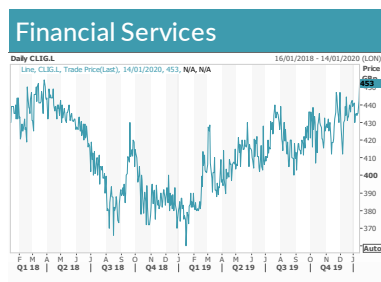




15 January 2020



Source: Refinitiv

Market data

EPIC/TKR	CLIG
Price (p)	452.5
12m High (p)	452.5
12m Low (p)	360.0
Shares (m)	26.6
Mkt Cap (£m)	120.2
EV (£m)	106.4
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	18.6%
Blackrock	10.1%
APQ Capital	5.5%
Cannacord Genuity	5.0%
Eschaton Opportunities	4.8%
Fund Management	
Polar Capital	3.7%

Diary

17 Feb	Half-year results
21 Apr	3Q FUM announcement
14 Jul	Pre-close update

Analyst

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bm@hardmanandco.com

CITY OF LONDON INVESTMENT GROUP**Perky markets support dividend hike**

City of London has announced a trading update for 2Q'20. At the end of December, FUM had grown to \$6.01bn, a 13% increase over the September 2019 figure of \$5.34bn. This was driven by healthy market growth and more inflows into the Developed World strategy. A rebound in the exchange rate means a smaller increase in FUM of 5% in sterling terms. The highlight for many investors will be in the increase in the interim dividend of 1p to 10p. While nothing has been said about the full-year dividend, increasing that at the same rate would still leave the five-year rolling dividend cover, on our estimates, above the 1.2x target.

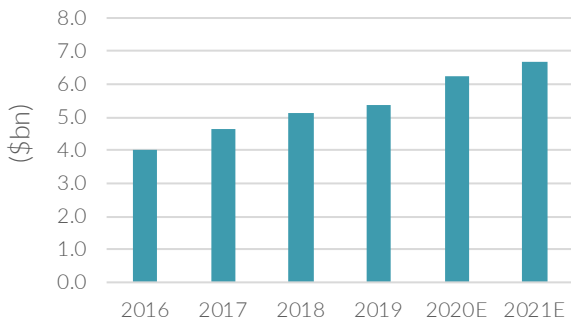
- **Operations:** The increased FUM in the diversifying strategies did not affect the revenue margin, which stayed at 75bps. The strong market performance and good inflows led to an estimated pre-tax profit of £6.3m, which was a little ahead of our forecast.
- **Performance:** Each of the Emerging Market, Developed Market and Opportunistic Value strategies outperformed, with NAV performance and discount narrowing being a factor in each. Frontier underperformed, with country allocation and discount widening both being factors.
- **Valuation:** The 2020E P/E of 10.5x is at a significant discount to the peer group. The underlying 2020E yield of 6.6% 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	6.23	6.67
Revenue	24.41	31.29	33.93	31.93	35.07	38.20
Statutory PTP	7.97	11.59	12.79	11.40	13.47	15.20
Statutory EPS (p)	23.3	36.9	39.5	34.9	43.1	48.6
DPS (p)	24.0	25.0	27.0	27.0	30.0	30.0
Special dividend (p)				13.5		
P/E (x)	19.4	12.3	11.5	13.0	10.5	9.3
Dividend yield	5.3%	5.5%	6.0%	9.0%	6.6%	6.6%

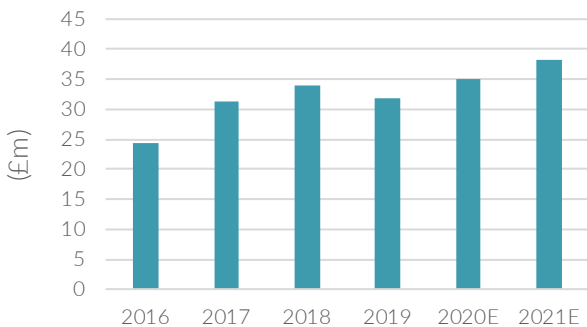
*2019 figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



