Edison investment research

18 August 2011

New City Energy Limited

12 Months Ending	Total Share Return* (%)	Total NAV Return* (%)	Total return S&P/TSX Energy* (%)	Total return S&P/ASX 200 En* (%)	Total return FTSE AW Oil & Gas* (%)
17/08/09	(37.3)	(21.1)	(13.9)	1.7	(12.7)
17/08/10	60.1	40.0	21.6	15.0	13.2
17/08/11	10.0	4.8	5.8	4.7	10.1

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

Investment summary: Bottom up, global energy exposure

Since its launch in 2008, New City Energy Limited (NCE) has outperformed the broader global energy sector, as measured by the FTSE All World Oil & Gas Index (sterling adjusted), by 3.9% and 20.8%, in terms of price total return and NAV total return respectively. NCE pays quarterly dividends and is on track to maintain its total yearly dividend at 1.6p for the year ending 30 September 2011. The manager considers that energy will be crucial to the next decade and, against a backdrop of a diminishing supply of oil and growing energy demand, remains very bullish on the long-term outlook for oil and the energy sector in general.

Investment strategy: Diversified global energy exposure

NCE is a fund that invests globally in energy-related equities and fixed interest securities. 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

Despite the general growth in the oil price during the last two years, the manager remains very positive on the long-term outlook for the oil and gas sectors, and energy in general. The considers that the oil supply is flat while energy demand continues to expand. The manager does not expect the oil supply will be exhausted, as a high oil price will stimulate investments into alternatives, but believes that the oil price has a long way to go before viable alternatives are developed and come on stream. The manager likes uranium over the long term but considers that the Fukushima Daiichi nuclear disaster has pushed the consensus back. The manager likes thermal coal and expects strong demand from China to continue.

Valuation: Discount in line with average since launch

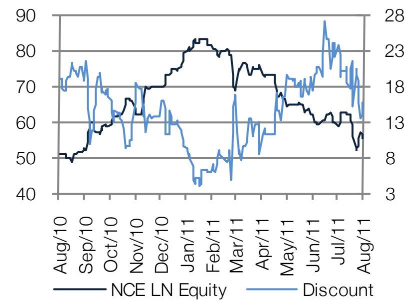
The discount based on the fully diluted NAV, currently at 15.9%, is above its one year average of 14.7%, below its three year average of 20.0% and in line with its average since launch of 15.8%. NCE offers a good yield and we believe it may be of interest to long-term investors looking for diversified global energy resources exposure.

Price	55.5p
Market Cap	£29.8m
AUM	£54.5m
NAV	66p*
Discount to NAV	15.9%*
NAV	66p**
Discount to NAV	15.9%**
Yield	2.7%

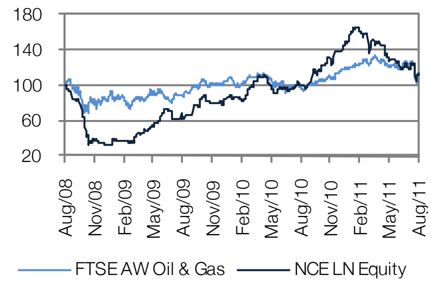
** Adjusted for debt at market value, including income and assuming no further dilution from the conversion of subscription shares. At 5 August 2011.*

*** Adjusted for debt at market value, including income and assuming full dilution from conversion of subscription shares at 70p. At 5 August 2011.*

Share price/discount graph



Three-year cumulative performance graph



Share details

Code	NCE
Listing	CISX, FULL
AIC Sector	N/A
Shares in issue	53.6m

Price

52 week	High	Low
Price	83.50p	48.75p
NAV*	89p	62p

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

Subscription share details

Code	NCEA
Subscription shares in issue	24.1m

Analyst

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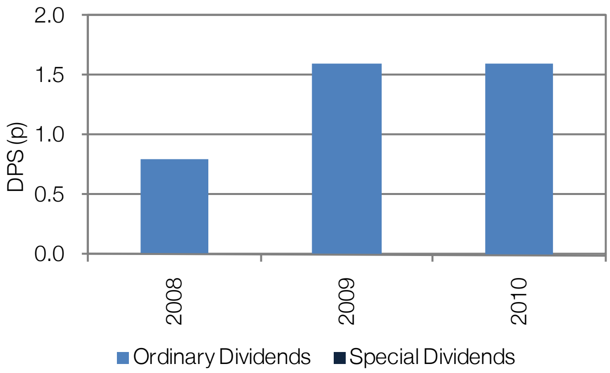
New City Energy Limited is a research client of Edison Investment Research Limited

