

8 October 2018

# City of London Investment Group\*

CLIG LN

Financials

## 1Q trading update

**What's new.** CLIG's 1Q trading update released this morning reveals details of Group Funds under Management (FuM) and operating profitability:

- **In 1Q to 30 Sept, FuM fell 1.9% to US\$5,008m**, MSCI EM TR Index fell 1.1%; EM products now contribute c **80%** and diversification products (i.e. Developed Market, Opportunistic Value and Frontier products) contributed c **20%**; Year-on-Year FUM rose 1.0%, while the MSCI EM TR Index fell 0.8%;
- **1Q flows were neutral:** net inflows to the Developed (\$98m) and Opportunistic Value (\$26m) strategies offset the net outflows from the Emerging Markets (\$95m) and Frontier (\$21m) strategies.
- **1Q investment management performance was slightly behind benchmark:** Emerging Market and Frontier strategies due to underlying close-end fund manager underperformance; Developed strategy due to widening discounts.
- The run rate for operating profit before profit share of 30% and estimated EIP charge of 2% is approximately £1.4m per month (1Q18: £1.6m per month); the unaudited 1Q PAT is £2.2m (1Q18: £2.5m);
- The final DPS of 18.0p (2017 final DPS: 17.0p), subject to approval at the AGM will be paid on 30 October 2018; CLIG shares go ex on Thursday 11 October.

CLIG's Annual General Meeting is on Monday 22 October.

**Zeus view.** This 1Q is consistent with recent news: the MXEF Index has fallen 20.6% since 26 January 2018; discounts on which closed-end fund trade have been widening; net inflows to CLIG's Developed and Opportunistic Value strategies have increased the diversification of CLIG business.

We leave our forecasts, which we set in July 2018 and are based on US\$:£ exchange rate of 1.3 and average FUM of \$5.3bn, unchanged.

**Valuation.** CLIG shares at 405p are cum 18.0p final DPS (4.4% yield on the final DPS alone). CLIG shares go "ex" on Thursday 11 October.

CLIG's investment process and growing non-Emerging-Market capability supports expectations of continued growth even in flat markets. Compared to market PER of 11x for Emerging Markets and 12.3x for the FT All Share, CLIG **PER of 9.7x** is attractive. Its forward **dividend yield of 7.1%** is a clear indication of value.

|                                 |             |
|---------------------------------|-------------|
| <b>Price</b>                    | <b>396p</b> |
| <b>Market Cap</b>               | £106m       |
| <b>Shares in Issue inc ESOT</b> | 26.9m       |
| <b>12m Trading Range</b>        | 459p-366p   |
| <b>Free float</b>               | 84%         |

### Price Performance



Source: Bloomberg

### Financial Forecasts

| YE June, £m          | 2017A       | 2018A       | 2019E       | 2020E       |
|----------------------|-------------|-------------|-------------|-------------|
| Revenue              | 31.3        | 33.9        | 35.3        | 36.5        |
| <b>Op profit</b>     | <b>16.4</b> | <b>19.2</b> | <b>20.4</b> | <b>21.8</b> |
| Profit margin (%)    | 52          | 57          | 58          | 60          |
| Profit share         | (4.9)       | (6.6)       | (6.9)       | (7.4)       |
| <b>PBT</b>           | <b>11.6</b> | <b>12.8</b> | <b>13.5</b> | <b>14.4</b> |
| Profit margin (%)    | 37          | 38          | 38          | 39          |
| PAT                  | 9.1         | 10.1        | 10.4        | 11.1        |
| <b>EPS fd (p)</b>    | <b>36.7</b> | <b>39.3</b> | <b>40.4</b> | <b>43.1</b> |
| Dividend cover (x)   | 1.47        | 1.46        | 1.44        | 1.49        |
| DPS (p)              | 25.0        | 27.0        | 28.0        | 29.0        |
| <b>Avg FuM (\$b)</b> | <b>4.4</b>  | <b>4.9</b>  | <b>5.3</b>  | <b>5.6</b>  |
| Net cash at YE       | 13.9        | 19.7        | 23.3        | 27.3        |
| <b>P/E (x)</b>       | <b>10.8</b> | <b>10.1</b> | <b>9.7</b>  | <b>9.1</b>  |
| Div Yield (%)        | 6.3         | 6.8         | 7.1         | 7.3         |

