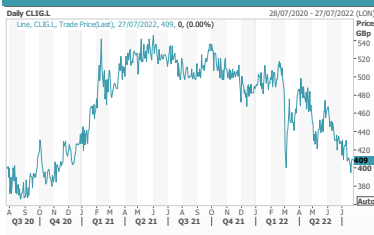




28 July 2022

Financial Services



Source: Refinitiv

Market data

EPIC/TKR	CLIG
Price (p)	409.0
12m high (p)	550.0
12m low (p)	400.0
Shares (m)	50.7
Mkt cap (£m)	207.3
EV (£m)	182.8
Country of listing	UK
Currency	GBP
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	Deepranjan Agrawal
Chairman	Barry Aling
	+44 (0)207 711 0771
	www.clig.com

Key shareholders

George Karpus	31.5%
Hargreaves Lansdown	7.3%
Aberforth Partners	6.9%
Interactive Investor	5.4%
Barry Olliff	2.5%
Other directors & staff	10.9%

Diary

19 Sep	Annual results
17 Oct	1Q FUM statement
31 Oct	AGM
4 Nov	Final dividend paid

Analyst

Brian Moretta +44 (0)203 693 7075
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CITY OF LONDON INVESTMENT GROUP

Robust profits in tough markets

City of London has announced its trading update for the final quarter of FY'22. It has been another tough quarter for fund managers, with global markets suffering significant setbacks. CLIM's two main benchmarks, the MSCI Emerging Markets Net TR Index and the MSCI All Country World Index ex US, declined 11% and 14%, respectively. Against that, it is no surprise that City of London's total FUM declined from \$10.26bn to \$9.22bn. This was helped by another quarter of net inflows, with the International strategy adding \$183m of net new assets. Against that was underperformance in most of CLIM's strategies.

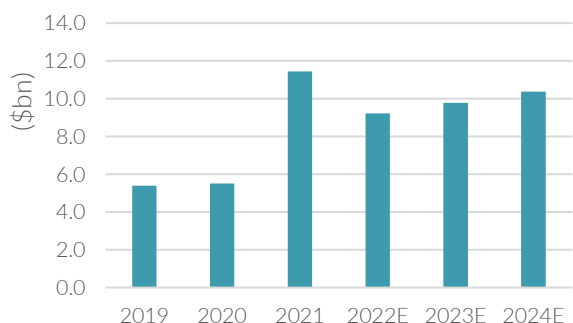
- **Operations:** City of London provided some estimated full-year figures for profitability in 2022: profit before amortisation and tax of £27.2m (£25.5m in 2021), and EPS better reflecting the full year of Karpus, with basic EPS of 37.1p (39.4p in 2021) and fully diluted EPS of 36.6p (38.8p in 2021).
- **Estimates:** The weak markets, offset by exchange rate movements, have led to downgrades to our earnings estimates. Our 2023 and 2024 underlying EPS forecasts are both reduced by 13%, from 46.9p to 40.7p and from 49.9p to 43.5p, respectively.
- **Valuation:** Despite the recent good performance, the 2023E P/E of 12.6x remains at a discount to the peer group. The 2023E dividend yield of 8.9% 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 40% 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 long-term investment performance and operational control, City of London is well-placed to grow organically. We believe the valuation remains reasonable. After recent special dividends, dividend increases, and with the EPS boost from Karpus complete, the prospects for future dividends increases may be more market-dependent.

Financial summary and valuation

Year-end Jun (£m)	2019*	2020	2021	2022E*	2023E	2024E
FUM (\$bn)	5.39	5.50	11.45	9.22	9.79	10.38
Revenue	31.93	33.26	55.12	62.32	57.75	60.69
Statutory PTP	11.40	9.41	22.25	23.10	22.00	23.80
Statutory EPS (p)	34.9	30.3	39.4	37.1	31.9	34.7
Underlying EPS (p)	34.9	38.0	50.0	45.7	40.7	43.5
DPS (p)	27.0	30.0	33.0	33.0	36.0	39.0
Special dividend (p)	13.5			13.5		
P/E (x)	11.7	13.5	10.4	11.0	12.8	11.8
Dividend yield	9.9%	7.3%	8.1%	11.4%	8.8%	9.5%