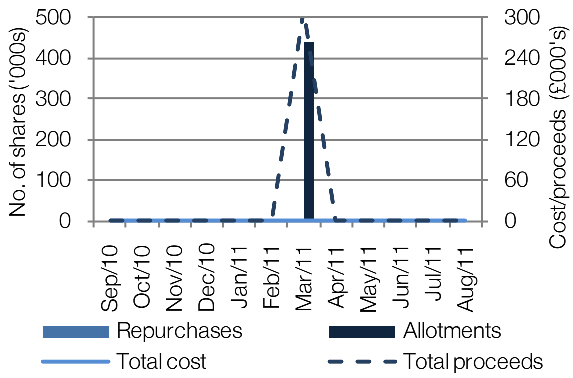
Exhibit 1: Trust at a glance

Investment objective and fund background	Developments last quarter
NCE's investment objective is to deliver returns to shareholders, principally in the form of capital growth, but with some prospect of income. NCE 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.	5 August 2011: Investment objective broadened. 30% of gross asset can be invested outside energy. 29 July 2011: Third interim dividend of 0.4p for financial year ending 30 September 2011 paid. 29 June 2011: Interim report released.

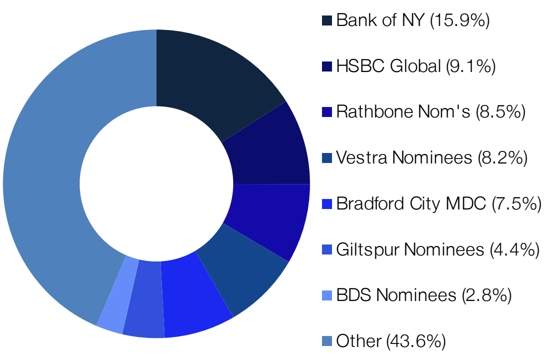
Forthcoming		Capital structure		Fund details	
AGM	March 2012	Total expense ratio	5.08%	Group	New City Investment Managers
Preliminary	December 2011	Net Gearing	29.9%	Manager	Merfyn Roberts, W Smith, J Wong
Year end	30 September	Annual mgmt fee	See Pg. 7	Address	New City Investment Managers, 5th Floor, 33 Chester Street, London SW1X 7LB
Dividend paid	Quarterly	Performance fee	See Pg. 7		
Launch date	February 2008	Trust life	Indefinite	Phone	020 7201 6900
Wind-up date	See Pg. 7	Loan facilities	See Pg. 7	Website	www.ncim.co.uk

Dividend policy and history	Share buyback policy and history
Quarterly dividends paid in January, April, July and October. Current policy is to maintain the quarterly dividend at 0.4p.	NCE's articles permit it to both allot and repurchase its ordinary shares.

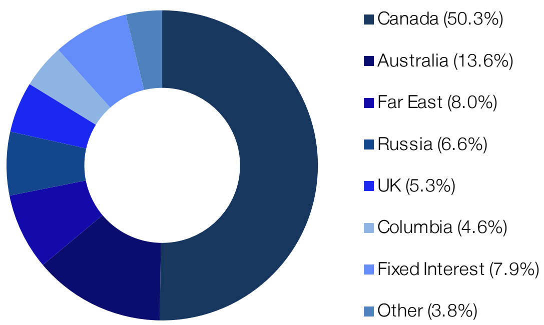




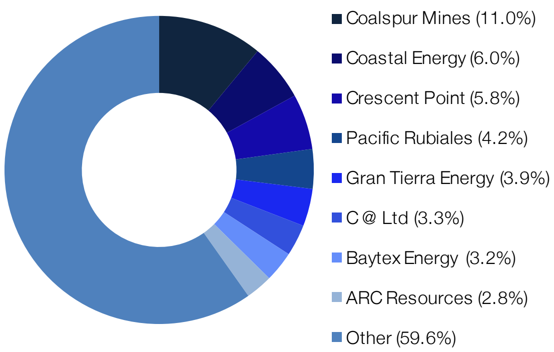
Shareholder base (as at 27 July 2011)



