EDISON

New City Energy

Specialist energy sector play with yield

Investment companies

New City Energy (NCE) is a specialist, actively-managed closed-ended fund investing in the energy sector. Performance has been weak with 2014 suffering from the sharp fall in the oil price (see page 5). The manager has increased the focus on dividend-paying, cash-generative companies with strong balance sheets and growth potential within the shale oil and gas sub-sector. This profile should allow NCE both to weather low oil prices and to capitalise on a potential recovery hinted at by trends in capex and drilling rates (see page 3). NCE's 10.1% yield could well underplay the portfolio's income generation prospects.

12 months ending	Total share price return (%)	Total NAV return (%)	S&P/TSX Energy (%)	S&P ASX 200 Energy (%)	S&P Global 1200 Energy (%)	WTI Crude Oil (%)
29/02/12	(20.4)	(14.1)	(12.7)	(2.3)	(1.0)	12.3
28/02/13	(20.3)	(24.0)	(2.7)	(4.0)	3.6	(9.5)
28/02/14	(19.8)	(20.2)	(3.6)	(17.6)	1.6	1.0
28/02/15	(40.0)	(39.5)	(12.8)	(16.4)	(3.2)	(47.3)

Note: Twelve-month rolling discrete £-adjusted total return performance.

Investment strategy: Focused on shale oil and gas

NCE aims to deliver capital growth with some prospect of income through investing primarily in quoted and unquoted (c 10%) equities in the shale oil and gas sub-sector, where the manager sees the most attractive investment opportunities. The manager's investment process is primarily based on bottom-up stock selection drawing on industry experience, management meetings and valuation analysis, supported by a top-down overlay paying attention to broader market themes. Income generation is supported by higher yield fixed income investments, typically representing c 20% of the portfolio and broadly matched by borrowings, leaving the equity portfolio largely ungeared.

Market outlook: Gradual recovery in prospect

After a dramatically adverse year for the oil industry, there are positive signs in the form of reduced capital spending by oil majors and a sharp reduction in the US oil rig count. These indicators may not result in lower output in the near term, as newly completed wells continue to come on stream and exporters focus on pushing output to generate revenue. However, a lower rate of new well completions and natural decline rates are expected to lower global oil supply by the end of the year, helping to rebalance the market. In the medium term, global economic growth is expected to drive a steady rise in oil demand supporting a gradual recovery in the oil price, albeit well below the highs of the last three years.

Valuation: Superior yield, narrowing discount

NCE's 10.1% yield is the highest of the dividend paying funds in the peer group by some margin, potentially underplaying the attention the manager is giving to income generation in the portfolio. NCE's share price discount to NAV (including income) has narrowed in 2015 and at 15.0% stands below the three-year average of 17.9%.

10 March 2015

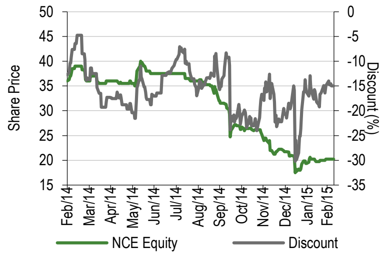
Price	**20.3p**
Market cap	**£10.9m**
AUM	**£14.8m**

NAV*	23.8p
Discount to NAV	15.0%
Yield	10.1%

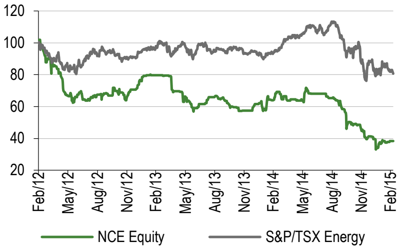
*Adjusted for debt at market value, including income.

Ordinary shares in issue	53.6m
Code	NCE
Primary exchange	LSE
Secondary exchange	Channel Islands SX
AIC sector	SS: Commodities & Natural Resources

Share price/discount performance*



Three-year cumulative perf. graph



52-week high/low	40.0p	17.5p
NAV** high/low	46.2p	22.9p

**Including income.

Gearing

Gross*	20.9%
Net*	20.9%

*As at 31 January 2015.

