

17 July 2018

City of London Investment Group*

CLIG LN

Financials

Detailed pre-close statement

What's new. CLIG's unaudited pre-close statement for the year to 30 June 2018 reveals strong growth, despite the recent fall in market values:

- 10% rise in Group Funds under Management to US\$5.1bn (£3.9bn), with Emerging Market products contributing 82% and diversification products (i.e. Developed Market, Opportunistic Value and Frontier products) 18%.
- 10.3% rise in PBT to £12.8m (3.8% below Zeus forecast of £13.3m), with a 22% tax charge 11.0% rise in PAT to £10.1m (0.9% below Zeus forecast of £10.2m).
- 7.1% rise in fully diluted EPS to 39.3p (2.5% below Zeus forecast of 40.3p) and 8.0% rise in Full Year DPS to 27p (precisely in line with Zeus forecast of 27p).

The full results on 17 September will provide further additional information, such as FY18E revenue (Zeus forecast is now £33.5m; previously forecast: £34.0m) and net cash (Zeus forecast is now £18.0m; previously forecast: £18.8m).

As always, CLIG outlook commentary is clear: "The core EM strategy underperformed for the full year as discounts widened and an underweight to China, specifically the IT sector detracted from performance. The [diversification products] all recorded positive relative performance due to a combination of positive discount and allocation effects."

Zeus view. In rising markets CLIG delivered FuM, revenue, EPS and DPS growth. The recent fall in emerging markets has depressed profits and EPS slightly below forecast. We are impressed by the success of CLIG's diversification products, where the relative performance has been positive and \$400m of net inflows have increased FUM to \$900m (up 95% on 30 June 2017: \$461m).

Rebasing our forecasts to current market levels (see pages 2 to 4), we cut our FY(Jun)19E EPS forecasts by 11.6% to 40.4p (previously 45.7p), and trim our FY(Jun)19E DPS forecast by 3.4% to 28p (previously 29p).

Valuation. CLIG shares at 400p are cum 18.0p final DPS (4.5% yield on the final DPS alone). CLIG shares goes "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 11.0x for Emerging Markets and 12.9x for the FT All Share, CLIG PER of 9.9x is very attractive. Its forward dividend yield of 7.0% is a clear indication of value.

| | |
|---------------------------------|-------------|
| Price | 400p |
| Market Cap | £107m |
| Shares in Issue inc ESOT | 26.9m |
| 12m Trading Range | 390p - 459p |
| Free float | 84% |

Price Performance



Source: Bloomberg

Financial Forecasts

| YE June, £m | 2017A | 2018E | 2019E | 2020E |
|----------------------|-------------|-------------|-------------|-------------|
| Revenue | 31.3 | 33.5 | 35.3 | 36.5 |
| Op profit | 16.4 | 18.5 | 20.4 | 21.8 |
| Profit margin (%) | 52 | 55 | 58 | 60 |
| Profit share | (4.9) | (5.9) | (6.9) | (7.4) |
| PBT | 11.6 | 12.8 | 13.5 | 14.4 |
| Profit margin (%) | 37 | 38 | 38 | 39 |
| PAT | 9.1 | 10.1 | 10.4 | 11.1 |
| EPS fd (p) | 36.7 | 39.3 | 40.4 | 43.1 |
| Dividend cover (x) | 1.47 | 1.46 | 1.44 | 1.49 |
| DPS (p) | 25.0 | 27.0 | 28.0 | 29.0 |
| Avg FuM (\$b) | 4.4 | 4.9 | 5.3 | 5.6 |
| Net cash at YE | 13.9 | 18.0 | 21.8 | 25.9 |
| P/E (x) | 10.9 | 10.2 | 9.9 | 9.3 |
| Div Yield (%) | 6.3 | 6.8 | 7.0 | 7.3 |

Source: Audited Accounts and Zeus Capital estimates

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Our forecasts

Emerging Markets rose in 2016 & 2017 In calendar year 2016, the MXEF\$ rose 8.6%; in 2017 the MXEF\$ Index rose 34.3%.