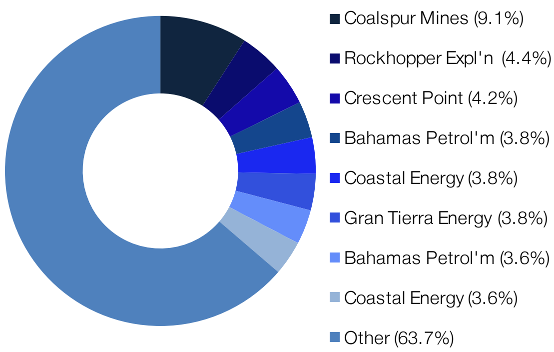
Geographic distribution of portfolio (as at 31 July 2011)



Portfolio composition (as at 31 July 2011)



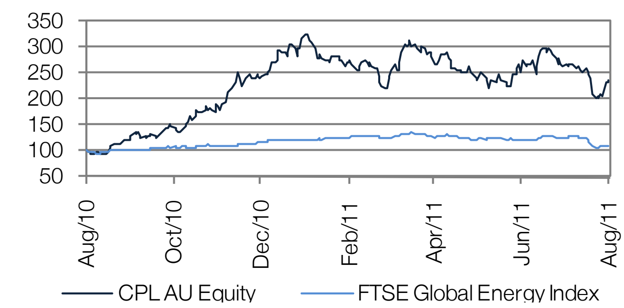
Portfolio composition (as at 31 January 2011)



Sources: New City Energy, Edison Investment Research

Exhibit 2: Top five holdings at a glance

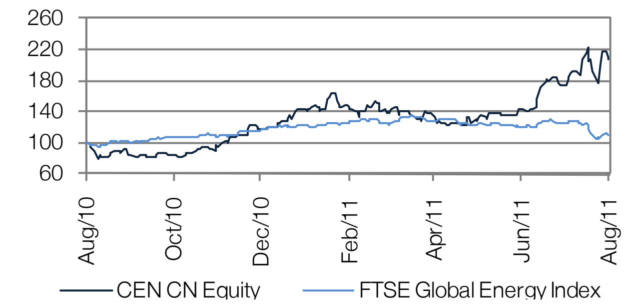
Coalspur Mines	Code: CPL AU	Market cap: A$898.6m



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

Based in Australia, Coalspur Mines (CPL) is engaged in the exploration and development of its Vista Coal Project (VCP) in Alberta, Canada. The VCP leases cover c 8.7k hectares and contains a JORC coal resource of c 906 million tonnes of low sulphur, high volatile, bituminous C thermal coal. CPL also has leases covering c 19.6k hectares in the Vista South Project.

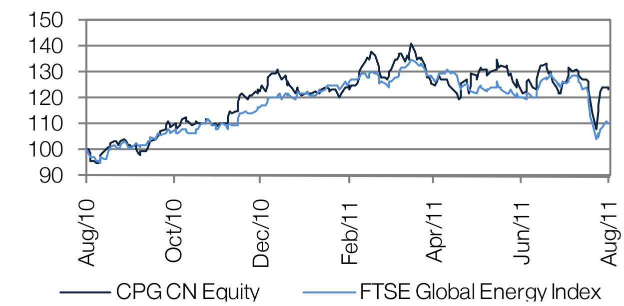
Coastal Energy	Code: CEN CN	Market Cap: C$1,155.2m



Div Yield (trail. 12 months)	N/A
Industry/Sector	Oil Comp/Exploration & Production
Listing	Canada – TSX, UK – 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 December 2010, CEN had proven plus probable reserves of 51.0mmboe. As at 30 June 2011, management estimate exploration had added an additional 61.7mmboe. CEN currently has 10,000boe/d average production.

