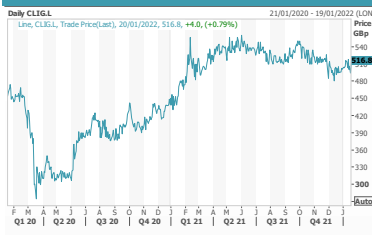




20 January 2022

Financial Services



Source: Refinitiv

Market data

EPIC/TKR	CLIG
Price (p)	506.0
12m High (p)	579.9
12m Low (p)	440.0
Shares (m)	50.7
Mkt Cap (£m)	256.4
EV (£m)	231.9
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	6.7%
Interactive Investor	5.2%
Barry Olliff	2.5%
Other directors & staff	10.8%

Diary

18 Feb	Interim results
26 Apr	3Q FUM statement
30 Jun	Year-end

Analyst

Brian Moretta +44(0)20 3693 7075
bm@hardmanandco.com

CITY OF LONDON INVESTMENT GROUP

You're so special!

City of London has announced its trading update for 2Q22. The big news, for most shareholders, will be the announcement of a special dividend of 13.5p per share. While we knew this was a possibility, we did not expect it so soon. The interim dividend has been kept unchanged from the previous year at 11p per share. City of London highlights its strong cash balance of £24.5m as of 31 December 2021, which is well in excess of both its capital and operational needs. The special dividend will cost £6.8m and still leave the company with a more-than-adequate cash balance.

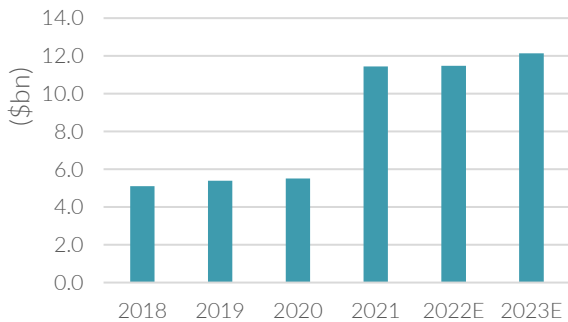
- **FUM:** The CLIM strategies all outperformed mixed markets, while the International strategy saw good net inflows of \$265m. While the other strategies saw smaller net outflows, the combined effect was to increase FUM by 2% from \$10.9bn to \$11.1bn.
- **Estimates:** The net inflows and positive performance have led to small upgrades to our earnings estimates, with an offset from lower fee rates. Our 2022E underlying EPS has risen 0.2%, to 49.0p, while our 2023E underlying EPS is up 0.6%, to 51.9p.
- **Valuation:** Despite the recent good performance, the 2022E P/E of 12.6x remains at a discount to the peer group. The 2023E yield of 7.1% 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 43% 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 maintained good investment performance and operational control, City of London is well placed to grow organically. The valuation remains reasonable. After special dividends in FY19 and FY22, dividend increases in FY20 and FY21, 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	11.47	12.13
Revenue	33.93	31.93	33.26	55.12	62.37	65.30
Statutory PTP	12.79	11.40	9.41	22.25	27.33	29.18
Statutory EPS (p)	39.5	34.9	30.3	39.4	40.2	43.1
Underlying EPS (p)	39.5	34.9	38.0	50.0	49.0	51.9
DPS (p)	27.0	27.0	30.0	33.0	33.0	36.0
Special dividend (p)		13.5			13.5	
P/E (x)	12.8	14.5	16.7	12.8	12.6	11.7
Dividend yield	5.3%	8.0%	5.9%	6.5%	9.2%	7.1%

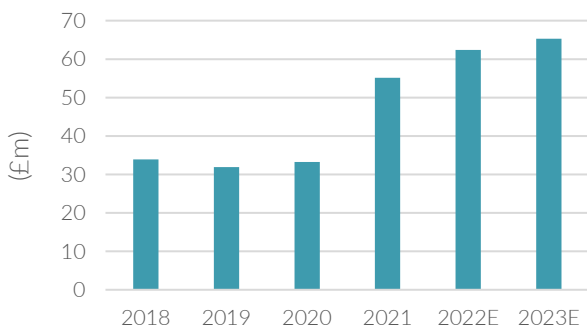
*2019 and 2022E figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



