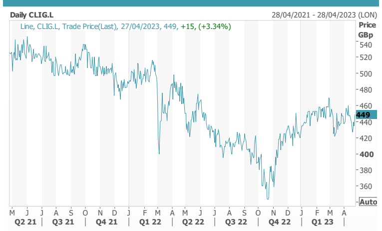
28 April 2023

Financial Services



Source: Refinitiv

Market data

EPIC/TKR	**CLIG**
Price (p)	**449.0**
12m high (p)	484.0
12m low (p)	343.5
Shares (m)	50.7
Mkt cap (£m)	227.5
EV (£m)	208.5
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
Chair	Barry Aling

+44 (0)207 711 0771

www.clig.com

Key shareholders

George Karpus	31.5%
Hargreaves Lansdown	7.7%
Aberforth Partners	7.1%
Interactive Investor	6.1%
AJ Bell	2.5%
Other directors & staff	9.6%

Diary

30 Jun	Year-end
23 Oct	AGM

Analyst

Brian Moretta +44 (0)203 693 7075

bm@hardmanandco.com

CITY OF LONDON INVESTMENT GROUP

Positive markets offset by revenue margins

City of London has announced its trading update results for 3Q'23. The headline figures are positive, with FUM increasing 3%, from $9.15bn at December 2022 to $9.47bn at the quarter-end. This was underpinned by good market performance: the MSCI Emerging Markets TR Index increased by 4.0% and the MSCI All Country World Index ex US rose by 6.9%. These were slightly offset at CLIM by some net outflows. Weak sentiment towards the end of the quarter led to widening discounts in closed-ended funds, and, as a consequence, there was some slight underperformance across the strategies.

- **Operations:** The ongoing decline in City of London's revenue margin was stronger this quarter, as it reduced from 73bps to 71bps. Fixed costs also increased, from £1.9m to £2.0m, and the run-rate operating profit before profit share declined to £2.5m per month.

- **Estimates:** Despite the increase in FUM, the reduced revenue margin has led to net downgrades to our estimates. We have lowered our underlying 2023E EPS by 2%, to 33.7p, while our underlying 2024E EPS has decreased by 5%, to 33.9p, and our 2025E EPS has also been lowered by 5%, to 35.9p.

- **Valuation:** After the recent performance, the 2024E P/E of 16.9x is roughly in line with the peer group. The 2024E dividend yield of 8.7% 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 39% 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.

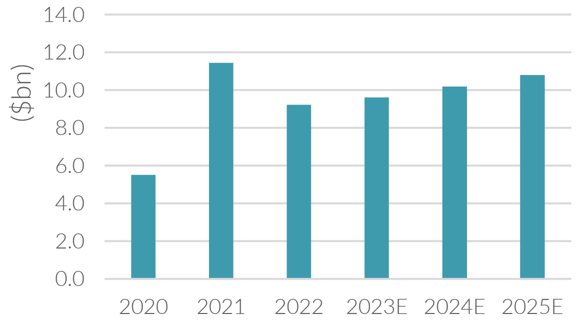
- **Investment summary:** Having maintained good long-term investment performance and operational control, City of London is well-placed to grow organically. We believe the valuation remains reasonable. Now that the Karpus transaction has settled down, the prospects for future dividend increases may be more dependent on markets and the ability to attract new business.

Financial summary and valuation

Year-end Jun (£m)	2020	2021	2022*	2023E	2024E	2025E
FUM ($bn)	5.50	11.45	9.22	9.61	10.19	10.80
Revenue	33.26	55.12	61.29	56.26	57.22	60.12
Statutory PTP	9.41	22.25	23.17	18.51	18.62	19.94
Statutory EPS (p)	30.3	39.4	36.9	26.3	26.5	28.6
Underlying EPS (p)	38.0	48.1	44.2	33.7	33.9	35.9
DPS (p)	30.0	33.0	33.0	33.0	39.0	39.0
Special dividend (p)			13.5			
P/E (x)	14.8	11.4	12.2	17.0	16.9	15.7
Dividend yield	6.7%	7.3%	10.4%	7.3%	8.7%	8.7%

