

Market data

EPIC/TKR	CLIG
Price (p)	436.5
12m High (p)	454.0
12m Low (p)	362.0
Shares (m)	26.9
Mkt Cap (£m)	117.5
EV (£m)	101.9
Market	LSE

Description

City of London is an investment manager specializing in using closed end funds to invest in emerging markets.

Company information

CEO	Barry Olliff
CFO	Tracy Rodrigues
Chairman	David Cardale

www.citlon.com

Key shareholders

Directors & staff	15.8%
Blackrock	9.9%
Cannacord Genuity	7.9%
Polar Capital	4.1%

Next event

17th July	Pre-close trading statement
17th Sept	Preliminary results
8th Oct	1Q FUM announcement
11th Oct	Ex-div date for final dividend

Analysts

Brian Moretta	020 7194 7622
	bm@hardmanandco.com

City of London Investment Group

Robust performance in volatile quarter

City of London published a trading statement yesterday morning, covering 3Q'18. Over a volatile quarter for markets, City of London's FUM rose by 1.7% to \$5.4bn. Most of this increase came from inflows, with asset gains of \$115m in the developed market and GTAA strategies offset by \$38m outflow from emerging markets. There was a small positive market contribution, with the MSCI Emerging Markets Index up 1% in the quarter. Short term performance was mixed. The market volatility led to discounts widening in emerging markets. In developed markets, strong NAV movements contributed to outperformance.

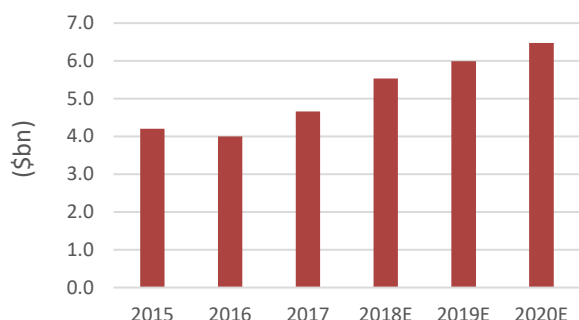
- ▶ **New business:** The pipeline continues to be active, with the \$400m of potential business being in line with the previous statement. City of London indicate that the opportunities are spread across all the product areas, suggesting the recent underperformance has not had an effect.
- ▶ **Operations:** With new business being at a lower fee rate than existing business, the average fee rate declined to 80bps. The rising exchange rate has also affected profitability, with the run rate for operating profit before profit share and EIP declining to £1.5m per month.
- ▶ **Valuation:** The prospective P/E of 10.9x times is at a significant discount to the peer group. The historical yield of 5.7% is very attractive and should, at the very least, provide support for the shares in the current markets.
- ▶ **Risks:** Although emerging markets can be volatile, City of London has proved to be more robust than some other EM fund managers, aided by its good performance and strong client servicing. Further EM volatility may increase the risk of fund outflows.
- ▶ **Investment summary:** Having shown robust performance in challenging market conditions, City of London is now reaping the benefits in a more supportive environment. The valuation remains reasonable. FY2017 saw the first dividend increase since FY2012 and, unless there is significant market disruption, more should follow in the next few years.

Financial summary and valuation

Year-end June (£m)	2015	2016	2017	2018E	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.53	5.99	6.47
Revenue (£m)	25.36	24.41	31.29	33.67	34.18	36.14
Statutory PTP	8.93	7.97	11.59	12.91	13.18	14.24
Statutory EPS (p)	26.4	23.3	36.9	40.2	40.8	44.1
DPS (p)	24.0	24.0	25.0	27.0	30.0	33.0
P/E (x)	16.5	18.7	11.8	10.9	10.7	9.9
Yield	5.5%	5.5%	5.7%	6.2%	6.9%	7.6%