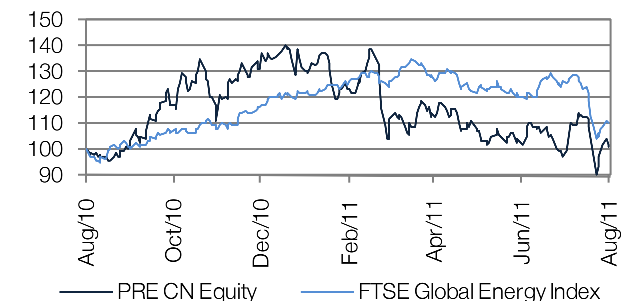
Crescent Point Energy	Code: CPG CN	Market cap: C$11,805.3m



Div Yield (trail. 12 months)	6.38%
Industry/Sector	Oil Comp/Exploration & Production
Listing	Canada – TSX
Website	www.crescentpointenergy.com

Crescent Point Energy (CPG) acquires, develops and holds interests in petroleum and natural gas assets. CPG 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.

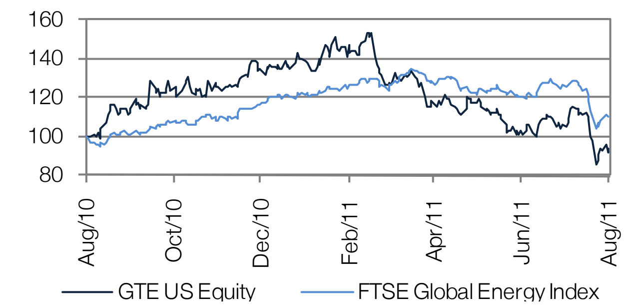
Pacific Rubiales Energy	Code: PRE CN	Market cap: C$6,918.8m



Div Yield (trail. 12 months)	1.08%
Industry/Sector	Oil Companies/Integrated
Listing	Canada – TSX, Colombia – BVC
Website	www.pacificrubiales.com

Pacific Rubiales Energy (PRE) is the largest independent oil and gas exploration and production company in Colombia. As at 31 December 2010, PRE had net production of c.85,000 boe/d, after royalties, with working interests in 40 blocks (35 in Colombia, three in Guatemala and two in Peru). As at 30 June, an additional five blocks have been added in Colombia.

Gran Tierra Energy	Code: GTE US	Market Cap: US$1,524.3m



Div Yield (trail. 12 months)	N/A
Industry/Sector	Oil Comp/Exploration & Production
Listing	NYSE – Amex
Website	www.grantierra.com

Incorporated in the US and headquartered in Canada, Gran Tierra Energy (GTE) is an independent energy company focused on the exploration, development and production of oil and gas projects in South America. As at April 2011 GTE had total net production, after royalties, between 17,500 and 19,000boe/d. 96% of this production was light oil.

Sources: New City Energy, Bloomberg, Thomson Datastream, Edison Investment Research

Fund profile

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 Limited Partnership, although day to day management has been delegated to the investment advisor, New City Investment Management (NCIM), since launch. Merfyn Roberts is the primary manager and is assisted by Will Smith and John Wong. NCE has no formal benchmark and is listed on both the Channel Islands Stock Exchange and the London Stock Exchange. On 5 August 2011, the investment objective was broadened to allow up to 30% of gross assets to be invested in companies operating outside of the energy sector.

The fund manager: Merfyn Roberts

Manager's view

Despite a generally strong performance during the last two and a half years, the manager remains hugely bullish on the long-term outlook for oil and the energy sector in general. The following are key themes currently employed in the management of the portfolio:

- 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. As such, reserves have been exploited to the point that capacity in the market is not expanding. New production is purely replacing that which is being lost in the Middle East. Against this backdrop energy demands are ever increasing, particularly from emerging economies. The manager considers that, over the longer term, these factors will stimulate the oil price and so the manager is a long-term oil bull.
- The manager expects that oil will never be exhausted as high oil prices will stimulate investment in alternatives. However, the oil price is expected to move up substantially before alternatives come on stream, particularly given the relative strength of the oil lobby.
- Compared to oil, natural gas is relatively abundant. However, there is currently a dislocation between oil and natural gas prices. Gas markets, and thus prices, are predominantly local in nature, although as infrastructure develops these can be expected to become increasingly global.
- The manager considers that nuclear power will be key to meeting future energy demand and still likes uranium as a long-term asset class, but believes that Fukishima has pushed the process back.
- Despite a strong performance, during the last two years, the manager likes metallurgical coal and expects demand from China to remain strong.
- The manager holds the view that many major currencies are under pressure and that loose monetary policy has created a fear of inflation. The manager considers that quantitative easing will ultimately lead to inflation and that, in this environment, the relatively inelastic demand for oil and gas means that these stocks serve as a natural hedge. In addition, with a substantial proportion of assets based overseas, NCE represents a strong play for those looking to diversify outside the pound.
- The manager likes management teams that are "sensible stewards of the business and shareholder capital". He prefers companies that look to avoid equity dilution and are prepared to use debt financing as an alternative.

