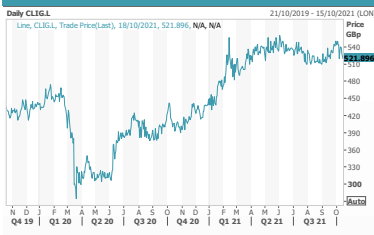




18 October 2021

Financial Services



Source: Refinitiv

Market data

EPIC/TKR	CLIG
Price (p)	520.0
12m High (p)	560.0
12m Low (p)	390.0
Shares (m)	50.7
Mkt Cap (£m)	263.5
EV (£m)	238.0
Market	LSE

Description

City of London is an investment manager, primarily using closed-ended funds to invest in emerging and other markets.

Company information

CEO	Tom Griffith
CFO	Deepnanjan Agrawal
Chairman	Barry Aling
	+44 207 711 0771
	www.clig.com

Key shareholders

George Karpus	31.5%
Aberforth Partners	7.1%
Hargreaves Lansdown	6.6%
Interactive Investor	5.0%
Barry Olliff	2.3%
Other directors & staff	10.0%

Diary

18 Oct	AGM
19 Jan	2Q FUM statement
21 Feb	Interim results
26 Apr	3Q FUM statement

Analyst

Brian Moretta 020 3693 7075
bm@hardmanandco.com

CITY OF LONDON INVESTMENT GROUP

Good performance offsets weak markets

City of London has announced its trading update for 1Q'22. After several strong quarters for global markets, they have fallen back over the past three months. Emerging markets were particularly weak, with the MSCI Emerging Markets TR Index down 8.1%. This was supplemented by ongoing rebalancing, with lagged reactions to previous strong emerging market performance. Offsetting this was good fund performance, which, in the Emerging Market, International and Opportunistic Value strategies more than offset the outflows. Outperformance was attributed to good country allocation and underlying NAV performance.

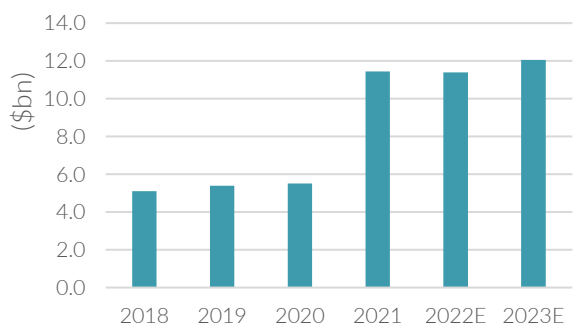
- **Operations:** Most of the operational figures are in line with previous figures. The only exception is the Karpus revenue run rate, which has dropped 1bp to 76bps of FUM p.a., although the rounding means that the actual reduction will be smaller. Cost and pre-profit share operating profit run rates are unchanged.
- **Estimates:** The weak markets have led to downgrades to our earnings estimates, with a small offset from exchange rate movements. Our 2022E underlying EPS has fallen 6%, to 48.9p, while our 2023E EPS is down 7%, to 51.6p.
- **Valuation:** Despite the recent good performance, the 2022E P/E of 13.0x remains at a discount to the peer group. The 2022E yield of 6.9% is attractive, in our view, and should, at the very least, provide support for the shares in the current markets.
- **Risks:** Although City of London has reduced its relative emerging markets exposure, it is still 47% of assets. It has proved to be more robust than some other fund managers, aided by its good performance and strong client servicing. Market volatility remains a risk, although increasing diversification is also mitigating this.
- **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. After a special dividend in FY'19, dividend increases in FY'20 and FY'21, and with the EPS boost from Karpus, the prospects for future dividend increases look very good.

