CITY OF LONDON INVESTMENT GROUP

Confirming an excellent first half

City of London has announced its interim results for 1H'22. Having announced a special dividend of 13.5p in its January trading statement, the main interest was in the details. Breaking down net inflows into gross inflow and outflows showed that 2Q was a distinct improvement over 1Q. City of London believes that, once the pandemic restrictions relax, a return to in-person meetings will improve its ability to market its products. Financially, we note that the cash conversion of profits remains excellent, at 87% of underlying earnings, underpinning its strong dividend-paying capability.

- **Operations:** The IT integration after the Karpus transaction is continuing and is expected to be finished before the end of the financial year. After a decline in the importance of the Middle East in equity market indices, City of London is closing its Dubai office – with some small cost savings.

- **Estimates:** We have increased our estimates of the net inflows into the new strategies and outflows from existing strategies, pushing down fee margins. Our 2022E underlying EPS has fallen 3%, to 47.3p, while our 2023E underlying EPS is down 4%, to 50.0p. Our new 2024E EPS is 53.1p, with an estimated dividend of 39p.

- **Valuation:** Despite the recent good performance, the 2023E P/E of 12.7x remains at a discount to the peer group. The 2023E yield of 6.8% 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. We believe the valuation remains reasonable. After special dividends in FY'19 and FY'22, 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 Services

Source: Refinitiv

Market data

EPIC/TKR	**CLIG**
Price (p)	**526.0**
12m High (p)	579.9
12m Low (p)	450.6
Shares (m)	50.7
Mkt Cap (£m)	266.6
EV (£m)	243.1
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

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Key shareholders

George Karpus	31.5%
Aberforth Partners	7.1%
Hargreaves Lansdown	6.8%
Interactive Investor	5.3%
Barry Olliff	2.5%
Other directors & staff	10.8%

Diary

26 Apr	3Q FUM statement
30 Jun	Year-end

Financial summary and valuation

Year-end Jun (£m)	2019*	2020	2021	2022E*	2023E	2024E
FUM ($bn)	5.39	5.50	11.45	11.47	12.13	12.83
Revenue	31.93	33.26	55.12	62.29	65.14	68.37
Statutory PTP	11.40	9.41	22.25	26.22	27.96	29.96
Statutory EPS (p)	34.9	30.3	39.4	38.5	41.2	44.3
Underlying EPS (p)	34.9	38.0	50.0	47.3	50.0	53.1
DPS (p)	27.0	30.0	33.0	33.0	36.0	39.0
Special dividend (p)	13.5			13.5		
P/E (x)	15.1	17.4	13.4	13.7	12.7	11.8
Dividend yield	7.7%	5.7%	6.3%	8.8%	6.8%	7.4%

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

Analyst

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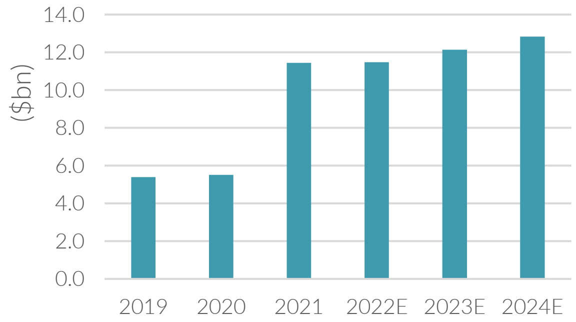
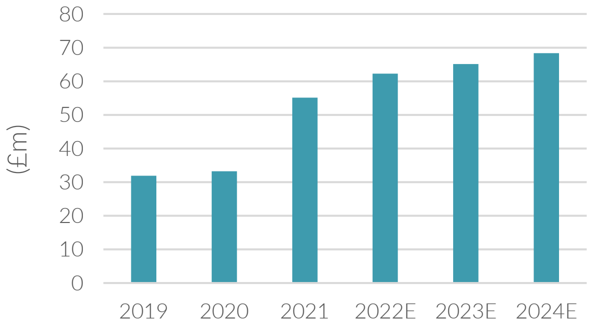
Funds under management (FUM)



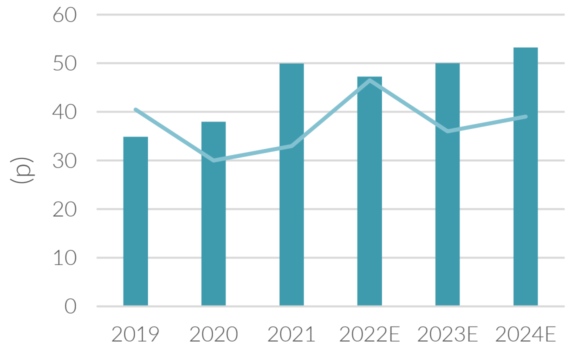
- Net inflows from 2014 to 2020, but rebalancing led to net outflows in 2021
- Addition of Karpus in 2021 added $3.58bn
- More normal market conditions should see a return to steadier growth
- Assumed steady net new business flows and equity market growth of 5% p.a.

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 addition of Karpus and strong markets

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; we believe our forecasts for 2023 are conservative

Source: Company data, Hardman & Co Research

Commentary

As usual, the headline figures were effectively announced in last month's trading statement. We will focus on the additional detail.