- The manager favours companies that have solid balance sheets, offer growth potential and have a strong capacity to pay dividends.

Asset allocation

Investment process

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 that 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 geographical or sectoral allocation targets or with reference to those of the underlying benchmark. Instead, the New City team focuses its efforts on the fundamental analysis of investment opportunities, meeting, on average, 10 energy companies a week. 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. It is not currently NCE's policy to attempt to hedge currency exposure, and so NCE is exposed to currency risk.

Overview

The overall portfolio is a diversified pool of 81 equity, six fixed income and eight warrant positions. The top eight equity holdings, account for 40.2% of net assets, fixed income accounts for 7.9% of net assets, while the warrant exposure, at 0.2%, is negligible. The remaining 71 equity investments and other net assets, account for 51.7% of net assets. Exhibit 3 illustrates NCE's sectoral allocations as at mid March 2011. Reflecting NCE's mandate the portfolio had a substantial allocation to global oil and gas stocks of 65.8%. Canadian royalty trusts, which provide NCE with income, accounted for 17.7%.

Sectoral allocation

Exhibit 3: Sector allocations, as at mid March 2011

	Trust weight (%)
Oil & Gas (Canadian Listed)	25.8
Oil & Gas (UK Listed)	20.0
Canadian Royalty Trusts	17.7
Coal	12.9
Oil & Gas (Australian Listed)	12.4
Oil & Gas (Other)	7.6
Uranium	3.6
Total	100.0

Sources: New City Energy

Top holdings

Exhibit 4: Eight largest equity holdings as at 31 July 2011

Notes: FTSE Global Energy one-year performance to 17 August 2011 (sterling adjusted) = 10.1%.

Holding		One-year total return price performance (%)	Performance relative to FTSE Global Energy Index (%)
Coalspur Mines	11.0	137.7	127.7
Coastal Energy	6.0	106.2	96.1
Crescent Point Energy	5.8	23.6	13.5
Pacific Rubiales Energy	4.2	1.3	(8.7)
Gran Tierra Energy	3.9	(5.9)	(16.0)
Exillon Energy	3.3	1125.0	1115.0
Baytex Energy	3.2	52.6	42.6
FAR	2.8	27.4	17.3
Total	40.2		

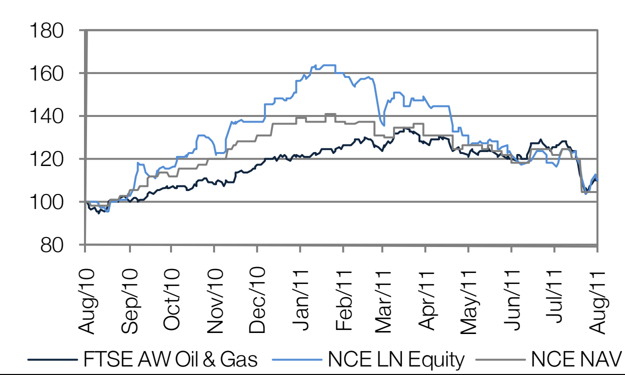
Sources: New City Energy, Thomson Datastream, Edison Investment Research

The FTSE All World Oil & Gas Index has risen 10.1%, on a total return sterling adjusted basis, during the 12 months to 17 August 2011. As Exhibit 4 shows, six of NCE's top eight holdings have outperformed the FTSE All World Oil & Gas Index during this period. Relative to the S&P/TSX Energy Index, S&P/ASX 200 Energy Index and S&P Global 1200 Energy Index, six of NCE's top eight holdings have also outperformed all of these indices during the same period.

