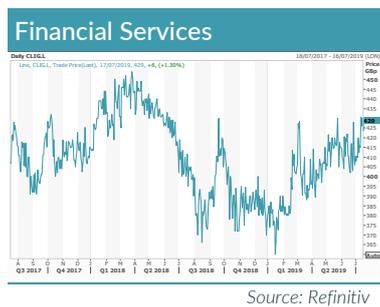




18 July 2019

**Market data**

EPIC/TKR	CLIG
Price (p)	424.0
12m High (p)	433.0
12m Low (p)	360.0
Shares (m)	26.6
Mkt Cap (£m)	114.2
EV (£m)	95.5
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	Tom Griffith
CFO	Tracy Rodrigues
Chairman	Barry Aling
	+44 207 860 8346
	<a href="http://www.citlon.com">www.citlon.com</a>

**Key shareholders**

Directors & staff	17.2%
Blackrock	10.1%
Cannacord Genuity	8.0%
Eschaton Opportunities	4.8%
Fund Management	
Polar Capital	4.1%

**Diary**

16 Sep	Preliminary results statement
9 Oct	1Q FUM announcement
10 Oct	Ex-div date for final
14 Jan	2Q FUM announcement

**Analyst**

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## CITY OF LONDON INVESTMENT GROUP

## Finishing ahead in a volatile year for markets

City of London has announced its pre-close trading update for FY2019. After a volatile fourth quarter, FUM finished ahead of the end-March figure, at \$5.39bn. This was an increase of \$282m (5.5%) over a year ago, of which \$96m was net inflows, with the balance from market movements. As indicated in the quarterly statements, both the Developed Markets and Opportunistic Value strategies saw net inflows over the year. Emerging Markets and Frontier Markets experienced net outflows. Performance in the Emerging Markets strategy was good, with outperformance of ca.300bps over the year.

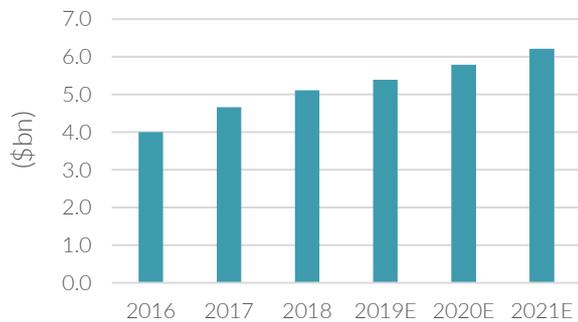
- **Operations:** Expected pre-tax profit for the year will be £11.4m, which, after tax and deducting of non-controlling interests, gives £8.8m attributable to shareholders. This is very slightly ahead of our forecast of £8.7m. Basic and diluted EPS are expected to be 34.9p and 34.1p, respectively.
- **Dividend:** The recommendation is for a final dividend of 18p, the same as last year. This will bring the total for the year to 40.5p, including the special dividend of 13.5p. The underlying dividend of 27p is covered 1.26x by fully-diluted earnings.
- **Valuation:** The 2020E P/E of 10.1x is at a significant discount to the peer group. The underlying 2020E yield of 6.4% is attractive, in our view, 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 raise the risk of such outflows, although increasing 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)	2016	2017	2018	2019E*	2020E	2021E
FUM (\$bn)	4.00	4.66	5.11	5.39	5.79	6.21
Revenue	24.41	31.29	33.93	31.98	35.41	37.56
Statutory PTP	7.97	11.59	12.79	11.40	13.09	14.16
Statutory EPS (p)	23.3	36.9	39.5	34.9	41.9	45.3
DPS (p)	24.0	25.0	27.0	40.5	27.0	27.0
Special dividend (p)				13.5		
P/E (x)	18.2	11.5	10.7	12.1	10.1	9.4
Dividend yield	5.7%	5.9%	6.4%	9.6%*	6.4%	6.4%

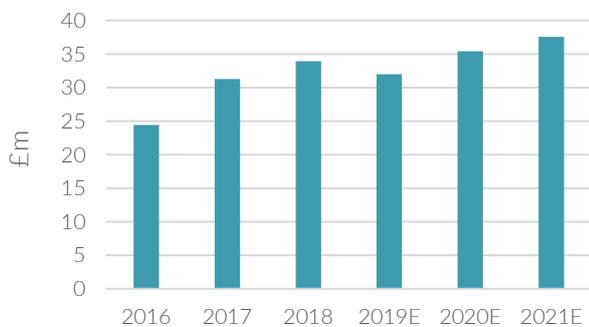
\*2019 figures include a special dividend of 13.5p.

