New City Energy

Investment company review

Edison investment research

Committed to energy sector growth

Investment trusts

New City Energy (NCE) is a fund that invests globally in energy-related equities and fixed-interest securities. It provides a combination of growth and yield but primarily targets growth from the energy sector. It focuses on small- and mid-cap companies where the manager sees the strongest longer-term growth potential. Circa 67% of gross assets are in invested in oil and gas equities, 23.0% in fixed-income securities (oil and gas related), with uranium and coal largely making up the balance. NCE pays quarterly dividends and increased its total dividend for the year to 30 September 2012 by 7.27% to 1.77p. NCE has further capacity to increase the dividend and the board has indicated that it remains committed to a progressive dividend policy. Energy is fundamental to economic growth and, against a backdrop of a diminishing supply of oil and growing energy demand, particularly from emerging economies, the manager remains very bullish with regard to the long-term outlook for oil and energy in general.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return S&P/TSX Energy* (%)	Total return S&P/ASX 200 Energy* (%)	Total return S&P Glbl 1200 Energy* (%)
12/12/2009	134.5	79.3	42.8	66.5	13.9
12/12/2010	71.5	55.8	19.6	19.6	13.9
12/12/2011	(26.8)	(18.5)	(9.1)	(9.8)	13.9
12/12/2012	(11.7)	(21.2)	0.9	(6.1)	13.9

Note: *Twelve-month rolling discrete performance; NAV assumes full conversion of subscription shares at 70p.

Investment strategy: Diversified global energy exposure

NCE's portfolio is invested in oil, gas, coal and uranium stocks. It is managed using a mixture of top-down and bottom-up strategies and maintains an extensively diversified portfolio of about 80 securities. The manager employs gearing when appropriate, to enhance returns over the longer term. NCE's mandate permits it to invest up to 30% of gross assets in companies outside the energy sector.

Sector outlook: Long-term positive outlook for energy

In our view, the long-term demand-supply situation is positive for the oil price. The oil price has continued to be resilient during 2012, supported by the global oil majors, but the junior oil and gas sector has continued to fall, largely reflecting concerns about the ability to finance ongoing operations in a credit-constrained environment. Juniors, without the production revenues of the majors and the need to fund development of their assets, are more vulnerable. For this reason, New City Investment Managers (NCIM) gives considerable weight to cash flows and the manager is positive about the outlook for the portfolio. Moreover, the cash-rich oil majors continue to look for reserves and may well be attracted by the historically cheap valuations of the juniors.

Valuation: Discount above average since launch

The discount, currently at 18.8%, is above its one-year, three-year and post-launch averages of 23.1%, 19.6% and 17.7%. NCE offers a good yield and may be of interest to long-term investors looking for a broad global energy resources exposure.

13 December 2012

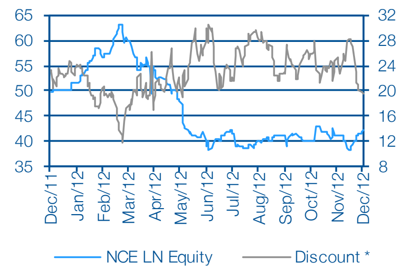
Price	42.25p
Market cap	£23m
AUM	£35m
NAV*	52.01p
Discount to NAV	18.8%
NAV**	52.01p
Discount to NAV	18.8%
Yield	4.2%

** Debt at market value, including income and assuming no further dilution from the conversion of subscription shares. As at 7 December 2012.*

*** Debt at market value, including income and assuming full dilution from conversion of subscription shares at 70p. At 7 December 2012.*

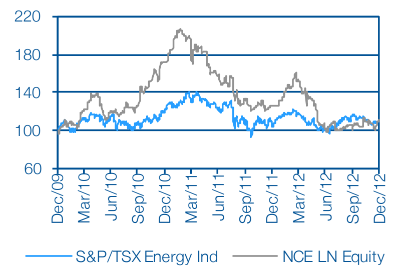
Ordinary shares in issue	53.6m
Code	NCE
Primary exchange	CISX, LSE
AIC Sector	Commodities & Natural Res's

Share price/discount performance



** Positive values indicate a discount; negative values indicate a premium*

Three-year cumulative performance



52-week high/low	63.00p	38.25p
NAV* high/low	74.00p	50.69p

** Assuming subscription shares are converted in full at 70p.*

Gearing

Gross	24.9%
Net	24.9%

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Edison profile page

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Exhibit 1: Investment company at a glance

Investment objective and fund background

NCE's investment objective is to deliver returns to shareholders, principally in the form of capital growth, but with some prospect of income. It invests in the securities of companies involved in the exploration, development and production of energy, as well as related service companies. These include, but are not limited to, shares, convertibles, fixed-income securities and warrants. Up to 30% of assets can be invested in companies outside the energy sector.

