Financial Services

Source: LSEG

Market data

EPIC/TKR	**CLIG**
Price (p)	**311.0**
12m high (p)	475.0
12m low (p)	300.0
Shares (m)	50.7
Mkt cap (£m)	157.6
EV (£m)	137.2
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	Rian Dartnell

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www.clig.com

Key shareholders

George Karpus	31.5%
Hargreaves Lansdown	8.2%
Aberforth Partners	7.1%
Interactive Investor	6.3%
AJ Bell	3.2%
Other directors & staff	10.8%

Diary

28 Mar	Interim dividend paid
22 Apr	3Q FUM statement

Analyst

Brian Moretta bm@hardmanandco.com

CITY OF LONDON INVESTMENT GROUP

First-half results going in the right direction

City of London has announced its interim results for 1H'24. With the main headline figures having being announced in January's trading statement, the principal interest was in some of the details. FUM of $9.58bn is 2% ahead of the level at 30 June 2023 and 5% ahead of the end of 2022. Gross revenues increased YoY by 2%, whereas, expenses grew 6%, resulting in a slightly lower operating profit of $10.0m. On an underlying basis, profit before tax of $13.3m was a 2% decline over the 1H'23 figure. Underlying EPS showed a similar decline, to 20.4¢, or 16.2p. The interim dividend, as previously announced, is unchanged at 11p.

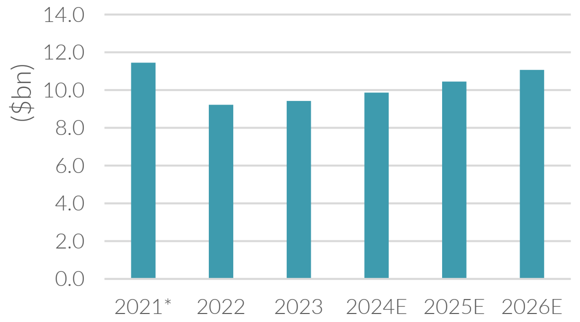
- **Funds:** Performance across the first half was variable, which is natural over a short six-month period. While City of London has indicated increased marketing efforts and interest, this has not translated into results yet. We believe that with positive long-term performance and a good value story, it will do so in due course.
- **Estimates:** Minor changes have led to small upgrades in our estimates. Our 2024E underlying EPS has increased by 0.5% from 42.1¢ to 42.3¢ and our 2025E EPS has increased by 2% from 46.6¢ to 47.8¢. We have introduced a 2026E EPS of 52.6¢.
- **Valuation:** After the recent performance, the 2025E P/E of 10.1x is a noticeable discount to the peer group. A 2025E dividend yield of 10.6% is well above the market average 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 37% 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 ($m)	2021 (£m)	2022*	2023	2024E	2025E	2026E
FUM ($bn)	11.45	9.22	9.42	9.86	10.45	11.07
Revenue	55.12	81.55	68.73	67.74	72.17	75.79
Statutory PTP	22.25	30.88	22.13	21.76	25.34	28.44
Statutory EPS (¢)	39.4	44.9	38.4	33.6	39.1	43.9
Underlying EPS (¢)	48.1	57.4	44.5	42.3	47.8	52.6
Underlying EPS (p)	48.1	44.2	36.5	33.3	37.6	41.4
DPS (p)	33.0	33.0	33.0	33.0	33.0	33.0
Special dividend (p)		13.5				
P/E (x)	7.9	8.8	10.3	11.7	10.1	9.0
Dividend yield	10.6%	15.0%	10.6%	10.6%	10.6%	10.6%

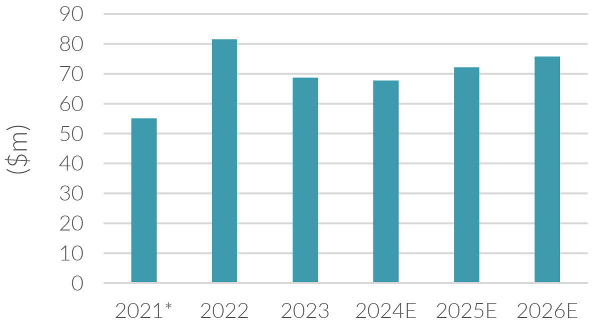
**2022 figures include a special dividend of 13.5p; Source: Hardman & Co Research*

Funds under management (FUM)



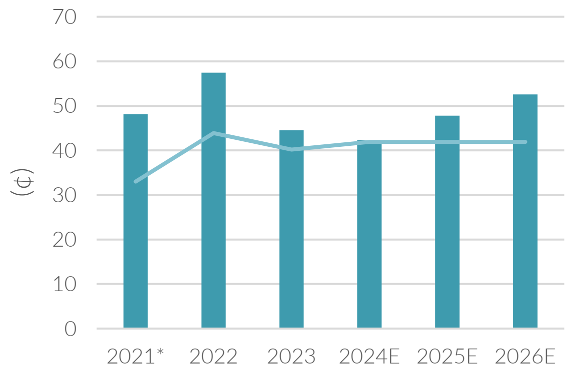
- Net outflows in 2023, after positive 2022
- Addition of Karpus in 2021 added $3.58bn
- More normal market conditions should see a return to steadier growth
- Assumed steady net new business flows and equity market growth of 5% p.a.