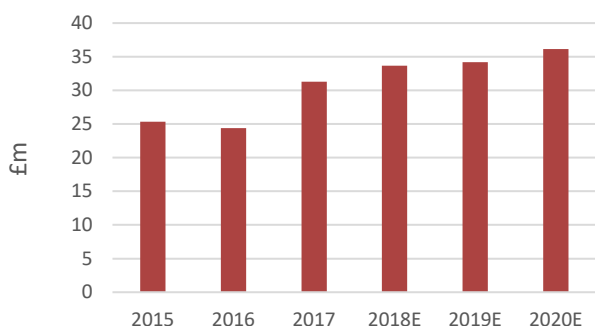
Source: Hardman & Co Research

Funds under Management



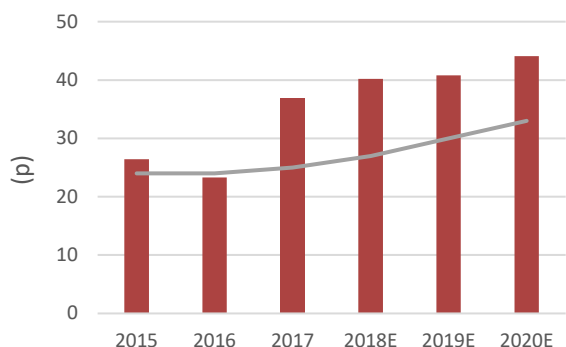
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Assumed steady new business flows and market growth of 5% p.a.

Revenues



- ▶ Revenues linked strongly to FUM
- ▶ Slight decrease in revenue margins from new business
- ▶ Some currency effects, particularly from strong US Dollar from 2015 to 2017

EPS (bar) and dividend (line)



- ▶ Profitability historically maintained by cost flexibility
- ▶ Currency movements led to step change in 2017 EPS
- ▶ Dividend shortfall in 2016 covered from reserves
- ▶ Final dividend increased in 2017 as well as at 2018 interims - we expect steady increases in the dividend over the next couple of years

Source: Company data; Hardman & Co Research

Estimate adjustments

On the back of this statement we have reduced our earnings estimates. Three factors have contributed to this. Firstly, volatile markets meant that FUM were slightly behind our estimates. Secondly, the fee margin was a little lower than we expected. Thirdly, the continued strength of sterling relative to the US dollar has reduced the expected revenues.

Overall, the net effect is to reduce our 2018E EPS by 2.7% to 40.2p. For 2019E the decline is 7.3% to 40.8p and, for 2020E, by 7.0% to 44.1p.

Other news

City of London has been an activist shareholder in several of the funds that it has invested in. Currently it is attempting to stimulate changes in The China Fund. The Fund raised a motion in New York for a restraining order against City of London, which was denied. The Fund has appealed this decision. This legal action should not have any direct effect on City of London's financials, though clearly management believe a positive resolution will enhance fund performance.

Since the last Hardman & Co report, Barry Olliff has continued his planned sale of shares. In March he sold 75,000 shares at 450p, and now has 250,000 left to sell at that price.

Financials

Summary financials						
Year – end June	2015	2016	2017	2018E	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.53	5.99	6.47
P&L (£m)						
Revenue	25.36	24.41	31.29	33.67	34.18	36.14
Expenses	16.63	16.66	19.79	20.78	21.01	21.92
Operating profit	8.73	7.76	11.51	12.89	13.17	14.22
PBT	8.93	7.97	11.59	12.91	13.18	14.24
Earnings	6.61	5.85	9.14	10.00	10.15	10.96
EPS (p)	26.4	23.3	36.9	40.2	40.8	44.1
DPS (p)	24.0	24.0	25.0	27.0	30.0	33.0
Key metrics						
	2015	2016	2017	2018E	2019E	2020E
Growth (%)						
FUM		-4.8	16.5	18.7	8.3	8.1
Revenue		-3.7	28.2	7.6	1.5	5.8
Operating Profit		-11.1	48.4	12.0	2.1	8.0
EPS		-11.7	58.4	8.9	1.5	8.0
DPS		0.0	4.2	8.0	11.1	10.0
Operating margins (%)						
Net FUM fee margin	0.86	0.86	0.84	0.82	0.80	0.80
Operating margin	34.4	31.8	36.8	38.3	38.5	39.4
Tax rate	26.0	26.5	21.1	23.0	23.0	23.0
Dividend cover	1.1	1.0	1.5	1.5	1.4	1.3
EPS sensitivity						
				2018E	2019E	2020E
No net new business						
EPS (p)				40.1	39.5	41.1
% change				-0.2	-3.1	-6.8
0% market growth (was 5% pa)						
EPS (p)				40.1	38.4	38.4
% change				-0.2	-5.8	-12.9