Developments last quarter

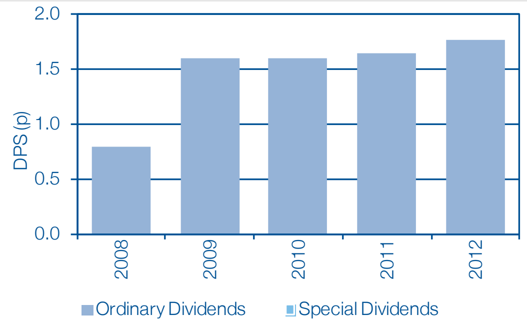
29 November 2012: Annual report for the year ended 30 September 2012 released.

31 October 2012: Fourth interim dividend for the year ended 30 September 2012, 0.57p, paid. Total 2012 dividend = 1.77p

Forthcoming		Capital structure		Fund details	
AGM	March 2013	Total expense ratio	2.83%	Group	New City Investment Managers
Preliminary results	December 2012	Net gearing	24.9%	Managers	Will Smith and Ian Francis
Year end	30 September	Annual mgmt fee	2.0% of net assets	Address	New City Inv Mgrs, 5th Floor, 33 Chester St, London SW1X 7LB
Dividend paid	Quarterly	Performance fee	20% over 8% hurdle		
Launch date	February 2008	Trust life	Indefinite	Phone	+44 (0)20 7201 6900
Wind-up date	See page 7	Loan facilities	£20m revolving	Website	www.ncim.co.uk

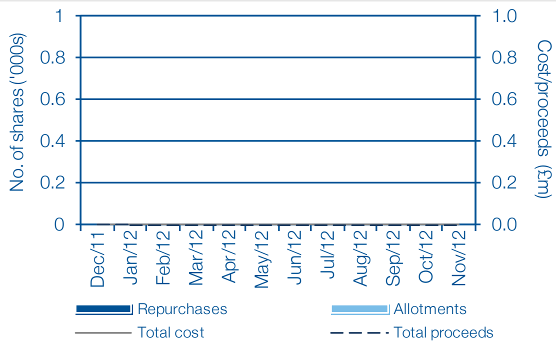
Dividend policy and history

Quarterly dividends paid in January, April, July and October. Current policy is to maintain the quarterly dividend at 0.4p, with a larger fourth interim paid in October each year.

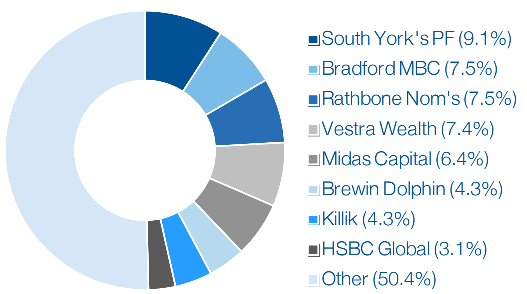


Share buy-back policy and history

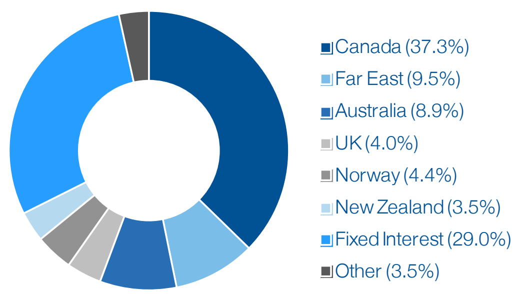
NCE's articles permit it to both allot and repurchase its ordinary shares.



