., secular, overall and cyclical) and their relationship to valuation and absolute/relative stock performance
- Product demand and profitability assessment (i.e., what creates demand, what creates competition, product prices, what affects costs and profits)
- Inter-relationships of companies within the industry sector by conducting comparative analyses between like companies
- Inter-relationships of peripheral companies and sectors that may affect the industry
- Inter-industry and intra-industry competition to determine how companies are positioned competitively in and out of their industry
- The impact of corporate actions (e.g., divestitures, mergers and acquisitions (M&A)) on the industry sector
- The potential impact of government and industry regulation, economic policy, monetary policy, and fiscal policy
- Projections about the direction of the industry sector

2.2 Conducts analysis of the data obtained about individual companies, including financial statement analysis

Knowledge of:

- Building and maintaining/updating a historical record of the company’s financial performance
 - Identifying short- and long-term trends within the historical record of the company to project future earnings and financial condition
- Fundamental analysis based on the company’s financial statements and supplemental information, including all footnotes
 - The company’s financial statements (e.g., income statements, cash flow statements, and balance sheets), and the inter-relationships of these statements, including relevant ratios or metrics
 - Factors that would influence a company’s profits or growth prospects (e.g., quality of management, current capacity and capacity for growth, new ideas or strategies, product assessment, strength of business model)
 - The impact of corporate actions (e.g., M&A, restructurings and divestitures) on individual companies
 - The company’s accounting practices for understanding the methodology variances and/or conservatism versus industry peers based on generally accepted accounting principles (GAAPs) and Financial Accounting Standards Board (FASB) principles
 - Other financial considerations (e.g., cash collection cycle including receivable turnover, inventory turnover, payables turnover, leases, pension liability accounting, tax accounting including tax rate calculation and deferred tax accounting)
 - Other key economic factors in the company’s accounting and financial statement analysis (e.g., pre-tax margin,

Series 86/87

- gross profit margin, net profit margin, inventory valuation (last-in, first-out (LIFO), first-in, first-out (FIFO)), net profit margin, return on equity (ROE), return on assets (ROA), return on invested capital (ROIC)
- Corporate governance, as detailed in proxy statements or other documents
- The impact of industry drivers on companies
- Projections about the earnings potential of a company, using qualitative and quantitative data
 - Forecasts of key financial statements (e.g., income statement, cash flow statement, balance sheet)
 - Performance of due diligence to evaluate assumptions and support the theory based on the data that was analyzed
 - Updating/maintaining/adjusting financial models and projections on an ongoing basis

2.3 Determines the valuation of the company's stock

Knowledge of:

- Valuation methods
 - Price to earnings (P/E)
 - Current ratio (working capital ratio)
 - Debt to capital ratio (total and long-term)
 - Debt to equity ratio (total and long-term)
 - Discounted cash flow (DCF)/dividend discount method
 - Enterprise value (EV) to earnings before interest, taxes, depreciation and amortization (EBITDA)
 - EV to sales
 - Interest coverage ratio
 - P/E to growth (PEG) ratio
 - Price-to-book (P/B) value (stated and tangible)
 - Quick ratio (acid test)
- Advantages and limitations of each ratio
- Valuation methods that may apply knowledge or calculation
 - Cost of capital
 - DCF
 - Dividend yield
 - Earnings yield
 - Economic profit
 - Free cash flow yield
 - P/E normalized earnings (for cyclical industries: mid-cycle or trend-line)
 - Price to free cash flow
 - Private equity value/sum of the parts analysis
- Analyzing the data (qualitative and quantitative) collected to determine if the company's stock is undervalued or overvalued

Series 86/87

- 2.4. **Identifies key catalysts that may alter the price of a stock and identifies patterns or events (macro, political, or company-specific) that move stock prices and create investment opportunities**

Knowledge of:

- The general market direction and characteristics
- Risk assessment: factors that could impact the perceived risk of an investment
- Supplemental information (e.g., charts/data analyses prepared by technical analysts)

Series 86/87

Function 3: Preparation of Research Reports — Prepares a Variety of Reports Summarizing the Research Conducted on Industry Sectors or Subject Companies. Develops Comprehensive Statements or Opinions Based on the Interpretation of the Data Collected and Analyzed. Creates Drafts of Research Reports or Notes

3.1. Adheres to regulatory requirements in preparing research reports

Knowledge of:

- Certifications (e.g., by analysts)
- Disclosures (e.g., investment banking conflicts)
- Firm's ownership of securities and market-making status
- Ratings systems
- Distribution of ratings issued by the firm
- Price chart with historical information
- Product risks

FINRA Rules

- 2241 – Research Analysts and Research Reports
- 2262 – Disclosure of Control Relationship with Issuer
- 2269 – Disclosure of Participation or Interest in Primary or Secondary Distribution
- 5121 – Public Offerings of Securities with Conflicts of Interest
- 5141 – Sale of Securities in a Fixed Price Offering
- 5230 – Payments Involving Publications that Influence Market Price of a Security

SEC Rules and Regulations

- 15c1-5 – Disclosure of Control
- 15c1-6 – Disclosure of Interest in Distributions
- Regulation A – Conditional Small Issues Exemption
- Regulation AC – Analyst Certification
- Regulation FD – Selective Disclosure and Insider Trading (Fair Disclosure)
- Regulation G – Non-GAAP Disclosures
- Regulation S – Rules Governing Offers and Sales Made Outside the U.S. Without Registration Under the Act of 1933