Note: £1 = \$1.42

Source: City of London Investment Group, Hardman & Co Research;

Notes

Disclaimer

Hardman & Co provides professional independent research services and all information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. However, because of possible human or mechanical error by Hardman & Co, its affiliates or its sources, Hardman & Co cannot guarantee the accuracy, validity, timeliness or completeness of any information provided for in this report. No guarantee, warranty or representation, express or implied, can be given by Hardman & Co as to the accuracy, adequacy or completeness of the information contained in this research and they are not responsible for any errors or omissions or results obtained from use of such information. Neither Hardman & Co, nor any affiliates, officers, directors or employees accept any liability or responsibility in respect of the information which is subject to change without notice and may only be correct at the stated date of their issue, unless in case of gross negligence, fraud or wilful misconduct. Hardman & Co expressly disclaims any warranties of merchantability or fitness for a particular purpose. In no event will Hardman & Co, its affiliates or any such parties be liable to you for any direct, special, indirect, consequential, incidental damages or any other damages of any kind even if Hardman & Co have been advised of the possibility thereof.

This research has been prepared purely for information purposes, and nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell any security, product, service or investment. The research reflects the objective views of the analyst(s) named on the front page and does not constitute investment advice. However, the companies or legal entities covered in this research may pay us a fee, commission or other remuneration in order for this research to be made available. A full list of companies or legal entities that have paid us for coverage within the past 12 months can be viewed at <http://www.hardmanandco.com/legal/research-disclosures>

Hardman & Co has a personal dealing policy which debars staff and consultants from dealing in shares, bonds or other related instruments of companies or legal entities which pay Hardman & Co for any services, including research. They may be allowed to hold such securities if they were owned prior to joining Hardman & Co or if they were held before the company or legal entity appointed Hardman & Co. In such cases, sales will only be allowed in limited circumstances, generally in the two weeks following publication of figures. No Hardman & Co staff, consultants or officers are employed or engaged by the companies or funds covered by this document in any capacity other than through Hardman & Co.

Hardman & Co does not buy or sell shares, either for its own account or for other parties and neither does it undertake investment business. We may provide investment banking services to corporate clients.

Hardman & Co does not make recommendations. Accordingly, we do not publish records of our past recommendations. Where a Fair Value price is given in a research note, such as a DCF or peer comparison, this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities/companies and legal entities but has no scheduled commitment and may cease to follow these securities/companies and legal entities without notice.

The information provided in this document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hardman & Co or its affiliates to any registration requirement within such jurisdiction or country.

Some or all alternative investments may not be suitable for certain investors. Investments in small and mid-cap corporations and foreign entities are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. Investments may be leveraged and performance may be volatile; they may have high fees and expenses that reduce returns. Securities or legal entities mentioned in this document may not be suitable or appropriate for all investors or geographical areas. Each investor's particular needs, investment objectives and financial situation were not taken into account in the preparation of this document and the material contained herein. Each investor must make their own independent decisions and obtain their own independent advice regarding any information, projects, securities, or financial instruments mentioned herein. The fact that Hardman & Co has made available through this document various information this constitutes neither a recommendation to enter into a particular transaction nor a representation that any financial instrument is suitable or appropriate for you. Each investor should consider whether an investment strategy of the purchase or sale of any product or security is appropriate for them in the light of their investment needs, objectives and financial circumstances.

This document constitutes a 'financial promotion' for the purposes of section 21 Financial Services and Markets Act 2000 (United Kingdom) ('FSMA') and accordingly, its distribution in the United Kingdom is restricted. Neither Hardman & Co nor any other person authorised by the Financial Conduct Authority (United Kingdom) (FCA) has approved or authorised the contents of this document for the purposes of section 21 FSMA. Accordingly, this document is only directed at:

- i. persons who have professional experience in matters relating to investments falling within Article 19(5) (Investment Professionals) or Article 49 (High Net Worth Companies, Unincorporated Associations etc.) of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005 (as amended) (the Order);
- ii. certified high net worth individuals within the meaning of Article 48 of the Order;
- iii. certified sophisticated investors and self-certified sophisticated investors within the meaning of Article 50 and Article 50A of the Order;
- iv. associations of high net worth investors or sophisticated investors within the meaning of Articles 51 of the Order; and
- v. any other person whom it may lawfully be communicated.