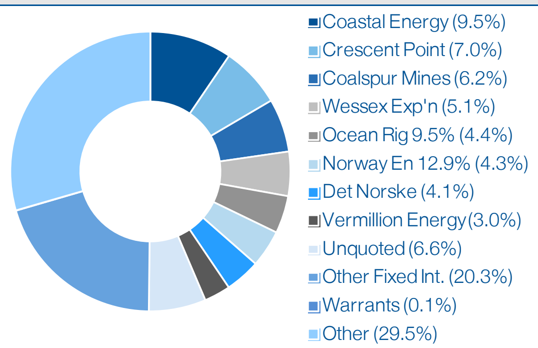
Shareholder base (as at 31 October 2012)



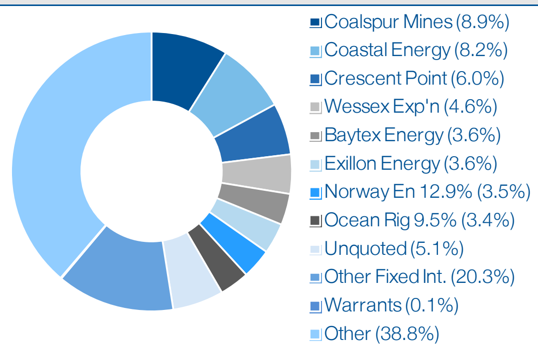
Geographic distribution of portfolio (as at 31 October 2012)*



Portfolio composition (as at 31 October 2012)*



Portfolio composition (as at 30 April 2012)*



Source: New City Energy, Edison Investment Research. Note: *Geographic distribution and portfolio composition are as a proportion of net assets. Borrowings as at 31 October 2012 and 30 April 2012 comprise 24.9% and 20.2% of net assets respectively.

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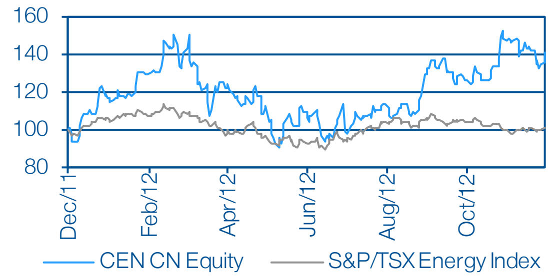
Exhibit 2: Top five holdings at a glance

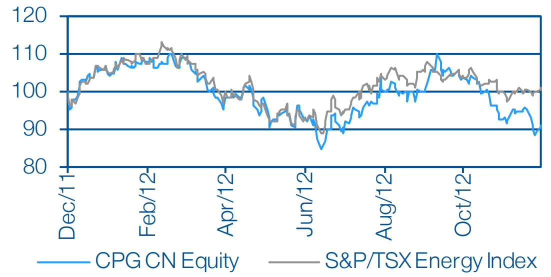
Coastal Energy	Code: CEN CN	Market cap: £1,419m



Div yield (trail. 12 months)	N/A
Industry/Sector	Oil Comp's-Exploration & Production
Listing	Canada – TSX, LSE – AIM
Website	www.coastalenergy.com

Coastal Energy (CEN) is an oil and gas exploration and production company, with assets in both onshore and offshore Thailand. As at 31 March 2012, CEN had proven plus probable reserves of 149.1 mmboe (31 December 2010: 51.0mmboe). CEN estimates 2012 production will average 24,500boe/d (2010:10,000boe/d) rising to 33,000boe/d for 2013). CEN has grown both production and reserves strongly during 2012 and continues to have strong growth prospects.

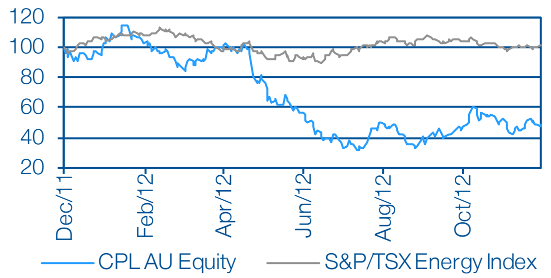
Crescent Point Energy Trust	Code: CPG CN	Market cap: C$13,791m (£8,686m)



Div yield (trail. 12 months)	7.44%
Industry/Sector	Oil Comp's-Exploration & Production
Listing	Canada – TSX
Website	www.crescentpointenergy.com

Crescent Point Energy Trust(CPG) acquires, develops and holds interests in petroleum and natural gas assets. It has a strong focus on western Canada and uses its relative balance sheet strength to acquire assets with long-life, high-quality reserves. Production is weighted 90% oil and 10% natural gas. CPG has a drilling inventory, with more than 6,000 locations. The manager considers that CPG has a diverse portfolio of assets that allows it to pay a strong and stable yield.