Financial summary and valuation

Year-end Jun (£m)	2018	2019*	2020	2021	2022E	2023E
FUM (\$bn)	5.11	5.39	5.50	11.45	11.39	12.05
Revenue	33.93	31.93	33.26	55.12	62.21	65.03
Statutory PTP	12.79	11.40	9.41	22.25	27.25	29.02
Statutory EPS (p)	39.5	34.9	30.3	39.4	40.1	42.8
Underlying EPS (p)	39.5	34.9	38.0	50.0	48.9	51.6
DPS (p)	27.0	27.0	30.0	33.0	36.0	39.0
Special dividend (p)		13.5				
P/E (x)	13.2	14.9	17.2	13.2	13.0	12.1
Dividend yield	5.2%	7.8%	5.8%	6.3%	6.9%	7.5%

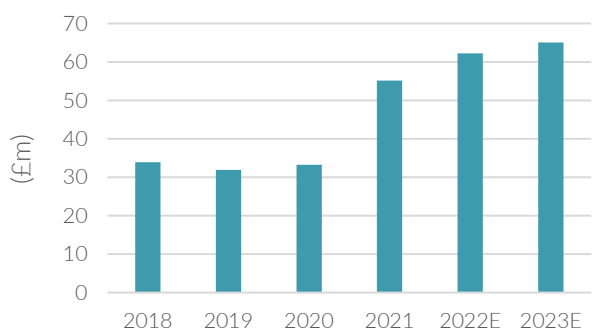
*2019 figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



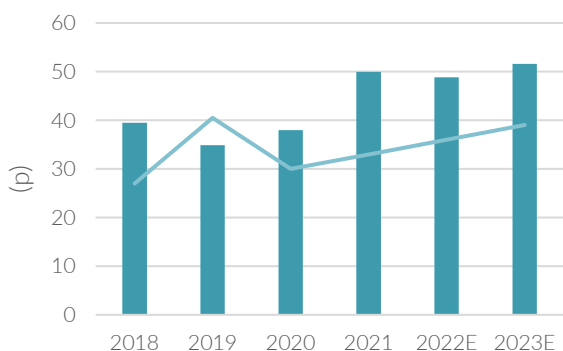
- ▶ Net inflows from 2014 to 2020 but net outflows in 2021
- ▶ Addition of Karpus in 2021 added \$3.58bn
- ▶ Market recovery since spring 2020 has more than offset sharp market fall
- ▶ Assumed steady new business flows and equity market growth of 5% p.a.

Revenue



- ▶ Revenue linked strongly to FUM
- ▶ Ongoing slow decrease in revenue margins from new business
- ▶ Karpus's revenue margin higher than City of London's
- ▶ 2021 boosted by Karpus and strong markets

Underlying EPS (bar) and DPS (line)



- ▶ Profitability maintained historically by cost flexibility
- ▶ Exceptional transaction costs reduce statutory 2020 and 2021 EPS
- ▶ Special dividend of 13.5p in 2019
- ▶ Dividend increased in 2020 and 2021; we believe our forecasts for 2022 and 2023 are conservative

Source: Company data, Hardman & Co Research

Commentary

Funds

Funds under management (FUM)				
(\$m)	Sep'21	Jun'21	Net flows	Other movements
Emerging Markets	4,937	5,393	-130	-326
International	1,840	1,880	-34	-6
Opportunistic Value	229	231	-3	1
Other	22	26	-5	1
CLIM total	7,028	7,530	-172	-330
KIM total	3,890	3,919	0	-29
Total	10,918	11,449	-172	-359

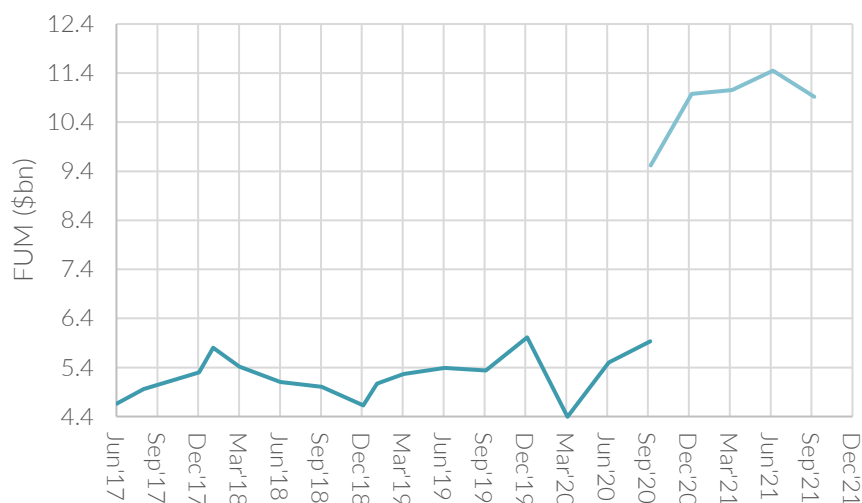
Source: Hardman & Co Research

Weak markets were the dominant feature of this quarter's movements, particularly emerging markets, which were down 8.1%. Offsetting this was good performance across the strategies. City of London cites positive contributions from country allocation and NAV performance in the underlying closed-ended funds, while discounts widened a little.

