**Market data**

EPIC/TKR	CLIG
Price (p)	410.0
12m High (p)	454.0
12m Low (p)	391.0
Shares (m)	26.9
Mkt Cap (£m)	110.1
EV (£m)	94.7
Market	LSE

Description

City of London is an investment manager specialising in using closed-end funds to invest in emerging markets.

Company information

CEO	Barry Olliff
CFO	Tracy Rodrigues
Chairman	David Cardale

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

17 Sep	Preliminary results
8 Oct	1Q FUM announcement
11 Oct	Ex-div. date for final dividend
22 Oct	AGM

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City of London Investment Group**Dividend increase boosts yield**

City of London published a trading statement this morning, covering FY2018. Profits are expected to be almost in line with Hardman & Co forecasts, with PBT of approximately £12.8m slightly lower and earnings of £10.1m slightly ahead. The latter represents an increase of over 10% relative to the previous year. The company also announced an increase of 1p in the final dividend, raising it to 18p, and taking the total for the year to 27p, an 8% increase over the total for FY2017. Dividend cover will be almost 1.5x for the second year in a row, well above the rolling five-year target of 1.2x.

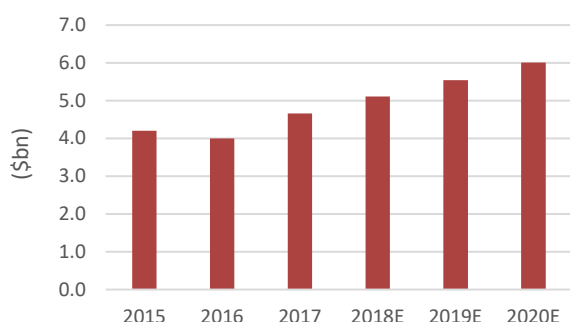
- **Funds under management (FUM):** Although, in dollar terms, FUM rose 9.5% to \$5.1bn over the year, this is down since the 31 March figures. Since then, emerging market equities have been very weak, falling over 10% during the quarter, although July has so far seen a slight recovery.
- **Diversification:** While the EM strategy had a mixed year, the diversification areas all gained assets and maintained outperformance. In aggregate, FUM in these areas almost doubled during the year and now represent 17.6% of FUM, from 9.8% a year ago. The diversification strategy is showing good results.
- **Valuation:** The prospective P/E of 9.9x is at a significant discount to the peer group. The historical yield of 6.6% is very 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 may increase the risk of such outflows, however.
- **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. FY2017 and FY2018 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 June (£m)	2015	2016	2017	2018A/E	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.11	5.55	6.01
Revenue	25.36	24.41	31.29	33.98	33.63	35.59
Statutory PBT	8.93	7.97	11.59	12.80	12.51	13.56
Statutory EPS (p)	26.4	23.3	36.9	40.6	38.7	42.0
DPS (p)	24.0	24.0	25.0	27.0	30.0	33.0
P/E (x)	15.2	17.2	10.8	9.9	10.3	9.5
Yield	6.0%	6.0%	6.3%	6.8%	7.5%	8.3%

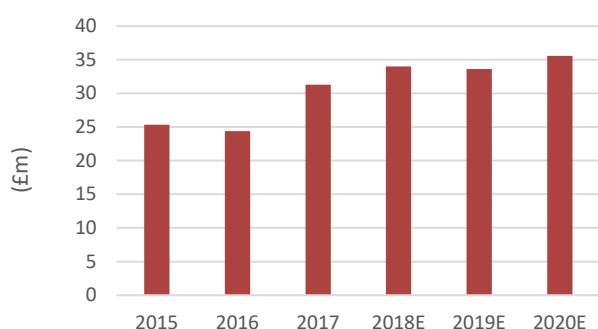
Source: Hardman & Co research

Funds under Management



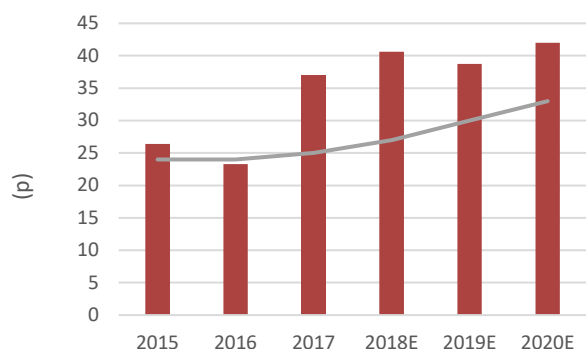
- ▶ Net inflows since 2014
- ▶ Market weakness in 2016 substantially offset by new business flows
- ▶ Assumed steady new business flows and market growth of 5% p.a.

