**Market data**

EPIC/TKR	CLIG
Price (p)	385.0
12m High (p)	398.5
12m Low (p)	285.0
Shares (m)	26.9
Mkt Cap (£m)	103.6
EV (£m)	93.2
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](http://www.citlon.com)

**Key shareholders**

Directors & staff	20.3%
Blackrock	10.0%
Hargreave Hale	4.9%
Polar Capital	3.3%
Slater Investments	3.0%

**Next event**

30 Jun-17	Financial year end
17 Jul -17	Pre-close trading update
18 Sep-17	Preliminary results

**Analysts**

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**City of London Investment Group****Rising markets and improved performance**

City of London has announced a trading statement for 2017Q3. Funds under management have grown to \$4.4bn. Rising equity markets have been the main reason behind this rise, with the MSCI Emerging Markets Index up 11% over the quarter. On the debit side there were net redemptions of \$140m, reducing the net rise in City of London's FUM to 8%. There was also a return to positive performance in the funds with 90% of exposure outperforming the relevant benchmarks, a welcome improvement after a tough period in the preceding six months.

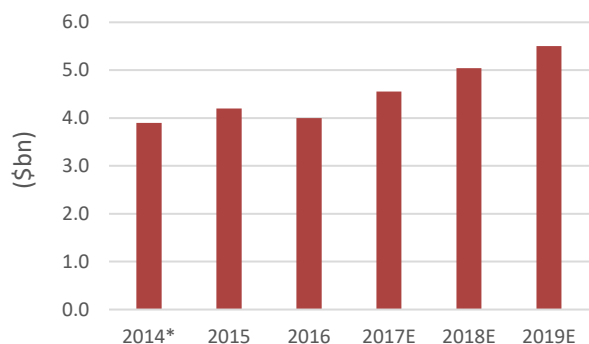
- ▶ **Pipeline:** The new business pipeline remains active, with over \$350m of potential mandates. While short term performance should have little affect on progress with these, the positive sentiment it generates may be helpful.
- ▶ **Operations:** The net margin on new business is 84bps, a slightly faster decline than we had predicted. Run rate operating profit before profit share is £1.5m per month, an improvement over the £1.4m at the end of Q2.
- ▶ **Valuation:** The prospective P/E of 9.7 times is at a significant discount to the peer group. The historic yield of 6.2% is very attractive and should at the very least provide support for the shares in the current volatile markets. At current market levels we'd expect dividend cover to be more than restored in 2017.
- ▶ **Risks:** To date, City of London has not experienced the sort of outflows that some other emerging market fund managers have, aided by its good performance and strong client servicing. Further EM volatility may increase the risk of such outflows however.
- ▶ **Investment summary:** City of London has continued to show robust performance in challenging market conditions. The valuation remains reasonable. At current FUM and exchange rates, dividend cover will return to a comfortable position and investors can perhaps start thinking about future increases.

**Financial summary and valuation**

Year end Jun (£m)	2014*	2015	2016	2017E	2018E	2019E
FUM (\$bn)	3.90	4.20	4.00	4.56	5.04	5.50
Revenue (£m)	24.22	25.36	24.41	31.62	34.71	35.37
Statutory PTP	5.20	6.61	5.85	8.74	9.90	10.18
Statutory EPS (p)	20.7	26.4	23.3	35.1	39.8	40.9
Dividend (p)	24.0	24.0	24.0	25.0	26.0	27.0
P/E (x)	18.6	14.6	16.5	11.0	9.7	9.4
Yield	6.2%	6.2%	6.2%	6.5%	6.8%	7.0%

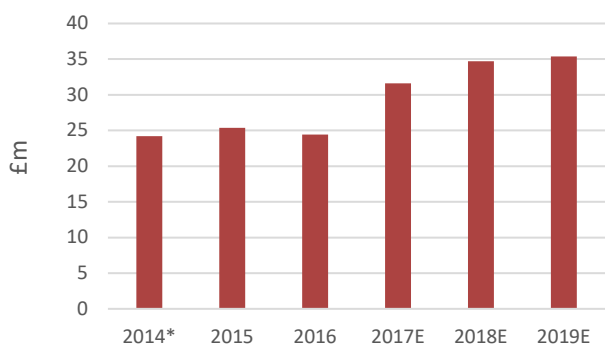
Source: Hardman & Co Research  
 \* 2014 had 13 months in financial year.