Source: Audited Accounts and Zeus Capital estimates

\*City of London Investment Group is a Broking client of Zeus Capital Limited

#### Analyst:

**Robin Savage** +44 20 3829 5611  
robin.savage@zeuscapital.co.uk

#### Zeus Capital Contacts:

|                   |                  |
|-------------------|------------------|
| Mike Cuthbert     | +44 20 3829 5621 |
| John Gould        | +44 20 3829 5601 |
| Dominic King      | +44 20 3829 5607 |
| Ben Robertson     | +44 20 3829 5625 |
| Victoria Ayton    | +44 20 3829 5603 |
| Mike Seabrook     | +44 20 3829 5626 |
| Rupert Woolfenden | +44 20 3829 5623 |
| Ronayne O'Mahony  | +44 20 3829 5624 |
| Ryan Mendy        | +44 20 3829 5615 |

Email: firstname.surname@zeuscapital.co.uk

## Our forecasts remain unchanged

### Emerging Markets rise 2016/17 & fall

As we noted in our 17 July 2018 research note, in calendar year 2016, the MXEF rose 8.6%; in 2017 the MXEF Index rose 34.3%. In 2018, year to date the index is down 7.2% (see Exhibit 4). The forward PER for Emerging Markets as a whole has fallen from over 12x to under 11x forward PER. The rise in Emerging Market valuations reflected the combination of growth and increasing PER multiples. The fall in Emerging Markets in 2018 has reduced PER multiples to two-year lows.

### 8.7% fall in calendar Q2

In the quarter ended 30 June 2018, the MXEF index fell 8.7% to 1070 (10.8% below our forecast and 15.9% below the high of 1273 on 26 January 2018); over the 6 months to 30 June 2018 the MXEF fell 7.6%. This fall in markets resulted in a \$0.6bn (i.e. 10%) fall in group FUM to \$5.1bn (previously \$5.7bn) and 5.7% fall in average FY18 FUM. This has resulted in actual PBT, PAT and EPS for FY(Jun)18 being 3.8%, 0.9%, 2.5% below Zeus forecasts (see Exhibit 2).

### Exhibit 1: Movement in CLIG's FUM, US\$m

| 1H to<br>Dec 2016 | 2H<br>Jun 2017 | 1H to<br>Dec 2017 | 2H<br>Jun 2017 | YE June, \$m                 | 2017A        | 2018A        | 2019E        |
|-------------------|----------------|-------------------|----------------|------------------------------|--------------|--------------|--------------|
| 4,047             | 4,140          | 4,663             | 5,329          | <b>Opening FUM</b>           | <b>4,047</b> | <b>4,663</b> | <b>5,107</b> |
| 57                | (363)          | 62                | 123            | Net inflows                  | (306)        | 185          | 250          |
| 36                | 886            | 604               | (347)          | Performance & Market effects | 922          | 259          | 143          |
| <b>4,140</b>      | <b>4,663</b>   | <b>5,329</b>      | <b>5,107</b>   | <b>Closing FUM</b>           | <b>4,663</b> | <b>5,107</b> | <b>5,500</b> |
| 2.3               | 12.6           | 14.3              | (4.2)          | Growth in FUM (%)            | 15.2         | 9.5          | 7.7          |
| <b>4,094</b>      | <b>4,401</b>   | <b>4,996</b>      | <b>5,218</b>   | <b>Average FUM</b>           | <b>4,355</b> | <b>4,885</b> | <b>5,304</b> |
| 862               | 1,011          | 1,158             | 1,070          | MXEF closing value           | 1,011        | 1,070        | 1,100        |

Source: Company (historic); Zeus Capital (forecasts)

### Growth in non-EM strategies

Net inflows of \$185m included \$400m (1H: \$151m; 2H: \$249m) of net inflows from non-Emerging Market, "non-EM", strategies. Non-EM strategies now contribute \$900m of FuM (up 95% from \$461m of FUM), which is 18% (June 2017: 10%) of group FUM. We continue to expect around \$250m of net inflows for FY(Jun)19E.

### Re-based forecasts

The 2018 profit before and after tax is precisely in line with the unaudited trading update released on 17 July 2018. The total income and operating profit are ahead of our July 2018 estimates. We maintain our forecast for 2019E.

### Exhibit 2: CLIG's financial forecasts

| 1H18       | 2H18       | YE June, £m                                | 2017A       | 2018A       | 2019E       |
|------------|------------|--|-------------|-------------|-------------|
| 17.1       | 16.8       | Total income                               | 31.3        | 33.9        | 35.3        |
| <b>9.6</b> | <b>9.8</b> | <b>Operating profit (pre-profit share)</b> | <b>17.1</b> | <b>19.2</b> | <b>20.4</b> |
| 6.6        | 6.2        | Profit before tax                          | 11.6        | 12.8        | 13.5        |
| <b>5.2</b> | <b>4.9</b> | <b>Profit after tax</b>                    | <b>9.1</b>  | <b>10.1</b> | <b>10.4</b> |
| 20.0       | 19.4       | Diluted EPS (p)                            | 36.7        | 39.3        | 40.4        |
| 9.0        | 18.0       | DPS (p)                                    | 25.0        | 27.0        |             |

