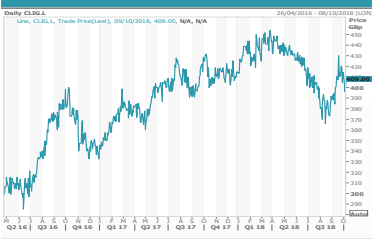




Financial Services



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	CLIG
Price (p)	400.0
12m High (p)	454.0
12m Low (p)	366.0
Shares (m)	26.9
Mkt Cap (£m)	107.6
EV (£m)	87.9
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 (0) 207 860 8346
	www.citlon.com

Key shareholders

Directors & staff	16.3%
Blackrock	9.9%
Cannacord Genuity	7.9%
Eschaton Opportunities	
Fund Management	4.7%
Polar Capital	4.1%

Diary

11 Oct	Ex-div. date for final dividend
22 Oct	AGM
16 Jan	2Q FUM announcement
18 Feb	Half year results

Analyst

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CITY OF LONDON INVESTMENT GROUP

Solid FUM update offset by margin changes

City of London has released its trading update for 1Q of FY'19. The statement shows a continuation of the trends seen in recent statements. Aggregate inflows into the newer strategies were largely offset by rebalancing outflows from the Emerging Markets strategy, resulting in a small amount of net inflows of \$8m. Market movements were mixed, with only developed markets rising during the quarter and MSCI EM index declining 1%. Fund performance was slightly behind benchmarks, with manager performance and widening discounts hampering different strategies. In aggregate, FUM declined slightly from \$5.11bn to \$5.01bn.

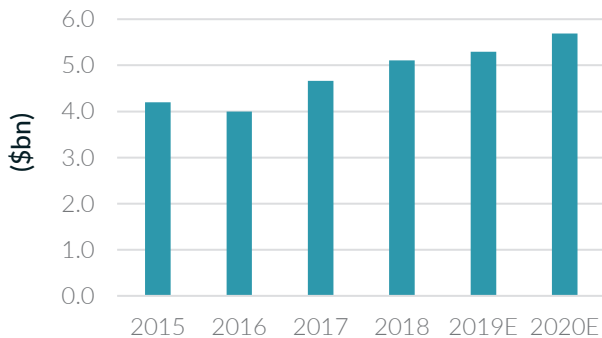
- **Operations:** The changing mix of the assets continues to affect the revenue margin. Both Developed Markets and Opportunistic Value are lower margin than the existing Emerging Market business. Their rising proportion led to a decline in revenue margin to 77bps, from the 80bps previously indicated.
- **Costs:** The costs were largely in line with those indicated at the time of the full-year results. The EIP charge has increased a little, to 4% from the 3% at the full-year results. Estimated earnings for the first quarter will be £2.2m, down from the previous year's figure of £2.5m.
- **Valuation:** The prospective P/E of 11.2x is at a significant discount to the peer group. The historical yield of 6.8% 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	5.29	5.69
Revenue	25.36	24.41	31.29	33.93	31.95	33.30
Statutory PTP	8.93	7.97	11.59	12.79	11.27	11.91
Statutory EPS (p)	26.4	23.3	36.9	39.5	35.8	37.8
Dividend (p)	24.0	24.0	25.0	27.0	30.0	33.0
P/E (x)	15.2	17.2	10.8	10.1	11.2	10.6
Yield	6.0%	6.0%	6.3%	6.8%	7.5%	8.3%