(together, the relevant persons).

This document is directed at only relevant persons and must not, under any circumstances be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this communication relates is only available to relevant persons and will be engaged in only with relevant persons. The UK compensation scheme and rules for the protection of private customers do not apply to the services provided or products sold by non-UK regulated affiliates.

The receipt of this document by any person is not to be taken as constituting the giving of investment advice by Hardman & Co to any to any such person.

No part of this document may be reproduced, stored in a retrieval system or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission from Hardman & Co.

By accepting this document, the recipient agrees to be bound by the limitations set out in this notice.

This notice shall be governed and construed in accordance with English law.

Hardman Research Ltd, trading as Hardman & Co, is an appointed representative of Capital Markets Strategy Ltd and is authorised and regulated by the Financial Conduct Authority (FCA) under registration number 600843. Hardman Research Ltd is registered at Companies House with number 8256259.

*Hardman & Co Research Limited (trading as Hardman & Co)
35 New Broad Street
London
EC2M 1NH*

*+44 (0) 20 7194 7622
Follow us on Twitter @HardmanandCo*

(Disclaimer Version 4 – Effective from April 2018)

Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies and legal entities about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public...'

The fact that we are commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: <http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf>

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

Hardman Team

Management team

+44 (0)20 7194 7622

John Holmes	jh@hardmanandco.com	+44 (0)20 7194 7629	Chairman
Keith Hiscock	kh@hardmanandco.com	+44 (0)20 7194 7630	CEO
David Banks	db@hardmanandco.com	+44 (0)20 7194.7622	Corporate Advisory/Finance

Investor engagement and marketing

+44 (0)20 7194 7622

Richard Angus	ra@hardmanandco.com	+44 (0)20 7194 7635
Max Davey	md@hardmanandco.com	+44 (0)20 7194 7622
Antony Gifford	ag@hardmanandco.com	+44 (0)20 7194 7622
Ann Hall	ah@hardmanandco.com	+44 (0)20 7194 7622
Gavin Laidlaw	gl@hardmanandco.com	+44 (0)20 7194 7627
Vilma Pabilionyte	vp@hardmanandco.com	+44 (0)20 7194 7637

Analysts

+44 (0)20 7194 7622

Agriculture

Doug Hawkins	dh@hardmanandco.com
Yingheng Chen	yc@hardmanandco.com

Bonds / Financials

Brian Moretta	bm@hardmanandco.com
Mark Thomas	mt@hardmanandco.com

Building & Construction

Tony Williams	tw@hardmanandco.com
Mike Foster	mf@hardmanandco.com

Consumer & Leisure

Steve Clapham	sc@hardmanandco.com
Mike Foster	mf@hardmanandco.com
Jason Streets	js@hardmanandco.com

Life Sciences

Martin Hall	mh@hardmanandco.com
Dorothea Hill	dmh@hardmanandco.com
Grégoire Pavé	gp@hardmanandco.com

Media

Derek Terrington	dt@hardmanandco.com
------------------	---------------------

Mining

Paul Mylchreest	pm@hardmanandco.com
-----------------	---------------------

Oil & Gas

Angus McPhail	if@hardmanandco.com
---------------	---------------------

Property

Mike Foster	mf@hardmanandco.com
-------------	---------------------

Services

Mike Foster	mf@hardmanandco.com
-------------	---------------------

Special Situations

Steve Clapham	Brian Moretta
Paul Singer	Chris Magennis
Yingheng Chen	yc@hardmanandco.com

Tax Enhanced Services

Brian Moretta	bm@hardmanandco.com
---------------	---------------------

Technology

Milan Radia	mr@hardmanandco.com
-------------	---------------------

Utilities

Nigel Hawkins	nh@hardmanandco.com
---------------	---------------------

Hardman & Co

35 New Broad Street
London
EC2M 1NH

Tel: +44(0)20 7194 7622

