

16 January 2019

City of London Investment Group*

CLIG LN

Financials

Tough 1H trading update

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

- **In 1H to Dec, FuM fell 9.4% to US\$4,625m**, with the MXEF Index down 9.7%; Year-on-Year FUM fell 12.5%, while the MXEF Index fell 16.6%;
- **1H flows were \$42m negative:** \$136m of net inflows to the Developed and Opportunistic Value strategies (1Q \$124m; 2Q \$12m), and \$157m net outflow from Emerging Market (1Q \$95m; 2Q \$62m) and \$21m of net outflow from Frontier (1Q \$21m; 2Q none) strategies.
- **1H investment performance was negative:** the statement echoes the 1Q statement which referred to "underlying close-end fund manager underperformance" and "widening discounts".
- **Unaudited 1H PBT of £5.2m is 21% below 1H18 PBT: £6.6m.** The run rate for operating profit before profit share of 30% and estimated EIP charge of 5% is now approximately £1.2m per month (1Q19: £1.4m a month);

The statement includes a graph based on assumptions, which compares an illustrated profit after tax to an estimated quarterly cost of a maintained dividend.

CLIG's interims will be on Monday 18 February.

Zeus view. This statement reveals lower current year FuM, lower net inflows, lower average revenue margin (Developed and Opportunistic Value strategies have lower margins than EM strategies) and lower interim PBT than we had forecast.

We have adjusted our forecasts (set in July 2018 and based on average FUM of US\$5.3bn) to US\$5.2bn, which results in a 9% cut to FY19E revenues, 16% cut to FY19E PBT, Adj EPS and DPS (i.e. a maintained DPS of 27p).

We have also rebased the FY20E forecasts to reflect 9% lower average FuM, 10% lower revenues, 16% lower PBT and 16% lower EPS and DPS.

At 30 June 2018, the group had no debt and £19.7m (73.8p per share) of net cash.

Valuation. CLIG shares at 375p are trading on 11.0x current year and 7.2% dividend yield compared to market PER of 11x for Emerging Markets and 12.0x for the FT All Share. CLIG's 7.2% dividend yield is based off a 27p full year dividend, which is 2.7x covered by net cash.

Price	375P
Market Cap	£100m
Shares in Issue	26.7m
12m Trading Range	459p-350p
Free float	83%

Price Performance



Source: Bloomberg

Financial Forecasts

YE June, £m	2017A	2018A	2019E	2020E
Revenue	31.3	33.9	32.0	33.0
Op profit	16.4	19.2	17.1	18.3
Profit margin (%)	52	57	54	55
Profit share	(4.9)	(6.6)	(5.9)	(6.3)
PBT	11.6	12.8	11.4	12.2
Profit margin (%)	37	38	36	37
PAT	9.1	10.1	8.8	9.4
EPS fd (p)	36.7	39.3	34.2	36.5
Dividend cover (x)	1.47	1.46	1.27	1.35
DPS (p)	25.0	27.0	27.0	27.0
Avg FuM (\$b)	4.4	4.9	5.2	5.3
Net cash at YE	13.9	19.7	21.6	23.9
P/E (x)	10.2	9.5	11.0	10.3
Div Yield (%)	6.7	7.2	7.2	7.2

Source: Audited Accounts and Zeus Capital estimates

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Changes to Zeus forecasts

Emerging Markets fell in 1H

In the 6 months to 31 December 2018 CLIG's FuM fell 9.4% to US\$4,625m, while the MXEF Index fell 9.7%. Year-on-Year CLIG's FUM fell 12.5%, while the MXEF Index fell 16.6%.

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

1H18 12/17	2H18 6/18	1H19 12/18	2H19E 6/19	YE June, \$m Period end	2018 June	2019E June	2020E June	2019E Old	2020E Old
4,663	5,329	5,107	4,625	Opening FUM	4,663	5,107	5,207	5,107	5,500
62	123	(42)	167	Net inflows	185	100	250	250	250
604	(347)	(440)	440	Performance & Market	259	-	-	143	-
5,329	5,107	4,625	5,207	Closing FUM	5,107	5,207	5,457	5,500	5,725
14.3	(4.2)	(9.4)	12.6	Growth in FUM (%)	9.5	2.0	4.8	7.7	4.5
4,996	5,218	4,866	4,916	Average FUM	4,885	5,157	5,332	5,304	5,625
1,158	1,070	966	1,070	MXEF closing value	1,070	1,070	1,070	1,100	1,100

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

Growth in non-EM strategies

The MXEF Index has risen 2.8% in the first 14 days of January 2019. We adjust our forecast of market level for 30 June 2019 to 1,070 (implying a rise of 7.8% from the current levels).