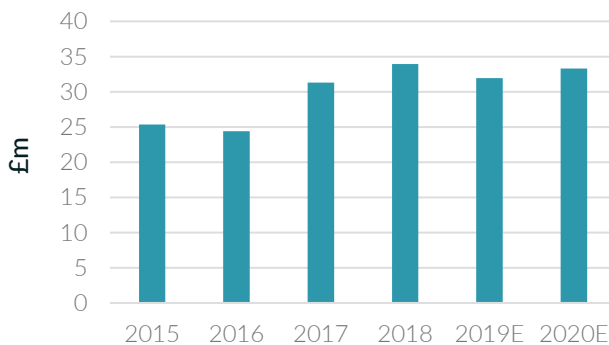
Source: Hardman & Co Research

Funds under management



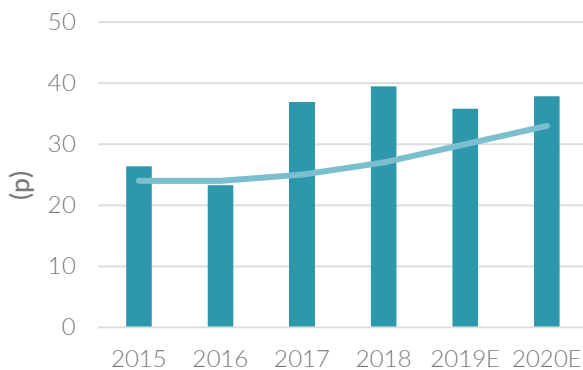
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Assumed steady new business flows and market growth of 5% p.a.

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

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 – we expect steady increases in the dividend over the next couple of years

Source: Company data; Hardman & Co Research

Commentary

Funds under management				
(\$m)	Sep 2018	Jun 2018	Net flows	Other movements
Emerging Markets	4,016	4,207	-95	-96
Developed Markets	577	481	98	-2
Frontier Markets	215	245	-21	-9
Opportunistic Value	200	174	26	0
Total	5,008	5,107	8	-107

Source: Hardman & Co Research

The figures for fund flows were somewhat mixed, although largely following the trends seen in recent statements. In particular, the newer diversifying strategies of Developed Markets and Opportunistic Value saw net inflows of assets. Figures for the latter include a new Municipal Bond mandate.

As seen recently, offsetting these were rebalancing outflows in Emerging Markets, although this quarter also saw rebalancing of some Frontier Market and Opportunistic Value assets too. The net effect was an aggregate new inflow of \$8m of FUM.

Market movements were mostly unfavourable, with only the developed market benchmark rising. This rise was offset in City of London's funds by widening discounts. In Emerging and Frontier Markets, the NAV performance of the underlying managers was weak. Overall performance was slightly behind benchmarks.

Estimate updates

Hardman & Co has made three main adjustments to its estimates in light of the latest statement. The largest is the rate of decline of the revenue margin. This is proceeding quicker than previously assumed, with the 77bps rate lower than our assumption for the end of FY'20. As well as moving the current rate down to the new level, a more aggressive future decline is now assumed.

FUM were lower than our estimates, and this has had an effect. Hardman & Co had been assuming a small net inflow for EM assets. Given the ongoing rebalancing does not appear to have been slowed by emerging market weakness, we have reduced this to zero.

A small adjustment has also been made to the rate of accrual of the EIP, which has ticked up compared with previously. The net effect is that the Hardman & Co 2019E EPS has declined from 41.8p to 35.8p and 2020 estimate from 45.3p to 37.8p.

Financials

Summary financials						
Year-end June	2015	2016	2017	2018	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.11	5.29	5.69
P&L (£m)						
Revenue	25.36	24.41	31.29	33.93	31.95	33.30
Expenses	16.63	16.66	19.79	21.40	20.70	21.40
Operating profit	8.73	7.76	11.51	12.53	11.26	11.90
PBT	8.93	7.97	11.59	12.79	11.27	11.91
Earnings	6.61	5.85	9.14	10.06	8.90	9.41
EPS (p)	26.4	23.3	36.9	39.5	35.8	37.8
DPS (p)	24.0	24.0	25.0	27.0	30.0	33.0
Key metrics						
	2015	2016	2017	2018	2019E	2020E
Growth (%)						
FUM	7.7	-4.8	16.5	9.6	3.6	7.5
Revenue	4.7	-3.7	28.2	8.4	-5.8	4.2
Operating Profit	24.7	-11.1	48.4	8.8	-10.1	5.7
EPS	27.5	-11.7	58.4	7.0	-9.4	5.7
DPS	0.0	0.0	4.2	8.0	11.1	10.0
Operating margins (%)						
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	35.2	35.7
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	1.1
EPS Sensitivity						
	2015	2016	2017	2018	2019E	2020E
No net new business						
eps (p)					35.4	36.4
change					-1.0%	-3.8%
0% market growth (was 5% pa)						
eps (p)					34.9	33.9
change					-2.4%	-10.3%

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

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