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Edison profile page

New City Energy Limited is a research client of Edison Investment Research Limited

Exhibit 1: Company at a glance

Investment objective and fund background

NCE's investment objective is to deliver attractive returns to shareholders principally in the form of capital growth, yet with some prospect of income, predominantly through investing in the shale oil and gas sector.

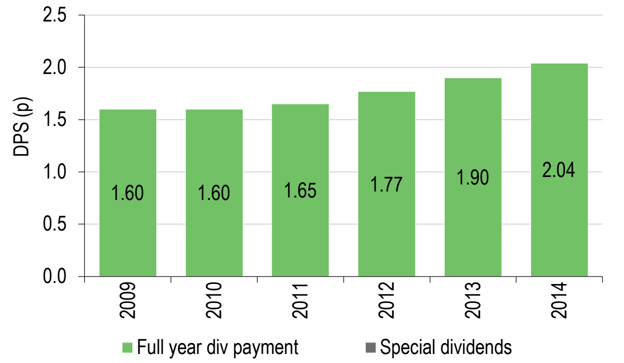
Recent developments

- 19 December 2014: Results for year to 30 Sept 2014 – NAV total return -5.8% vs S&P/TSX Energy index +9.8%, WTI Crude Oil -11.0%.
- 18 December 2014: 0.42p Q115 dividend declared; in line with Q114.
- 18 September 2014: 0.78p Q414 dividend declared; FY14 total dividend +7.3% to 2.04p.

Forthcoming		Capital structure		Fund details	
AGM	18 March 2015	Ongoing charges	2.84%	Group	New City Investment Managers
Interim results	June 2015	Net gearing	20.9% at 31 Jan 2015	Managers	Will Smith, Ian Francis
Year end	30 September	Annual mgmt fee	1.375% of gross assets	Address	5th Floor, 33 Chester Street, London SW1X 7BL UK
Dividend paid	Quarterly	Performance fee	20% above 8% pa hurdle		
Launch date	February 2008	Company life	7 years	Phone	+44 (0)20 7201 6900
Continuation vote	18 March 2015	Loan facilities	Up to 35% gearing	Website	www.ncim.co.uk

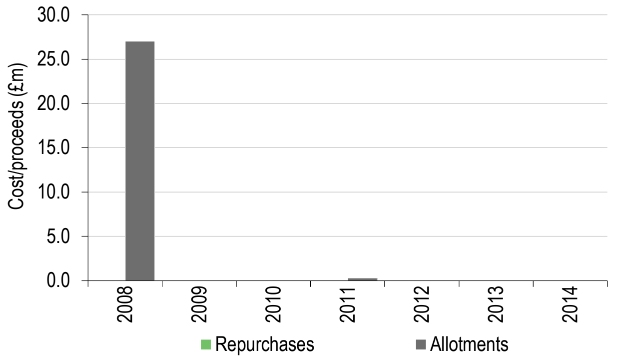
Dividend policy and history

NCE pays quarterly dividends and, while not a specific objective, has maintained or increased the level of dividend for each financial year since launch.

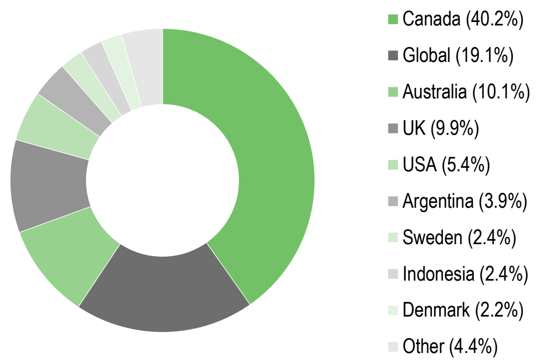


Share buyback policy and history

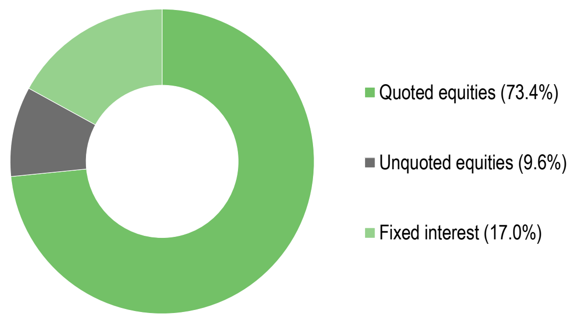
Subject to annual renewal, NCE is authorised to allot ordinary shares at a premium to NAV and to repurchase up to 14.99% of its ordinary shares.