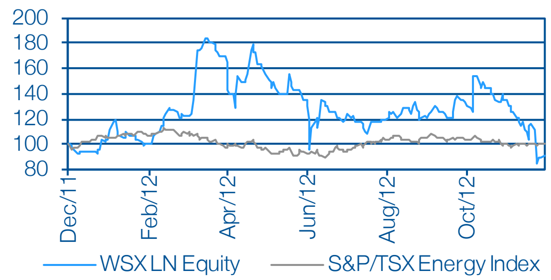
Coalspur Mines	Code: CPL AU	Market cap: A$487m (£319m)



Div yield (trail. 12 months)	N/A
Industry/Sector	Coal
Listing	Australia – ASX
Website	www.coalspur.com

Coalspur Mines (CPL) is engaged in the exploration and development of its Vista Coal Project (VCP) in Alberta, Canada. The VCP leases contain a JORC coal resource of c 1,290m tonnes of low sulphur, high volatile, bituminous C thermal coal. CPL also has leases covering c 19.6k hectares in the Vista South Project. Recent weakness reflects financing concerns, but the manager considers that CPL has plenty of options and has used the weakness to add to NCE's position.

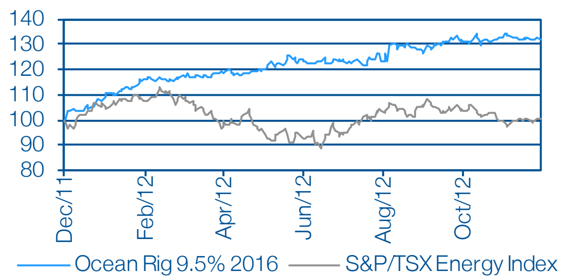
Wessex Exploration	Code: WSX LN	Market cap: £35m



Div yield (trail. 12 months)	N/A
Industry/Sector	Oil Comp's-Exploration & Production
Listing	LSE – AIM
Website	www.wessexexploration.com

Wessex Exploration (WSX) has interests in two exploration licences, in the UK, Western Sahara/North Africa and the Mozambique Channel. The manager considers that WSX's 1.25% interest in an exclusive exploration licence for offshore Guyane (c 30,000 km^2) is now key. Recent results disappointed the market. The first of four wells did not encounter commercial hydrocarbons, but the manager is encouraged by the discovery of 85 metres of reservoir quality sands with oil.

Ocean RIG UDW	ISIN code: NO0010607625	Issue Size: US$5000m



Coupon/Price	9.5% / 102.75
Seniority	Senior unsecured
Maturity	27 April 2016
S&P Rating/Moody's Rating	CCC+/Caa1

Ocean Rig owns and operates two fifth-generation semi-submersible drilling rigs and four sixth-generation drill ships. All six units are constructed for ultra deep water (UDW) and harsh environments. Ocean RIG has three more UDW drill ships under construction, designed to work at a water depth of 12 000 feet (drilling depth 40,000 feet). The manager considers that as the market for UDW rigs is very tight, it commands very strong day rates, which is expected to continue.

Source: New City Energy, Thomson Datastream, Edison Investment Research

Fund profile: Junior oil & gas exposure with fixed-income support

Launched in February 2008, NCE is a Jersey-registered, closed-ended investment company, which invests in the securities of companies involved in the exploration, development and production of energy, as well as related service companies in the energy sector. The investment manager is CQS Cayman, although day-to-day management has been delegated to the investment adviser, NCIM. Co-managers, Will Smith and Ian Francis, are responsible for the portfolio. NCE has no formal benchmark and is listed on both the Channel Islands and London stock exchanges. August 2011 saw the investment objective broadened to allow up to 30% of gross assets to be invested in companies operating outside the energy sector. NCE has a substantial fixed-income allocation (currently 29.0% of net assets, which is used to support the dividend).

