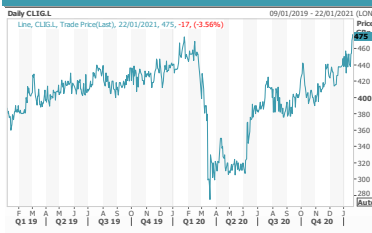




22 January 2021

## Financial Services



Source: Refinitiv

## Market data

EPIC/TKR	CLIG
Price (p)	477.0
12m High (p)	477.0
12m Low (p)	275.0
Shares (m)	50.7
Mkt Cap (£m)	241.7
EV (£m)	224.2
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
Head of Finance	Deepnanjan Agrawal
Chairman	Barry Aling
	+44 207 860 8312
	<a href="http://www.citlon.com">www.citlon.com</a>

## Key shareholders

George Karpus	31.5%
Barry Olliff	3.7%
Directors & staff	11.7%

## Diary

15 Feb	Interim results
4 Mar	Interim ex-dividend date
20 Apr	3Q FUM statement

## Analyst

Brian Moretta 020 3693 7075  
 bm@hardmanandco.com

## CITY OF LONDON INVESTMENT GROUP

## Strong markets and merger support dividend hike

City of London has announced a trading statement covering its second-quarter FUM and first-half financial performance. These are excellent, even allowing for the boost that the Karpus transaction has given. The highlight for many investors will be the interim dividend increase to 11p (from 10p in 2020), with strong profit progress and an increased cash balance of £17.5m underpinning future dividend prospects. Estimated pre-tax and pre-amortisation profit for the half-year is estimated at £9.9m, a 60% increase over the 2020 figure. Exceptional transaction costs of £1.7m give an underlying figure of £11.6m.

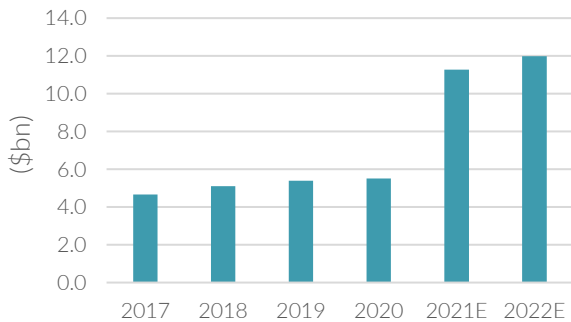
- **FUM:** In 2Q, FUM rose from \$9.52bn to £10.98bn, a 15% increase. Strong markets were the main driver, with a significant boost from good outperformance in the three main CLIM strategies. This has some offset from fund flows, as investors rebalanced.
- **Operations:** The CLIM revenue run rate continued its recent trend and ticked down to 73bps. Nevertheless, the run rate for operating profit before profit share is approximately £3.4m per month, double the rate before the merger. This is despite adverse exchange-rate movements.
- **Valuation:** Despite the recent good performance, the 2021E P/E of 10.3x remains at a discount to the peer group. The 2021E 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, a dividend increase in FY'20 and with the 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	11.27	11.98
Revenue	31.29	33.93	31.93	33.26	54.78	65.52
Statutory PTP	11.59	12.79	11.40	9.41	26.20	34.32
Statutory EPS (p)	36.9	39.5	34.9	30.3	46.2	53.9
DPS (p)	25.0	27.0	27.0	30.0	33.0	36.0
Special dividend (p)			13.5			
P/E (x)	12.9	12.1	13.7	15.7	10.3	8.8
Dividend yield	5.2%	5.7%	8.5%	6.3%	6.9%	7.5%

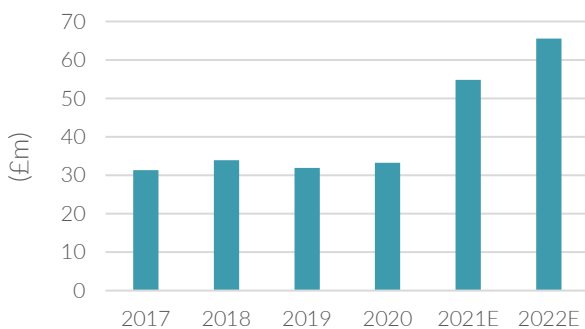
\*2019 figures include a special dividend of 13.5p; Source: Hardman &amp; Co Research

