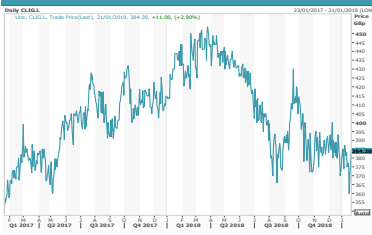




21 January 2019

## Financial Services



Source: Eikon Thomson Reuters

## Market data

EPIC/TKR	CLIG
Price (p)	379.0
12m High (p)	454.0
12m Low (p)	360.0
Shares (m)	26.9
Mkt Cap (£m)	102.0
EV (£m)	82.3
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	Barry Olliff
CFO	Tracy Rodrigues
Chairman	David Cardale
	+44 207 860 8346
	<a href="http://www.citlon.com">www.citlon.com</a>

## Key shareholders

Directors & staff	16.7%
Blackrock	10.0%
Cannacord Genuity	8.0%
Eschaton Opportunities	
Fund Management	4.8%
Polar Capital	4.1%

## Diary

18 Feb	Half-year results
7 Mar	Interim ex-dividend date
16 Apr	3Q FUM announcement
16 Jul	Pre-close trading statement

## Analyst

Brian Moretta 020 7194 7622  
[bm@hardmanandco.com](mailto:bm@hardmanandco.com)

## CITY OF LONDON INVESTMENT GROUP

## Solid FUM update offset by margin changes

City of London has released its trading update for 2Q of FY'19. In this period, market weakness dominated movements in FUM: the 7% fall in the MSCI Emerging Markets Index was trumped by a 13% fall in the MSCI ACWI. Fund flows, in contrast, had a quieter quarter, with a net \$15m of inflows to the Opportunistic Value strategies offset by net outflows of \$62m from Emerging Markets. City of London has indicated that there may be some positive rebalancing, with \$125m of net inflows expected to be funded over the next quarter. The MSCI Emerging Markets is up 4% so far in 2019, suggesting an improvement since the year-end.

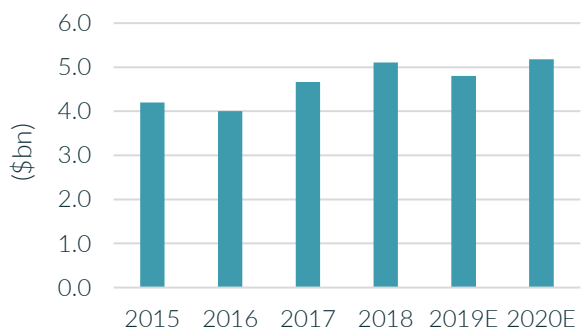
- **Performance:** The Emerging Markets strategy had an inconsistent 2018 in terms of performance, but it finished well, with narrowing discounts and country allocation contributing to outperformance. The other strategies, which had done well earlier in the year, underperformed towards the end of the year.
- **Operations:** Costs were in line with those indicated in the last announcement. The EIP charge has increased a little, to 5%, from 3% at the full-year results. However, falling markets have impacted revenues, and the first-half profit before tax will be around £5.2m, compared with £6.6m in the previous first half.
- **Valuation:** The prospective P/E of 11.9x is at a significant discount to the peer group. The historical yield of 7.1% 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 increase 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)	2015	2016	2017	2018	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.11	4.80	5.18
Revenue	25.36	24.41	31.29	33.93	29.93	30.27
Statutory PTP	8.93	7.97	11.59	12.79	10.00	10.02
Statutory EPS (p)	26.4	23.3	36.9	39.5	31.8	31.8
DPS (p)	24.0	24.0	25.0	27.0	27.0	27.0
P/E (x)	14.4	16.3	10.3	9.6	11.9	11.9
Dividend yield	6.3%	6.3%	6.6%	7.1%	7.1%	7.1%