### Funds under Management



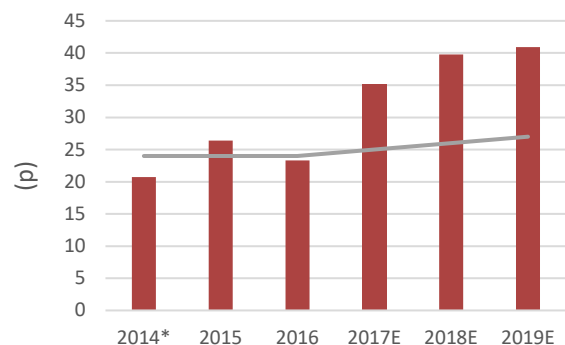
- ▶ Net inflows from 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Assumed steady new business flows and market growth of 5% pa in 2018 and 2019

### Revenues



- ▶ Revenues strongly linked 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 lead to step change in 2017
- ▶ Dividend shortfall in 2014 and 2016 covered from reserves
- ▶ If market remains at current levels then we would expect dividend to be covered and increased in 2017

## Commentary

We have been forecasting a slow decline in the rate at which City of London earns its fees. The fee margin of 84 basis points given in the statement is 1bps lower than our forecast, suggesting that the funds that had been lost were earning an above average fee margin.

City of London cites a narrowing of the Size Weighted Average Discount as being the main factor behind the improvement in performance this quarter. We note that this has been very wide for some time and, although there has been some narrowing, it will have much further to go to reach the lows of a few years ago.

## Estimate Updates

The main influence on our estimates has been the faster than expected growth in markets, with a slight offset from the change in the fee margin. For the first time in a while there is no change due to exchange rate movements. Overall this has led to a 2% upgrade to our 2017E eps, which is now 35.1p. For 2018E the improvement is 4% to 39.8p and for 2019E there is also a 4% upgrade to 40.9p.

For an unchanged dividend this would lead to cover of 1.46x this year and 1.66x next year. With the company's target cover of 1.2x over a five year period we don't see any sharp changes in the dividend in the near future and our forecasts remain for an increase of 1p in each of FY2017, FY2018 and FY2019.

## Financials

Summary Financials						
	June Year End					
	2014*	2015	2016	2017E	2018E	2019E
FUM (\$bn)	3.90	4.20	4.00	4.56	5.04	5.50
<b>P&amp;L (£m)</b>						
Revenue	24.22	25.36	24.41	31.62	34.71	35.37
Expenses	17.22	16.63	16.66	19.95	21.37	21.63
Operating Profit	7.00	8.73	7.76	11.67	13.34	13.73
PBT	7.24	8.93	7.97	11.81	13.37	13.76
Earnings	5.20	6.61	5.85	8.74	9.90	10.18
eps (p)	20.7	26.4	23.3	35.1	39.8	40.9
dps (p)	24.0	24.0	24.0	25.0	26.0	27.0
<b>Key Metrics</b>						
	2014*	2015	2016	2017E	2018E	2019E
<b>Growth (%)</b>						
FUM		7.7	-4.8	13.9	10.7	9.1
Revenue		4.7	-3.7	29.5	9.8	1.9
Operating Profit		24.7	-11.1	50.5	14.3	2.9
EPS		27.5	-11.7	50.8	13.2	2.9
DPS		0.0	0.0	4.2	4.0	3.8
<b>Operating Margins (%)</b>						
Net FUM fee margin	0.88	0.86	0.86	0.85	0.83	0.83
Operating Margin	28.9	34.4	31.8	36.9	38.4	38.8
Tax Rate	28.2	26.0	26.5	26.0	26.0	26.0
Dividend cover	0.9	1.1	1.0	1.4	1.5	1.5
<b>eps Sensitivity</b>						
				2017E	2018E	2019E
<b>No net new business</b>						
eps (p)				35.1	37.2	37.7
% change				0.0	-6.4	-8.0
<b>0% market growth (was 5% pa)</b>						
eps (p)				35.0	37.5	37.9
% change				-0.3	-5.6	-7.4

Source: City of London Investment Group, Hardman & Co Research  
\* 13-month year as year end change.

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*(Disclaimer Version 2 – Effective from August 2015)*

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