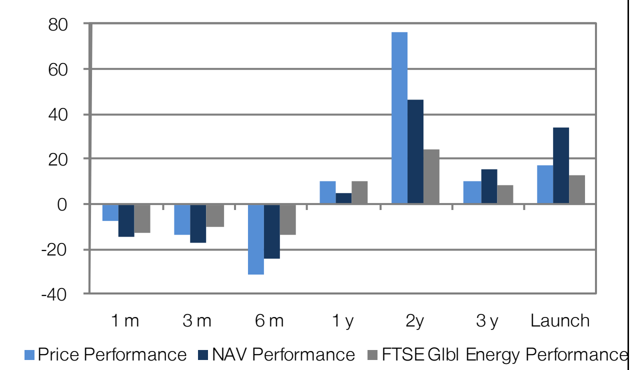
Recent performance

Exhibit 5: Investment trust performance

Price, NAV & benchmark total return perf., one year rebased



Price, NAV & benchmark total return performance (%)



Sources: New City Energy, Datastream, Edison Investment Research

As Exhibits 5 and 6 illustrate, NCE has outperformed the FTSE All-World Oil & Gas Index, in terms of price total return, over the one-month, two-year and three-year periods and since its launch in February 2008. In terms of NAV total return performance, NCE has outperformed the FTSE All-World Oil & Gas Index over two-year and three-year periods.

Exhibit 6: Share price and NAV total return performance (sterling adjusted), relative to benchmarks

	1 month	3 months	6 months	1 year	2 years	3 years	Launch
Price relative to S&P/TSX Energy	4.5	(2.8)	(13.6)	4.2	47.5	(0.3)	1.0
NAV relative to S&P/TSX Energy	(2.3)	(7.0)	(7.0)	(1.1)	18.0	4.9	17.8
Price relative to S&P/ASX 200 Energy	0.8	0.7	(18.0)	5.3	55.8	(11.9)	(35.4)
NAV relative to S&P/ASX 200 Energy	(6.0)	(3.6)	(11.4)	0.1	26.3	(6.7)	(18.6)
Price relative to FTSE AW Oil & Gas	5.3	(3.6)	(17.5)	(0.0)	51.6	1.9	3.9
NAV relative to FTSE AW Oil & Gas	(1.5)	(7.9)	(10.9)	(5.3)	22.1	7.1	20.8
Price relative to S&P Global 1200 Energy	5.2	(4.0)	(17.5)	(2.6)	49.0	(1.0)	0.5
NAV relative to S&P Global 1200 Energy	(1.6)	(8.2)	(10.9)	(7.9)	19.5	4.3	17.3

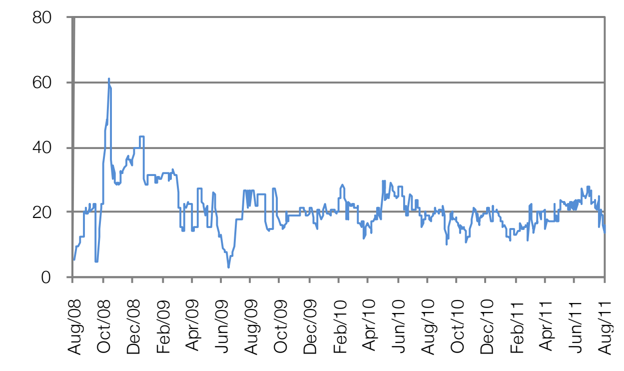
Source: Thomson Datastream, Edison Investment Research

Discount

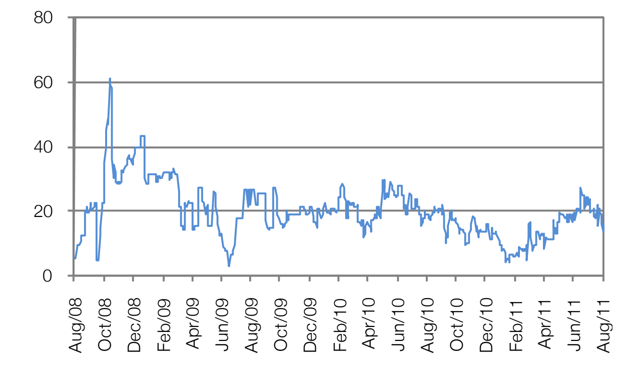
NCE has the authority to both allot and repurchase shares, which provides the manager with a mechanism to influence the discount. However, an explicit commitment to maintain the discount at a particular level has not been provided. Since its launch in February 2008, NCE has not used the repurchase authority and the allotment authority has been used three times. The first allotment occurred in May 2008, to address post launch demand for NCE's shares, and the second and third allotments occurred in March 2010 and March 2011, following conversion of NCE's subscription shares. Exhibit 7 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. Prior to September 2010, the two graphs are identical. 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 19.8%, NAV calculated in par value terms, and 17.8%, 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 the potential for dilution should these rise again. The discount based on the fully diluted NAV is currently at 15.9%. This is above its one-year average of 14.7% and below its two-year, three-year and since launch averages of 17.8%, 20.0% and 15.8% respectively.