The net outflows were again mainly due to rebalancing. With emerging markets performing well over the preceding 12 months, there is a slightly delayed reaction by some clients.

The only news on new business is that the focus will be on the Emerging Market, International, Opportunistic Value and Karpus balanced mandates. City of London notes that each of these have additional capacity available, while we would add that all have good performance to markets as well.

CLIG's FUM progress since FY'18



Note: Jump at Sep'20 due to Karpus transaction; Source: Company data, Hardman & Co Research

Operations

With only a short period since the full-year results and City of London's steady operational capability, the limited figures give few surprises. The revenue run rate in Karpus has ticked down to 76bps, while CLIM's remains at 73bps. However, the run

rate for fixed costs of £1.6m per month and the operating profit before profit share of £3.3m remain the same as three months ago.

Dividends

The final dividend of 22p will be paid, subject to AGM approval, on 29 October.

Share sales

Since the full-year results, Barry Olliff has resumed his share sales. Over several transactions, he has sold 69,608 shares, at £5.50 per share. His remaining holding is 1,158,410 shares. While his specific intentions are no longer disclosed, there is an expectation that his remaining holding will be reduced in due course.

Estimate updates

The reduction in FUM has led us to reduce our forecasts, with a small exchange rate offset. Our new 2022E underlying EPS is 48.9p, a 6% reduction over our previous estimate, and our 2023E underlying EPS is 51.6p, a 7% reduction.

Financials

Summary financials						
Year-end Jun	2018	2019*	2020	2021	2022E	2023E
FUM (\$bn)	5.11	5.39	5.50	11.45	11.39	12.05
P&L (£m)						
Revenue	33.93	31.93	33.26	55.12	62.21	65.03
Expenses	21.40	21.43	21.66	31.55	34.98	36.02
Operating profit	12.53	10.50	11.60	23.57	27.23	29.00
Statutory PTP	12.79	11.40	9.41	22.25	27.25	29.02
Earnings	10.06	9.05	7.37	16.99	19.67	21.01
Statutory EPS (p)	39.5	34.9	30.3	39.4	40.1	42.8
Underlying EPS (p)	39.5	34.9	38.0	50.0	48.9	51.6
DPS (p)	27.0	40.5	30.0	33.0	36.0	39.0
Key metrics						
	2018	2019*	2020	2021	2022E	2023E
Growth						
FUM		5.5%	2.1%	108.1%	-0.5%	5.8%
Revenue		-5.9%	4.2%	65.7%	12.9%	4.5%
Operating profit		-16.2%	10.4%	103.2%	15.5%	6.5%
Underlying EPS		-11.6%	8.9%	31.5%	-2.2%	5.6%
DPS (excl. special div.)		50.0%	-25.9%	10.0%	9.1%	8.3%
Operating margins						
Net FUM fee margin	0.80%	0.76%	0.75%	0.75%	0.74%	0.74%
Operating margin	36.9%	32.9%	34.9%	42.8%	43.8%	44.6%
Tax rate	21.4%	20.6%	21.7%	23.6%	24.0%	24.0%
Dividend cover (x, excl. special div.)	1.5	0.9	1.0	1.2	1.1	1.1
Rolling 5-year cover (x, excl. special div.)	1.2	1.3	1.2	1.3	1.2	1.1
Rolling u/l 5-year cover (x, excl. special div.)			1.2	1.4	1.3	1.3
Underlying EPS sensitivity						
					2022E	2023E
No net new business						
EPS (p)					48.6	50.5
change					-0.6%	-2.2%
0% market growth (was 5% p.a.)						
EPS (p)					48.1	48.1
change					-1.6%	-6.7%

*2019 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research
£1=\$1.37

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