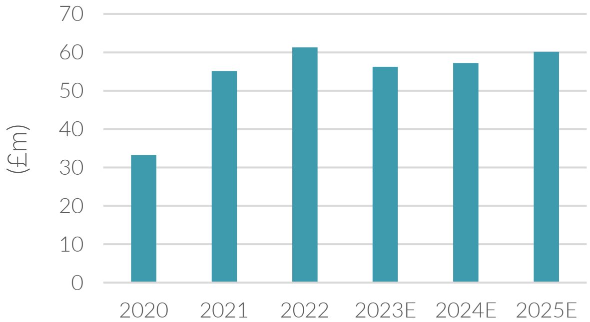
**2022 figures include a special dividend of 13.5p; Source: Hardman & Co Research*

Funds under management (FUM)



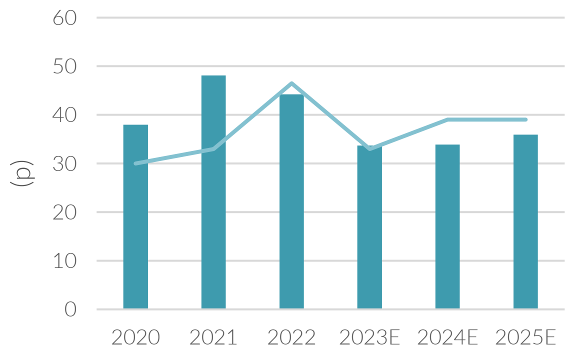
- Net inflows restored in 2022, after a weaker 2021
- Addition of Karpus in 2021 added $3.58bn
- More normal market conditions should see a return to steadier growth
- Assumed steady net new business flows and equity market growth of 5% p.a.

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 2022
- Dividend increased in 2020 and 2021, but flat since then

Source: Company data, Hardman & Co Research

Commentary

Funds

3Q funds under management (FUM) movements

($m)	Mar'23	Dec'22	Net flows	Other movements
Emerging Markets	3,661	3,570	-14	105
International	1,984	1,894	-23	113
Opportunistic Value	237	240	-12	9
REIT/other	91	77	0	14
CLIM total	**5,973**	**5,781**	**-49**	**241**
KIM total	**3,494**	**3,369**	**1**	**124**
Total	**9,467**	**9,150**	**-48**	**364**

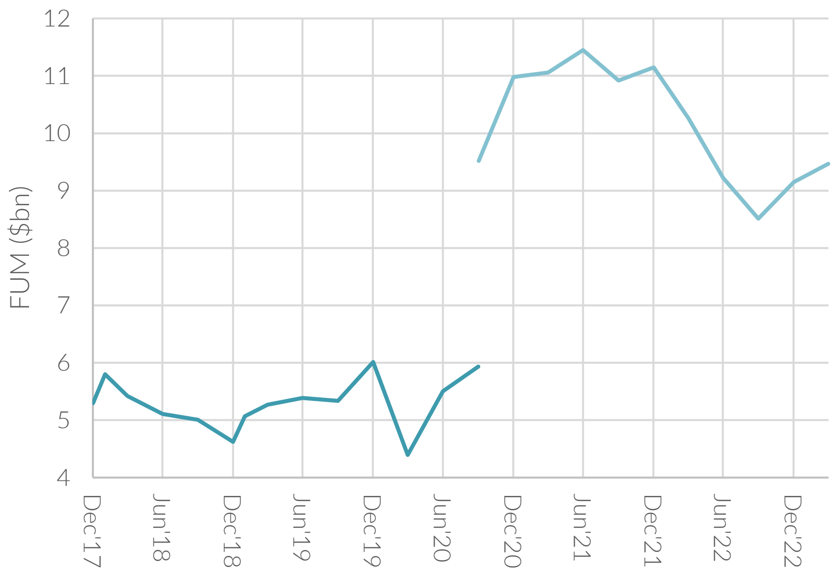
Source: Hardman & Co Research

Positive markets underpinned the 3% increase in FUM. This masks some ongoing volatility in the quarter, with a very positive January for stock markets being offset by subsequent declines.

