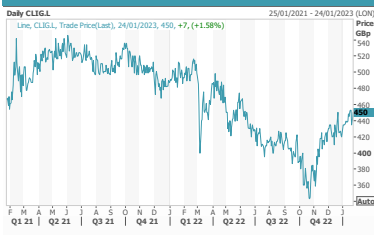


25 January 2023

## Financial Services



Source: Refinitiv

## Market data

EPIC/TKR	<b>CLIG</b>
Price (p)	<b>435.0</b>
12m high (p)	530.0
12m low (p)	343.5
Shares (m)	50.7
Mkt cap (£m)	220.5
EV (£m)	201.4
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
	<a href="http://www.clig.com">www.clig.com</a>

## Key shareholders

George Karpus	31.5%
Hargreaves Lansdown	7.6%
Aberforth Partners	7.1%
Interactive Investor	5.8%
Barry Olliff	2.1%
Other directors & staff	9.8%

## Diary

22 Feb	Interim results
31 Mar	Interim dividend paid
25 Apr	3Q FUM announcement
30 Jun	Year-end

## Analyst

Brian Moretta +44 (0)203 693 7075  
[bm@hardmanandco.com](mailto:bm@hardmanandco.com)

# CITY OF LONDON INVESTMENT GROUP

## Swings and roundabouts

City of London has announced a trading statement for 1H'23 and, implicitly, 2Q'23. After 1Q'23 being weak for markets, they bounced back in 2Q, recovering the losses – and a bit more. Fund performance was also solid. After a good 1Q for inflows, the market gains were offset by some outflows across the strategies. The net result is that FUM increased by 7% over the quarter, from \$8.51bn to \$9.15bn. This was a marginal decline, over the half year, on the \$9.22bn as of 30 June 2022. An unchanged interim dividend of 11p was also announced. The shares go ex-dividend on 2 March, and the dividend will be paid on 31 March 2022.

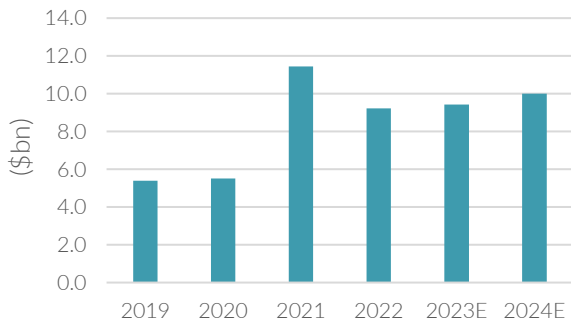
- ▶ **Operations:** While the market recovery boosted revenues in dollar terms, a weak exchange rate offset much of the benefits. The run rate profit before tax and amortisation is the same as it was three months ago, at £2.7m. City of London's estimated profit before tax and amortisation for 1H'23 is £11.9m.
- ▶ **Estimates:** The increase in FUM and the depreciation of the dollar relative to the pound almost exactly cancel each other out in our estimates. Our underlying 2023E EPS is unchanged, at 33.8p, while our 2024E EPS has decreased by 0.2%, to 35.5p.
- ▶ **Valuation:** After the recent performance, the 2023E P/E of 16.3x is roughly in line with the peer group. The 2023E dividend yield of 8.0% 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 the EPS boost from the Karpus transaction, the prospects for future dividend increases may be more market-dependent.

## Financial summary and valuation

Year-end Jun (£m)	2019*	2020	2021	2022*	2023E	2024E
FUM (\$bn)	5.39	5.50	11.45	9.22	9.43	10.00
Revenue	31.93	33.26	55.12	61.29	56.60	58.41
Statutory PTP	11.40	9.41	22.25	23.17	19.07	20.14
Statutory EPS (p)	34.9	30.3	39.4	36.9	27.6	29.2
Underlying EPS (p)	34.9	38.0	48.1	44.2	33.8	35.5
DPS (p)	27.0	30.0	33.0	33.0	36.0	39.0
Special dividend (p)	13.5			13.5		
P/E (x)	12.9	14.9	11.4	12.2	16.3	15.4
Dividend yield	9.0%	6.7%	7.3%	10.3%	8.0%	8.7%

