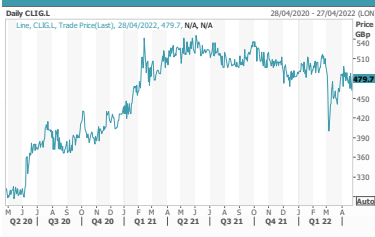




28 April 2022

Financial Services



Source: Refinitiv

Market data

EPIC/TKR	CLIG
Price (p)	484.0
12m high (p)	560.0
12m low (p)	400.0
Shares (m)	50.7
Mkt cap (£m)	245.3
EV (£m)	220.8
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	7.0%
Interactive Investor	5.4%
Barry Olliff	2.5%
Other directors & staff	10.7%

Diary

30 Jun	Year-end
19 Jul	4Q FUM statement
19 Sep	Annual results
17 Oct	1Q FUM statement

Analyst

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

Fighting the market invasion

City of London has announced its trading update for 3Q'22. It has been a tough quarter, with the Russia/Ukraine conflict leading to weakness in markets, albeit they have partially recovered from their initial reaction. Overall, FUM fell from \$11.1bn at the end of 2021 to \$10.3bn at the quarter-end, a decline of 8%. This compares with declines in the MSCI Emerging Markets total return Index of 7.0% and the MSCI All Country World ex US Index of 5.4%. CLIM saw net inflows across all the strategies, but also underperformance in each of them. KIM experienced small outflows, but positive relative performance.

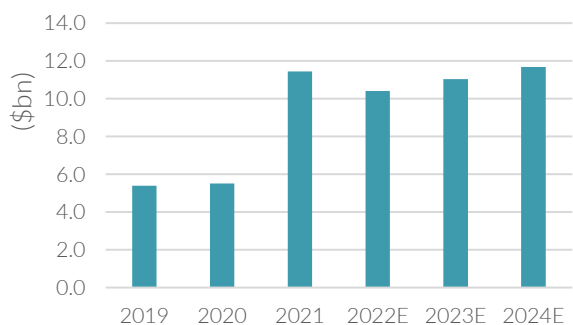
- ▶ **Board:** After the Karpus transaction took place, City of London had a board that did not fulfil current governance standards. This was kept in place to take advantage of expertise during the merger process. Changes have been announced that will shrink the board and restore an independent majority.
- ▶ **Estimates:** The weak markets and lower fee rates, offset by exchange rate movements, have led to downgrades to our earnings estimates. Our 2022E underlying EPS has decreased by 0.4%, to 47.1p, while our 2023E and 2024E underlying EPS are down 7%, to 46.9p and 49.9p, respectively.
- ▶ **Valuation:** Despite the recent good performance, the 2023E P/E of 12.7x remains at a discount to the peer group. The 2023E dividend yield of 7.4% 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 41% 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 summary and valuation

Year-end Jun (£m)	2019*	2020	2021	2022E*	2023E	2024E
FUM (\$bn)	5.39	5.50	11.45	10.41	11.03	11.67
Revenue	31.93	33.26	55.12	62.52	62.83	65.98
Statutory PTP	11.40	9.41	22.25	26.09	25.97	27.92
Statutory EPS (p)	34.9	30.3	39.4	38.3	38.1	41.1
Underlying EPS (p)	34.9	38.0	50.0	47.1	46.9	49.9
DPS (p)	27.0	30.0	33.0	33.0	36.0	39.0
Special dividend (p)	13.5			13.5		
P/E (x)	13.9	16.0	12.3	12.6	12.7	11.8
Dividend yield	8.4%	6.2%	6.8%	9.6%	7.4%	8.1%

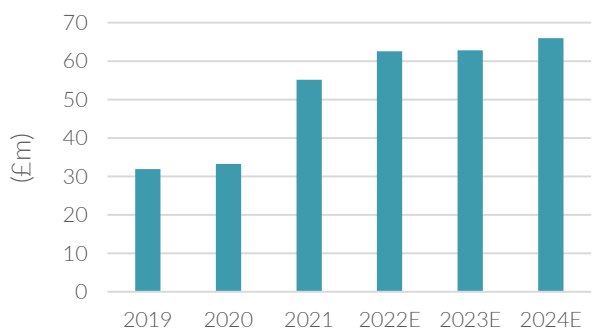
*2019 and 2022E figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



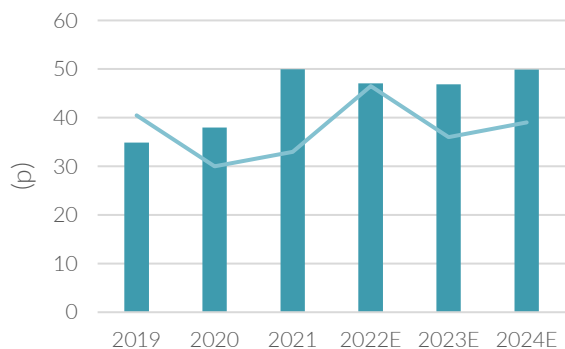
- ▶ Net inflows from 2014 to 2020, but rebalancing led to net outflows in 2021
- ▶ Addition of Karpus in 2021 added \$3.58bn
- ▶ More normal market conditions should see a return to steadier growth
- ▶ Assumed steady net new business flows and equity market growth of 5% p.a.

