**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.

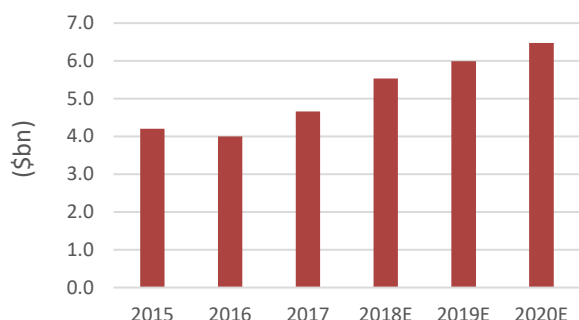
- ▶ **New business:** The pipeline continues to be active, with the \$400m of potential business being in line with the previous statement. City of London indicate that the opportunities are spread across all the product areas, suggesting the recent underperformance has not had an effect.
- ▶ **Operations:** 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%

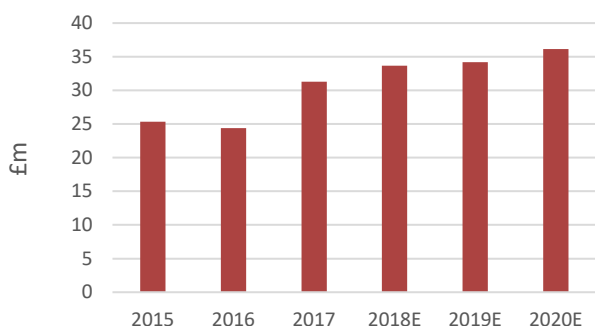
Source: Hardman & Co Research

Funds under Management



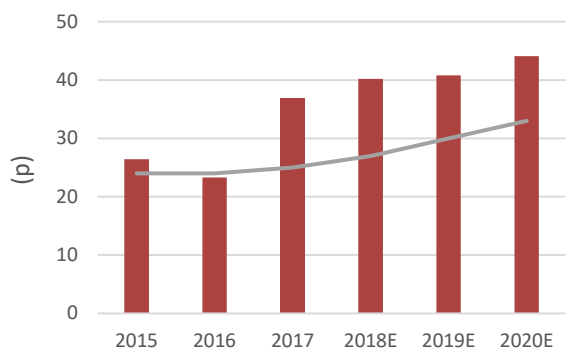
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Assumed steady new business flows and market growth of 5% p.a.

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

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*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*

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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>

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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

