CITY OF LONDON INVESTMENT GROUP

Positive markets offset by revenue margins

City of London has announced its pre-close update for FY'23. FUM has grown by 2% over the past year, to $9.42bn, from $9.22bn, albeit it has taken a volatile path in between and the total is slightly down from the end of 3Q'23. Broadly speaking, the rise was due to market and strategy outperformance, with the MSCI Emerging Markets Net TR Index rising 1.7% and the MSCI ACWI ex USA Index increasing 12.7%. This was offset by net outflows across most of the strategies (Opportunistic Value being the exception). Performance was generally strong, with outperformance across most strategies.

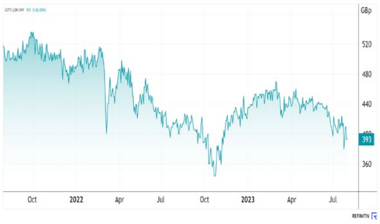
- **Operations:** As usual in its pre-close statement, City of London announced its expectations for year-end results. Expected earnings will be £14.8m, compared with £18.1m in 2022, and basic EPS is expected to be 30.4p, 18% lower than 2022's 36.9p.
- **Estimates:** Decreased FUM, exchange rate movements and changes to tax rates have all affected our own estimates. However, the net result is that our 2024E EPS is unchanged, at 33.9p, while our 2025 estimate is trimmed by 0.3%, to 35.8p. We have also adjusted our dividend forecasts.
- **Valuation:** After the recent performance, the 2024E P/E of 14.8x is roughly in line with that of the peer group. The 2024E dividend yield of 8.4% 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 38% 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	9.42	10.00	10.59
Revenue	33.26	55.12	61.29	56.11	54.89	57.67
Statutory PTP	9.41	22.25	23.17	18.47	17.29	18.54
Statutory EPS (p)	30.3	39.4	36.9	30.4	26.5	28.5
Underlying EPS (p)	38.0	48.1	44.2	37.1	33.9	35.8
DPS (p)	30.0	33.0	33.0	33.0	33.0	33.0
Special dividend (p)			13.5			
P/E (x)	13.0	10.0	10.7	12.9	14.8	13.8
Dividend yield	7.6%	8.4%	11.8%	8.4%	8.4%	8.4%

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

Financial Services



Source: Refinitiv

Market data

EPIC/TKR	**CLIG**
Price (p)	**410.0**
12m high (p)	470.0
12m low (p)	343.5
Shares (m)	50.7
Mkt cap (£m)	199.2
EV (£m)	180.1
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

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www.clig.com

Key shareholders

George Karpus	31.5%
Hargreaves Lansdown	7.7%
Aberforth Partners	7.1%
Interactive Investor	5.9%
AJ Bell	2.6%
Other directors & staff	10.0%

Diary

18 Sep	Final results
13 Oct	1Q FUM announcement
23 Oct	AGM

Analyst

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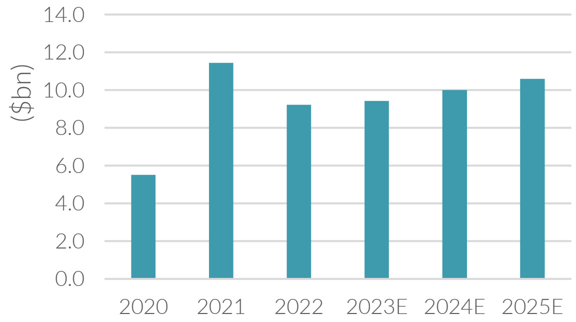
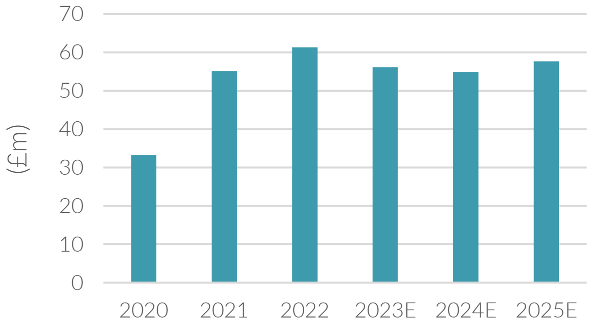
Funds under management (FUM)



