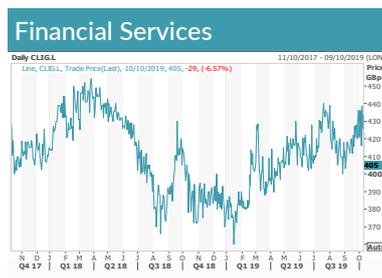




10 October 2019



Market data	
EPIC/TKR	CLIG
Price (p)	433.5
12m High (p)	440.0
12m Low (p)	360.0
Shares (m)	26.6
Mkt Cap (£m)	115.1
EV (£m)	101.3
Market	LSE

Description

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

Company information

CEO Tom Griffith
 CFO Tracy Rodrigues
 Chairman Barry Aling

+44 207 860 8346
www.citlon.com

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

Diary

21 Oct AGM
 14 Jan 2Q FUM announcement
 17 Feb Half-year results

Analyst

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CITY OF LONDON INVESTMENT GROUP

Keeping steady against weak markets

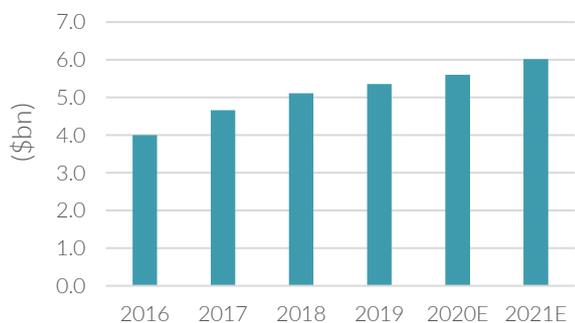
City of London has announced a trading update for 1Q'20. Weak markets were largely offset by inflows and outperformance in the Emerging Markets strategy, meaning FUM finished the quarter at \$5.34bn, down \$61m from the June figure of \$5.39bn. The main beneficiary of inflows was the Developed Markets strategy, which received a net \$142m, and assets rose 16.5% to \$849m. In the Emerging Markets strategy, outperformance came from positive NAV performances and narrowing discounts. The Developed Markets strategy was impacted by European and UK weakness, while Frontier Markets saw an impact from exposure to Argentina.

- ▶ **Operations:** The increased FUM in the diversifying strategies continue to affect the revenue margin, which slipped to 75bps. This, together with weak markets, weighed a little on revenues and, with costs in line with expectations, the expected post-tax profit of £2.4m for 1Q'20 is a little behind our forecast.
- ▶ **Board:** From 1 January 2020, Carlos Yuste, Head of Business Development, will re-join the board as an Executive Director. He was previously on the board from 2006 until 2015.
- ▶ **Valuation:** The 2020E P/E of 10.6x is at a significant discount to the peer group. The underlying 2020E yield of 6.2% 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	2019*	2020E	2021E
FUM (\$bn)	4.00	4.66	5.11	5.39	5.60	6.02
Revenue	24.41	31.29	33.93	31.98	34.22	36.49
Statutory PTP	7.97	11.59	12.79	11.40	12.75	13.88
Statutory EPS (p)	23.3	36.9	39.5	34.9	40.8	44.4
DPS (p)	24.0	25.0	27.0	27.0	27.0	27.0
Special dividend (p)				13.5		
P/E (x)	18.6	11.7	11.0	12.4	10.6	9.8
Dividend yield	5.5%	5.8%	6.2%	9.3%	6.2%	6.2%

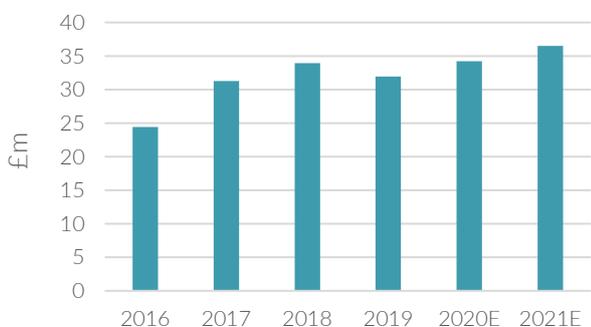
*2019 figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