Exhibit 7: Discount since launch

Assuming all outstanding subscription shares remain unexercised.



Assuming all outstanding subscription shares are exercised.



Sources: Thomson Datastream, Edison Investment Research

Capital structure

NCE has a conventional structure with two classes of security in issue, nil par value ordinary shares and nil 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 subscription price of 70p. There is one subscription date per 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. The first conversion was completed in March 2010 under which NCE allotted 3,000 ordinary shares raising proceeds of £2.1k. The second conversion, in March 2011, saw NCE allot 444k ordinary shares raising proceeds of £310k. The low level of conversion, at the first conversion, reflects that the subscription shares were substantially out of the money (in both price and NAV terms) and the ordinary shares were trading at a moderately high discount. NCE's ordinary share closing price on 26 February 2010 was 45.25p, NCE's NAV was 60p and so NCE was trading at a discount of 24.6%. By comparison, on 17 March 2011, NCE's closing price was 69p, NCE's NAV was 83p and so NCE was trading at a discount of 16.9%. As such, converting subscription shares, rather than purchasing the ordinary shares directly, became relatively more compelling when the second conversion opportunity fell due.

NCE's articles of association permit the use of gearing and, accordingly, NCE has a bank borrowing facility with Credit Suisse that can be used for this purpose. As at 31 July 2011, NCE had net gearing of 29.9% of net assets. The management fee, paid monthly in arrears, is 2.0% per annum 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 annum hurdle rate. This performance fee is subject to a high watermark provision. No performance fee was accrued for the years ended 30 September 2008 or 2009. However, a performance fee of £1.5m was accrued for the year ended 30 September 2010. The total expense ratio (TER), inclusive of performance fees, was 5.08% for the year ended 30 September 2011 (1.33% for the year ended 30 September 2009). Excluding performance fees the 2010 TER was 1.85% (2009 = 1.33%). The investment management contract, with CQS Cayman, can be terminated at a 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

Dividends are paid quarterly. For any given complete financial year, the first, second, third and fourth interim dividends are paid in January, April, July and October respectively. Since launch, NCE's dividend policy has been to maintain the quarterly dividend at 0.4p. As such, for the year ending 30 September 2010 STS paid a total dividend of 1.6p (2009 = 1.6p) and is on track to do the same for the current financial year. The investment management fee and other expenses are charged fully against the capital account which bolsters NCE's revenue reserves and provides greater flexibility in making dividend payments. As at 31 March 2011, NCE had revenue reserves equal to 4.93x last year's total dividend. As such, we expect that NCE will comfortably be able to maintain the quarterly dividend for the year ending 30 September 2011 at 0.4p while retaining considerable capacity to smooth dividends as necessary going forward.

Peer group comparison

Exhibit 8 illustrates a peer group comparison across the commodities and natural resources sector. Although there are 18 constituents (a sample is given below), the investment focuses can vary quite markedly. Within this peer group, NCE ranks 10th and eighth over the one-year and three-year periods when considering share price total return, and seventh and third over the one-year and three-year periods when considering NAV total return.

Exhibit 8: Commodities and natural resources peers, as at 17 August 2011

Company	Price performance			NAV performance		
	One year	Three year	Five year	One year	Three year	Five year
New City Energy	15.8	8.4	N/A	22.1	44.2	N/A
BlackRock New Energy	-17.1	-52.2	-32.4	-15.4	-40.7	-13.6
City Natural Resources High Yield Trust	49.6	98.9	172.7	51.0	96.3	210.6
Close Enhanced Commodities II	14.8	5.1	N/A	31.0	4.0	N/A
Ecofin Water & Power Opportunities	-3.3	-19.2	10.7	2.9	-6.6	36.0
Premier Energy & Water Trust	-4.0	-7.1	20.0	-16.9	-23.1	-2.7

Source: Trustnet, Edison Investment Research

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 3.2 years