

Source: Eikon Thomson Reuters

Market data	
EPIC/TKR	CLIG
Price (p)	439.0
12m High (p)	439.0
12m Low (p)	350.0
Shares (m)	26.9
Mkt Cap (£m)	118.1
EV (£m)	104.2
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

Key shareholders

Directors & staff	16.2%
Blackrock	9.9%
Cannacord Genuity	7.9%
Polar Capital	4.1%

Next event

19 Feb-18	Half year results
1 Mar-18	Interim ex-div date
16 Mar-18	Interim div payment
18 Apr-18	3Q FUM Announcement

Analysts

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City of London Investment Group

FUM, profits and dividend all moving on up

City of London has published a trading statement this morning covering 1HFY2018. The headline figures are very positive, with funds under management (FUM) growing 14% over the six-month period to \$5.33bn. This was driven by positive market performance and inflows from the diversifying strategies, with an offset from net outflows in the Emerging Market strategy. Fund performance was mostly good, with outperformance across all the diversifying strategies, although Emerging Markets underperformed. The interim dividend has been increased by 1p to 9p.

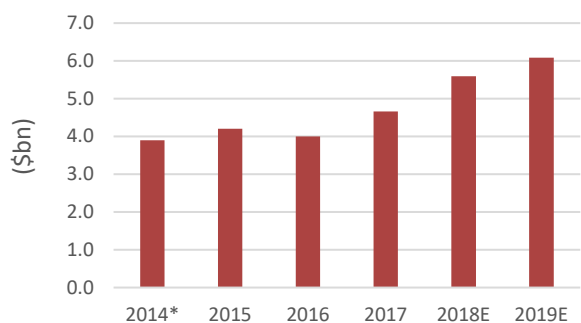
- **Operations:** Revenue and profitability numbers are ahead of expectations. The revenue accrual rate has dropped to 82 basis points of FUM from 84 basis points at the end of 1Q 2018, although this will affect future revenues more than those announced today. Costs are in line with previous figures.
- **Profits:** The run-rate operating profitability before profit share and EIP is currently £1.7m per month. This is based on the calendar year-end exchange rate of 1.35 US\$/£. The net result is that the estimated first-half pre-tax profit is £6.6m, a 14% increase over 1H FY2017.
- **Valuation:** The prospective P/E of 10.5 times is at a significant discount to the peer group. The historic 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 emerging market fund managers, aided by its good performance and strong client servicing. Further EM volatility may increase the risk of such outflows however.
- **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)	2014*	2015	2016	2017	2018E	2019E
FUM (\$bn)	3.90	4.20	4.00	4.66	5.59	6.08
Revenue (£m)	24.22	25.36	24.41	31.29	34.99	35.73
Statutory PTP	7.24	8.93	7.97	11.59	13.52	13.99
Statutory EPS (p)	20.7	26.4	23.3	36.9	41.9	43.3
Dividend (p)	24.0	24.0	24.0	25.0	27.0	29.0
P/E (x)	21.2	16.6	18.8	11.9	10.5	10.1
Yield	5.5%	5.5%	5.5%	5.7%	6.2%	6.6%

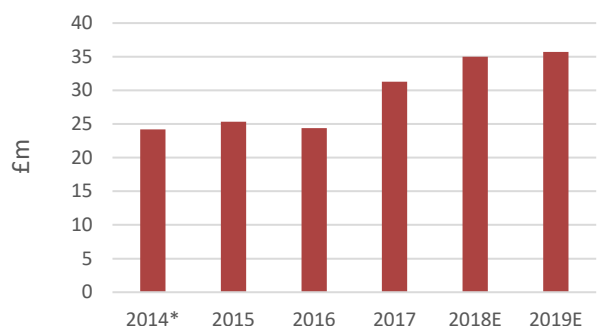
Source: Hardman & Co Research
* 2014 had 13 months in financial year.