Distribution of portfolio by geography (as at 30 September 2014)



Distribution of portfolio by type of security (as at 30 September 2014)



Top 10 holdings (as at 31 January 2015)

			Portfolio weight %	
Company	**Country**	**Security**	**31 January 2015**	**31 March 2014**
Vermilion Energy	Canada	Equity	10.5	8.1
Impact Oil & Gas	UK	Unquoted equity	6.5	N/A
ARC Resources	Canada	Equity	6.0	3.3
Crescent Point Energy	Canada	Equity	5.4	3.7
Antares Energy 10% 2023	Australia	Fixed income	5.0	2.2
REA Holding 9% Pref.	Indonesia	Equity	4.6	2.2
Northern Blizzard	Canada	Equity	4.5	N/A
Welltec 8% 2019	Denmark	Fixed income	4.0	2.1
Trafigura Beheer 7.625% Perpetual Call	Global	Fixed income	3.8	1.7
Canadian International Oil	Canada	Unquoted equity	3.8	1.7
Top 10			**54.1**	**N/A**

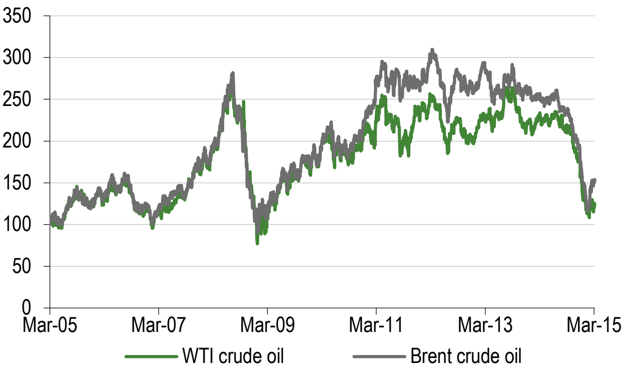
Source: New City Energy, Edison Investment Research. Note: N/A where stock not in March 2014 portfolio.

Sector outlook: Gradual oil price recovery in prospect

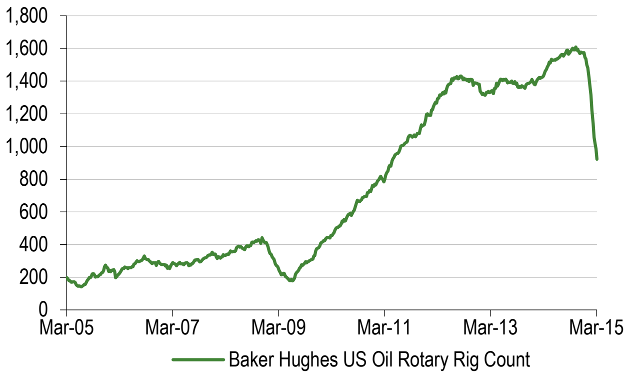
2014 was a dramatically adverse year for the oil industry, with crude oil prices seeing similar falls to those during the 2008 global financial crisis (see Exhibit 2, left-hand chart). However, in 2015, crude oil prices have stabilised with Brent crude rebounding by c 30% and market sentiment positively affected by a sharp and ongoing drop in the US oil rig count (right-hand chart). The oil majors have responded by cutting capital expenditure and US unconventional oil companies are acting rapidly to scale back production. While the 2008 price fall was demand-driven, the recent correction was also influenced by strong supply growth, driven largely by North American unconventional oil producers. With OPEC producers currently maintaining stable output levels, the greatest supply-side reaction has been from US oil producers, reflected by the 41% drop in the Baker Hughes rig count.