Revenue



- ▶ Revenue linked strongly to FUM
- ▶ Slight decrease in revenue margins from new business
- ▶ Some currency effects, particularly from strong US Dollar from 2015 to 2017

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
- ▶ Final 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

EM strategy

As well as difficult market conditions, the EM strategy has endured two other headwinds during the year. Hardman & Co has discussed the rebalancing issue in previous reports. In essence, as emerging markets equities have grown, managers have been selling positions to keep their overall exposure steady. With the setback in emerging market equities this year, we would expect this to slow, although decision-making often lags performance, and City of London's earnings template now assumes no net inflows.

This is the main reason behind the net outflows for the strategy. It is perhaps worth noting that the figure is net, with inflows to the strategy being exceeded by outflows.

The EM strategy has also seen underperformance this year of 330bps, net of fees. Of this, over 200bps came from widening discounts, a typical move when markets are weak. While disappointing, this is not large enough to seriously damage the long-term performance figures.

Estimate adjustments

While the 2018 earnings and dividends were in line with our estimates, the decline in emerging markets over the quarter has led to FUM being lower than expected, with a corresponding impact on our forecasts. Offsetting this, to some extent, has been the strengthening of the US Dollar against Sterling, which is beneficial to City of London.

The net effect is that our 2019E EPS has been reduced by 5.1% to 38.7p and our 2020E EPS by 4.8% to 42.0p. We have left our dividend forecasts unchanged, as our reduced earnings estimates still give cover comfortably in excess of 1.2x.

Other news

Earlier in July, City of London announced a new significant shareholder: Eschaton Opportunities Fund Management, a Miami-based fund manager, has taken a 4.7% stake. The transactions appear to have taken place late in 2017, but it is only now that notification has been received.

Financials

Summary financials						
Year-end June	2015	2016	2017	2018A/E	2019E	2020E
FUM (\$bn)	4.20	4.00	4.66	5.11	5.55	6.01
P&L (£m)						
Revenue	25.36	24.41	31.29	33.98	33.63	35.59
Expenses	16.63	16.66	19.79	21.01	21.14	22.04
Operating profit	8.73	7.76	11.51	12.97	12.50	13.55
PBT	8.93	7.97	11.59	12.80	12.51	13.56
Earnings	6.61	5.85	9.14	10.10	9.63	10.44
EPS (p)	26.4	23.3	36.9	40.6	38.7	42.0
DPS (p)	24.0	24.0	25.0	27.0	30.0	33.0
Key metrics						
	2015	2016	2017	2018A/E	2019E	2020E
Growth (%)						
FUM		-4.8	16.5	9.6	8.6	8.3
Revenue		-3.7	28.2	8.6	-1.0	5.8
Operating profit		-11.1	48.4	12.7	-3.7	8.4
EPS		-11.7	58.4	10.0	-4.6	8.4
DPS		0.0	4.2	8.0	11.1	10.0
Operating margins (%)						
Net FUM fee margin	0.86	0.86	0.84	0.82	0.79	0.80
Operating margin	34.4	31.8	36.8	38.2	37.2	38.1
Tax rate	26.0	26.5	21.1	23.0	23.0	23.0
Dividend cover	1.1	1.0	1.5	1.5	1.3	1.3
EPS sensitivity						
					2019E	2020E
No net new business						
EPS (p)					37.8	39.2
% change					-2.4	-6.5
0% market growth (was 5% p.a.)						
EPS (p)					37.2	37.1
% change					-4.0	-11.5

Source: City of London Investment Group, Hardman & Co research;
£1 = \$1.33

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The fact that we are 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>

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