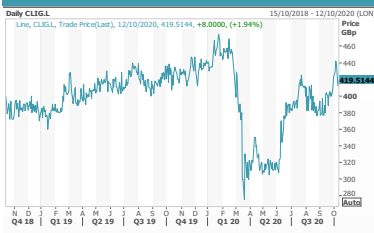




13 October 2020

Financial Services



Source: Refinitiv

Market data

EPIC/TKR	CLIG
Price (p)	406.5
12m High (p)	474.0
12m Low (p)	275.0
Shares (m)	50.7
Mkt Cap (£m)	206.0
EV (£m)	191.4
Market	LSE

Description

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

Company information

CEO	Tom Griffith
Head of Finance	Deepnanjan Agrawal
Chairman	Barry Aling
	+44 207 860 8312
	www.citlon.com

Key shareholders

George Karpus	31.5%
Directors & staff	9.5%
APQ Capital	3.2%
Other former Karpus shareholders	16.1%

Diary

19 Oct	AGM
30 Oct	Final dividend payment
19 Jan	2Q FUM statement
15 Feb	Interim results

Analyst

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bm@hardmanandco.com

CITY OF LONDON INVESTMENT GROUP

Boost from positive markets and deal completion

City of London has announced a trading statement covering its first quarter FUM and financial performance. With the Karpus merger taking place on 1 October, all figures refer to the pre-transaction entity. Markets were very supportive over the quarter, with a smaller offset from net outflows. At the quarter-end, FUM were \$5.94bn, an increase of 8% on the \$5.50bn at the financial year-end. Fund performance was good in the main strategies, with Frontier being the exception. It was also the source of the majority of the outflows, as the largest client reallocated away from the sector.

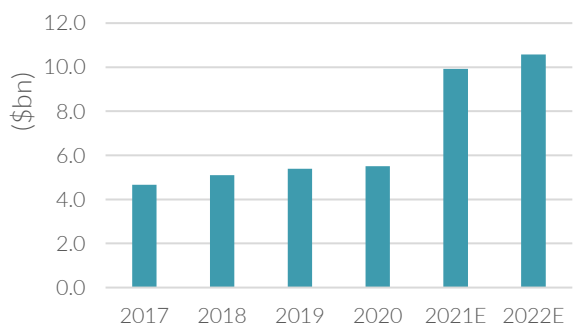
- **Operations:** Operational performance was slightly above our expectations, with revenue margin constant at 74bps and “fixed” costs still at £1.1m per month. The balance of the £1.8m exceptional expenses for Karpus (which are not tax deductible) reduced profit after tax to £1.0m for the quarter.
- **Karpus completion:** As expected, completion was on 1 October. Karpus client servicing has done a good job of getting approvals and 98% of client assets have been retained. The net result is that FUM at completion were \$3.6bn, bringing the group total to \$9.5bn.
- **Valuation:** The 2021E P/E of 9.5x is at a discount to the peer group. The underlying 2021E yield of 8.1% is attractive, in our view, and should, at the very least, provide support for the shares in the current markets.
- **Risks:** Although emerging markets can be volatile, City of London has proved to be more robust than some other EM fund managers, aided by its good performance and strong client servicing. Further EM volatility could raise the risk of such outflows, 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, FY'20 saw another dividend increase. With the expected EPS boost from Karpus in 2021, the prospects for future dividend increases look very good.

Financial summary and valuation

Year-end Jun (£m)	2017	2018	2019*	2020	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	5.51	9.93	10.58
Revenue	31.29	33.93	31.93	33.26	52.91	62.07
Statutory PTP	11.59	12.79	11.40	9.41	24.34	32.12
Statutory EPS (p)	36.9	39.5	34.9	30.3	42.8	50.5
DPS (p)	25.0	27.0	27.0	30.0	33.0	36.0
Special dividend (p)			13.5			
P/E (x)	11.0	10.3	11.6	13.4	9.5	8.1
Dividend yield	6.2%	6.6%	10.0%	7.4%	8.1%	8.9%