Funds under management (FUM)



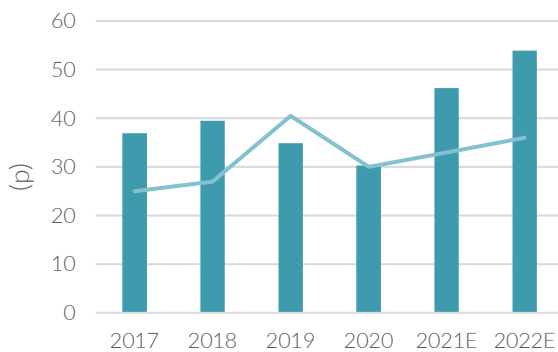
- ▶ Net inflows since 2014
- ▶ Addition of Karpus in 2021 added \$3.58bn
- ▶ Market recovery since spring 2020 has more than offset sharp market fall
- ▶ Assumed steady new business flows and market growth of 5% p.a.

Revenue



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

EPS (bar) and DPS (line)



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

Source: Company data, Hardman & Co Research

# Commentary

## Funds

Funds under management (FUM)				
(\$m)	Dec'20	Sep'20	Net flows	Other movements
Emerging Markets	5,196	4,235	-85	1,046
International	1,700	1,355	-2	347
Opportunistic Value	306	268	0	38
Other	27	82	-63	8
Karpus	3,749	3,578	-140	311
Total	10,978	9,518	-290	1,750

Source: Hardman & Co Research

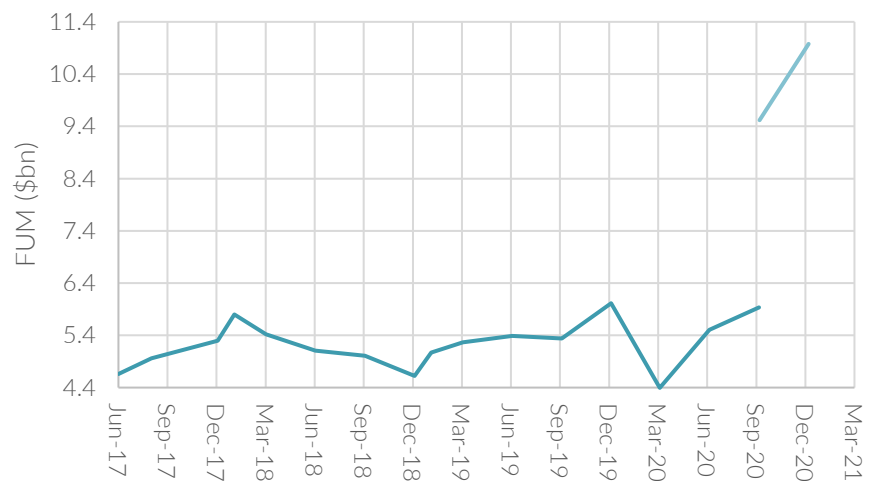
As this is the first quarter since the completion of the Karpus transaction, there are some changes in the data. Although, technically, the transaction took place in October 2020, the Karpus FUM of \$3.58bn have been included in the figures at the end of September. The smaller CLIM strategies have been consolidated into a single "Other" line, which includes Frontier and REIT.

Overall FUM grew by 15%, with market gains of 18% of starting assets being offset by outflows equivalent to 3%. This was aided by the three main CLIM strategies all significantly outperforming. Discount narrowing was the biggest influence, with positive underlying NAV performance also making a lesser contribution.

This quarter saw a return to net outflows for the EM strategy, as good performance led to further rebalancing. The main diversifying strategies saw little net move. Under Other, the Frontier strategy saw significant outflows as the anchor client finalised its withdrawal. Post the merger, EM exposure has fallen from 71% of FUM to 47%.