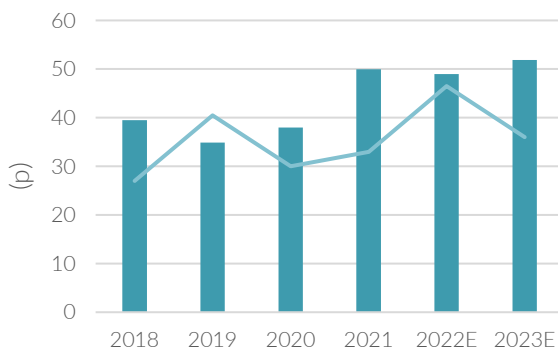
- ▶ Net inflows from 2014 to 2020, but rebalancing led to net outflows in 2021
- ▶ Addition of Karpus in 2021 added \$3.58bn
- ▶ More normal market conditions should see a return to steadier growth
- ▶ Assumed steady net new business flows and equity market growth of 5% p.a.

Revenue



- ▶ Revenue linked strongly to FUM
- ▶ Ongoing slow decrease in revenue margins from new business
- ▶ Karpus's revenue margin higher, and probably more robust, than CLIM'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 and 2022E
- ▶ Dividend increased in 2020 and 2021; we believe our forecasts for 2023 are conservative

Source: Company data, Hardman & Co Research

Commentary

Funds

Funds under management (FUM)				
(\$m)	Dec21	Sep21	Net flows	Other movements
Emerging Markets	4,800	4,937	(149)	12
International	2,147	1,840	265	42
Opportunistic Value	232	229	(4)	7
Other	22	22		0
CLIM total	7,201	7,028	112	61
KIM total	3,949	3,890	(53)	112
Total	11,150	10,918	59	173

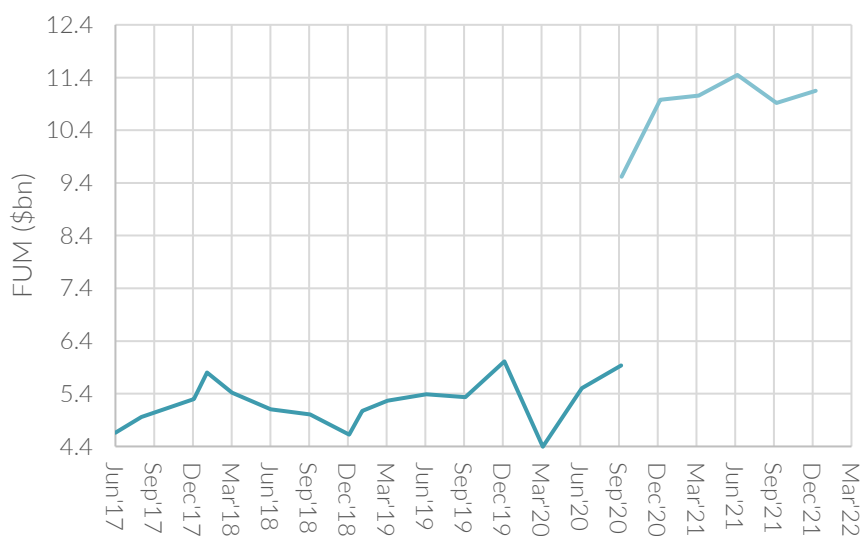
Source: Hardman & Co Research

City of London had a satisfactory quarter against a market backdrop that was mixed. The MSCI All-World Index ex US (International benchmark) was up 1.8% while the MSCI Emerging Markets net total return Index was down 1.3%. As the table shows, City of London had good relative performance with positive NAV performance and discount narrowing. Overall, the company recovered about half of the 1Q decline, which was primarily due to weak markets.

The marketing of the International strategy did well in the quarter: the net inflows of \$265m were 14% of the starting FUM for that area. There was some offset from Emerging Markets and KIM, where year-end rebalancing and tax planning led to net outflows.

As before, the new business 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 market as well.

CLIG's FUM progress since FY18



Note: Jump at Sep20 due to Karpus transaction; Source: Company data, Hardman & Co Research

Operations

With International strategy inflows generating lower margins than outflows from the Emerging Market strategy, CLIM's revenue margin continues its ongoing reduction. It is now accruing at 72bps, while KIM's is unchanged at 76bps. Monthly fixed costs and operating profit, before profit share, are also unchanged at £1.6m and £3.3m, respectively.