Although performance was positive across the strategies, it was slightly behind the relevant benchmarks. The negative sentiment and market weakness since January have widened discounts on closed-ended funds, leading to some underperformance.

While City of London attracted inflows of ca.$125m during the quarter, these were more than offset by redemptions of ca.$173m, leading to net outflows of $48m (0.5% of December FUM). While the three main CLIM strategies experienced slight drags, we note the net positive at KIM. The latter is the first quarter in which this has happened since the transaction, and is hopefully a sign that the investment in new business capability is already making a difference.

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

We have previously noted that there is gradual decline in City of London's revenue margin, as new business is generally lower-margin than on the back book. In particular, the back book in the Emerging Markets strategy was higher-margin than the new business in the newer areas, and it has been experiencing net outflows. So as funds turn over, the margin declines. This quarter, the revenue margin dropped from 73bps to 71bps.

As presaged in the interim report, City of London is investing in its new business. In 3Q, fixed costs ticked up a little, from the December figure of £1.9m to £2.0m. There was an adverse exchange rate movement too (weakening of the dollar). The net effect is that, despite the increase in FUM, the run-rate monthly operating profit before profit share declined from £2.7m to £2.5m.

Board

Perhaps the biggest announcement was some forthcoming board changes. The Chair, Barry Aling, is approaching 10 years on the board and, consequently, will retire from the AGM on 23 October. He will be replaced by Rian Darnell, who is currently a non-executive director.

Estimate updates

The rate of the decrease in the fee margin was faster than we had expected, and, combined with the exchange rate movement, has led to downgrades to our forecasts. Our underlying 2023E EPS has decreased by 2%, from 34.4p to 33.7p, while our 2024E EPS has decreased by 5%, from 35.7p to 33.9p, and our 2025E EPS has also decreased 5%, from 37.8p to 35.9p.

We have tinkered with our dividend forecasts. Another 13.5p special dividend would cost ca.£6.6m, while an annual dividend of 33p costs ca.£16.1m (both slightly reduced by the 1.9m shares held in the Employee Benefit Trust). The cash balance at the interim results was £19.1m. Given this, we do not believe market performance is strong enough to justify a special dividend this year, and we have set it at the regular dividend rate of 33p for the year.

We have kept our other dividend forecasts unchanged. Within that, we expect an unchanged regular dividend, and a smaller chance of a special dividend. The latter is hard to predict. With markets bouncing back, and with strong cash reserves, a special dividend is not impossible in the next couple of years if markets perform strongly. However, volatility makes that uncertain.

Financials

Summary financials						
Year-end Jun	2020	2021	2022*	2023E	2024E	2025E
FUM ($bn)	5.50	11.45	9.22	9.61	10.19	10.80
P&L (£m)						
Revenue	33.26	55.12	61.29	56.26	57.22	60.12
Expenses	21.66	31.55	37.34	38.16	38.87	40.45
Operating profit	11.60	23.57	23.95	18.10	18.34	19.67
Statutory PTP	9.41	22.25	23.17	18.51	18.62	19.94
Earnings	7.37	16.99	18.09	12.92	13.01	14.01
Statutory EPS (p)	30.3	39.4	36.9	26.3	26.5	28.6
Underlying EPS (p)	38.0	48.1	44.2	33.7	33.9	35.9
Total DPS (p)	30.0	33.0	46.5	33.0	39.0	39.0

Key metrics						
	2020	2021	2022*	2023E	2024E	2025E
Growth						
FUM		108.1%	-19.4%	4.2%	6.0%	6.0%
Revenue		65.7%	11.2%	-8.2%	1.7%	5.1%
Operating profit		103.2%	1.6%	-24.4%	1.4%	7.2%
Underlying EPS		26.7%	-8.1%	-23.8%	0.5%	6.0%
DPS (excl. special div.)		10.0%	0.0%	0.0%	18.2%	0.0%
Operating margins						
Net FUM fee margin	0.75%	0.75%	0.73%	0.72%	0.71%	0.70%
Operating margin	34.9%	42.8%	39.1%	32.2%	32.1%	32.7%
Tax rate	21.7%	23.6%	24.0%	24.0%	24.0%	24.0%
Dividend cover (x, incl. special div.)	1.0	1.2	0.8	1.0	1.2	0.8
Rolling 5-year cover (x, excl. special div.)	1.2	1.3	1.2	1.2	1.3	1.2
Rolling u/l 5-year cover (x, excl. special div.)	1.2	1.3	1.3	1.2	1.3	1.3