3.2. Prepares various types of research reports

Knowledge of:

- Initiation reports: coverage of companies not previously covered
- Earnings analysis, earnings preview, and earnings review reports
- Fundamental reports
- Topical reports on relevant issues or theme pieces
- Reports announcing change of ratings, recommendations or projected earnings
- Reports announcing eliminating coverage of companies
- Short notes and summaries of pertinent news
- Industry reports

Series 86/87

3.3. Writes reports with a conclusion supported by evidence and analysis

Knowledge of:

- Business model analysis
- Company overview
- Competitive position
- Dividend outlook
- Financial position
- Industry overview
- Industry and company outlook (projection)
- Investment thesis
- Quality/quantity of earnings
- Quality of management
- Ratings or recommendations
- Review of recently released financial data
- Review of recent news
- Risk of investment
- Sensitivity of company costs and revenues
- Valuation of company stock

3.4. Ensures adherence to regulatory and compliance requirements

Knowledge of:

- Proper disclosures (by the analyst and the firm) included in reports and in oral dissemination of information
- Appropriate approvals obtained prior to disseminating reports or information
- Presentation of reports that contain changes of ratings, initiation of coverage and termination of coverage
- Compliance with the restrictions on the issuance of research reports and participation in public appearances
- Compliance with communications restrictions and disclosure requirements
- Compliance with compensation restrictions and disclosures
- Compliance with trading restrictions associated with publishing research
- Compliance with record keeping and document retention procedures
- Compliance with other applicable SRO rules or regulations

FINRA Rules

- 1220(a)(14) – Supervisory Analyst
- 2210 – Communications with the Public
- 3110 – Supervision
- 3120 – Supervisory Control System

FUNCTION 4: Dissemination of Information — Presents the Results of the Analysis, Orally and in Writing, to Various Parties

4.1. Presents and discusses recommendations with the following individuals and/or groups

Knowledge of:

- Clients and any other buyers (*i.e.*, buy-side analysts, portfolio managers, hedge fund managers, mutual fund managers, pension fund managers, money managers)
- Institutional sales force
- Retail sales force (registered representatives)
- Trading departments
- Management of companies
- Press and media

FINRA Rule

1220(b)(6) – Research Analyst

4.2. Meets with clients

Knowledge of:

- One-on-one meetings and group meetings

4.3. Disseminates information via various means

Knowledge of:

- Telephone, blast voice mail, facsimile, email, firm's website, internal "squawk box," external news information sources and social media

FINRA Rule

435(5)T – Miscellaneous Prohibitions-Circulation of Rumors

2220 – Options Communications

SEC Rules and Regulations

Securities Act of 1933

Section 5(b)(1)(2) – Prospectus Requirements – Delivery of Prospectus for New Issues

Section 11 – Civil Liabilities on Account of False Registration Statement

Section 12 – Civil Liabilities Arising in Connection with Prospectuses and Communication

Section 15 – Liabilities of Controlling Persons

Section 17 – Fraudulent Interstate Transactions

Securities Exchange Act of 1934

Section 9(a)(5) – Dissemination of Information for Consideration — Market Manipulation

Section 15D – Securities Analysts and Research Reports

10b-1 – Prohibition of Use of Manipulative or Deceptive Devices or

Contrivances with Respect to Certain Securities Exempted from Registration

10b-3 – Employment of Manipulative and Deceptive Devices (by Brokers or Dealers)

17a-4 – Records to Be Preserved by Certain Exchange Members, Brokers and Dealers

Regulation A-R – Special Exemptions

134 – Communications Not Deemed a Prospectus

134a – Options Material Not Deemed a Prospectus

Series 86/87

135 – Notice of Proposed Registered Offerings

137 – Publications or Distributions of Research Reports by Brokers or Dealers that are not Participating in an Issuer's Registered Distribution of Securities (*i.e.*, definition of “offers,” “participates” or “participation” in Section 2(11) of the Securities Act of 1933 in relation to certain publications by persons independent of participants in a distribution)

138 – Publications or Distributions of Research Reports by Brokers or Dealers About Securities Other than Those They Are Distributing (*i.e.*, definition of “offer for sale” and “offer to sell” in Sections 2(a)(10) and 5(c) of the Securities Act of 1933 in relation to certain publications)

139 – Publications or Distributions of Research Reports by Brokers or Dealers Distributing Securities (*i.e.*, definition of “offer for sale” and “offer to sell” in Sections 2(a)(10) and 5(c) of the Securities Act of 1933 in relation to certain publications)

144 – Persons Deemed Not To Be Engaged in a Distribution and Therefore Not Underwriters

144A – Private Resales of Securities to Institutions

174 – Delivery of Prospectus by Dealers; Exemptions Under Section 4(3) of the Act

Regulation M

101(b)(1) – Activities by Distribution Participant: Research

101(c)(1) – Activities by Distribution Participant: Excepted Securities

4.4. Responds to inquiries from clients and/or the public

4.5. Discusses market trends with clients, the firm's institutional and retail sales forces, and trading department