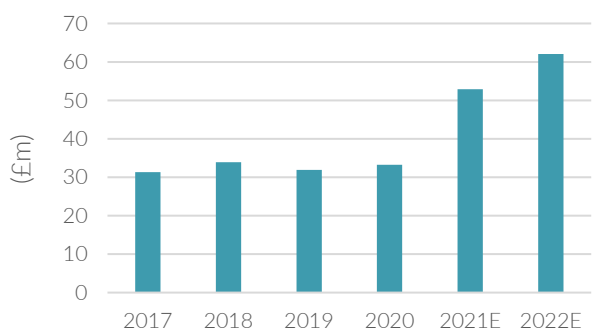
*2019 figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



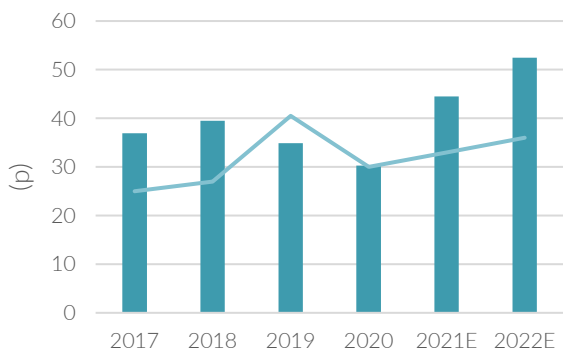
- ▶ Net inflows since 2014
- ▶ Addition of Karpus in 2021
- ▶ Market recovery in 2Q has offset the 1Q market fall
- ▶ Assumed steady new business flows and market growth of 5% p.a.

Revenue



- ▶ Revenue linked strongly to FUM
- ▶ Ongoing decrease in revenue margins from new business
- ▶ Karpus revenue margin higher than City of London's
- ▶ 2020 growth affected by volatile markets and reduction of revenue margins

EPS (bar) and DPS (line)



- ▶ Profitability historically maintained by cost flexibility
- ▶ Exceptional transaction costs affect 2020 and 2021E
- ▶ Special dividend of 13.5p in 2019
- ▶ Dividend increased in 2017, 2018 and 2020; we believe our forecasts for 2021 and 2022 are conservative

Source: Company data, Hardman & Co Research

Commentary

Funds

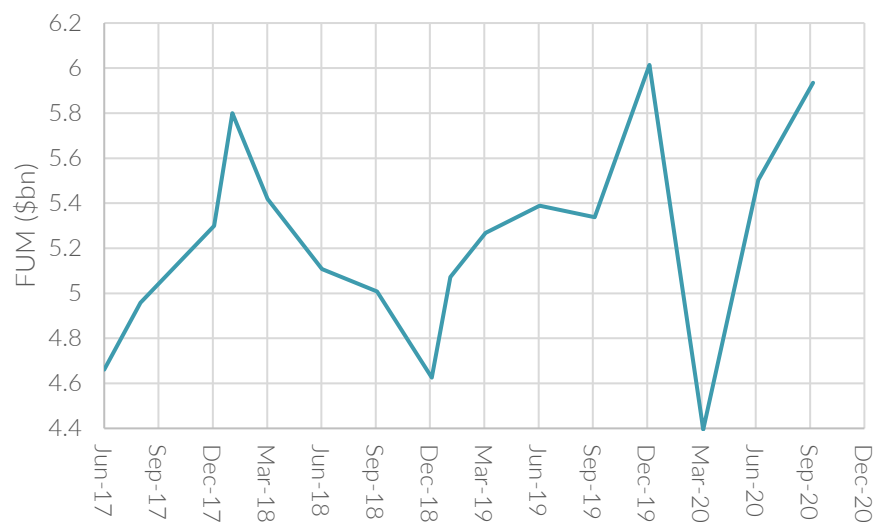
Funds under management (FUM)				
(\$m)	Sep'20	Jun'20	Net flows	Other movements
Emerging Markets	4,240	3,828	39	373
International	1,355	1,244	-10	121
Opportunistic Value	268	256	-5	17
Frontier Markets	72	175	-107	4
Total	5,935	5,503	-83	515

Source: Hardman & Co Research

There were small flows in the main strategies this month, with EM receiving inflows equivalent to 1% of its assets, while International and Opportunistic Value saw outflows of 1% and 2%, respectively. Unfortunately, Frontier experienced much larger redemptions. This appears to be the largest client in the strategy, which has changed its asset allocation to remove exposure to Frontier markets. As the smallest strategy, the outflow was less than 2% of total assets, albeit these are higher margin than other strategies. The strategy had been closed to new assets, but will now be re-opened, although building up the marketing may take a little time.