Equity outlook

Despite a global slowdown and difficulties in the US and Europe, global GDP is expected to continue to grow. In June, the World Bank estimated GDP growth for 2012 at 2.5% and forecast GDP growth for 2013 and 2014 at 3.0% and 3.3% respectively. Much of this growth is expected to be fuelled by developing economies, where demand for energy continues to grow; a trend that is expected to continue. Looking to the supply side, supply of both renewables and non-renewables are constrained over the longer term, exerting upward pressure on prices. The trend for non-renewables is one of increasing difficulty in finding and extracting resources and for renewables, climate change and population growth are frequently a check on expansion.

The fund manager: Will Smith and Ian Francis

The manager's view: Long-term positive on oil price

As equity markets declined in 2011, reflecting a worsening global economic outlook, the oil price held up well. This benefited the oil and gas majors but not the juniors, as the space became polarised. It reflected concerns about the ability of smaller companies to finance operations in a lower-growth, credit-constrained environment. 2012 has seen more of the same, with a further expansion of this dislocation. However, a precipitous collapse in oil prices still appears unlikely. The manager considers that an oil price below $90 is not sustainable, as it would cause many OPEC countries to run a fiscal deficit, although the market is well supplied and the cost of production is increasing. The consensus for world economic growth is lower but still positive and political supply risks remain. Valuations for smaller oil and gas stocks remain attractive in absolute terms and relative to the majors.

Looking to the long term, the manager considers that, unlike other natural resource sectors that have experienced a bear market during the last 20 years and seen exploration cut back, investment in the oil sector has been strong. Reserves have been exploited to the point that capacity in the market is not expanding. Against this backdrop, energy demands are ever increasing, particularly from emerging economies. The manager considers that these factors will stimulate the oil price over the longer term, and so is a long-term oil bull. The manager expects that oil will never be exhausted, as high oil prices will stimulate investment in alternatives such as shale gas, although the oil price is expected to move up substantially before alternatives come on stream. Compared to oil, natural gas is relatively abundant but dislocation between oil and natural gas prices remains. Gas markets are predominantly local in nature, although as infrastructure develops, we can expect these to become increasingly global. The manager believes nuclear power will be key to meeting future energy demand. Fukishima has upset the consensus that in an increasingly carbon-conscious world where energy consumption is growing, nuclear power will take a more prominent role in meeting energy needs. However, it is difficult to see realistic alternatives to expanding nuclear power in the energy mix if carbon levels are to be reduced.

Asset allocation

Investment process: Bottom-up stock selection

In common with other NCIM funds, NCE is managed using a mixture of top-down and bottom-up investment strategies. The process begins with the identification of sectors and geographical areas, which the manager favours to varying degrees. This serves as a guide to the evolution of the portfolio. However, the portfolio is not managed with specific reference to geographic or sector allocation targets or with reference to those of any underlying benchmark. Instead, the New City team focuses its efforts on the fundamental analysis of investment opportunities meeting 10 energy companies a week on average. The manager frequently backs management teams that have delivered in the past, looking to construct a portfolio of assets with a 'lot of talk' and for small cap exposures there has to be a clear path to financing a project. Once included in the portfolio, the New City team continues to assess stocks on an ongoing basis to ascertain whether the level of holding remains appropriate. An initial holding can be no larger than 8%, but can increase with price appreciation. It is not currently NCE's policy to attempt to hedge currency exposure, and it is therefore exposed to currency risk.

Overview: Overwhelmingly focused on global oil and gas equities

The overall portfolio is a diversified pool of 63 equity, 14 fixed-income and nine warrant positions. The top eight quoted holdings account for 43.6% of net assets, other fixed-income accounts for 20.3%, unquoted equities for 6.6%, while the warrant exposure (less than 0.05%) is negligible. Borrowings and the remaining quoted equity investments account for -24.9% and 54.4% of net assets respectively. Exhibit 3 illustrates NCE's sector allocations as at 31 October 2012. Reflecting NCE's mandate, the portfolio had a substantial allocation to global oil and gas stocks of 87.6% of net assets. Bonds, which provide NCE with income, accounted for 29.0% of net assets.

