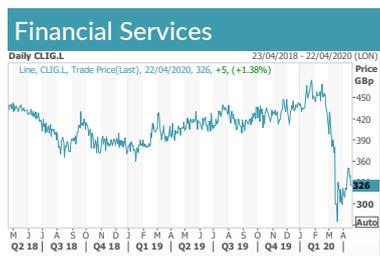




22 April 2020



Source: Refinitiv

Market data

EPIC/TKR	CLIG
Price (p)	325.5
12m High (p)	474.0
12m Low (p)	275.0
Shares (m)	26.6
Mkt Cap (£m)	86.6
EV (£m)	73.9
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	18.0%
Blackrock	10.1%
APQ Capital	6.2%
Cannacord Genuity	5.0%
Eschaton Opportunities	4.8%
Fund Management	
Polar Capital	3.7%

Diary

14 Jul	Pre-close update
14 Sep	Preliminary results
7 Oct	1Q FUM statement

Analyst

Brian Moretta 020 7194 7622
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CITY OF LONDON INVESTMENT GROUP**Handling challenging markets well**

City of London has announced a trading update for 3Q'20. Market conditions have been challenging for fund managers. With a largely institutional investor base, there has been a mixture of subscriptions and withdrawals, with net withdrawals in the quarter of \$35m. Falling markets weighed more heavily on FUM and, at the end of March, total FUM were \$4.40bn, down from \$6.01bn three months earlier. We do note that markets have recovered somewhat so far in April, suggesting current FUM will have clawed some of that back. No decision has been taken on the dividend, but near-term increases look unlikely.

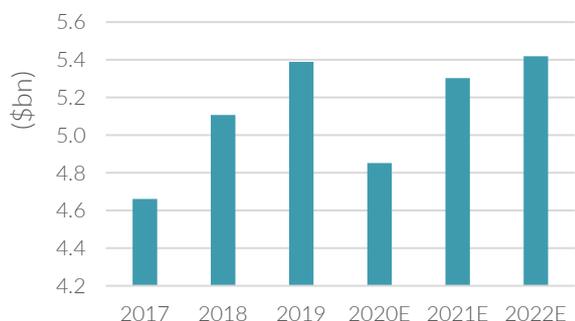
- ▶ **Operations:** The revenue margin is holding steady at 75bps. There is no direct news on costs, with City of London's financial strength and desire for stability allowing it to prioritise keeping its team in place. Operationally, it has executed its business continuity plan, and all staff are working remotely.
- ▶ **Performance:** All of the strategies underperformed over the quarter, particularly in March. Widening discounts were the main cause, perhaps aggravated by liquidity issues, although NAV underperformance also contributed. There has been some narrowing of discounts in April.
- ▶ **Valuation:** The 2020E P/E of 8.9x is at a discount to the peer group. The underlying 2020E yield of 8.6% 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. While dividend increases may be unlikely amid the current volatility, we believe the company can keep the dividend steady in current market conditions.

Financial summary and valuation

Year-end Jun (£m)	2017	2018	2019*	2020E	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	4.85	5.30	5.42
Revenue	31.29	33.93	31.93	31.93	31.64	34.21
Statutory PTP	11.59	12.79	11.40	11.45	11.09	12.51
Statutory EPS (p)	36.9	39.5	34.9	36.6	35.4	40.0
DPS (p)	25.0	27.0	27.0	28.0	28.0	28.0
Special dividend (p)			13.5			
P/E (x)	8.8	8.2	9.3	8.9	9.2	8.1
Dividend yield	7.7%	8.3%	12.4%	8.6%	8.6%	8.6%

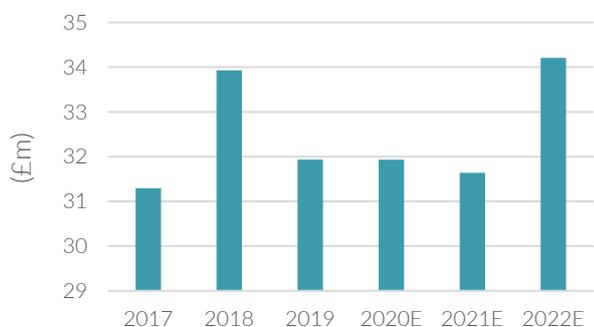
*2019 figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



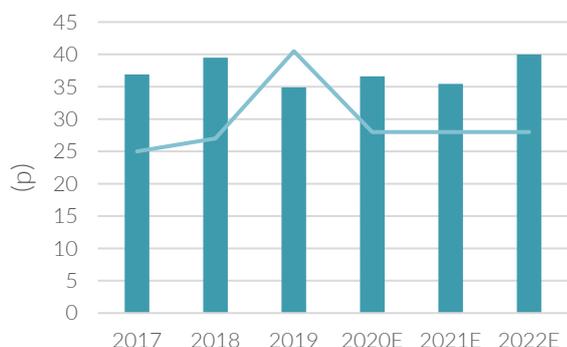
- ▶ Net inflows since 2014
- ▶ Market recovery in 3Q'19 completely offset weakness in preceding quarter
- ▶ The market recovery in April has not offset the 1Q market fall
- ▶ Assumed steady new business flows and market growth of 5% p.a.