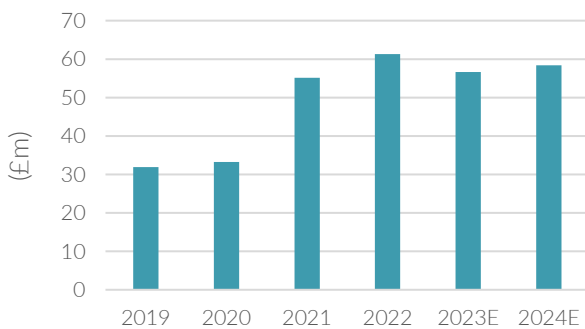
\*2019 and 2022 figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



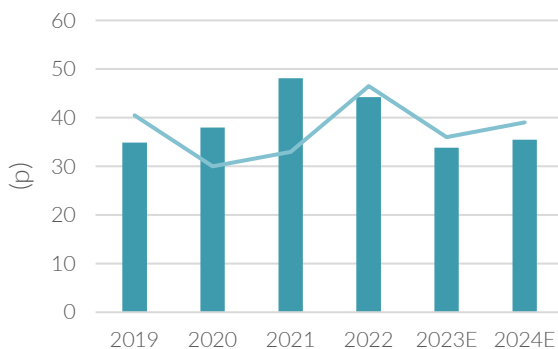
- ▶ Net inflows restored in 2022 after a weaker 2021
- ▶ Addition of Karpus in 2021 added \$3.58bn
- ▶ More normal market conditions should see a return to steadier growth
- ▶ Assumed steady net new business flows and equity market growth of 5% p.a.

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 was first full year)

Underlying EPS (bar) and DPS (line)



- ▶ Market movements drive changes, but profitability supported historically by cost flexibility
- ▶ Exceptional transaction costs reduced statutory 2020 and 2021 EPS
- ▶ Special dividend of 13.5p in 2019 and 2022
- ▶ Dividend increased in 2020 and 2021 - future increases subject to market conditions

Source: Company data, Hardman & Co Research

# Commentary

## Funds

2Q funds under management (FUM) movements				
(\$m)	Dec'22	Sep'22	Net flows	Other movements
Emerging Markets	3,570	3,249	-34	355
International	1,894	1,642	-7	259
Opportunistic Value	240	234	-9	15
Other	77	78		-1
<b>CLIM total</b>	<b>5,781</b>	<b>5,203</b>	<b>-50</b>	<b>628</b>
<b>KIM total</b>	<b>3,369</b>	<b>3,309</b>	<b>-97</b>	<b>157</b>
<b>Total</b>	<b>9,150</b>	<b>8,512</b>	<b>-147</b>	<b>785</b>

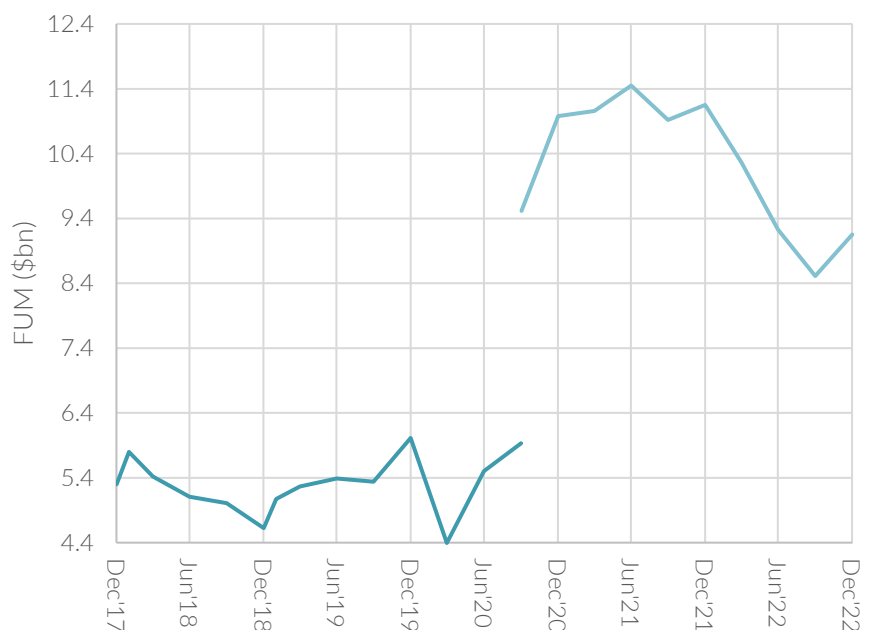
Source: Hardman & Co Research

Within the period of the first half, market performance had a strong effect on City of London’s FUM. However, there is a sense of “swings and roundabouts”, as markets bounced back in 2Q’23, and only slightly exceeded the effect of the market declines in the first quarter (increase of \$785m vs. decline of \$752m in 1Q’23).