Underlying EPS sensitivity			
	2023E	2024E	2025E
No net new business			
Underlying EPS (p)	33.7	33.3	34.7
change	-0.1%	-1.6%	-3.4%
0% market growth (was 5% p.a.)			
Underlying EPS (p)	33.7	32.1	31.7
change	-0.2%	-5.2%	-11.7%

**2022 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research*
£1=$1.25

Disclaimer

Hardman & Co provides professional independent research services and all information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. However, no guarantee, warranty or representation, express or implied, can be given by Hardman & Co as to the accuracy, adequacy or completeness of the information contained in this research and they are not responsible for any errors or omissions or results obtained from use of such information. Neither Hardman & Co, nor any affiliates, officers, directors or employees accept any liability or responsibility in respect of the information which is subject to change without notice and may only be correct at the stated date of their issue, except in the case of gross negligence, fraud or wilful misconduct. In no event will Hardman & Co, its affiliates or any such parties be liable to you for any direct, special, indirect, consequential, incidental damages or any other damages of any kind even if Hardman & Co has been advised of the possibility thereof.

This research has been prepared purely for information purposes, and nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell any security, product, service or investment. The research reflects the objective views of the analyst(s) named on the front page and does not constitute investment advice. However, the companies or legal entities covered in this research may pay us a fixed fee in order for this research to be made available. A full list of companies or legal entities that have paid us for coverage within the past 12 months can be viewed at http://www.hardmanandco.com/legals/research-disclosures. *Hardman may provide other investment banking services to the companies or legal entities mentioned in this report.*

Hardman & Co has a personal dealing policy which restricts staff and consultants' dealing in shares, bonds or other related instruments of companies or legal entities which pay Hardman & Co for any services, including research. No Hardman & Co staff, consultants or officers are employed or engaged by the companies or legal entities covered by this document in any capacity other than through Hardman & Co.

Hardman & Co does not buy or sell shares, either for their own account or for other parties and neither do they undertake investment business. We may provide investment banking services to corporate clients. Hardman & Co does not make recommendations. Accordingly, they do not publish records of their past recommendations. Where a Fair Value price is given in a research note, such as a DCF or peer comparison, this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities, companies and legal entities but has no scheduled commitment and may cease to follow these securities, companies and legal entities without notice.

The information provided in this document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hardman & Co or its affiliates to any registration requirement within such jurisdiction or country.

Some or all alternative investments may not be suitable for certain investors. Investments in small and mid-cap corporations and foreign entities are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. Investments may be leveraged and performance may be volatile; they may have high fees and expenses that reduce returns. Securities or legal entities mentioned in this document may not be suitable or appropriate for all investors. Where this document refers to a particular tax treatment, the tax treatment will depend on each investor's particular circumstances and may be subject to future change. Each investor's particular needs, investment objectives and financial situation were not taken into account in the preparation of this document and the material contained herein. Each investor must make his or her own independent decisions and obtain their own independent advice regarding any information, projects, securities, tax treatment or financial instruments mentioned herein. The fact that Hardman & Co has made available through this document various information constitutes neither a recommendation to enter into a particular transaction nor a representation that any financial instrument is suitable or appropriate for you. Each investor should consider whether an investment strategy of the purchase or sale of any product or security is appropriate for them in the light of their investment needs, objectives and financial circumstances.

This document constitutes a 'financial promotion' for the purposes of section 21 Financial Services and Markets Act 2000 (United Kingdom) ('FSMA') and accordingly has been approved by Capital Markets Strategy Ltd which is authorised and regulated by the Financial Conduct Authority (FCA).

(Disclaimer Version 8 – Effective from August 2018)

Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January 2018, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies, legal entities and issuers about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public…'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

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

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

research@hardmanandco.com

1 Frederick's Place
London
EC2R 8AE

+44(0)203 693 7075

www.hardmanandco.com