Exhibit 2: Oil price and drilling activity over 10 years

WTI crude oil price vs Brent crude oil price rebased



Baker Hughes rotary rig count – US oil



Source: Thomson Datastream, Baker Hughes, Edison Investment Research

Despite the sharply reduced rig count, newly completed wells continue to come on stream and US oil output may not start to decline until the second half of 2015. In addition, lower prices incentivise oil-exporting countries to push output to generate revenue, limiting the prospect of production cuts in other regions. Consequently, global output may continue to rise in the near term; only starting to diminish after further falls in the rig count and natural decline rates in existing wells come into play. In the medium term, prices could be pushed higher by a steady rise in oil demand driven by global economic growth and a lower rate of supply growth resulting from reduced capital spending by the oil majors. In its February 2015 medium-term outlook, the International Energy Agency (IEA) suggests a relatively swift rebalancing of the oil market could be followed by a gradual recovery in the oil price with the futures curve indicating a rise in the Brent crude oil price from an average US$55/bbl in 2015 to US$73/bbl in 2020, substantially below the highs of the last three years.

Market concerns have recently been raised surrounding the potential for near-term oversupply to lead to storage levels reaching capacity at the major oil distribution hub at Cushing in Oklahoma. Whether these concerns are well-founded or otherwise, while the market remains in oversupply, there is scope for fluctuating sentiment, driven by short-term data such as weekly oil inventory reports, to lead to increased volatility in the oil price and oil-related equities.

Fund profile: Focus on shale oil and gas

New City Energy (NCE) was launched in February 2008 with an initial life of seven years, subsequently subject to annual continuation vote; the next is scheduled at the March 2015 AGM. NCE's objective is to provide attractive returns principally in the form of capital growth with some prospect of income, predominantly from investing in companies involved in the exploration, development and production of energy, and related service companies. In December 2013, the board gave approval for the portfolio to focus specifically on the shale oil and gas sector. A higher yield fixed-income element of the portfolio is maintained to support the payment of dividends. The manager focuses on achieving absolute returns and performance is not benchmarked against a specific index. NCE has been managed since inception by natural resources and high-yield specialist New City Investment Managers (NCIM), owned by CQS, a global multi-strategy asset manager with US$14bn under management. The portfolio is co-managed by Will Smith and Ian Francis, who are supported by Keith Watson and Rob Crayfourd. Will Smith is primarily responsible for equity investments in the portfolio, while Ian Francis focuses on fixed-interest securities.

The fund managers: Will Smith and Ian Francis

The manager's view: Shale sub-sector offers the best prospects

Will Smith maintains his conviction that shale projects should achieve greater returns at lower risk than conventional oil and gas projects and thus offer the best investment prospects within the oil and gas industry. He is focused on lower cost producers with slower rates of decline, which he expects to be most resilient in periods of market volatility. He believes deep water exploration is fundamentally challenged by its high capital costs and relatively low success rates, and he expects service companies' margins will remain under pressure as the industry scales back capital expenditure. Within the shale sector, he prefers to invest in cash-generative producers with strong balance sheets, committed to maintaining dividend payouts. He notes the generally more conservative management style and lower gearing of Canadian producers compared with US peers, supporting his preference for the region. He emphasises the conservative gearing of NCE's top 10 holdings, of which three are ungeared, five have debt/cash flow ratios between 1.0x and 1.7x, and two have debt/cash flow ratios of 2.4x and 3.9x, the latter effectively a regulated utility.