Growth in non-EM strategies

In 1H19 there was a \$42m net outflow:

- Net inflows of \$136m for CLIG's Developed and Opportunistic Value strategies
- Net outflows of \$157m for CLIG's EM strategy
- Net outflow of \$21m for CLIG's Frontier strategy

For 3Q "[CLIG has] received notification of \$125 million of net inflows in aggregate across all strategies". The pipeline is "active" particularly in non-EM CEF strategies (i.e. Developed & Opportunistic Value). With \$42m of net outflows in 1H and \$125m in 3Q, we cut our forecast for net inflows for FY(Jun)19E by 60% from \$250m to \$100m.

Overall, with lower market values and lower net inflows we have reduced our forecast FuM for 30 June 2019 and 2020 by 5.3% and 5.1% respectively, and average FUM by 3%. This is partially offset by the weakening of Sterling: US\$/£ rate falling from 1.30 to 1.28.

Re-based forecasts

We have adjusted our revenue margin from 85bp to 77bp. It is this change which has resulted in the forecast for 2019E.

Exhibit 2: CLIG's financial forecasts

1H18	2H18	1H19E	2H19E	YE June, £m	2018A	2019E New	2020E New	Change	2019E Old	2020E Old
17.1	16.8			Total income	33.9	32.0	33.0	(9) (10)	35.3	36.5
9.6	9.8			Op profit (pre-profit share)	19.2	17.1	18.3	(16) (16)	20.4	21.8
6.6	6.2	5.2	5.2	Profit before tax	12.8	11.4	12.2	(16) (16)	13.6	14.5
5.2	4.9			Profit after tax	10.1	8.8	9.4	(16) (16)	10.5	11.1
20.0	19.4			Diluted EPS (p)	39.3	34.2	36.5	(16) (16)	40.7	43.4
9.0	18.0			DPS (p)	27.0	27.0	27.0	(16) (16)	28.0	29.0

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

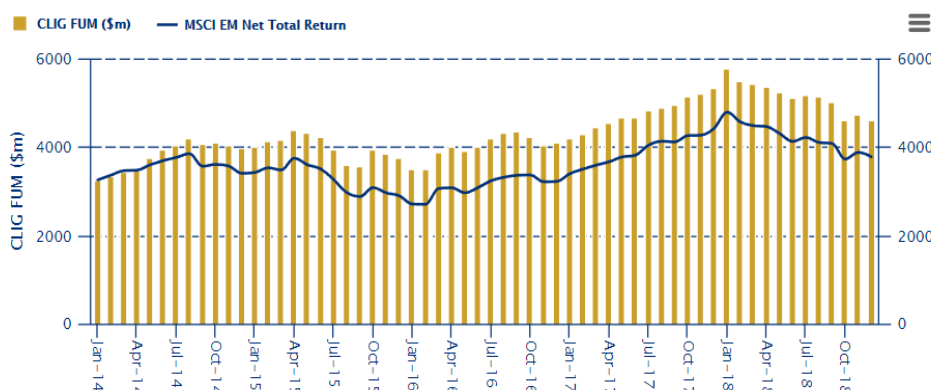
Key charts & variables

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 31 December 2018 was \$4,625m; previously 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 1001; Sterling \$1.28=£1

Over the past 4 years (see Exhibits 4 & 5), the MXEF index rose from a low of 688 in early 2016 to a high of 1,273 in early 2018, before falling to 1,001 on 14 January 2019; the US\$:£ exchange rate has fallen from 1.70 in July 2014 to a low of 1.20 in January 2017, bouncing up to over 1.40 in January 2018 before falling back down to 1.28 on 14 January 2019.

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 1.1x 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 to 1,070 and the US\$:£ exchange rate remaining close to 1.28 (i.e. similar to current US\$:£ exchange rate of 1.28).

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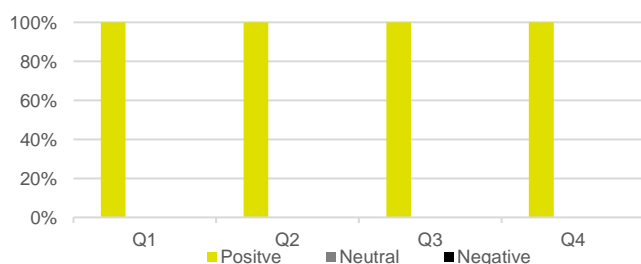
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12 Month Recommendation History



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Joint Broker	2
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