Exhibit 3: Sector allocations as at 31 October 2012

	Portfolio weight (%)*
Oil and gas (North America and Canada)	35.1
Oil and gas (Other)	13.9
Oil and gas (Australia and New Zealand)	11.8
Oil and gas (Far East)	9.5
Oil and gas (UK and Europe)	9.0
Coal	6.2
Uranium	4.0
Oil and gas (Africa)	2.5
Oil and gas (Latin America)	1.8
Oil and gas (Middle East)	0.2
Other	1.9
Bonds	29.0
Borrowing	(24.9)
Total	100

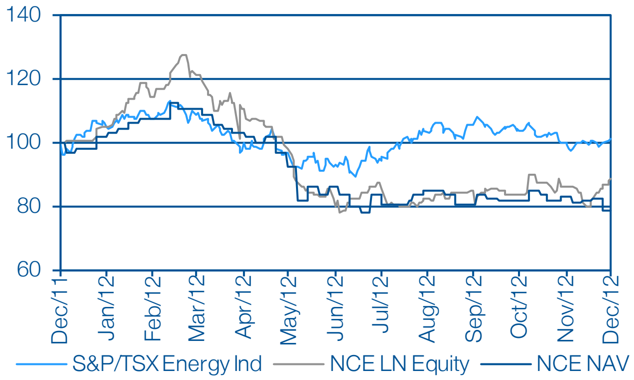
Source: New City Energy, Edison Investment Research. Note: *Portfolio weight as a proportion of net assets.

Recent performance: Difficult during the last two years

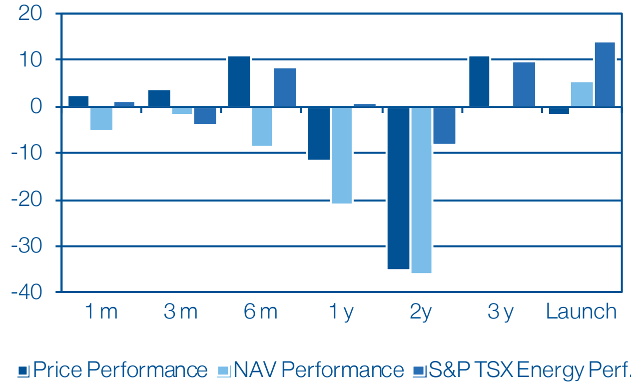
An analysis of NCE's NAV performance relative to the S&P/TSX Energy Index shows it has experienced two periods of substantial underperformance. The first resulted from the financial crisis, which saw NCE move from a c 50% lead, from its launch (in February 2008), to a 30% lag. In this instance, the performance recovered recapturing the lost outperformance during the next 26 months so that NCE was once again c 50% ahead of the S&P/TSX Energy Index. The last 22 months have seen a prolonged period of underperformance, which has seen NCE give up c 40% in relative performance. A similar pattern is witnessed if NCE's performance is compared to that of the S&P/ASX 200 Energy Index. The performance during these periods arguably reflects that of the junior oil and gas sector, in which NCE is overwhelmingly invested. Despite oil price resilience, which acted as a boost to the majors, the juniors were subject to near-continuous downward pressure in 2011, which led to a dislocation in performance. This has continued during 2012, with the dislocation increasing. For example, three of NCE's top five holdings have underperformed the S&P/TSX Energy Index during the last 12 months: Crescent Point Energy (-6.1%), Coalspur (-47.3%) and Wessex Exploration (-8.0%). This has largely centred on concerns about the ability of juniors to finance operations in a difficult environment. While considerable uncertainty about the global economy remains, we consider NCE is well positioned to benefit when the market moves back into a risk on phase.

Exhibit 4: Investment company performance

Price, NAV and benchmark total return perf, one year rebased



Price, NAV and benchmark total return performance (%)



Source: New City Energy, Thomson Datastream, Edison Investment Research

Exhibit 5: Share price and NAV (with debt valued at par) total return performance (sterling adjusted), relative to benchmarks

