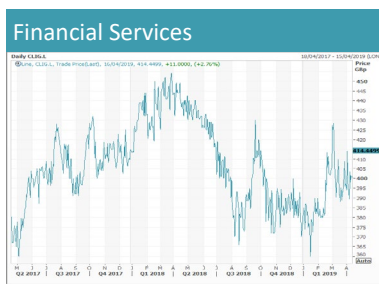




17 April 2019



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	CLIG
Price (p)	409.0
12m High (p)	449.0
12m Low (p)	360.0
Shares (m)	26.9
Mkt Cap (£m)	110.1
EV (£m)	91.4
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
	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

16 Jul	Pre-close trading statement
16 Sep	Preliminary results statement
9 Oct	1Q FUM announcement
10 Oct	Ex-div date for final

Analyst

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CITY OF LONDON INVESTMENT GROUP

Market bounce gives FUM bounce

City of London has announced its FUM as of 31 March for 3Q'19. They were positive on all counts, with strong markets complemented by net inflows into most strategies and outperformance as well. Overall, FUM grew by 11% to \$5,268m, supported notably by the MSCI Emerging Markets Index, which was up 10%. The EM strategy also saw welcome net inflows of \$45m, with Developed Markets receiving another \$101m, and Opportunistic Value \$7m. These three strategies also outperformed due to narrowing discounts and some positive NAV movements. The Frontier strategy was the exception, with no net flows and underperformance.

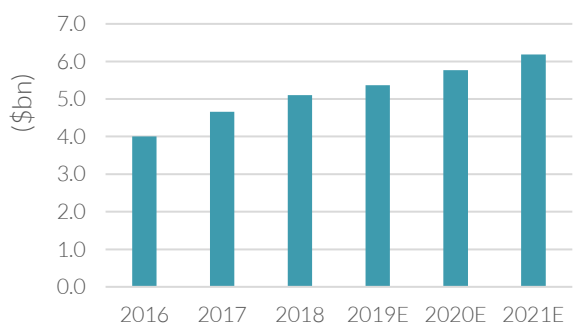
- **Operations:** Fixed costs were unchanged at a monthly run-rate of £1.1m. Fund flows, unfortunately, brought the revenue margin down from 77 to 76 basis points. Nevertheless, the monthly operating profit before profit share/EIP still increased to £1.5m.
- **Board change:** Due to other commitments, Mark Driver will be retiring from the board on 30 June, to be replaced by Peter E. Roth with effect from 1 June. The latter is a Managing Partner of Rothpoint Group llc and a trustee of the Guggenheim Credit Income Fund.
- **Valuation:** The prospective P/E of 11.8x is at a significant discount to the peer group. The historical yield of 6.6% 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 raise 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)	2016	2017	2018	2019E*	2020E	2021E
FUM (\$bn)	4.00	4.66	5.11	5.37	5.77	6.19
Revenue	24.41	31.29	33.93	31.42	34.16	36.24
Statutory PTP	7.97	11.59	12.79	10.88	12.49	13.53
Statutory EPS (p)	23.3	36.9	39.5	34.6	39.8	43.1
DPS (p)	24.0	25.0	27.0	27.0	27.0	27.0
Special dividend (p)				13.5		
P/E (x)	17.6	11.1	10.4	11.8	10.3	9.5
Dividend yield	5.9%	6.1%	6.6%	9.9%*	6.6%	6.6%

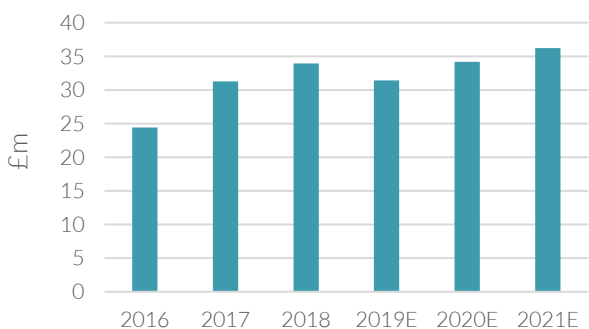
*2019 figures include a special dividend of 13.5p.