7.2% fall in 2018

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 \$0.6m (i.e. 10%) fall in group FUM to \$5.1m (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 Dec 2016 | 2H Jun 2017 | 1H to Dec 2017 | 2H Jun 2017 | YE June, \$m | 2017A | 2018E | 2019E |
|-------------------|----------------|-------------------|----------------|------------------------------|--------------|--------------|--------------|
| 4,047 | 4,140 | 4,663 | 5,329 | Opening FUM | 4,047 | 4,663 | 5,107 |
| 57 | (363) | 62 | 123 | Net inflows | (306) | 185 | 250 |
| 36 | 886 | 604 | (347) | Performance & Market effects | 922 | 259 | 143 |
| 4,140 | 4,663 | 5,329 | 5,107 | Closing FUM | 4,663 | 5,107 | 5,500 |
| 2.3 | 12.6 | 14.3 | (4.2) | Growth in FUM (%) | 15.2 | 9.5 | 7.7 |
| 4,094 | 4,401 | 4,996 | 5,218 | Average FUM | 4,355 | 4,885 | 5,304 |
| 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

With lower current market levels, we rebase our expectation of June 2019 Group FuM to \$5.5bn and average FY(Jun)19E FUM to \$5.3bn (i.e. cut of 9.0%). With 9% cut in average FUM, we reduce forecast revenue for FY(Jun)19E by 6.4% to £35.3m and cut PBT by 10.5% to £13.5m and diluted EPS by 11.6% to 40.4p (See Exhibit 2).

Exhibit 2: CLIG's financial forecasts

| 1H18 | 2H18E new | YE June, £m | 2017A | 2018E new | 2019E new | 2018E previous | 2019E previous | 2018E change (%) | 2019E change (%) |
|------------|--------------|-------------------------|-------------|---------------|--------------|-------------------|-------------------|---------------------|---------------------|
| 17.1 | 16.4 | Total income | 31.2 | 33.5 | 35.3 | 34.0 | 37.7 | (1.5) | (6.4) |
| 9.6 | 8.9 | Operating profit | 16.4 | 18.5 | 20.4 | 19.2 | 22.8 | (3.6) | (10.5) |
| 6.6 | 6.2 | Profit before tax | 11.6 | # 12.8 | 13.5 | 13.3 | 15.1 | (3.6) | (10.5) |
| 5.2 | 4.9 | Profit after tax | 9.1 | # 10.1 | 10.4 | 10.2 | 11.6 | (1.2) | (10.5) |
| 20.0 | 19.4 | Diluted EPS (p) | 36.7 | # 39.3 | 40.4 | 40.3 | 45.7 | (2.3) | (11.6) |
| 9.0 | # 18.0 | DPS (p) | 25.0 | # 27.0 | | | | | |

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

as set out in the pre-close statement

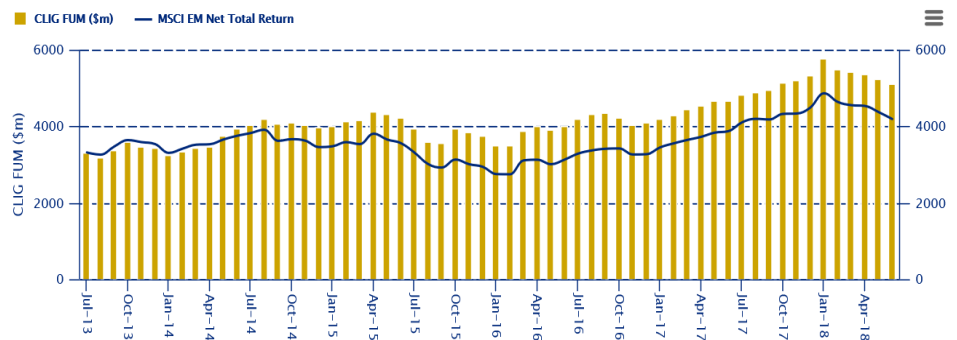
Key charts & variables

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 June 2018 was \$5,107m.

