**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

Brian Moretta	020 7194 7622
	bm@hardmanandco.com

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.

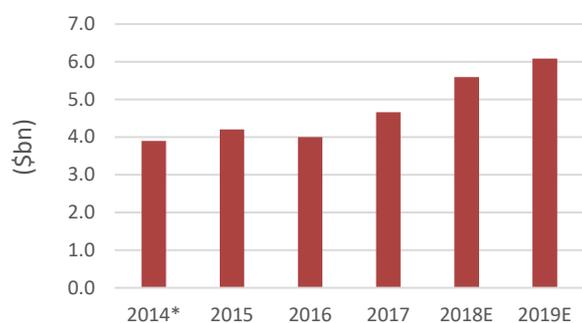
- ▶ **Operations:** Revenue and profitability numbers are ahead of expectations. The revenue accrual rate has dropped to 82 basis points of FUM from 84 basis points at the end of 1Q 2018, although this will affect future revenues more than those announced today. Costs are in line with previous figures.
- ▶ **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%

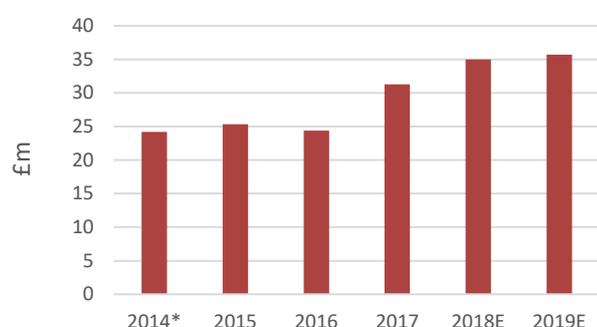
Source: Hardman & Co Research
* 2014 had 13 months in financial year.

Funds under Management



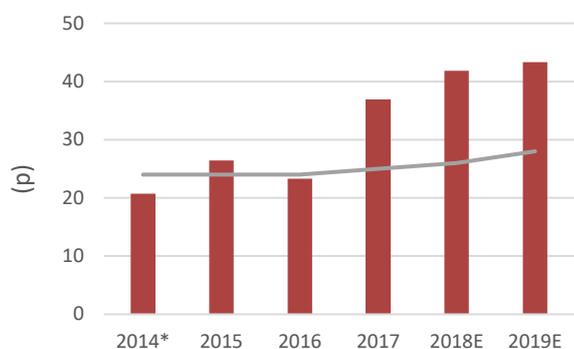
- ▶ Net inflows from 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Assumed steady new business flows and market growth of 5% pa in 2018 and 2019

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.

Disclaimer

Hardman & Co provides professional independent research services. Whilst every reasonable effort has been made to ensure that the information in the research is correct, this cannot be guaranteed.

The research reflects the objective views of the analysts named on the front page. However, the companies or funds 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 funds that have paid us for coverage within the past 12 months can be viewed at <http://www.hardmanandco.com/>

Hardman & Co has a personal dealing policy which debars staff and consultants from dealing in shares, bonds or other related instruments of companies which pay Hardman for any services, including research. They may be allowed to hold such securities if they were owned prior to joining Hardman or if they were held before the company appointed Hardman. In such cases sales will only be allowed in limited circumstances, generally in the two weeks following publication of figures.

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 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 but has no scheduled commitment and may cease to follow these securities/companies without notice.

Nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell securities by us.

This information is not tailored to your individual situation and the investment(s) covered may not be suitable for you. You should not make any investment decision without consulting a fully qualified financial adviser.

This report may not be reproduced in whole or in part without prior permission from Hardman & Co.

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. However, the information in this research report is not FCA regulated because it does not constitute investment advice (as defined in the Financial Services and Markets Act 2000) and is provided for general information only.

*Hardman & Co Research Limited (trading as Hardman & Co)
35 New Broad Street
London
EC2M 1NH
T +44 (0) 207 194 7622*

Follow us on Twitter @HardmanandCo

(Disclaimer Version 2 – Effective from January 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 research and, specifically, whether it can be accepted without a commercial arrangement. Hardman's company research is paid for by the companies 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 an[sic] 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 is not inducing the reader of our research to trade through us, since we do not deal in any security.

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

Marketing / Investor Engagement

+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 Pabillionyte	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
Thomas Wigglesworth	tcw@hardmanandco.com

Bonds

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

Financials

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

Life Sciences

Martin Hall	mh@hardmanandco.com
Dorothea Hill	dmh@hardmanandco.com
Gregoire Pave	gp@hardmanandco.com

Media

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

Mining

Ian Falconer	if@hardmanandco.com
--------------	---------------------

Oil & Gas

Angus McPhail	am@hardmanandco.com
---------------	---------------------

Property

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

Services

Mike Foster	mf@hardmanandco.com
Paul Singer	

Special Situations

Steve Clapham	mf@hardmanandco.com
Paul Singer	

Tax Enhanced Services

Brian Moretta	bm@hardmanandco.com
Chris Magennis	cm@hardmanandco.com

Utilities

Nigel Hawkins

Hardman & Co

35 New Broad Street
London
EC2M 1NH

Tel: +44(0)20 7194 7622