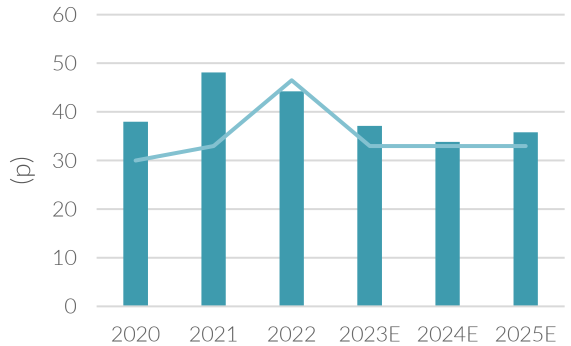
- Net outflows in 2023, after positive 2022
- Addition of Karpus in 2021 added $3.58bn
- More normal market conditions should see a return to steadier growth
- Assumed steady net new business flows and equity market growth of 5% p.a.

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
- Volatile markets weighed on 2022 and 2023 results
- Special dividend of 13.5p in 2022. As cash accrues, we expect further specials in due course..
- Ordinary dividend increased in 2020 and 2021, but flat since then

Source: Company data, Hardman & Co Research

Commentary

Funds

4Q funds under management (FUM) movements				
($m)	Jun'23	Mar'23	Net flows	Other movements
Emerging Markets	3,580	3,661	-127	46
International	1,983	1,984	-41	40
Opportunistic Value	244	237	-1	8
REIT/other	97	91	-6	12
CLIM total	**5,904**	**5,973**	**-175**	**106**
KIM total	**3,520**	**3,494**	**-27**	**53**
Total	9,424	9,467	-202	159

Source: Hardman & Co Research

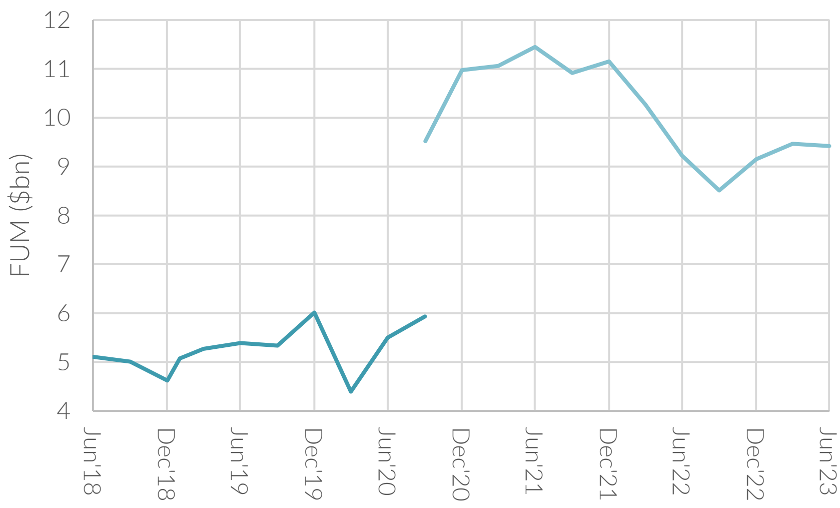
City of London saw a small reduction in FUM in 4Q'23, with positive fund movements being more than offset by net outflows across the strategies.

The MSCI Emerging Markets Index was almost flat in the quarter, but the Emerging Markets strategy showed a small gain. The International strategy also appears to be ahead of its benchmark in the quarter, with the latter rising 1%. The positive result for KIM is also welcome, given that interest rates and bond yields both rose during the quarter.

City of London gave indications of drivers of performance for the full year. Despite widening discounts in the underlying closed-ended funds, the bulk of CLIM's assets outperformed over the year. The Emerging Market strategy saw strong NAV performance, and Opportunistic Value outperformed too. The International strategy was slightly behind its benchmark.

Within KIM, several key strategies outperformed, notably taxable fixed income, although equity strategies were an exception.

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

Net fund flows were negative across the board, with this quarter being the worst of the year. City of London attributes this to ongoing market volatility, pension fund de-risking and competition from cash products. The latter is new and an inevitable function of the level to which US interest rates have risen. City of London intends to use the wide discounts in its marketing strategy, although we observe that it may take a bit more confidence in markets for clients to be open to that message.

Operations

As usual in its pre-close statement, City of London gave indications of its profits for the year, as well as updating its run-rate figures. Currency and market movements affected both items.