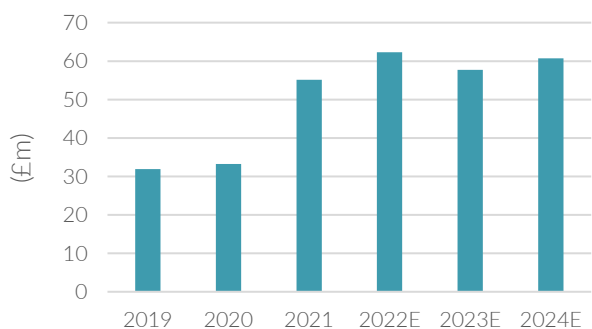
*2019 and 2022E figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



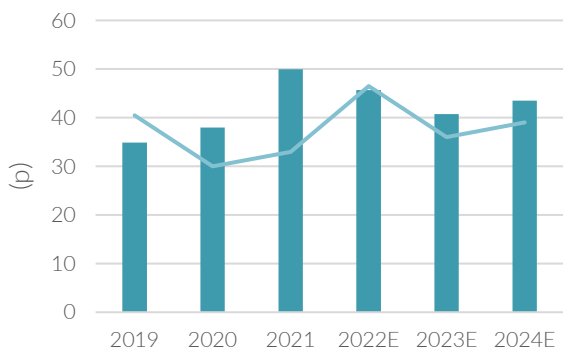
- ▶ Net inflows restored in 2022 after a weaker 2021
- ▶ Addition of Karpus in 2021 added \$3.58bn
- ▶ More normal market conditions should see a return to steadier growth
- ▶ Assumed steady net new business flows and equity market growth of 5% p.a.

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 and 2022 boosted by addition of Karpus, latter is first full year

Underlying EPS (bar) and DPS (line)



- ▶ Market movements drive changes, but profitability supported 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 - future increases subject to market conditions

Source: Company data, Hardman & Co Research

Commentary

Funds

Funds under management (FUM)				
(\$m)	Jun'22	Mar'22	Net flows	Other movements
Emerging Markets	3,703	4,221	-68	-450
International	1,812	1,950	183	-321
Opportunistic Value	193	225	-3	-29
Other	83	103	0	-20
CLIM total	5,791	6,499	112	-820
KIM total	3,433	3,766	-44	-289
Total	9,224	10,265	68	-1,109

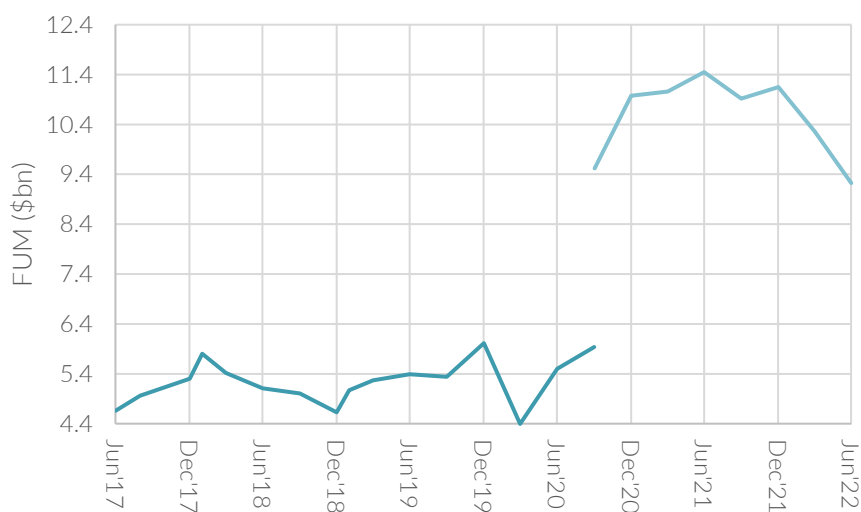
Source: Hardman & Co Research

The final quarter of the year was another tough one for fund managers, with equity markets weak globally and rising interest rates adversely affecting bonds. CLIM's two main benchmarks, the MSCI Emerging Markets Net TR Index and the MSCI All Country World Index ex US, declined 11% and 14%, respectively.

Against that backdrop, City of London did well to attract aggregate inflows of \$68m. The International strategy was again the standout, with \$183m of net inflows, 9.9% of the starting total. The Emerging Markets strategy saw ongoing rebalancing, although no real impact from the wider concerns that geopolitics are currently bringing to this area. KIM's outflows are attributed to clients reducing market exposure due to volatility.

