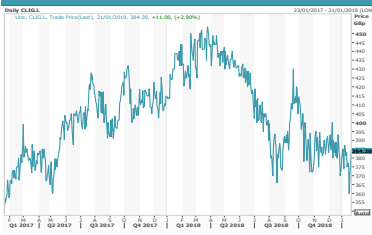




21 January 2019

Financial Services



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	CLIG
Price (p)	379.0
12m High (p)	454.0
12m Low (p)	360.0
Shares (m)	26.9
Mkt Cap (£m)	102.0
EV (£m)	82.3
Market	LSE

Description

City of London is an investment manager specialising in using closed-end funds to invest in emerging and other markets.

Company information

CEO	Barry Olliff
CFO	Tracy Rodrigues
Chairman	Barry Aling
	+44 207 860 8346
	www.citlon.com

Key shareholders

Directors & staff	16.7%
Blackrock	10.0%
Cannacord Genuity	8.0%
Eschaton Opportunities	
Fund Management	4.8%
Polar Capital	4.1%

Diary

18 Feb	Half-year results
7 Mar	Interim ex-dividend date
16 Apr	3Q FUM announcement
16 Jul	Pre-close trading statement

Analyst

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CITY OF LONDON INVESTMENT GROUP

Solid FUM update offset by margin changes

City of London has released its trading update for 2Q of FY'19. In this period, market weakness dominated movements in FUM: the 7% fall in the MSCI Emerging Markets Index was trumped by a 13% fall in the MSCI ACWI. Fund flows, in contrast, had a quieter quarter, with a net \$15m of inflows to the Opportunistic Value strategies offset by net outflows of \$62m from Emerging Markets. City of London has indicated that there may be some positive rebalancing, with \$125m of net inflows expected to be funded over the next quarter. The MSCI Emerging Markets is up 4% so far in 2019, suggesting an improvement since the year-end.

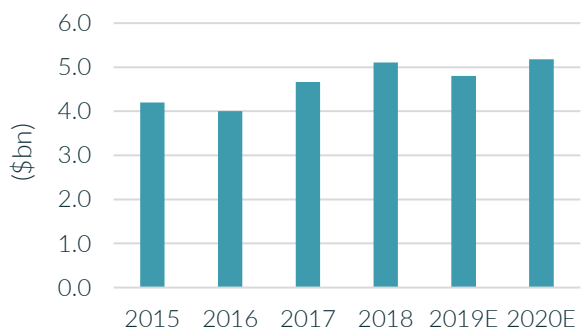
- **Performance:** The Emerging Markets strategy had an inconsistent 2018 in terms of performance, but it finished well, with narrowing discounts and country allocation contributing to outperformance. The other strategies, which had done well earlier in the year, underperformed towards the end of the year.
- **Operations:** Costs were in line with those indicated in the last announcement. The EIP charge has increased a little, to 5%, from 3% at the full-year results. However, falling markets have impacted revenues, and the first-half profit before tax will be around £5.2m, compared with £6.6m in the previous first half.
- **Valuation:** The prospective P/E of 11.9x is at a significant discount to the peer group. The historical yield of 7.1% is 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 could increase the risk of such outflows, although increased diversification is also mitigating this.
- **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. FY'17 and FY'18 both saw dividend increases and, unless there is significant market disruption, more should follow in the next few years.

Financial summary and valuation

Year-end Jun (£m)	2015	2016	2017	2018	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.11	4.80	5.18
Revenue	25.36	24.41	31.29	33.93	29.93	30.27
Statutory PTP	8.93	7.97	11.59	12.79	10.00	10.02
Statutory EPS (p)	26.4	23.3	36.9	39.5	31.8	31.8
DPS (p)	24.0	24.0	25.0	27.0	27.0	27.0
P/E (x)	14.4	16.3	10.3	9.6	11.9	11.9
Dividend yield	6.3%	6.3%	6.6%	7.1%	7.1%	7.1%