Funds under Management



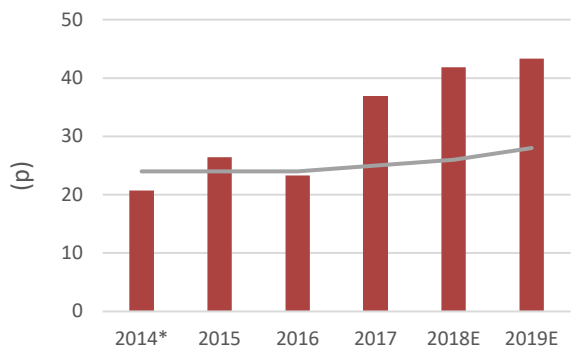
- ▶ Net inflows from 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Assumed steady new business flows and market growth of 5% pa in 2018 and 2019

Revenues



- ▶ Revenues 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 lead to step change in 2017 EPS
- ▶ Dividend shortfall in 2014 and 2016 covered from reserves
- ▶ Final dividend increased in 2017 with cover of 1.46 and we expect steady increases in the dividend over the next couple of years

Source: Company data; Hardman & Co Research

Positive results in H1

With this update, City of London introduced a new presentation format. Over the last few years it has been growing the assets in its diversifying strategies. This has been a long term project, but with FUM in these areas now approaching 13% of the total, we believe it is right that more detail is supplied on a regular basis.

The emerging markets strategy remains the largest component, with FUM of \$4.66bn, up 11% over the half year. Strong market performance saw the MSCI Emerging Markets Index post a gain of 16%, which was somewhat offset by net redemptions of \$89m and some underperformance. During 2017 City of London cited rebalancing by clients, as the latter keep exposure within targets by selling down strong performing areas. We understand that this continues. The closed end funds in this sector have also experienced widening discounts, while City of London was underweight the Chinese IT sector which proved to be a strong performer. With a very good long-term record, this underperformance should not materially affect City of London's prospects.

The diversifying areas all experienced net inflows and outperformance from the funds. Developed markets had the largest net inflows, at \$129m, and FUM is now \$337m or 6% of the total.

The financial results were slightly better than expected, with PBT of £6.6m a little ahead of our estimate of £6.5m. Costs were in line, suggesting that the higher FUM has brought better than expected revenue.

We have previously noted that new business, particularly in the Developed Markets and GTAA strategies, has a lower margin than the existing business. In this half, City of London both gained new assets in these areas and lost some from the existing higher margin business. This has lowered the revenue margin down to 82 basis points from 84 basis points at the end of 1Q2018. That this move took place over the last quarter suggests that most of the first half will have experienced the prior higher rate. However, this will obviously have an effect on revenues going forward.

Estimate Updates

While the larger than expected increase in FUM is positive for earnings, this has been somewhat offset by the lower revenue margin and a slightly stronger US Dollar. The net effect has been a small upgrade to our EPS figures, with 2018E going from 41.7p to 41.9p and 2019E from 43.2p to 43.3p.

There has been an interim dividend increase this year, and in expectation of the usual split we have increased our full-year estimate to 27p. However, we have also increased our 2019E by 2p to 29p.

Financials

Summary Financials						
June year end	2014*	2015	2016	2017	2018E	2019E
FUM (\$bn)	3.90	4.20	4.00	4.66	5.59	6.08
P&L (£m)						
Revenue	24.22	25.36	24.41	31.29	34.99	35.73
Expenses	17.22	16.63	16.66	19.79	21.48	21.76
Operating profit	7.00	8.73	7.76	11.51	13.51	13.98
PBT	7.24	8.93	7.97	11.59	13.52	13.99
Earnings	5.20	6.61	5.85	9.14	10.41	10.77
EPS (p)	20.7	26.4	23.3	36.9	41.9	43.3
Dividend (p)	24.0	24.0	24.0	25.0	27.0	29.0
Key Metrics						
	2014*	2015	2016	2017	2018E	2019E
Growth (%)						
FUM		7.7	-4.8	16.5	20.0	8.7
Revenue		4.7	-3.7	28.2	11.8	2.1
Operating Profit		24.7	-11.1	48.4	17.4	3.5
EPS		27.5	-11.7	58.4	13.4	3.5
DPS		0.0	0.0	4.2	8.0	7.4
Operating margins (%)						
Net FUM fee margin	0.88	0.86	0.86	0.85	0.83	0.82
Operating margin	28.9	34.4	31.8	36.8	38.6	39.1
Tax rate	28.2	26.0	26.5	26.0	26.0	26.0
Dividend cover	0.9	1.1	1.0	1.5	1.6	1.5
eps Sensitivity						
					2018E	2019E
No net new business						
EPS (p)					41.5	42.5
% change					-0.8	-1.8
0% market growth (was 5% pa)						
EPS (p)					41.4	42.4
% change					-1.0	-2.1

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

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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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