Run-rate revenue accrual was unchanged on 3Q, at 71 bps of FUM. Run-rate costs dropped slightly, from £2.0m to £1.9m, leading to run-rate operating profit before profit-share and amortisation increasing to £2.6m.

For the full year, expenses are expected to increase from £19.7m to £22.5m. A weaker sterling was the largest contributor to the increase, although there was an effect from employee retention and retiral costs too.

Full-year estimated profit before amortisation and tax is £23.4m (down 14% from £27.2m in FY'22). As well as the cost increase, lower FUM will have contributed too, although exchange rates will benefit the revenue line.

The full-year tax charge of £3.9m is slightly lower than expected, at 21% of PBT. With the increase in UK Corporation Tax, it is expected to be higher going forward. Earnings are estimated at £14.8m, a 18% decrease on the previous year.

City of London has announced that, as from the next financial year, it will change its reporting currency to US Dollars. Given that almost all of the revenues and the majority of its expenses are incurred in that currency, this seems a sensible move.

Dividend

As expected, there is a proposed final dividend of 22p, unchanged from the previous year, bringing the total for the year to 33p. Rolling five-year cover, excluding special dividends, is 1.24x.

Estimate updates

Once we adjust for market movements, exchange rates and the tax charge, the figures were very close to our estimates. The only additional adjustment we have made to our estimates is for UK Corporation Tax increasing to 25% from April 2023.

The net result is a small downgrades to our underlying 2025 EPS forecasts, to 35.8p, from 35.9p, while our 2024 estimate is unchanged, at 33.9p.

We have also tinkered with our dividend forecasts. We had included a probabilistic expectation of a special dividend, but we have now removed that. Broadly, we expect the ordinary dividend to stay flat, at 33p.

When considering a special dividend, the last two specials have been 13.5p, and we would guess that City of London will most likely wait until it can pay something similar. Given the market weakness, we think another special is unlikely in 2024. There is a better chance in 2025, but this is, of course, very market-dependent, as this affects the ability of City of London to add extra cash to its balance sheet.

Financials

Summary financials

Year-end Jun	2020	2021	2022*	2023E	2024E	2025E
FUM ($bn)	5.50	11.45	9.22	9.42	10.00	10.59
P&L (£m)						
Revenue	33.26	55.12	61.29	56.11	54.89	57.67
Expenses	21.66	31.55	37.34	38.05	37.87	39.40
Operating profit	11.60	23.57	23.95	18.06	17.01	18.27
Statutory PTP	9.41	22.25	23.17	18.47	17.29	18.54
Earnings	7.37	16.99	18.09	14.57	13.02	13.96
Statutory EPS (p)	30.3	39.4	36.9	30.4	26.5	28.5
Underlying EPS (p)	38.0	48.1	44.2	37.1	33.9	35.8
Total DPS (p)	30.0	33.0	46.5	33.0	33.0	33.0

Key metrics

	2020	2021	2022*	2023E	2024E	2025E
Growth						
FUM		108.1%	-19.4%	2.2%	6.1%	6.0%
Revenue		65.7%	11.2%	-8.5%	-2.2%	5.1%
Operating profit		103.2%	1.6%	-24.6%	-5.8%	7.4%
Underlying EPS		26.7%	-8.1%	-16.1%	-8.7%	5.7%
DPS (excl. special div.)		10.0%	0.0%	0.0%	0.0%	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%	31.0%	31.7%
Tax rate	21.7%	23.6%	24.0%	24.0%	24.7%	24.7%
Dividend cover (x, incl. special div.)	1.0	1.2	0.8	0.9	0.8	0.9
Rolling 5-year cover (x, excl. special div.)	1.2	1.3	1.2	1.1	1.0	1.0
Rolling u/l 5-year cover (x, excl. special div.)	1.2	1.3	1.3	1.3	1.2	1.2

Underlying EPS sensitivity

	2024E	2025E
No net new business		
Underlying EPS (p)	33.5	34.8
change	-1.1%	-2.8%
0% market growth (was 5% p.a.)		
Underlying EPS (p)	32.7	32.4
change	-3.3%	-9.6%

**2022 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research*
£1=$1.28

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(Disclaimer Version 8 – Effective from August 2018)

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