	One month	Three months	Six months	One year	Two years	Three years	Launch
Price relative to S&P/TSX Energy	1.4	8.0	2.2	(12.6)	(27.1)	1.1	(15.7)
NAV relative to S&P/TSX Energy	(6.2)	2.2	(17.4)	(22.1)	(27.6)	(9.7)	(8.6)
Price relative to S&P/ASX 200 Energy	1.0	6.0	7.7	(5.6)	(20.1)	9.6	(46.1)
NAV relative to S&P/ASX 200 Energy	(6.6)	0.3	(12.0)	(15.1)	(20.5)	(1.3)	(39.0)
Price relative to FTSE AW Oil & Gas	0.8	6.1	3.2	(14.1)	(39.0)	(5.5)	(23.5)
NAV relative to FTSE AW Oil & Gas	(6.8)	0.3	(16.5)	(23.6)	(39.5)	(16.3)	(16.4)
Price relative to S&P Global 1200 Energy	0.6	6.2	3.3	(14.4)	(42.1)	(10.3)	(29.5)
NAV relative to S&P Global 1200 Energy	(7.0)	0.4	(16.3)	(23.8)	(42.5)	(21.2)	(22.4)

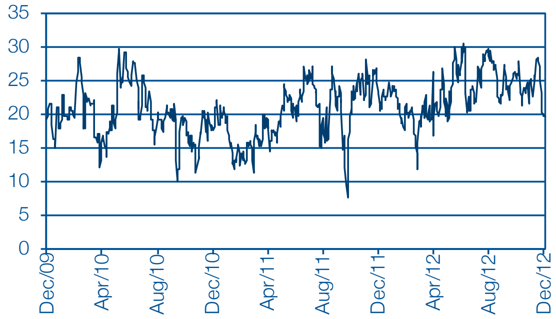
Source: New City Energy, Thomson Datastream, Edison Investment Research – put in extra column

Discount: Above longer term averages

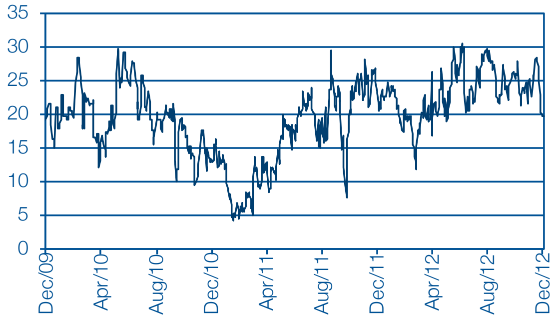
An explicit commitment to maintain the discount at a particular level has not been provided. Since its launch in February 2008, NCE has not used its repurchase authority and its allotment authority has been used three times: first in May 2008, to address post-launch demand, and then in March 2010 and March 2011, following conversion of NCE's subscription shares. Exhibit 6 illustrates the discount since NCE's launch. The first graph is produced using par NAVs and assumes that any outstanding subscription shares remain unexercised. The second graph assumes dilution from the full exercise of all outstanding subscription shares at 70p. Before September 2010 and from October 2011, the two graphs are identical, as the subscription shares are out of the money. From launch to July 2008, NCE frequently traded at a premium. However, from July 2008, the trust moved out to a consistent discount. The discount reached its all-time high of 60.8% in October 2008, before settling down to a discount that has averaged 21.5%, NAV calculated in par value terms, and 19.6%, NAV calculated in fair value terms, over the last two years. With both NCE's price and NAV now back below the exercise price, the subscription shares currently have no dilutary effect. However, there is potential for dilution if these rise again. The discount based on the fully-diluted NAV is currently at 18.8%. This is above its one-year, three-year and post-launch average of 23.1%, 19.6% and 17.7% respectively.

Exhibit 6: Discount over three years

Assuming all outstanding subscription shares remain unexercised.



Assuming all outstanding subscription shares are exercised.



Source: New City Energy, Thomson Datastream, Edison Investment Research.