With a rapidly changing market the manager has been active in adjusting portfolio exposures and taking some investment opportunities. The main changes have been the sale of service companies such as PHX Energy Services, and additions to holdings in producing companies expected to maintain dividend payouts such as Canadian oil producer Whitecap Resources. Another exit from the portfolio was Gran Tierra Energy, which saw the CEO resign and a strategic review initiated in February 2015. While avoiding other service companies, NCE has increased its holding in shipping company BW LPG, expecting it to enjoy elevated charter rates for the next two to three years, driven by a rise in demand for US LPG exports to Asia, a side-effect of the growth in shale oil and gas production. A number of new investment opportunities have arisen from the recent market correction and Canadian oil producer Northern Blizzard is a new addition to the portfolio. Recent share price weakness has prompted the manager to add to holdings in AJ Lucas (owns 45% of Cuadrilla Resources) and IGAS Energy, which give exposure to the developing UK shale industry.

Smith expects global oil supply and demand to be more balanced by the end of 2015 with recent production cuts by North American peripheral shale producers translating into a reduction in global supply towards the end of the year. However, he believes volatility is likely to remain a feature of the oil and gas sector over the next six months. To provide flexibility to withstand any potential short-term market correction and capitalise on investment opportunities that may arise, Smith notes that NCE's gearing has been temporarily reduced to c 12% in mid-February 2015.

Asset allocation

Investment process: Bottom-up with top-down overlay

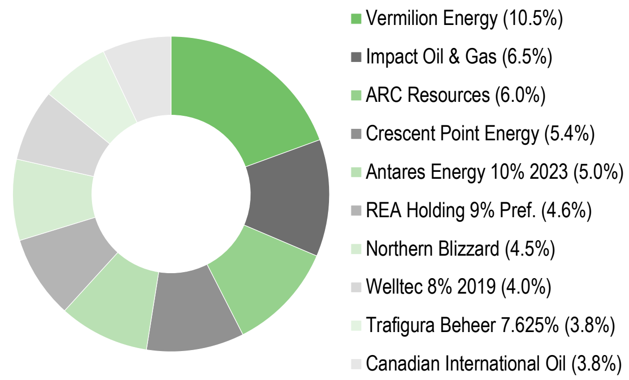
NCE's investment process is primarily based on bottom-up stock selection supported by a top-down overlay. An assessment of the macroeconomic environment through fundamental research and interaction with CQS trading teams identifies broader themes that are taken into consideration in the stock selection process, including geopolitical concerns, currency trends, market liquidity and sentiment. Additionally, sector analysis is performed addressing global demand factors to establish an asset allocation overlay. Stock selection is performed by NCIM's experienced investment team with extensive industry knowledge and is based on management meetings and detailed valuation analysis. A range of valuation metrics are considered to identify undervalued assets and valuations are stress-tested at a range of commodity price forecasts.

Current portfolio positioning

NCE's overall portfolio concentration has increased over the last 12 months with the total number of holdings declining from 63 at 31 January 2014 to 52 as at 31 January 2015, reflecting a reduction in exposure to exploration and service companies. The top 10 holdings weighting has seen a more modest change, increasing from 50% to 54%, although this can fluctuate due to differentiated performance within the portfolio and has ranged between 53% and 60% over the last six months.

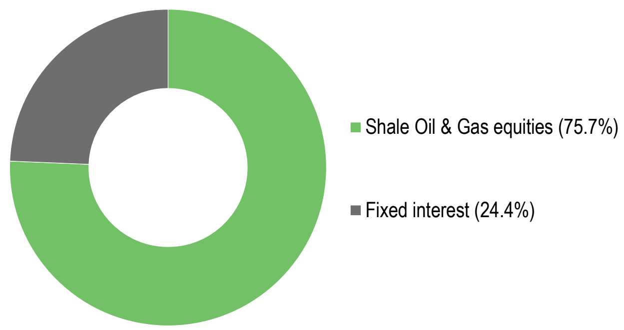
As shown in Exhibit 4, shale oil & gas equities represent 76% of the portfolio, similar to the 74% weighting at end January 2014, while fixed-income securities increased from 22% to 24% and there is no longer any exposure to non-shale oil & gas equities. The fixed-income element of the portfolio is generally kept broadly in line with gearing, although the manager indicates that fixed-income exposure has not been adjusted with the temporary reduction in gearing to c 12% in February 2015.