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 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

Funds

Funds under management (FUM)				
(\$m)	Mar'22	Dec'21	Net flows	Other movements
Emerging Markets	4,221	4,800	31	610
International	1,950	2,147	39	-236
Opportunistic Value	225	232	11	-18
Other	103	22	79	2
CLIM total	6,499	7,201	160	-862
KIM total	3,766	3,949	-13	-170
Total	10,265	11,150	147	-1,032

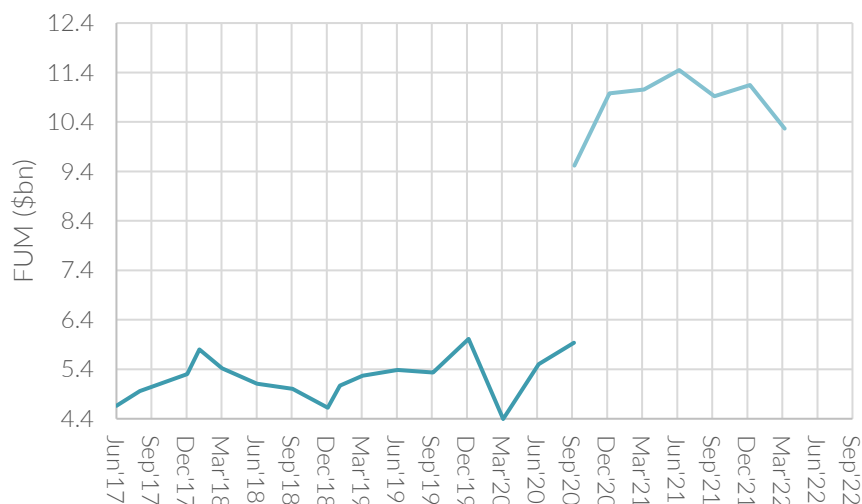
Source: Hardman & Co Research

The third quarter was a tough one for City of London, although not all was negative. The Russia/Ukraine conflict impacted markets generally, and emerging markets in particular, with the benchmark declining 7.0% over the quarter. Within the Emerging Markets strategy, performance was also adversely affected by country allocation and NAV performance.

CLIM's other strategies also underperformed, with the International strategy affected by poor NAV performance and widening discounts. We note that the strategies have had a long run of good performance – so one weak quarter should not damage the long-term performance too much. KIM had positive relative performance over the quarter.

The good news for CLIM was that all the strategies received net inflows over the quarter. This is particularly pleasing in the Emerging Markets strategy. While it has been receiving inflows, these have been outweighed by outflows from rebalancing, as the strategy performed well. The latter will have slowed in the weak markets.

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

With a stronger decline in the higher-margin areas, CLIM's revenue margin continues its ongoing reduction. It is now accruing at 71bps, while KIM's is

unchanged, at 76bps. Monthly fixed costs are unchanged, at £1.6m, while operating profit before profit share is affected by the lower FUM, and is reduced to £3.0m, from £3.3m at the start of the quarter.

With the interim and special dividends having been paid, the only dividend news is that the final dividend will be announced in the July trading statement.

Board changes

City of London had previously noted that its board was not compliant with best practice but had kept experienced directors in place during the period of the KIM transaction and integration. It has announced changes that will take effect from 30 June 2022.

The main change is the formation of a Group Executive Committee, which will give executive oversight of CLIM and KIM. Its main duties will be the day-to-day management of the group. The committee will be chaired by Tom Griffith (CEO), and will have an initial membership of Carlos Yuste (Head of Business Development), Mark Dwyer (Chief Investment Officer, CLIM), Dan Lippincot (Chief Investment Officer, KIM) and Deepranjan Agrawal (Chief Financial Officer).

As part of this change, Carlos Yuste, Mark Dwyer and Dan Lippincot will step down from the group board. This will restore independent directors to a majority of the board.

In addition, Barry Olliff, the founder of City of London, will retire from the board on 31 July 2022.

Estimate updates

The statement has led to downgrades to our forecasts, due to the decline in FUM and slightly lower revenue margin. Our assumptions of 5% market growth and steady inflow imply that it will be 2024 before the recent high will be reached again. There has been an offset with movements in the sterling dollar exchange rate to \$1.27/£ supporting earnings. The net result is that we have lowered our 2022E underlying EPS by 0.4%, to 47.1p, and our 2023E and 2024E EPS by 7%, to 46.9p and 49.9p, respectively.

Financials

Summary financials						
Year-end Jun	2019*	2020	2021	2022E*	2023E	2024E
FUM (\$bn)	5.39	5.50	11.45	10.41	11.03	11.67
P&L (£m)						
Revenue	31.93	33.26	55.12	62.52	62.83	65.98
Expenses	21.43	21.66	31.55	36.45	36.87	38.07
Operating profit	10.50	11.60	23.57	26.08	25.96	27.90
Statutory PTP	11.40	9.41	22.25	26.09	25.97	27.92
Earnings	9.05	7.37	16.99	18.79	18.70	20.18
Statutory EPS (p)	34.9	30.3	39.4	38.3	38.1	41.1
Underlying EPS (p)	34.9	38.0	50.0	47.1	46.9	49.9
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%	-9.0%	5.9%	5.8%
Revenue		4.2%	65.7%	13.4%	0.5%	5.0%
Operating profit		10.4%	103.2%	10.7%	-0.5%	7.5%
Underlying EPS		8.9%	31.5%	-5.8%	-0.4%	6.4%
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%	41.7%	41.3%	42.3%
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	1.0	1.1
Rolling u/l 5-year cover (x, excl. special div.)		1.2	1.4	1.4	1.3	1.3
Underlying EPS sensitivity						
				2022E	2023E	2024E
No net new business						
EPS (p)				47.0	46.3	48.6
change				-0.1%	-1.3%	-2.7%
0% market growth (was 5% p.a.)						
EPS (p)				47.0	44.9	45.1
change				-0.2%	-4.3%	-9.6%

*2019 and 2022E figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research
£1=\$1.27

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