Funds

Funds under management (FUM)				
($m)	Dec'21	Jun'21	Net flows	Other movements
Emerging Markets	4,800	5,393	-279	-314
International	2,147	1,880	231	36
Opportunistic Value	232	231	-7	8
Frontier	13	10	-5	2
Other/REIT	13	12		-1
CLIM total	**7,201**	**7,530**	**-60**	**-269**
Karpus retail	2,830	2,804	-34	60
Karpus institutional	1,119	1,115	-19	23
KIM total	**3,949**	**3,919**	**-53**	**83**
Total	**11,150**	11,449	**-113**	**-186**

Source: Hardman & Co Research

Although the Interim report added some additional details on FUM, these mostly confirmed the patterns that we saw in the trading statement. There is a comment that some of the outflows from the Emerging Markets strategy have become inflows to the International strategy. This further confirms that the outflows from the former are more about rebalancing than dissatisfaction with the manager.

The gross figures for inflows do show some positive trends. The gross total for 2Q was $311m, a notable increase over the $124m in 1Q. Outflows also reduced from $295m to $198m. The International strategy was the largest net recipient, benefiting from the full effect of having reopened at the start of 2021. It is now 19% of the group FUM.

Clients have expressed interest in a Global product, covering US and non-US markets. City of London has seeded a new product in this area with $2.5m. This will be managed by the International team. The track record from that team's existing strategy can be used for marketing, and City of London is optimistic that the new strategy can attract assets in the next couple of years.

Within KIM, both retail and institutional business showed similar patterns. Tax considerations mean that there is usually some shuffling of assets at the end of the calendar year, which has led to net outflows.

City of London believes the inability to market in-person has constrained its growth. Both institutional and high-net-worth (HNW) businesses are relationship-driven – so this is understandable. The company expects the relaxation of pandemic restrictions to make this easier going forward.

Operations

The interim results announcement included a brief update on the business integration. The moving of CLIM and KIM to a common IT infrastructure is progressing and should be complete in this FY. While the Karpus deal was not about synergies, there could be some opportunities, as a larger entity, to negotiate better deals from IT suppliers.

CLIM has had an office in Dubai since 2007. With the Middle East gradually becoming a smaller part of emerging market and frontier indices, the need for a research base there has been diminished. The office was small, with only two members of staff, one of whom is being retained and is moving to the Pennsylvania office. The change is not enough to change our forecasts, but re-emphasises City of London's longstanding good cost management.

Finances

With the headline figures being in line with January's trading statement, we note that the comparison figures are somewhat flattered by the timing of the Karpus transaction, which was only included for one quarter in 1H'21 and both quarters in 1H'22. The figures were in line with our expectations.

We have previously noted the decline in revenue margins at CLIM. This is being driven by the growth in the lower-margin International strategy relative to the existing book in the Emerging Markets strategy. This is now 72bps, and we expect this to continue to reduce over the next couple of years.

Statutory profit after tax for the half was up 60%, to £10.6m, while statutory EPS rose 21%, to 21.5p. On an underlying basis, excluding amortisation and exceptional acquisition costs, profits after tax rose 39%, to £12.5m, while underlying EPS rose 3%, to 24.5p.

As usual, cash conversion was excellent, at 122% of statutory profits, or 89% of underlying profits. City of London highlighted, in its January trading statement, that its cash balance was now £24.5m and that it was paying a special dividend.

Estimate updates

With little additional information from January's trading statement, we have made only small changes to our estimates. The main change is to increase the expected inflows to the new strategies at CLIM to $300m p.a. and the annual outflows from the Emerging Markets strategy to $200m. This has pushed down the revenue margin in our model somewhat

The net effect is that 2022E underlying EPS has dropped slightly to 47.3p from 49.0p and 2023E underlying EPS from 51.9p to 50.0p. We have also introduced estimates for 2024, forecasting underlying EPS of 53.1p, a growth rate of 6% over the previous year. We are forecasting a 2024 dividend of 39.0p. On a five-year rolling basis, this would be covered 1.1x by statutory earnings and 1.4x by underlying earnings. While market volatility means our forecasts are unlikely to be met exactly, if they are matched, then cash balances will rise meaningfully again by the end of 2024.

Financials

Summary financials						
Year-end Jun	**2019***	**2020**	**2021**	**2022E***	**2023E**	**2024E**
FUM ($bn)	5.39	5.50	11.45	11.47	12.13	12.83
P&L (£m)						
Revenue	31.93	33.26	55.12	62.29	65.14	68.37
Expenses	21.43	21.66	31.55	36.09	37.19	38.43
Operating profit	10.50	11.60	23.57	26.20	27.95	29.94
Statutory PTP	11.40	9.41	22.25	26.22	27.96	29.96
Earnings	9.05	7.37	16.99	18.88	20.21	21.73
Statutory EPS (p)	34.9	30.3	39.4	38.5	41.2	44.3
Underlying EPS (p)	34.9	38.0	50.0	47.3	50.0	53.1
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%	0.2%	5.8%	5.7%
Revenue		4.2%	65.7%	13.0%	4.6%	5.0%
Operating profit		10.4%	103.2%	11.2%	6.7%	7.1%
Underlying EPS		8.9%	31.5%	-5.4%	5.7%	6.2%
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%	0.73%	0.72%
Operating margin	32.9%	34.9%	42.8%	42.1%	42.9%	43.8%
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	1.1	1.1
Rolling 5-year cover (x, excl. special div.)	1.3	1.2	1.3	1.1	1.1	1.1
Rolling u/l 5-year cover (x, excl. special div.)		1.2	1.4	1.4	1.3	1.4

Underlying EPS sensitivity			
	2022E	**2023E**	**2024E**
No net new business			
EPS (p)	47.2	49.2	51.6
change	-0.2%	-1.5%	-2.7%
0% market growth (was 5% p.a.)			
EPS (p)	46.9	47.3	47.6
change	-0.7%	-5.3%	-10.3%

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

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(Disclaimer Version 8 – Effective from August 2018)

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The full detail is on page 26 of the full directive, which can be accessed here: https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF

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