Exhibit 3: CLIG FUM & MXEF Index



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

MXEF 1075; Sterling \$1.32=£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 1.32 now.

Exhibit 4: MXEF index (\$)



Source: Bloomberg data; Zeus Capital chart

Exhibit 5: US\$: £ exchange rate



Source: Bloomberg data; Zeus Capital chart

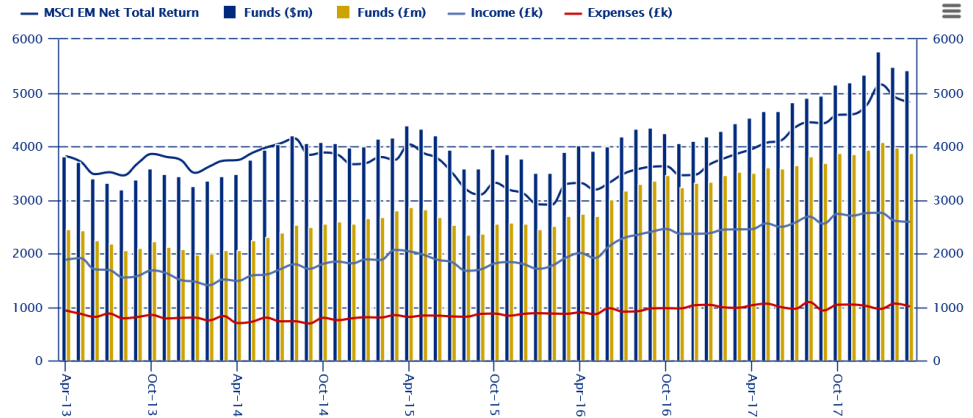
Forecasts based on current variables

The MXEF index is trading on a forward PER of under 11x, price to sale of under 1.2x and EV/EBITDA of under 8x. While we see potential for the MXEF Index to rise >11% to >1200 (see Exhibit 4), we base our forecasts on the MXEF remaining at 1100 and the USD:£ exchange rate at 1.30 (i.e. current levels to 2sf).