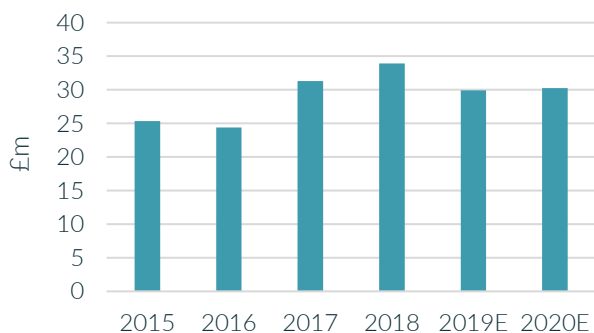
Source: Hardman &amp; Co Research

Funds under management



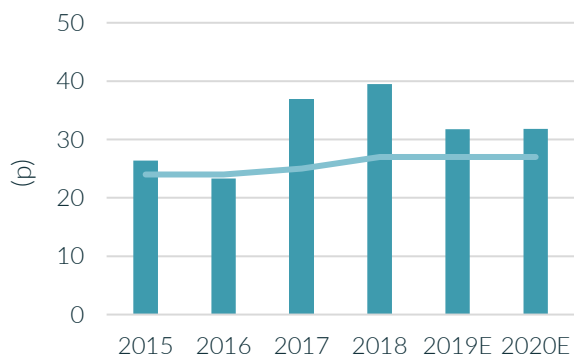
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Market weakness from late 2018 impacting 2019
- ▶ Assumed steady new business flows and market growth of 5% p.a.

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 dividend (line)



- ▶ Profitability historically maintained by cost flexibility
- ▶ Currency movements led to step change in 2017 EPS
- ▶ Dividend shortfall in 2016 covered from reserves
- ▶ Dividend increased in 2017 and 2018 but, with recent market falls, now forecasting a flat dividend

Source: Company data, Hardman & Co Research

## Commentary

Funds under management				
(\$m)	Dec 2018	Sep 2018	Net flows	Other movements
Emerging Markets	3,734	4,016	-62	-220
Developed Markets	495	577	0	-82
Frontier Markets	197	215	0	-18
Opportunistic Value	199	200	15	-16
Total	4,625	5,008	-47	-336

Source: Hardman & Co Research

The figures for fund flows remain somewhat mixed: although the quarter was quieter, with smaller net flows, both EM and Opportunistic Value followed the trends seen in recent statements.

Market movements dominated the other movements, with EM gaining an offset from outperformance in the period.

### Estimate updates

Although City of London has continued to maintain its usually tight operations, with flat costs during the quarter, the falling markets have had a strong impact on revenues. Pre-tax profits for the first half of the year are expected to fall to £5.2m, from £6.6m in the previous first half.

This has had a similar impact on Hardman & Co forecasts. Our estimated 2019 EPS has been reduced from 35.8p to 31.8p and 2020 EPS from 37.8p to 31.8p also. Unfortunately, this would have reduced EPS below our previously forecast dividend increases, and, accordingly, we now forecast the dividend to remain flat at 27p in both 2019 and 2020. This would leave cover at 1.2x in each of those years.

## Financials

Summary financials						
Year-end Jun	2015	2016	2017	2018	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.11	4.80	5.18
<b>P&amp;L (£m)</b>						
Revenue	25.36	24.41	31.29	33.93	29.93	30.27
Expenses	16.63	16.66	19.79	21.40	19.95	20.27
Operating profit	8.73	7.76	11.51	12.53	9.99	10.00
PBT	8.93	7.97	11.59	12.79	10.00	10.02
Earnings	6.61	5.85	9.14	10.06	7.90	7.91
EPS (p)	26.4	23.3	36.9	39.5	31.8	31.8
DPS (p)	24.0	24.0	25.0	27.0	27.0	27.0
Key metrics						
	2015	2016	2017	2018	2019E	2020E
<b>Growth (%)</b>						
FUM	7.7	-4.8	16.5	9.6	-5.9	7.7
Revenue	4.7	-3.7	28.2	8.4	-11.8	1.1
Operating profit	24.7	-11.1	48.4	8.8	-20.3	0.2
EPS	27.5	-11.7	58.4	7.0	-19.6	0.2
DPS	0.0	0.0	4.2	8.0	0.0	0.0
<b>Operating margins (%)</b>						
Net FUM fee margin	0.86	0.86	0.84	0.80	0.77	0.76
Operating margin	34.4	31.8	36.8	36.9	33.4	33.0
Tax rate	26.0	26.5	21.1	21.0	21.0	21.0
Dividend cover (x)	1.1	1.0	1.5	1.5	1.2	1.2
EPS sensitivity						
	2015	2016	2017	2018	2019E	2020E
<b>No net new business</b>						
EPS (p)					31.6	30.7
change					-0.5%	-3.6%
<b>0% market growth (was 5% p.a.)</b>						
EPS (p)					31.4	28.9
change					-1.1%	-9.0%