Capital structure: Conventional, c 25% net gearing

NCE has a conventional structure with two classes of security in issue, zero par value ordinary shares and zero par value subscription shares. The latter, which are both listed and tradable, confer the right but not the obligation to subscribe for one ordinary share at any subscription date at a price of 70p. There is one subscription date each year. This is defined as the 30th day after NCE's audited accounts are dispatched to shareholders for the financial years 2008 to 2013 inclusive. The final subscription date will be 28 February 2014. NCE can gear up to 30% of net assets and has a bank borrowing facility with Credit Suisse. As at 31 October 2012, NCE had gross and net gearing of 24.9% of net assets. NCE is currently geared quite close to its maximum, because on a longer-term basis the manager believes oil juniors are attractively priced. The management fee, paid monthly in arrears, is 2.0% pa of the net asset value of the company valued monthly, with assets valued using bid prices. The manager is also entitled to a performance fee of 20% of any of the outperformance of NCE's net assets, in total return terms, above an 8% per year hurdle rate. This performance fee is subject to a high watermark provision. No performance fee was accrued for the years ended 30 September 2011 or 2012. The total expense ratio (TER) was 2.83% for the year ended 30 September 2012 (2.69% for the year ended 30 September 2011). The investment management contract with CQS Cayman can be terminated at one year's notice by either side. The investment advisory agreement with NCIM terminates at the same time. NCE has an initial seven-year fixed life from 8 February 2008 to 8 February 2015. However, from 2014, a continuation vote will be put to shareholders annually at each AGM by way of ordinary resolution. As such, NCE's life is indefinite, but with annual continuation votes from 2014.

Dividend policy and record: Quarterly dividends

Dividends are paid quarterly and, for any given complete financial year, the first, second, third and fourth interim dividends are paid in January, April, July and October respectively. From launch to the year ended 30 September 2010, NCE's dividend policy was to maintain the quarterly dividend at 0.4p for all four quarters. However, for the year ended 30 September 2011 and going forward, this policy has been amended. NCE still maintains the quarterly payment at 0.4p for the first three quarters, but makes a larger payment for the fourth quarter (2012=0.57p, 2011=0.45p). As such, for the year ended 30 September 2012, NCE paid a total dividend of 1.77p (2011=1.65p). This compares to a revenue return during the year of 2.03p, allowing NCE to add 0.26p to revenue reserves. The fixed-income weighting is constructed with the aim that it should fully cover the dividend. Year-on-year growth in the total dividend for 2012 was 7.27%. As at 30 September 2012, NCE had revenue reserves equal to 6.47p per share after payment of the fourth quarterly dividend or 3.65x the increased total dividend for 2012. This reflects a strong accumulation of revenue reserves relative to payment, as well as both the board's and the manager's confidence that NCE can provide further dividend growth. The investment management fee and other expenses are charged fully against the capital account.

Peer group comparison

As Exhibit 7 illustrates, the AIC commodities and natural resources specialist sector is a relatively small peer group, with eight constituents, whose investment focuses can vary markedly. In this peer group, NCE ranks third over one year and sixth over three years when considering share price total return.

Exhibit 7: Specialist sector – Commodities and natural resources, as at 12 December 2012

Company	Share price total return on £100			Ongoing charges (%)	(Disc)/ prem.	Net gearing (100=no gearing)	Five-year dividend growth (%)	Div. yield
	One year	Three years	Five years					
Sector average	**94.3**	**115.9**	**93.2**	**1.57**	**(12.5)**	**108**	**30.4**	**2.6**
New City Energy	**88.3**	**110.9**	**N/A**	**2.65**	**(19.5)**	**125**	**15.6**	**3.9**
Altus Resource Capital	85.8	129.4	N/A	2.00	10.8	93	N/A	N/A
Baker Steel Resources	87.7	N/A	N/A	2.36	(24.1)	104	N/A	N/A
BlackRock Commodities Inc.	101.5	112.9	96.2	1.32	(1.6)	103	1.3	4.9
BlackRock World Mining	98.3	113.7	91.2	1.31	(13.2)	106	36.1	2.4
City Natural Resources Hi. Yld.	83.8	113.9	115.6	1.48	(16.3)	123	13.2	2.4
El Oro	81.2	170.0	N/A	1.92	(21.0)	129	N/A	4.1
Geiger Counter	57.2	46.2	32.0	2.63	(20.7)	105	N/A	0.0
International Oil & Gas Tech.	78.0	53.5	N/A	4.81	(53.1)	90	N/A	2.1

Source: The Association of Investment Companies

The board

All directors are non-executive and independent of the investment manager: David Norman (chairman), Douglas Breen, Graeme Ross and Craig Stewart (directors). Graeme Ross and Craig Stewart are principals of R&H Fund Services, which provides administrative services to the company. The average length of director service is 4.5 years.

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