After a more positive quarter for inflows, the second quarter saw net outflows. Redemptions from the Emerging Markets strategy and required minimum distributions in Karpus were the primary causes. Over the first half, City of London had gross inflows of ca.\$295m, but \$402m of outflows gave net outflows of \$107m. The net result was a marginal decline in FUM over 1H’23.

City of London describes its fund performance in 1H’23 as “solid”, with good NAV performance in the underlying closed-ended funds being the strongest contributor.

### City of London’s FUM progress over past five years



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

## Operations

The weighted average run rate for revenue was 73bps, unchanged on the previous quarter. Fixed costs ticked up again, to £1.9m per month, from £1.8m at the end of 1Q'23. Despite this, the run rate for operating profit, before profit share, is unchanged, at £2.7m per month. The main offset to the market gains has been movements in the exchange rate, which moved from \$1.117/£ to \$1.208.

City of London's estimated profit before amortisation and taxation for 1H'23 is £11.9m. Although this is a decline on the £15.5m in 1H'22 (due primarily to weak markets), it is slightly ahead of our estimates.

At 31 December 2022, cash and cash equivalents stood at £19.1m, with seed investments of £7.6m. While the former are down on the £22.7m as of 30 June 2022, it has paid the final dividend since then.

## Dividend

City of London is proposing an unchanged interim dividend of 11p. Given market volatility and the reduced earnings in the first half, this is no great surprise. We have previously observed that City of London manages its dividend conservatively. We believe that, in the near future, surplus cash is more likely to be distributed through further special dividends than increases in the regular dividend.

## Estimate updates

The higher-than-expected FUM and strengthening of sterling almost exactly offset each other in our forecasts. Our underlying EPS estimate for 2023 is unchanged, at 33.8p, while that for 2025 has reduced by 0.5%, to 35.5p.

We have kept our dividend forecasts unchanged. Within that, we expect an unchanged regular dividend and only a small chance of a special dividend. The latter is hard to predict. With markets bouncing back and strong cash reserves, a special dividend is not impossible if markets continue to perform strongly. However, in probabilistic terms, we believe the odds are more in favour of nothing extra this year.

# Financials

Summary financials						
Year-end Jun	2019*	2020	2021	2022*	2023E	2024E
FUM (\$bn)	5.39	5.50	11.45	9.22	9.43	10.00
<b>P&amp;L (£m)</b>						
Revenue	31.93	33.26	55.12	61.29	56.60	58.41
Expenses	21.43	21.66	31.55	37.34	37.41	38.15
Operating profit	10.50	11.60	23.57	23.95	19.19	20.26
Statutory PTP	11.40	9.41	22.25	23.17	19.07	20.14
Earnings	9.05	7.37	16.99	18.09	13.52	14.34
Statutory EPS (p)	34.9	30.3	39.4	36.9	27.6	29.2
Underlying EPS (p)	34.9	38.0	50.0	44.2	33.8	35.5
Total DPS (p)	40.5	30.0	33.0	46.5	36.0	39.0
Key metrics						
	2019*	2020	2021	2022*	2023E	2024E
<b>Growth</b>						
FUM		2.1%	108.1%	-19.4%	2.2%	6.1%
Revenue		4.2%	65.7%	11.2%	-7.7%	3.2%
Operating profit		10.4%	103.2%	1.6%	-19.9%	5.6%
Underlying EPS		8.9%	31.5%	-8.1%	-23.5%	4.9%
DPS (excl. special div.)		11.1%	10.0%	0.0%	9.1%	8.3%
<b>Operating margins</b>						
Net FUM fee margin	0.76%	0.75%	0.75%	0.73%	0.73%	0.72%
Operating margin	32.9%	34.9%	42.8%	39.1%	33.9%	34.7%
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	0.8	0.7
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	1.2	1.1
Underlying EPS sensitivity						
				2022	2023E	2024E
<b>No net new business</b>						
EPS (p)					33.7	34.8
change					-0.3%	-2.1%
<b>0% market growth (was 5% p.a.)</b>						
EPS (p)					33.5	33.1
change					-0.9%	-6.7%

\*2019 and 2022 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research  
£1=\$1.23

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