Exhibit 3: Top 10 holdings at 31 January 2015



Source: New City Energy, Edison Investment Research

Exhibit 4: Portfolio distribution at 31 January 2015



Source: New City Energy, Edison Investment Research

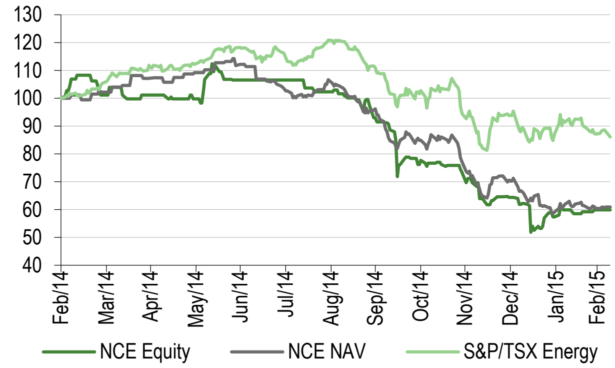
At 30 September 2014, NCE held 10 unquoted equities representing 10% of the portfolio. These are long-term investments that have been held in the portfolio for over three years. The manager confirms that unquoted securities' valuations are reviewed on a monthly basis, with the majority adjusted downwards over recent months, and indicates that they currently represent 12% of the portfolio. The majority of this exposure comes from two of the top 10 holdings, Impact Oil & Gas and Canadian International Oil, which together represent 10% of the portfolio (see Exhibit 3).

Performance: Unfavourable effect of oil price fall

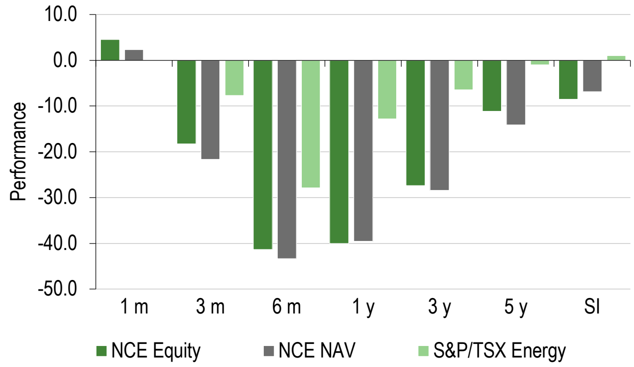
As illustrated in Exhibit 5, after making a positive start to 2014, NCE's NAV total return performance weakened significantly during the second half of the year. This can be attributed to the effect of the sharp fall in the oil price and associated negative sentiment towards North American shale oil and gas equities in particular. NCE's underperformance during this period reflects its focused exposure compared with the more broadly diversified S&P/TSX Energy index, which includes companies less directly affected by oil price movements such as oil refiners. Arguably, NCE's focus on North American oil producers makes a comparison with the WTI crude oil price of more relevance, particularly over the last 18 months. Exhibit 7 illustrates NCE's strong and steady outperformance versus WTI from launch until February 2011, which corresponds with a period of strength for small-cap resources shares. This was followed by a period of underperformance through to August 2013 with contributory factors including weakening Australian and Canadian dollars against sterling and poor performance of individual holdings exposed to conventional oil and gas exploration, uranium and coal sectors. The outperformance versus WTI since mid-2013 is a reflection of the manager's preference for more resilient income producing shale oil and gas stocks.