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
- ▶ Special dividend of 13.5p in 2019
- ▶ Dividend increased in 2017, 2018 and 2020 (interim); however, given recent market volatility, we are now forecasting no further dividend changes

Source: Company data, Hardman & Co Research

Commentary

Funds under management (FUM)				
(\$m)	Mar'20	Dec'19	Net flows	Other movements
Emerging Markets	3,237	4,429	-68	1,124
Developed Markets	774	1,109	-5	330
Opportunistic Value	231	270	30	69
Frontier Markets	153	206	8	61
Total	4,395	6,014	-35	1,584

Source: Hardman & Co Research

The flow movements consist of a mixture of inflows and outflows. Institutional investors, who dominate the City of London client base, tend to be more considered than retail investors. While some have taken advantage of liquidity to rebalance money away, others have seen a value opportunity in the widening of CEF discounts and have added positions. Some of that may leave as and when discounts narrow again, but, for the moment, it is providing some stability to flows.

We understand that the new business pipeline remains engaged. While there is a natural tendency for allocators to sit on their hands when markets are so volatile, City of London remains optimistic that some of this will materialise over the next few months.

Since the end of March, there has been a partial recovery in both markets and discounts. The MSCI Emerging Markets Index is up almost 8% to date. In the EM strategy, discounts have recovered ca.400bps of the roughly 900bps widening that they experienced. This suggests current FUM is materially higher than the figure given above.

Estimate updates

Given the current market volatility, making estimates for the next two months presents challenges and, for the next two years, seems foolhardy. We have kept our basis largely consistent with our previous estimates. For market levels, we have increased the March-end figures by 8%. While that will certainly have changed, even by the time this report is being read, it is where we are at the time of writing. We would highlight our sensitivity figures on the next page as a gauge to how market movements may affect earnings.

The strengthening of the US Dollar exchange rate to \$1.23/£ is favourable for City of London. Almost all its revenues are in US Dollars, while it has significant UK operating expenses. We have trimmed expense growth for the next two years to 2% p.a. The net effect is to reduce the Hardman & Co 2020E EPS estimate by 16% to 36.6p. The 2021E EPS gets a full year at reduced market levels and is reduced 29% to 35.4p, while the 2022E EPS is reduced by 27% to 40p.

City of London has stated that no decision has been made on the full-year dividend. With a very strong balance sheet and a good portion of the shareholder base invested for the attractive yield, there is no need for management to cut the dividend at current market levels. We note that the end of March market levels would leave the dividend uncovered in 2021 at the current rate, but by a small amount relative to the cash available in reserve. No further increases would leave the rolling five-year dividend cover around the target of 1.2x – so we have reduced our DPS estimates to 28p for our forecast period.

Financials

Summary financials						
Year-end Jun	2017	2018	2019*	2020E	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	4.85	5.30	5.42
P&L (£m)						
Revenue	31.29	33.93	31.93	31.93	31.64	34.21
Expenses	19.79	21.40	21.43	20.49	20.57	21.72
Operating profit	11.51	12.53	10.50	11.44	11.07	12.49
Statutory PTP	11.59	12.79	11.40	11.45	11.09	12.51
Earnings	9.14	10.06	9.05	9.16	8.87	10.01
Statutory EPS (p)	36.9	39.5	34.9	36.6	35.4	40.0
DPS (p)	25.0	27.0	40.5	28.0	28.0	28.0
Key metrics						
	2017	2018	2019*	2020E	2021E	2022E
Growth (%)						
FUM		9.6	5.5	-10.0	9.3	2.2
Revenue		8.4	-5.9	0.0	-0.9	8.1
Operating profit		8.8	-16.2	8.9	-3.2	12.9
EPS		7.0	-11.6	4.9	-3.2	12.8
DPS (excluding special div.)		8.0	0.0	3.7	0.0	0.0
Operating margins (%)						
Net FUM fee margin	0.84	0.80	0.76	0.75	0.74	0.74
Operating margin	36.8	36.9	32.9	35.8	35.0	36.5
Tax rate	21.1	21.4	20.6	20.0	20.0	20.0
Dividend cover (x, excluding special div.)	1.5	1.5	1.3	1.3	1.3	1.4
EPS sensitivity						
				2020E	2021E	2022E
No net new business						
EPS (p)				36.5	33.9	36.5
change				-0.2%	-4.2%	-8.6%
0% market growth (was 5% p.a.)						
EPS (p)				36.5	33.2	34.5
change				-0.2%	-6.3%	-13.7%

*2019 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research
£1=\$1.23

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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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