Karpus has a more complicated dynamic. The largest movements tend to be in the 4Q of the calendar year as investors either realise or invest prior to the end of the tax year. This year, the former was stronger, as strong gains and concerns over possible tax rises under the new Biden administration prompted tax reduction strategies, including gifting appreciated assets. Karpus has added a cash management product to improve returns on cash balances.

### CLIG FUM progress since FY'18



Source: Company data, Hardman & Co Research

## Financial progress

Following the merger, the revenue, expense and profit figures quoted are significantly larger than those previously.

The estimated pre-tax, pre-amortisation profit for the half-year is £9.9m, which includes £1.7m of exceptional merger expenses, giving an underlying figure of £11.6m. We estimate that the 1Q figure was £3.4m pre-exceptionals, giving a net PBT figure for 2Q of £8.2m. This should be a better comparison for future quarterly performance than the half-year figures, which include a mix of pre- and post-merger figures.

Within CLIM, the changes in the asset mix ticked the fee rate down from 74bps to 73bps. The current estimated run rate for operating profit, pre-profit share, is £3.4m per month, double the £1.7m given in the October statement.

The improved profitability has also improved the company's cash position, which increased from £14.6m at the end of June to £17.5m at 31 December 2020. There is an additional £4.1m of seed investments in the REIT strategy. Note, this cash increase is after the payment of the final dividend, as well as the exceptional transaction costs. Although the larger company will have a slightly higher capital requirement, most of this cash is not required for the business but provides a buffer in case of adverse market movements.

As we forecast, the interim dividend was increased by 1p to 11p. Historically, the interim dividend has been one-third of the full-year amount. While stock-market volatility could set back ongoing profits, the company would seem to have more than adequate reserves to fund our forecast increases and/or special dividends further down the line.

## Estimate updates

The main adjustment to our estimates has been for the greater-than-expected growth in FUM, with a small adjustment to expenses. This has been offset to some extent by the continued increase in sterling relative to the US dollar. The net result is that our 2021E EPS increases by 8% from 42.8p to 46.2p. Our 2022E EPS similarly increases by 7% from 50.5p to 53.9p.

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 or special dividends. Alternatively, there is some margin to protect against stock market volatility.

# Financials

Summary financials						
Year-end Jun	2017	2018	2019*	2020	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	5.50	11.27	11.98
<b>P&amp;L (£m)</b>						
Revenue	31.29	33.93	31.93	33.26	54.78	65.52
Expenses	19.79	21.40	21.43	21.66	27.49	31.22
Operating profit	11.51	12.53	10.50	11.60	27.29	34.30
Statutory PTP	11.59	12.79	11.40	9.41	26.20	34.32
Earnings	9.14	10.06	9.05	7.37	19.85	26.42
Statutory EPS (p)	36.9	39.5	34.9	30.3	46.2	53.9
DPS (p)	25.0	27.0	40.5	30.0	33.0	36.0
Key metrics						
	2017	2018	2019*	2020	2021E	2022E
<b>Growth (%)</b>						
FUM		9.6	5.5	2.1	104.8	6.3
Revenue		8.4	-5.9	4.2	64.7	19.6
Operating profit		8.8	-16.2	10.4	135.3	25.7
EPS		7.0	-11.6	-13.2	52.4	16.7
DPS (excl. special div.)		8.0	50.0	-25.9	10.0	9.1
<b>Operating margins (%)</b>						
Net FUM fee margin	0.84	0.80	0.76	0.75	0.75	0.74
Operating margin	36.8	36.9	32.9	34.9	49.8	52.4
Tax rate	21.1	21.4	20.6	21.7	23.0	23.0
Dividend cover (x, excl. special div.)	1.5	1.5	0.9	1.0	1.4	1.5
Rolling 5-year cover (x, excl. special div.)	1.1	1.2	1.3	1.2	1.3	1.3
EPS sensitivity					2021E	2022E
<b>No net new business</b>						
EPS (p)					46.1	52.9
change					-0.2%	-1.8%
<b>0% market growth (was 5% p.a.)</b>						
EPS (p)					45.8	51.0
change					-0.9%	-5.3%

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

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