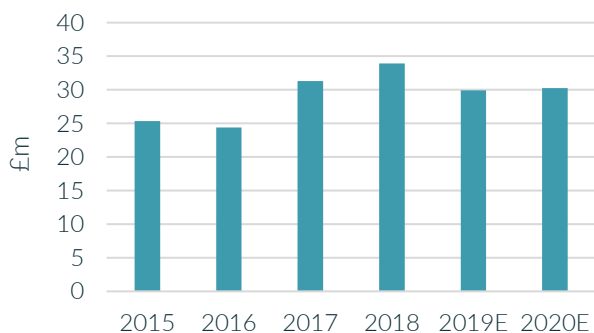
Source: Hardman & Co Research

Funds under management



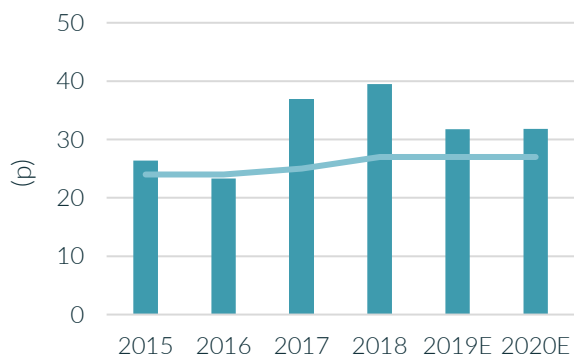
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Market weakness from late 2018 impacting 2019
- ▶ Assumed steady new business flows and market growth of 5% p.a.

Revenue



- ▶ Revenue strongly linked to FUM
- ▶ Ongoing decrease in revenue margins from new business
- ▶ Some currency effects, particularly from a strong US dollar between 2015 and 2017
- ▶ 2019E growth affected by reduction of revenue margins, as well as weak markets

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
- ▶ Dividend increased in 2017 and 2018 but, with recent market falls, now forecasting a flat dividend

Source: Company data, Hardman & Co Research

Commentary

Funds under management				
(\$m)	Dec 2018	Sep 2018	Net flows	Other movements
Emerging Markets	3,734	4,016	-62	-220
Developed Markets	495	577	0	-82
Frontier Markets	197	215	0	-18
Opportunistic Value	199	200	15	-16
Total	4,625	5,008	-47	-336

Source: Hardman & Co Research

The figures for fund flows remain somewhat mixed: although the quarter was quieter, with smaller net flows, both EM and Opportunistic Value followed the trends seen in recent statements.

Market movements dominated the other movements, with EM gaining an offset from outperformance in the period.

Estimate updates

Although City of London has continued to maintain its usually tight operations, with flat costs during the quarter, the falling markets have had a strong impact on revenues. Pre-tax profits for the first half of the year are expected to fall to £5.2m, from £6.6m in the previous first half.

This has had a similar impact on Hardman & Co forecasts. Our estimated 2019 EPS has been reduced from 35.8p to 31.8p and 2020 EPS from 37.8p to 31.8p also. Unfortunately, this would have reduced EPS below our previously forecast dividend increases, and, accordingly, we now forecast the dividend to remain flat at 27p in both 2019 and 2020. This would leave cover at 1.2x in each of those years.

Financials

Summary financials						
Year-end Jun	2015	2016	2017	2018	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.11	4.80	5.18
P&L (£m)						
Revenue	25.36	24.41	31.29	33.93	29.93	30.27
Expenses	16.63	16.66	19.79	21.40	19.95	20.27
Operating profit	8.73	7.76	11.51	12.53	9.99	10.00
PBT	8.93	7.97	11.59	12.79	10.00	10.02
Earnings	6.61	5.85	9.14	10.06	7.90	7.91
EPS (p)	26.4	23.3	36.9	39.5	31.8	31.8
DPS (p)	24.0	24.0	25.0	27.0	27.0	27.0
Key metrics						
	2015	2016	2017	2018	2019E	2020E
Growth (%)						
FUM	7.7	-4.8	16.5	9.6	-5.9	7.7
Revenue	4.7	-3.7	28.2	8.4	-11.8	1.1
Operating profit	24.7	-11.1	48.4	8.8	-20.3	0.2
EPS	27.5	-11.7	58.4	7.0	-19.6	0.2
DPS	0.0	0.0	4.2	8.0	0.0	0.0
Operating margins (%)						
Net FUM fee margin	0.86	0.86	0.84	0.80	0.77	0.76
Operating margin	34.4	31.8	36.8	36.9	33.4	33.0
Tax rate	26.0	26.5	21.1	21.0	21.0	21.0
Dividend cover (x)	1.1	1.0	1.5	1.5	1.2	1.2
EPS sensitivity						
	2015	2016	2017	2018	2019E	2020E
No net new business						
EPS (p)					31.6	30.7
change					-0.5%	-3.6%
0% market growth (was 5% p.a.)						
EPS (p)					31.4	28.9
change					-1.1%	-9.0%

Source: City of London Investment Group, Hardman & Co Research
£1=\$1.31

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