Performance was also broadly good, with the three largest strategies again outperforming over the quarter. The Frontier strategy was again the exception, with discounts widening sharply.

CLIM FUM progress since FY'18



Source: Company data, Hardman & Co Research

Karpus transaction

The Karpus transaction was completed as planned on 1 October, although little financial information is available yet. While the majority of clients have consent presumed by default, a large portion required active approval. The Karpus client servicing team has been very active in obtaining this, no doubt aided by the good performance of the various strategies. Ultimately, 98% of client assets were retained. As of 30 September, and after the small client losses, Karpus had \$3.6bn of FUM and the total FUM for the group has risen to \$9.5bn.

With 24.12m shares issued to Karpus shareholders, the number in issue has increased to 50.67m.

Board

With Susannah Nicklin having stepped down, Rian Dartnell has re-joined the board as a non-executive director. He was previously on the board for five years up to 2016, when he stepped down due to external commitments. His schedule now allows him to return. It is fortunate that City of London has found such a suitable replacement at short notice.

Estimate updates

The main adjustment to our estimates has been for the greater-than-expected growth in FUM, with a smaller adjustment to expenses and tax for the exceptional expenses. We have also adjusted the tax rate for the higher rate that Karpus pays. The net result is that our 2021E EPS increases by 3% from 41.7p to 42.8p. Our 2022E EPS similarly increases 3% from 48.8p to 50.5p.

We have made no adjustment to our dividend forecast. On our current estimates, the rolling cover will be 1.3x in 2022; so, if EPS comes in line with our forecasts, then there may be scope for larger increases.

Financials

Summary financials						
Year-end Jun	2017	2018	2019*	2020	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	5.51	9.93	10.58
P&L (£m)						
Revenue	31.29	33.93	31.93	33.26	52.91	62.07
Expenses	19.79	21.40	21.43	21.66	26.78	29.96
Operating profit	11.51	12.53	10.50	11.60	26.13	32.11
Statutory PTP	11.59	12.79	11.40	9.41	24.34	32.12
Earnings	9.14	10.06	9.05	7.37	18.40	24.73
Statutory EPS (p)	36.9	39.5	34.9	30.3	42.8	50.5
DPS (p)	25.0	27.0	40.5	30.0	33.0	36.0
Key metrics						
	2017	2018	2019*	2020	2021E	2022E
Growth (%)						
FUM		9.6	5.5	2.1	80.5	6.5
Revenue		8.4	-5.9	4.2	59.1	17.3
Operating profit		8.8	-16.2	10.4	125.3	22.9
EPS		7.0	-11.6	-13.2	41.3	17.9
DPS (excl. special div.)		8.0	0.0	11.1	10.0	9.1
Operating margins (%)						
Net FUM fee margin	0.84	0.80	0.76	0.75	0.76	0.76
Operating margin	36.8	36.9	32.9	34.9	49.4	51.7
Tax rate	21.1	21.4	20.6	20.0	23.0	23.0
Dividend cover (x, excl. special div.)	1.5	1.5	0.9	1.0	1.3	1.4
Rolling 5-year cover (x, excl. special div.)	1.1	1.2	1.3	1.2	1.3	1.3
EPS sensitivity					2021E	2022E
No net new business						
EPS (p)					42.6	49.7
change					-0.4%	-1.6%
0% market growth (was 5% p.a.)						
EPS (p)					42.0	47.1
change					-2.0%	-6.7%

*2019 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research
£1=\$1.29

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