The estimate for profit before amortisation and taxation in the first half is £15.5m. This is an increase of 57% over the comparable period last year, although the KIM transaction was only completed half-way through that period.

City of London has also disclosed that its cash balance at the end of December 2021 was £24.5m, which is a decrease of £1m since the end of June, albeit includes the payment of the final dividend. It also has seed investments in its funds of £6.1m, which gives the company a very strong balance sheet relative to its capital and operational requirements.

Dividends

Although a special dividend is not a complete surprise, it is still a pleasant one for shareholders. The payment of 13.5p per share will be made at the same time as the interim dividend. The latter is kept at 11p per share, the same as last year. The special dividend will return £6.8m to shareholders, which will still leave a more-than-adequate cash balance. We note that, on our forecasts, a 33p dividend in this year would have cover of 1.2x compared with the statutory EPS and 1.5x when compared with the underlying EPS.

Both dividends will be payable on 25 March 2022 to shareholders on the register as at 25 February 2022.

Share transactions

Since our latest report, there have been some share purchases by executives and directors. In December, Barry Olliff acquired 100,000 shares while Barry Aling (Chairman) and Carlos Yuste (Head of Business Development) each purchased 50,000.

Estimate updates

The statement has led to some small adjustments to our forecasts. Net FUM growth is partially offset by reduced revenue margins and a slight strengthening of sterling. The net result is that our 2022E underlying EPS has been increased by 0.2% to 49.0p, while our 2023E EPS is increased 0.6% to 51.9p.

Although we were aware that a special dividend at some point was a possibility, we had not forecast one. However, we had forecast a dividend increase for 2022E. We now reduce that to a flat dividend for the full year, of 33p per share, with 2023E returning to an increase at 36p. While the special dividend will reduce the cash balance, good performance could see it grow again. We would suggest that the use of a special dividend this year emphasises City of London's conservative management in case the next year or two prove to be volatile.

Financials

Summary financials						
Year-end Jun	2018	2019*	2020	2021	2022E*	2023E
FUM (\$bn)	5.11	5.39	5.50	11.45	11.47	12.13
P&L (£m)						
Revenue	33.93	31.93	33.26	55.12	62.37	65.30
Expenses	21.40	21.43	21.66	31.55	35.05	36.14
Operating profit	12.53	10.50	11.60	23.57	27.32	29.17
Statutory PTP	12.79	11.40	9.41	22.25	27.33	29.18
Earnings	10.06	9.05	7.37	16.99	19.73	21.14
Statutory EPS (p)	39.5	34.9	30.3	39.4	40.2	43.1
Underlying EPS (p)	39.5	34.9	38.0	50.0	49.0	51.9
Total DPS (p)	27.0	40.5	30.0	33.0	46.5	36.0
Key metrics						
	2018	2019*	2020	2021	2022E*	2023E
Growth						
FUM		5.5%	2.1%	108.1%	0.2%	5.8%
Revenue		-5.9%	4.2%	65.7%	13.1%	4.7%
Operating profit		-16.2%	10.4%	103.2%	15.9%	6.8%
Underlying EPS		-11.6%	8.9%	31.5%	-2.0%	5.9%
DPS (excl. special div.)		0.0%	11.1%	10.0%	0.0%	9.1%
Operating margins						
Net FUM fee margin	0.80%	0.76%	0.75%	0.75%	0.74%	0.73%
Operating margin	36.9%	32.9%	34.9%	42.8%	43.8%	44.7%
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	0.9	1.2
Rolling 5-year cover (x, excl. special div.)	1.2	1.3	1.2	1.3	1.1	1.1
Rolling u/l 5-year cover (x, excl. special div.)			1.2	1.4	1.4	1.4
Underlying EPS sensitivity						
					2022E	2023E
No net new business						
EPS (p)					48.9	50.9
change					-0.3%	-1.8%
0% market growth (was 5% p.a.)						
EPS (p)					48.7	49.1
change					-0.7%	-5.4%

*2019 and 2022E figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research
£1=\$1.36

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