Source: Company (historic); Zeus Capital (forecasts)

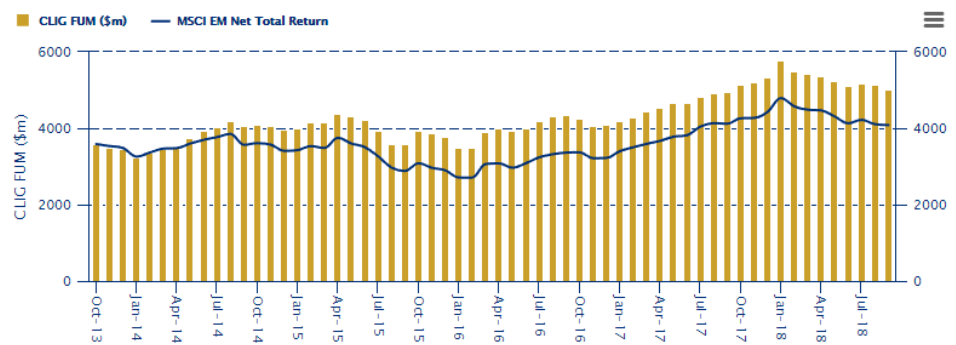
## Key charts & variables

Correlation with MXEF Index

CLIG's interims and full year report and accounts contain many tables and charts which provide evidence of the improving profitability and scope for further improvement. One chart, Exhibit 3, which is updated monthly on CLIG's website shows the strong correlation between CLIG's Funds Under Management (FUM) and the Morgan Stanley Emerging Markets Index.

FUM on 30 September 2018 was \$5,008m; on 30 June 2018 it was \$5,107m (see Exhibit 3).

### Exhibit 3: CLIG FUM & MXEF Index



Source: <http://citlon.co.uk/shareholders/announcements.php>

MXEF 1018; Sterling \$1.31=£1

Over the past 4 years (see Exhibits 4 & 5), the MXEF index has risen to 1075, from a low of 700 in early 2016; the US\$:£ exchange rate has moved from 1.70 in July 2014 to a low of 1.20 in January 2017 and then back to 1.31 now.

### Exhibit 4: MXEF index (\$)



Source: Bloomberg data; Zeus Capital chart

### Exhibit 5: US\$ : £ exchange rate



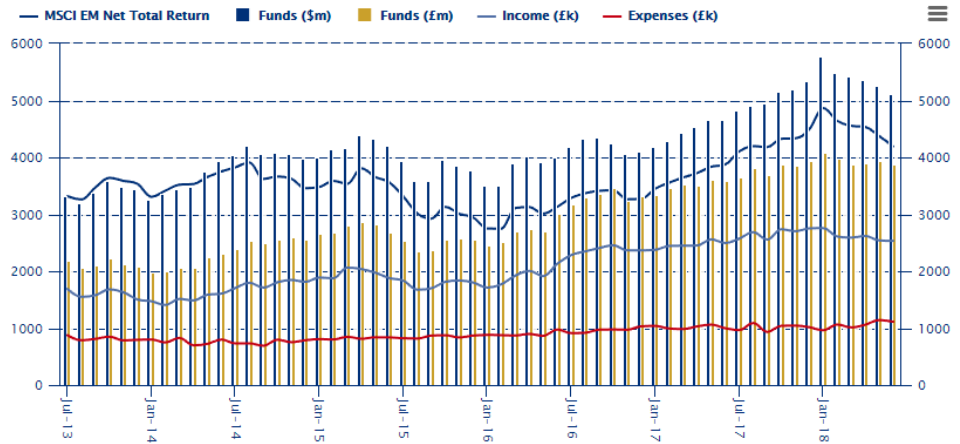
Source: Bloomberg data; Zeus Capital chart

Forecasts based on current variables

The MXEF index is trading on a forward PER of under 11x, price to sales of under 1.2x and EV/EBITDA of under 8x. While we see potential for the MXEF Index to rise substantially (see Exhibit 4), we base our forecasts on the MXEF rising 8% to 1100 and the US\$:£ exchange rate remaining close 1.30 (i.e. similar to current US\$:£ exchange rate of 1.31).