Exhibit 5: Investment company performance to 28 February 2015

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



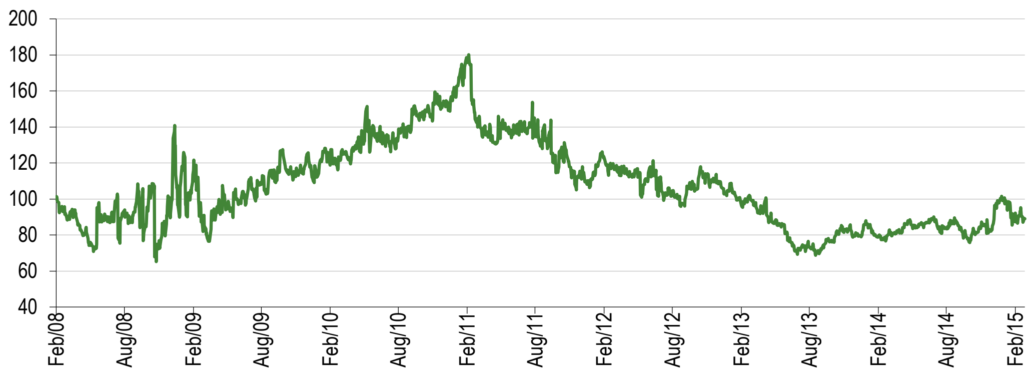
Source: Thomson Datastream, Edison Investment Research. Note: Three- and five-year and SI (since inception) performance figures annualised.

Exhibit 6: Share price and NAV total return performance, versus indices and oil price (percentage points)

	One month	Three months	Six months	One year	Three years	Five years	Since launch
Price versus S&P/TSX Energy	4.5	(11.4)	(18.7)	(31.2)	(53.2)	(41.8)	(50.3)
NAV versus S&P/TSX Energy	2.3	(15.1)	(21.4)	(30.7)	(55.2)	(50.8)	(43.5)
Price versus S&P ASX 200 Energy	(2.0)	(12.3)	(17.6)	(28.3)	(42.0)	(30.2)	(53.0)
NAV versus S&P ASX 200 Energy	(4.0)	(16.0)	(20.4)	(27.7)	(44.5)	(41.1)	(46.6)
Price versus S&P Global 1200 Sec Energy	2.2	(18.2)	(31.2)	(38.0)	(62.4)	(56.1)	(61.2)
NAV versus S&P Global 1200 Sec Energy	0.1	(21.6)	(33.5)	(37.5)	(64.0)	(62.9)	(55.9)
Price versus WTI Crude Oil	3.1	6.7	7.1	13.8	(20.4)	(10.1)	(20.4)
NAV versus WTI Crude Oil	0.9	2.3	3.5	14.8	(23.8)	(24.1)	(9.5)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-February 2015. Indices and WTI Crude Oil price returns expressed in sterling. Geometric calculation.

Exhibit 7: NAV total return performance relative to WTI crude oil price since launch



Source: Thomson Datastream, Edison Investment Research

Discount: Similar to three-year average

While NCE has annually renewed authority to repurchase and allot shares, the board has not made any commitment to maintain the discount at a particular level. Exhibit 8 illustrates that NCE's share price discount to NAV (including income) was relatively stable during the second half of 2014 when the oil price fell sharply and, apart from briefly widening to 30% in mid-January 2015, the discount has narrowed in 2015. The current discount of 15.0% is slightly narrower than the 12-month average of 16.0% and also lower than the three-year average of 17.9%.

Exhibit 8: Share price discount to NAV (including income) over three years (%)

Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

NCE has 53.6m shares in issue; unchanged over the last three years. All unexercised subscription shares were cancelled in February 2014. NCE's overdraft facility allows gearing up to a maximum 35% but, in practice, the managers aim to work to a 25% limit. Gearing averaged c 20% during the last financial year, broadly matching the portfolio's fixed income exposure. Exceptionally, the manager reduced gearing to 12/13% in February 2015 while maintaining fixed income exposure at c 20%. This should enable the fund to take advantage of investment opportunities arising over the next three to six months, during which the manager sees potential for increased market volatility.

The management fee paid to NCIM was reduced from 2.0% to 1.375% of gross assets with effect from January 2014. NCIM is also entitled to a 20% performance fee above an 8% pa hurdle subject to a high watermark provision. The ongoing charge declined from 3.35% in FY13 to 2.84% in FY14 helped by the lower management fee, which will have a full-year effect in the current financial year.