Funds under management



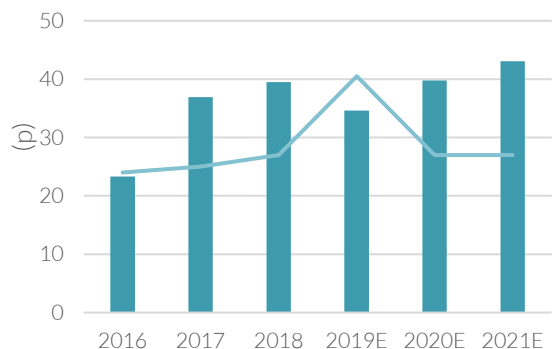
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ The market recovery in 3Q'19 has completely offset the weakness in the preceding quarter
- ▶ Assumed steady new business flows and market growth of 5% p.a.

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 weak 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 falls, now forecasting a flat dividend, excluding the special

Source: Company data, Hardman & Co Research

Commentary

Funds under management				
(\$m)	Mar 2019	Dec 2018	Net flows	Other movements
Emerging Markets	4,180	3,732	45	403
Developed Markets	660	495	101	64
Frontier Markets	201	197	0	4
Opportunistic Value	227	199	7	21
Total	5,268	4,623	153	492

Source: Hardman & Co Research

Apart from the strong inflows, City of London continues to emphasise an active pipeline, particularly in Developed Markets and Opportunistic Value. The former, in particular, is realising some of the potential that the size of that market presents.

Estimate updates

With costs in line with previous figures and the exchange rate barely moving, the only meaningful change to the Hardman & Co estimates has been to allow for the increased FUM. This has, inevitably, led to upgrades. The 2019E EPS has increased 2% to 34.6p, 2020E EPS by 6% to 39.8p and 2021E EPS by 6% to 43.1p.

These EPS figures may give scope to increase the dividend, although we note that with a flat dividend the rolling five-year average cover to 2020 would be 1.2x, exactly on target. City of London still has surplus capital, but having just declared a special dividend and with regular dividends in line with cover targets, further buybacks seem to be the mostly likely method of returning it in the near future.

Financials

Summary financials						
Year-end Jun	2016	2017	2018	2019E*	2020E	2021E
FUM (\$bn)	4.00	4.66	5.11	5.37	5.77	6.19
P&L (£m)						
Revenue	24.41	31.29	33.93	31.42	34.16	36.24
Expenses	16.66	19.79	21.40	20.56	21.68	22.73
Operating profit	7.76	11.51	12.53	10.86	12.48	13.51
PBT	7.97	11.59	12.79	10.88	12.49	13.53
Earnings	5.85	9.14	10.06	8.70	9.99	10.82
EPS (p)	23.3	36.9	39.5	34.6	39.8	43.1
DPS (p)	24.0	25.0	27.0	40.5*	27.0	27.0
Key metrics						
	2016	2017	2018	2019E*	2020E	2021E
Growth (%)						
FUM		16.5	9.6	5.1	7.5	7.3
Revenue		28.2	8.4	-7.4	8.7	6.1
Operating profit		48.4	8.8	-13.3	14.9	8.3
EPS		58.4	7.0	-12.4	14.8	8.3
DPS (excluding special))		4.2	8.0	0.0	0.0	0.0
Operating margins (%)						
Net FUM fee margin	0.86	0.84	0.80	0.76	0.76	0.76
Operating margin	31.8	36.8	36.9	34.6	36.5	37.3
Tax rate	26.5	21.1	21.4	20.0	20.0	20.0
Dividend cover (x)	1.0	1.5	1.5	0.9	1.5	1.6
EPS sensitivity						
				2019E	2020E	2021E
No net new business						
EPS (p)				34.6	38.9	41.0
change				-0.1%	-2.2%	-4.8%
0% market growth (was 5% p.a.)						
EPS (p)				34.5	37.3	37.1
change				-0.3%	-6.2%	-13.7%

Source: City of London Investment Group, Hardman & Co Research
£1=\$1.29

*2019 figures include a special dividend of 13.5p.

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