Charting increase in income & PBT

Costs well controlled with revenue rising

Exhibit 6: Funds Under Management, revenues & costs



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

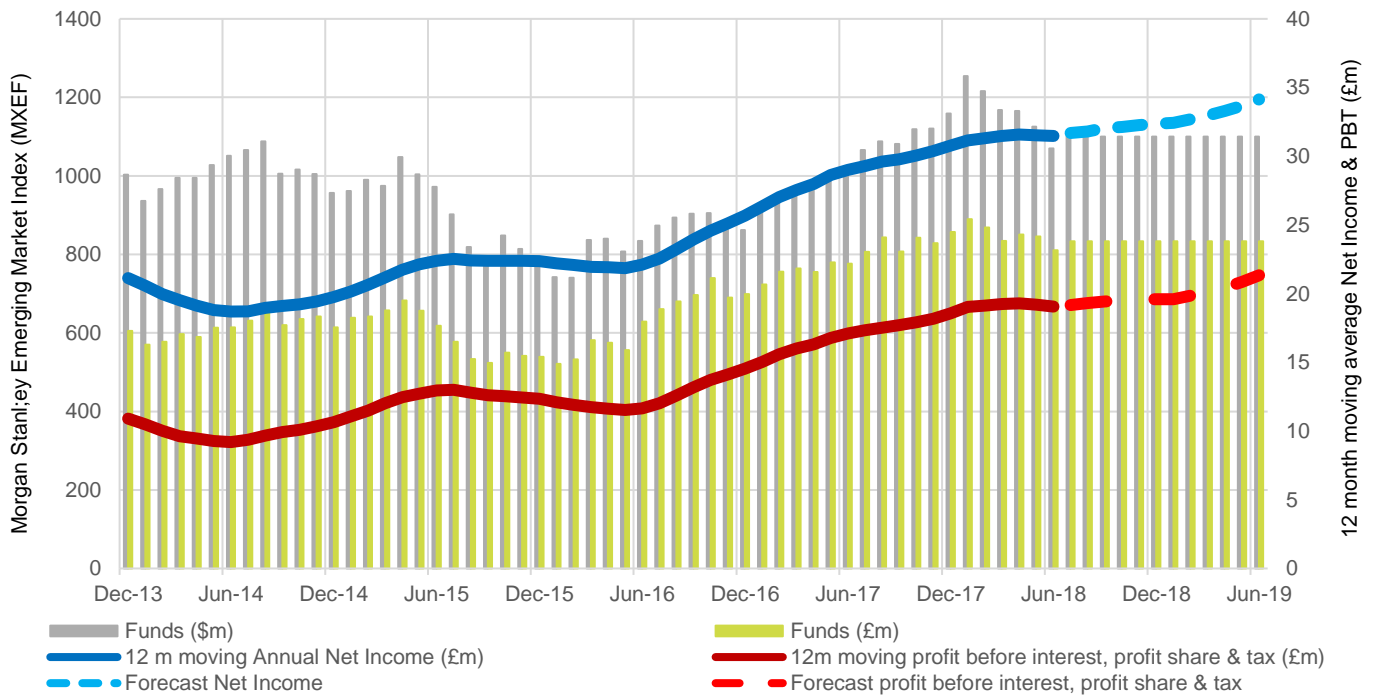
Encouraging rise in revenue & PBT

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 remains at 1,100 and the US\$: £ exchange rate is 1.32.

Trends consistent with Exhibit 7

The monthly data is consistent with FY(Jun)18E net revenue of £33.5m (FY19E: £35.3m). The profit before interest, profit share and tax for FY(Jun)18E of £18.5m (FY19E: £20.4m), after profit share of £5.9m and £6.9m, 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

Valuation

6.7% historical dividend yield

The yield on the dividends proposed by CLIG for the 12 months to 30 June 2018 is 6.7%, which is 77% above the FT All Share yield of 3.8% and the prospects for dividend growth are better than the FT All Share.

7.0% prospective dividend yield

For FY(Jun)19 we forecast a DPS of 28p (9p interim DPS; 19p final DPS); at 401p CLIG shares yield 7.0%, which is 67% higher than the FT All Share yield of 4.2%.

Dividend & strategic attractions

Funds should recognize CLIG's dividend yield attractions, and the significant strategy-value for investors in Closed End Funds (CEF).

Exhibit 8: CLIG share price (pence) & MXEF-\$ index



Source: Bloomberg 26 February 2018

Exhibit 8 shows the close correlation between the CLIG share price and the MSCI Emerging Markets Index (MXEF), which reflects the fact that over 82% of group FUM is within Emerging Markets.

CLIG c 460p if correlation holds

If the correlation were to hold we expect CLIG shares to trading at over **460p**, with the **MXEF index at over 1200**, as it did earlier this year.

With the MXEF index at 1076, CLIG shares would be trading in line with the correlation, except for the fact that CLIG is trading *cum 18p final DPS*.

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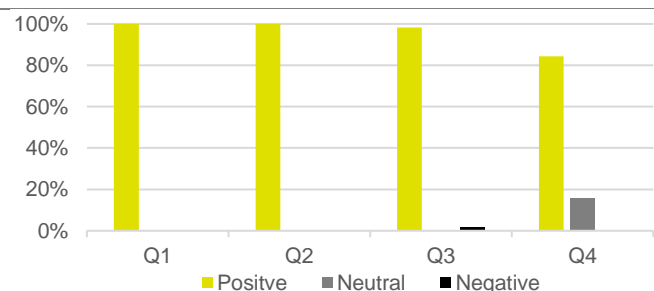
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Recommendation distribution at 30 June 2018 Source: Zeus Capital

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| Joint Broker | 3 |
| Nomad | 1 |
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