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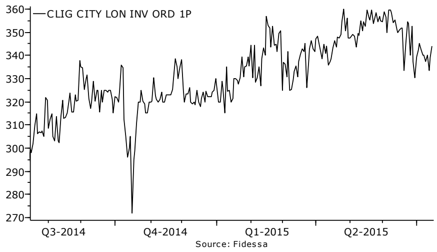

Price	**353.50p**
12m High	359.50p
12m Low	272.00p
Mkt Cap	£91.2m
Shares	26.9m
Sector	Financial Services
Market	London Full List
Broker	Canaccord Genuity
Website	http://www.citlon.co.uk

Description: City of London is an investment manager specialising in using closed end funds to invest in emerging markets.

City of London Investment Group

(CLIG.L)

Leaving dividend concerns behind

Today's trading update gives a solid set of figures for the full year despite difficult market conditions in Q4. Profit after tax came in at £6.5m and, as expected, an unchanged full year dividend of 24p is once again covered by earnings.

Emerging equity markets have been weak since the last update in April, but a combination of new business and good performance has kept funds under management at $4.2bn. Over the financial year as a whole FUM have grown 8% in US Dollars against a fall of 5% in the MSCI Emerging Markets Index supported to new business and outperformance.

There is mixed news on new business. The full year inflows of $477m to emerging markets and $255m to new strategies are pretty much in line with targets. Unfortunately emerging market outflows of $437m mean net inflows of only $40m in that area.

A key issue for investors is the return to dividend cover for the full year. Profit after tax was £6.49m, slightly behind our estimates due to weak markets and a slight strengthening of sterling since April. The dividend was kept unchanged for the full year and is covered 1.1 times by earnings.

	FY13	* FY14	FY15	FY16E	FY17E
FUM ($bn)	3.71	3.90	4.20	4.92	5.67
Revenue (£m)	29.36	24.22	25.36	25.68	28.82
PBT (£m)	8.86	7.24	8.79	9.72	11.67
eps (p)	24.9	20.7	26.1	28.4	34.1
dps (p)	24	24	24	24	25
PE	14.2	17.1	13.5	12.4	10.4
Yield	6.8%	6.8%	6.8%	6.8%	7.1%

**Note: Financial year end changed from 31 May to 30 June in 2014, so FY14 is 13 months.*

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Outlook

Investors will know that this is not an easy time for emerging markets, with the Greek debt crisis and Chinese stock market making big headlines just now. The global economy continues to recovery slowly and both India and China are taking positive steps to support their economies. So investors know conditions will get better, even if no-one can be sure of exactly when.

Nevertheless this is having an effect on investors and currently there are less opportunities than usual for City of London to win new emerging market mandates. We are sure that will improve, but given the uncertainty on timing the company's decision to reduce its new business target in FY2016 to $250m from $500m seems a sensible move.

Diversifying its products has been a priority for the company over the last couple of years and it has made good progress. The net inflows of £235m ($255m new business less $20m outflows) has helped to raise the proportion of assets in new areas to 8.5% from 2% a year ago. We expect further progress this year, and in the short term the prospects for new business are probably stronger in this area than emerging markets. Given that a revised annual target of $250m looks a little conservative.

Fund performance remains good, with roughly 2% of the FUM gain relative to the market coming from that source and first or second quartile results so far in 2015. This gives us confidence that City of London can continue to win mandates when they come available.

Forecast Update

The earnings figure for FY2015 came in 2.7% behind our April estimate. The main sources of the shortfall were lower FUM, mostly due to market weakness, and a small strengthening of sterling.

The same factors have influenced our FY2016 and FY2017 estimates, with a lower FUM having a significant effect due to compounding. There are also two other slight negative factors. Although we did not have the full $500m new business forecast in each area in our estimate, the new target of $250m is less than we had forecast in FY2016. As indicated above, we are optimistic that the new product areas will reach or beat that, but this is offset by short term caution for emerging markets. We also note the lumpy nature of new business – the $255m in new products came from only 4 mandates – so progress may be uneven.

The second is that we have increased our expense growth assumption to 8%, as have City of London in their template. We understand that some of this growth is discretionary, and would expect some deferrals if market conditions remain difficult.

Since our last update the CEO, Barry Olliff, completed his share sales at 350p. His intention to sell 500,000 further shares at each of 400p and 450p remains in place.

Key financials

Net inflows should help FUM grow

Dividend cover restored in current FY

	May Year End		June Year End			
	FY12	**FY13**	*** FY14**	**FY15**	**FY16E**	**FY17E**
FUM ($bn)	4.48	3.71	3.9	4.20	4.92	5.67
P&L (£m)						
Revenue	34.14	29.36	24.22	25.36	25.68	28.82
Expenses	23.11	21.01	17.22	16.63	16.00	17.20
Operating Profit	11.03	8.36	7.00	8.73	9.68	11.62
PBT	11.46	8.86	7.24	8.79	9.72	11.67
Earnings	8.50	6.27	5.20	6.49	7.10	8.52
eps (p)	33.8	24.9	20.7	26.1	28.4	34.1
dps (p)	24	24	24	24	24	25

Key Metrics	**FY12**	**FY13**	**FY14**	**FY15**	**FY16E**	**FY17E**
Growth (%)						
FUM		(17.1)	5.0	7.7	17.2	15.2
Revenue		(14.0)	(17.5)	4.7	1.3	12.2
Operating Profit		(24.2)	(16.3)	24.7	10.9	20.1
EPS		(26.3)	(16.9)	26.1	8.8	20.0
DPS		0.0	0.0	0.0	0.0	4.2
Operating Margins (%)						
Net FUM fee margin	0.87	0.92	0.88	0.85	0.83	0.82
Operating Margin	32.3	28.5	28.9	34.4	37.7	40.3
Tax Rate	25.9	29.3	28.2	27	27	27
Dividend cover	1.4	1.0	0.9	1.1	1.2	1.4

Dividend cover still maintained if things don't go to plan

Eps Sensitivity	**FY16E**	**FY17E**
No net new business		
eps (p)	26.7	27.7
% change	(6.1)	(18.7)
0% market growth (was 5% pa)		
eps (p)	27.5	30.6
% change	(3.1)	(10.1)

Source: Company data, Hardman & Co

**Note: Financial year end changed from 31 May to 30 June in 2014, so FY14 is 13 months.*

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