Source: City of London Investment Group, Hardman & Co Research  
£1=\$1.31

## Disclaimer

Hardman & Co provides professional independent research services and all information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. However, no guarantee, warranty or representation, express or implied, can be given by Hardman & Co as to the accuracy, adequacy or completeness of the information contained in this research and they are not responsible for any errors or omissions or results obtained from use of such information. Neither Hardman & Co, nor any affiliates, officers, directors or employees accept any liability or responsibility in respect of the information which is subject to change without notice and may only be correct at the stated date of their issue, except in the case of gross negligence, fraud or wilful misconduct. In no event will Hardman & Co, its affiliates or any such parties be liable to you for any direct, special, indirect, consequential, incidental damages or any other damages of any kind even if Hardman & Co has been advised of the possibility thereof.

This research has been prepared purely for information purposes, and nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell any security, product, service or investment. The research reflects the objective views of the analyst(s) named on the front page and does not constitute investment advice. However, the companies or legal entities covered in this research may pay us a fixed fee in order for this research to be made available. A full list of companies or legal entities that have paid us for coverage within the past 12 months can be viewed at <http://www.hardmanandco.com/legals/research-disclosures>. Hardman may provide other investment banking services to the companies or legal entities mentioned in this report.

Hardman & Co has a personal dealing policy which restricts staff and consultants' dealing in shares, bonds or other related instruments of companies or legal entities which pay Hardman & Co for any services, including research. No Hardman & Co staff, consultants or officers are employed or engaged by the companies or legal entities covered by this document in any capacity other than through Hardman & Co.

Hardman & Co does not buy or sell shares, either for their own account or for other parties and neither do they undertake investment business. We may provide investment banking services to corporate clients. Hardman & Co does not make recommendations. Accordingly, they do not publish records of their past recommendations. Where a Fair Value price is given in a research note, such as a DCF or peer comparison, this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities, companies and legal entities but has no scheduled commitment and may cease to follow these securities, companies and legal entities without notice.

The information provided in this document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hardman & Co or its affiliates to any registration requirement within such jurisdiction or country.

Some or all alternative investments may not be suitable for certain investors. Investments in small and mid-cap corporations and foreign entities are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. Investments may be leveraged and performance may be volatile; they may have high fees and expenses that reduce returns. Securities or legal entities mentioned in this document may not be suitable or appropriate for all investors. Where this document refers to a particular tax treatment, the tax treatment will depend on each investor's particular circumstances and may be subject to future change. Each investor's particular needs, investment objectives and financial situation were not taken into account in the preparation of this document and the material contained herein. Each investor must make his or her own independent decisions and obtain their own independent advice regarding any information, projects, securities, tax treatment or financial instruments mentioned herein. The fact that Hardman & Co has made available through this document various information constitutes neither a recommendation to enter into a particular transaction nor a representation that any financial instrument is suitable or appropriate for you. Each investor should consider whether an investment strategy of the purchase or sale of any product or security is appropriate for them in the light of their investment needs, objectives and financial circumstances.

This document constitutes a 'financial promotion' for the purposes of section 21 Financial Services and Markets Act 2000 (United Kingdom) ('FSMA') and accordingly has been approved by Capital Markets Strategy Ltd which is authorised and regulated by the Financial Conduct Authority (FCA).

No part of this document may be reproduced, stored in a retrieval system or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission from Hardman & Co. By accepting this document, the recipient agrees to be bound by the limitations set out in this notice. This notice shall be governed and construed in accordance with English law. Hardman Research Ltd, trading as Hardman & Co, is an appointed representative of Capital Markets Strategy Ltd and is authorised and regulated by the FCA under registration number 600843. Hardman Research Ltd is registered at Companies House with number 8256259.

(Disclaimer Version 8 – Effective from August 2018)

## Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies, legal entities and issuers about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public...'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

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>

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