Funds under management (FUM)



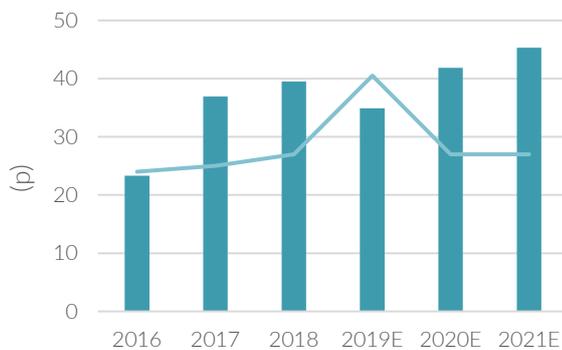
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Market recovery in 3Q'19 completely offset weakness in preceding quarter
- ▶ Assumed steady new business flows and market growth of 5% p.a.

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 volatile markets

EPS (bar) and DPS (line)



- ▶ Profitability historically maintained by cost flexibility
- ▶ Currency movements led to step change in 2017 EPS
- ▶ Dividend shortfall in 2016 covered from reserves
- ▶ Special dividend of 13.5p in 2019
- ▶ Dividend increased in 2017 and 2018; however, with recent market volatility, now forecasting flat dividend, excluding the special dividend

Source: Company data, Hardman & Co Research

## Commentary

Funds under management (FUM)				
(\$m)	June 2019	June 2018	Net flows	Other movements
Emerging Markets	4,221	4,207	-184	198
Developed Markets	729	481	253	-5
Frontier Markets	206	245	-21	-18
Opportunistic Value	233	174	48	11
Total	5,389	5,106	96	187

Source: Hardman & Co Research

While emerging markets had a volatile year, the MSCI Emerging Markets Index finished the year up 1%. City of London's funds outperformed by 300bps, with discounts narrowing and a positive effect from country allocation. These offset the net outflows, and the net effect was that FUM in the Emerging Markets strategy were slightly up over the year.

The other three strategies did not do so well, with negative NAV performance and country allocation effects leading to underperformance in each.

This year's figures show the return of a non-controlling interest. City of London has seeded the new REIT strategy, although there is a small amount of external investment. Currently, all gains (or losses) are consolidated into earnings, with the amount due to the external investors (£0.2m in 2019) deducted below the profit after tax line. While this accounting treatment will change when City of London no longer has a controlling interest, the usual strategy is to dis-invest once there is a critical mass of investors.

### Estimate updates

With costs and earnings in line with our estimates, we have made no change to our operational figures. The main adjustment is for the weakness in Sterling, with a small amount from FUM being slightly ahead. The net effect is that the Hardman & Co 2020E EPS is increased by 5% to 41.9p and 2021E also by 5% to 45.3p.

With the dividend being kept flat, we have kept our forecasts for a flat dividend in place. We do note that, particularly in 2021, our forecasts would allow an increase, while keeping the rolling five-year cover (excluding the special dividend) above the company's 1.2x target.

# Financials

Summary financials						
Year-end Jun	2016	2017	2018	2019E*	2020E	2021E
FUM (\$bn)	4.00	4.66	5.11	5.39	5.79	6.21
<b>P&amp;L (£m)</b>						
Revenue	24.41	31.29	33.93	31.98	35.41	37.56
Expenses	16.66	19.79	21.40	20.88	22.34	23.42
Operating profit	7.76	11.51	12.53	11.10	13.07	14.15
Statutory PTP	7.97	11.59	12.79	11.40	13.09	14.16
Earnings	5.85	9.14	10.06	8.80	10.47	11.33
Statutory EPS (p)	23.3	36.9	39.5	34.9	41.9	45.3
DPS (p)	24.0	25.0	27.0	40.5	27.0	27.0

Key metrics						
	2016	2017	2018	2019E*	2020E	2021E
<b>Growth (%)</b>						
FUM		16.5	9.6	5.5	7.5	7.3
Revenue		28.2	8.4	-5.8	10.7	6.1
Operating profit		48.4	8.8	-11.4	17.8	8.2
EPS		58.4	7.0	-11.6	20.0	8.2
DPS (excluding special)		4.2	8.0	0.0	0.0	0.0
<b>Operating margins (%)</b>						
Net FUM fee margin	0.86	0.84	0.80	0.76	0.76	0.76
Operating margin	31.8	36.8	36.9	34.7	36.9	37.7
Tax rate	26.5	21.1	21.4	20.0	20.0	20.0
Dividend cover (x) (excluding special)	1.0	1.5	1.5	1.3	1.6	1.7

EPS sensitivity		
	2020E	2021E
<b>No net new business</b>		
EPS (p)	41.2	43.5
change	-1.5%	-4.0%
<b>0% market growth (was 5% p.a.)</b>		
EPS (p)	40.1	40.0
change	-4.1%	-11.8%

Source: City of London Investment Group, Hardman & Co Research  
 £1=\$1.25

\*2019 figures include a special dividend of 13.5p.

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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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