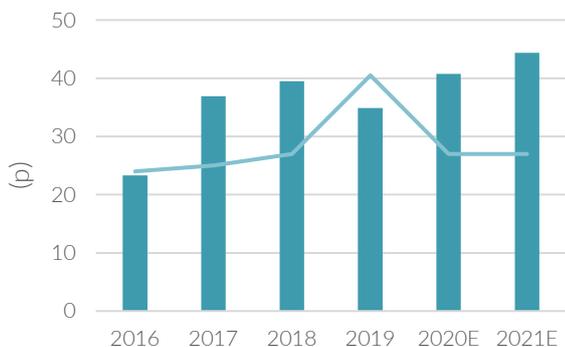
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Market recovery in 3Q'19 completely offset weakness in preceding quarter
- ▶ Assumed steady new business flows and market growth of 5% p.a.

Revenue



- ▶ Revenue linked strongly to FUM
- ▶ Ongoing decrease in revenue margins from new business
- ▶ Some currency effects, particularly from a strong US dollar, between 2015 and 2017
- ▶ 2020E 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)	Sep'19	Jun'19	Net flows	Other movements
Emerging Markets	4,058	4,221	-12	-151
Developed Markets	849	729	142	-22
Opportunistic Value	245	233	10	2
Frontier Markets	186	206	-	-20
Total	5,338	5,389	140	-191

Source: Hardman & Co Research

The quarter was positive for inflows, with large inflows for Developed Markets. The total net inflow for the quarter exceeded that for the last financial year.

These were more than offset by weak markets, with the MSCI Emerging Markets Index declining 4.2% over the quarter, the MSCI ACWI ex US Index falling 1.8% and the S&P Frontier 150 Index down 5.6%. Following the trend of the last couple of quarters, the Emerging Markets strategy continued to outperform, while the Developed Markets and Frontier Markets strategies underperformed. The inflows to the Developed Markets strategy show that the long-term track record remains good.

The benefits of the diversification strategy started several years ago are now coming through strongly, with the Developed Markets and Opportunistic Value strategies now representing over 20% of assets.

Estimate updates

The market weakness in 1Q'20 and a slightly faster decline in the revenue margin than we had anticipated have led to a small decrease in our earnings estimates. The Hardman & Co 2020E EPS is lowered by 7% to 40.8p and the 2021E EPS by 6% to 44.4p. We have made no adjustments to our dividend forecasts.

Financials

Summary financials						
Year-end Jun	2016	2017	2018	2019*	2020E	2021E
FUM (\$bn)	4.00	4.66	5.11	5.36	5.60	6.02
P&L (£m)						
Revenue	24.41	31.29	33.93	31.93	34.22	36.49
Expenses	16.66	19.79	21.40	21.43	21.48	22.63
Operating profit	7.76	11.51	12.53	10.50	12.74	13.86
Statutory PTP	7.97	11.59	12.79	11.40	12.75	13.88
Earnings	5.85	9.14	10.06	9.05	10.20	11.10
Statutory EPS (p)	23.3	36.9	39.5	34.9	40.8	44.4
DPS (p)	24.0	25.0	27.0	40.5	27.0	27.0
Key metrics						
	2016	2017	2018	2019*	2020E	2021E
Growth (%)						
FUM		16.5	9.6	4.9	4.6	7.4
Revenue		28.2	8.4	-5.9	7.2	6.6
Operating profit		48.4	8.8	-16.2	21.3	8.8
EPS		58.4	7.0	-11.6	16.8	8.8
DPS (excluding special div.)		4.2	8.0	0.0	0.0	0.0
Operating margins (%)						
Net FUM fee margin	0.86	0.84	0.80	0.76	0.75	0.75
Operating margin	31.8	36.8	36.9	32.9	37.2	38.0
Tax rate	26.5	21.1	21.4	20.0	20.0	20.0
Dividend cover (x) (excluding special div.)	1.0	1.5	1.5	1.3	1.5	1.6
EPS sensitivity						
					2020E	2021E
No net new business						
EPS (p)					40.4	42.8
change					-0.9%	-3.5%
0% market growth (was 5% p.a.)						
EPS (p)					40.2	40.4
change					-1.4%	-8.9%

Source: Company data, Hardman & Co Research
£1=\$1.24

*2019 figures include a special dividend of 13.5p

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