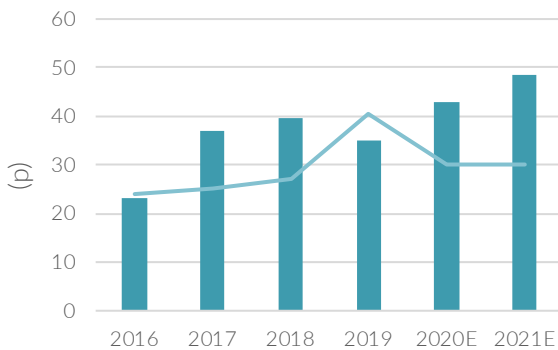
- ▶ Net inflows since 2014
- ▶ Market recovery in 3Q'19 completely offset weakness in preceding quarter
- ▶ 2020 seeing a similar pattern so far
- ▶ Assumed steady new business flows and market growth of 5% p.a.

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, 2018 and 2020; however, with recent market volatility, now forecasting flat dividend in 2021, excluding the special dividend

Source: Company data, Hardman & Co Research

Commentary

Funds under management (FUM)				
(\$m)	Dec'19	Sep'19	Net flows	Other movements
Emerging Markets	4,429	4,058	-106	467
Developed Markets	1,109	849	130	130
Opportunistic Value	270	245	10	15
Frontier Markets	206	186	8	12
Total	6,014	5,338	42	634

Source: Hardman & Co Research

The quarter was positive for inflows, with further large inflows for Developed Markets, partially offset by increased outflows from Emerging Markets.

This quarter, the flows were complemented by strong markets, with the MSCI Emerging Markets Index increasing 7% over the quarter, the MSCI ACWI ex US Index rising 17% and the S&P Frontier 150 Index flat. After a couple of weak quarters, the Developed Markets strategy returned to outperformance, while the Emerging Markets Index continued its good year.

Estimate updates

With costs in line with previous quarters, the main deviations from our assumptions were the higher FUM and stronger sterling. Although the latter has a negative effect on earnings, the former proved more significant, and we have upgraded our earnings forecasts. The Hardman & Co 2020E EPS is increased by 6% to 43.1p and the 2021E EPS by 9% to 48.6p.

With the increase in the interim dividend, we have raised our 2020 forecast for the full year to 30p, which compares with 27p last year (excluding the special dividend). We have kept our forecast for 2021 flat. Our current earnings forecasts would allow a dividend increase and would still keep the five-year rolling dividend cover above the 1.2x target. However, this quarter's upgrades of our estimates simply offset the downgrades from the weak markets in 1Q'20. Given the sensitivity of our forecasts, it seems prudent to not forecast further increases for now.

Financials

Summary financials						
Year-end Jun	2016	2017	2018	2019*	2020E	2021E
FUM (\$bn)	4.00	4.66	5.11	5.39	6.23	6.67
P&L (£m)						
Revenue	24.41	31.29	33.93	31.93	35.07	38.20
Expenses	16.66	19.79	21.40	21.43	21.61	23.02
Operating profit	7.76	11.51	12.53	10.50	13.46	15.18
Statutory PTP	7.97	11.59	12.79	11.40	13.47	15.20
Earnings	5.85	9.14	10.06	9.05	10.78	12.16
Statutory EPS (p)	23.3	36.9	39.5	34.9	43.1	48.6
DPS (p)	24.0	25.0	27.0	40.5	30.0	30.0
Key metrics						
	2016	2017	2018	2019*	2020E	2021E
Growth (%)						
FUM		16.5	9.6	5.5	15.6	7.1
Revenue		28.2	8.4	-5.9	9.8	8.9
Operating profit		48.4	8.8	-16.2	28.1	12.8
EPS		58.4	7.0	-11.6	23.4	12.8
DPS (excluding special div.)		4.2	8.0	0.0	11.1	0.0
Operating margins (%)						
Net FUM fee margin	0.86	0.84	0.80	0.76	0.75	0.74
Operating margin	31.8	36.8	36.9	32.9	38.4	39.7
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	1.4	1.6
EPS sensitivity						
					2020E	2021E
No net new business						
EPS (p)					42.9	47.4
change					-0.4%	-2.4%
0% market growth (was 5% p.a.)						
EPS (p)					42.6	44.9
change					-1.0%	-7.6%

*2019 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research
£1=\$1.30

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