# Charting increase in income & PBT

Costs well controlled with revenue rising **Exhibit 6: Funds Under Management, revenues & costs**



Source: <https://citlon.com/investor-relations/funds-under-management.php>

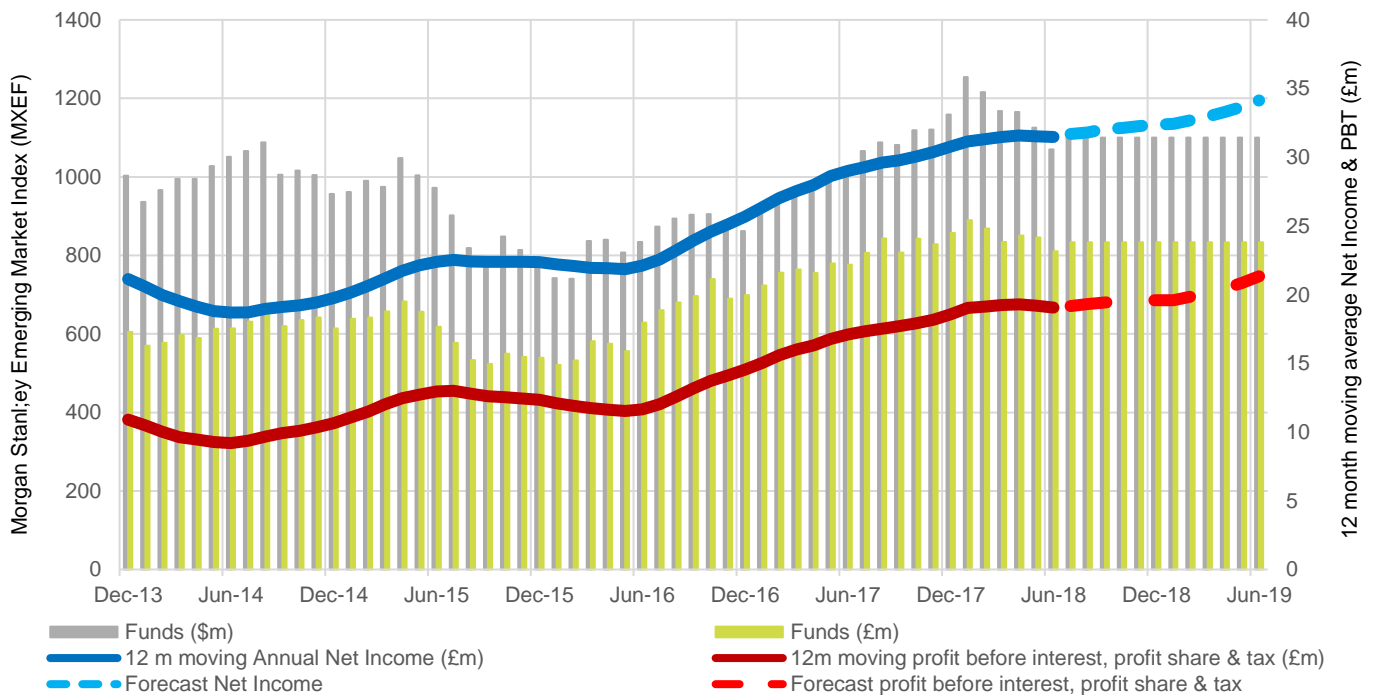
Encouraging rise in revenue & PBT

The data in Exhibit 6 has been used to create a 12 month moving average net income and PBT (Exhibit 7) assuming the MXEF index returns to 1,100 and the US\$ : £ exchange rate is 1.3.

Trends consistent with Exhibit 7

The monthly data is consistent with actual FY(Jun)18E net revenue of £33.9m (FY19E: £35.3m). The profit before interest, profit share and tax for FY(Jun)18 of £19.4m (after profit share of £5.9m, EIP charge of £0.5m), is consistent with PBT of £12.8m (FY19E: £13.5m).

## Exhibit 7: CLIG FUM, revenue & profits with forecast, £m



Source: Company (historical) Zeus Capital research forecasts

8 October 2018

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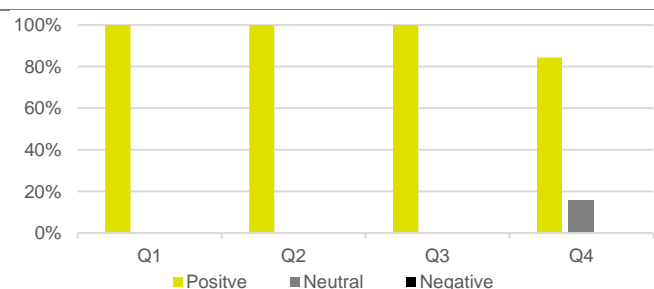
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**Zeus London Office**  
10 Old Burlington Street  
London  
W1S 3AG  
Tel: +44 20 3829 5000

**Zeus Manchester Office**  
82 King Street  
Manchester  
M2 4WQ  
Tel: +44 161 831 1512

**Zeus Birmingham Office**  
3 Brindleyplace  
Birmingham  
B1 2JB  
Tel: +44 121 231 7210