Unfortunately, it was a weaker quarter for the performance of most of CLIM's assets. The main reason in the Emerging Markets strategy was its country allocation. In the International and Opportunistic Value strategies, NAV performance in the underlying closed-end funds was weaker. Within KIM, the equity and fixed-income strategies both outperformed, while US equity lagged.

City of London's FUM progress since FY'18



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

Operations

For the run-rate figures, there has been a strong exchange rate effect, in addition to the effects of market movements, with sterling moving from \$1.31 to \$1.22. This caused the fixed costs to tick up to £1.7m per month (from £1.6m a quarter ago). However, it has boosted revenue and offset some of the reduction in FUM. The monthly run-rate for pre-profit share and amortisation operating profit is £2.8m (£3.0m as of end-March).

City of London has provided some full-year figures for FY'22. It should be noted, when comparing with the previous year, that the FY'21 figures included Karpus for only three quarters, with FY'22 being the first full year of inclusion.

For the full year, the estimated overheads are £19.7m (£16.8m in 2021). PBT before amortisation is estimated at £27.2m, almost unchanged on the previous year if the merger costs are removed. Statutory earnings are estimated at £18.1m, 6% higher than the FY'21 figure of £17.0m.

Basic and fully diluted EPS, which reflect the full year of Karpus, both declined 6%, to 37.1p and 36.6p, respectively (39.4p and 38.8p, respectively, in 2021). The numbers also reflect the weak markets that we have seen in the past six months, and the basic EPS is 3% behind our April estimated figure.

Dividend

The proposed final dividend for the year is 22p. While this is unchanged on 2021, the special dividend means the payout for the year will be 46.5p, compared with 33p in 2021. This will take the five-year rolling cover, excluding special dividends, to 1.22x, which is almost exactly in line with the 1.2x target.

Estimate updates

The reduction in FUM has led to further downgrades to our estimates, although they have been somewhat mitigated by the strengthening of the US Dollar. To remind readers, almost all City of London's revenue is in US Dollars, but this is the case for only two thirds of its expenses.

The net result is that our new underlying EPS estimates are 40.7p for 2023 and 43.5p for 2024, reductions of 13% for each.

Financials

Summary financials						
Year-end Jun	2019*	2020	2021	2022E*	2023E	2024E
FUM (\$bn)	5.39	5.50	11.45	9.22	9.79	10.38
P&L (£m)						
Revenue	31.93	33.26	55.12	62.32	57.75	60.69
Expenses	21.43	21.66	31.55	36.50	35.77	36.90
Operating profit	10.50	11.60	23.57	22.87	21.98	23.79
Statutory PTP	11.40	9.41	22.25	23.10	22.00	23.80
Earnings	9.05	7.37	16.99	18.10	15.68	17.05
Statutory EPS (p)	34.9	30.3	39.4	37.1	31.9	34.7
Underlying EPS (p)	34.9	38.0	50.0	45.7	40.7	43.5
Total DPS (p)	40.5	30.0	33.0	46.5	36.0	39.0
Key metrics						
	2019*	2020	2021	2022E*	2023E	2024E
Growth						
FUM		2.1%	108.1%	-19.4%	6.1%	6.0%
Revenue		4.2%	65.7%	13.1%	-7.3%	5.1%
Operating profit		10.4%	103.2%	-3.0%	-3.9%	8.2%
Underlying EPS		8.9%	31.5%	-8.5%	-10.9%	6.9%
DPS (excl. special div.)		11.1%	10.0%	0.0%	9.1%	8.3%
Operating margins						
Net FUM fee margin	0.76%	0.75%	0.75%	0.74%	0.72%	0.72%
Operating margin	32.9%	34.9%	42.8%	36.7%	38.1%	39.2%
Tax rate	20.6%	21.7%	23.6%	24.0%	24.0%	24.0%
Dividend cover (x, excl. special div.)	0.9	1.0	1.2	0.8	0.9	0.9
Rolling 5-year cover (x, excl. special div.)	1.3	1.2	1.3	1.2	1.1	1.0
Rolling u/l 5-year cover (x, excl. special div.)		1.2	1.4	1.3	1.3	1.3
Underlying EPS sensitivity						
				2022E	2023E	2024E
No net new business						
EPS (p)					40.3	42.3
change					-1.1%	-2.8%
0% market growth (was 5% p.a.)						
EPS (p)					39.5	39.8
change					-3.0%	-8.7%

*2019 and 2022E figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research
£1=\$1.22

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