Dividend policy

While NCE's investment objective is oriented towards capital growth, the manager's preference for investing in cash-generative companies and the significant allocation to fixed interest securities result in a healthy level of income generation. The board recognises the importance of an income stream to investors and dividends are paid quarterly with three equal interim payments usually followed by a larger final payment each year. The total dividend paid has been maintained or increased in each financial year since inception (see Exhibit 1). Although income declined from 2.17p per share to 1.82p in the year to 30 September 2014, the total dividend was increased by 7.4% to 2.04p supported by revenue reserves that equated to 6.52p per share at the year end. It is understood that the board is prepared to utilise revenue reserves to maintain the dividend, as long as the manager can provide clear sight to a covered dividend. The first interim dividend of the current financial year was maintained at 0.42p.

Peer group comparison

Exhibit 9 illustrates a comparison of NCE with a closed-ended peer group comprising the AIC specialist commodities and natural resources sector constituents excluding CEB Resources, a sub-

£1m market cap outlier, which would distort the averages. NCE's focus on shale oil and gas differs from peers, which include both diversified and focused funds across the commodities and natural resources sector. Similar to many of its peers, NCE's performance has been influenced by a significant commodity price fall in at least one of the last five years. While NCE's NAV total return is lower than the peer group average over one, three and five years, it ranks close to the median over three and five years. Excluding Tiger Resource Finance, which distorts the average, NCE's ongoing charge is modestly above the 2.66% peer group average, largely reflecting its smaller fund size. While NCE's gearing is above-average, its debt is broadly matched by investments in fixed income securities, which leaves its equity portfolio largely ungeared. NCE's dividend yield is the highest of the five dividend-paying funds in the peer group by some margin.

Exhibit 9: Commodities and natural resources sector peer group as at 9 March 2015

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Discount (ex-par)	Ongoing charge	Perf fee	Net gearing	Dividend yield (%)
New City Energy	10.9	(40.6)	(63.4)	(56.9)	(13.2)	2.84	Yes	114	10.1
Altus Resource Capital	23.0	(27.7)	(68.3)	(56.7)	(1.9)	2.39	Yes	82	
Baker Steel Resources	36.2	(56.2)	(66.4)		(25.0)	2.17	Yes	100	
BlackRock Commodities Income	95.1	(16.5)	(26.3)	(20.3)	8.0	1.46	No	103	6.7
BlackRock World Mining Trust	549.6	(29.7)	(54.1)	(47.8)	(7.0)	1.37	No	110	6.8
City Natural Resources	69.0	(19.6)	(59.3)	(42.3)	(15.5)	1.70	No	127	5.4
El Oro	32.2	8.5	(27.2)	(1.7)	(48.5)	2.23	Yes	147	7.4
Geiger Counter	14.4	(29.4)	(66.6)	(67.4)	(25.0)	2.66	Yes	112	
Global Resources	7.5	(43.4)			(64.5)	2.01	Yes	118	
Golden Prospect Precious Metals	15.9	(38.7)	(72.2)	(54.6)	(9.2)	2.37	Yes	101	
International Oil & Gas Technology	2.3	4.4	(63.4)	(69.8)	(88.5)	4.44	Yes		
Praetorian Resources	1.8	(55.9)			(55.1)	6.48	Yes	130	
RAB Special Situations	5.1	(29.1)	(67.9)	(71.9)	(36.0)	4.31	Yes	96	
Riverstone Energy	777.8	10.7			(3.8)	0.87	Yes	99	
Tiger Resource Finance	1.1	(40.3)	(66.4)	(63.6)	(37.2)	24.09	No	47	
Average	**109.5**	**(26.9)**	**(58.4)**	**(50.3)**	**(28.2)**	**4.09**		**106**	**7.3**

Source: Morningstar, Edison Investment Research. Note: TR=total return. Net gearing is total assets less cash/cash equivalents as a percentage of net assets.

The board

The board consists of four non-executive directors. David Norman (chairman), Douglas Breen and Graeme Ross were appointed in January 2008 with Craig Stewart appointed as an additional director in February 2009. Graeme Ross and Craig Stewart are also directors of R&H Fund Services (Jersey), which provides fund administration services to NCE.

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