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
- Ordinary dividend flat since 2021

**2021 figures in GBP. Source: Company data, Hardman & Co Research*

Commentary

Funds

Funds under management (FUM) movements during 1H'24

($m)	Dec'23	Jun'23	Net flows	Other movements
Emerging Markets	3,578	3,580	(171)	169
International	2,004	1,983	(90)	111
Opportunistic Value	278	244	15	19
Frontier	10	9	0	1
Other / REIT	88	88	(3)	3
CLIM total	**5,958**	**5,904**	**(249)**	**303**
Karpus retail	2,472	2,441	(40)	71
Karpus institutional	1,146	1,079	(6)	73
KIM total	**3,618**	**3,520**	**(46)**	**144**
Total	**9,576**	**9,424**	**(295)**	**837**

Source: Hardman & Co Research

Most of the figures for markets and flows were given in January's trading statement, with some extra detail added in the interim results. Overall, the pattern was one of positive market performance more than offsetting net outflows. The exception to this was the Opportunistic Value strategy, which saw net inflows.

The report makes specific mention of two separate challenges among investors. The first is "EM fatigue": emerging markets have now underperformed developed markets for some time. The challenges of China, which is the largest constituent, are well known, as are the conflicts in Ukraine and Israel Gaza.

In the short term, supply chain disruption has reduced, but we appear to have passed peak globalisation, at least for now. While there are signs of Asian countries, in particular, reshaping a more cooperative relationship among themselves, the risks seem to outweigh the prospects for many investors. We note that the CEF discounts in the Emerging Markets strategies are wider than for the others.

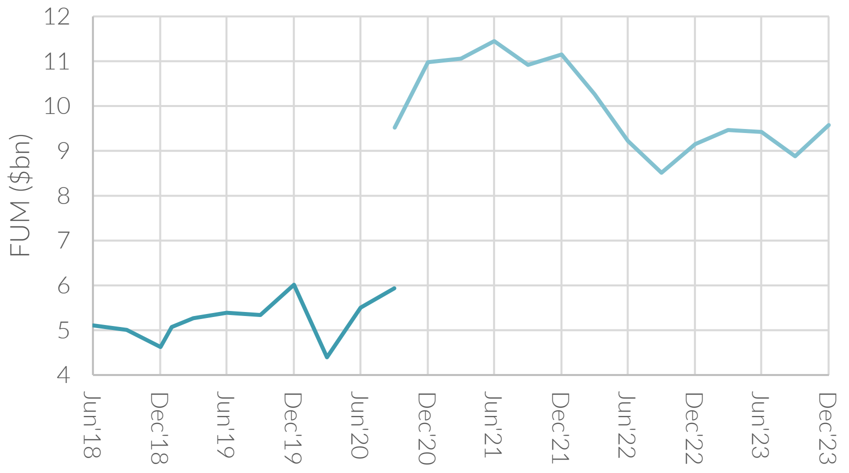
The second challenge is that of the resurrection of positive cash returns. This seems to have affected retail investors most strongly, some of whom have taken the all-too-common step of selling equity markets after a fall to flee to the "safety" of deposits or money market funds. If US rate cuts materialise as markets expect, then these outflows should at least slow, and perhaps reverse slightly if equity markets continue to recover.

City of London reports increased marketing activity over the half year. The intention to expand marketing efforts was announced in spring 2023. Unfortunately, the lead time for institutional business can be long and, as yet, this has not translated into significantly improved new business. Hopefully, 2H'24 can be more productive.

Over the past six months, there was variable performance across the strategies, as is often the case over short periods. Within CLIM, Opportunistic Value outperformed, the International strategy delivered neutral performance while Emerging Markets slightly underperformed. KIM's Taxable Fixed Income and Tax-sensitive Fixed Income strategies both outperformed, while US Equity and Conservative Balance underperformed.

Nevertheless, long-term performance remains good and with CEF discounts being at or near long-term lows across most of the strategies, there is a good marketing pitch to be made to investors.

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

Finances

Have switched the reporting currency from sterling to dollars at the last financial year-end, these are the first results that have been reported in the new format.

The above chart shows that average FUM, in 1H'24, was higher than for the same period last year. While fee income was offset a little by the ongoing compression in fee margins, it still grew by 2%, from $33.5m to $34.2m. Administrative expenses also grew, as IT costs, inflationary salary increases and a strengthening of sterling had an impact; they rose 6% to $22.6m.

The rise in interest rates had a positive effect on interest income and there were also $560,000 of gains on investments, most of which was from realisations.

The profit figures were in line with January's trading statement. Underlying profit before tax and statutory profit both declined 2% to $13.3m and $8.22m, respectively. Underlying EPS declined 4% to ¢20.4p, or 16.2p in sterling terms. Cash conversion was excellent, as usual, with net operating cashflow of $9.31m.

The balance sheet remains very strong, with the cash on the balance sheet at $25.9m, a 12% increase over a year ago. As usual, it was down on the full-year total of $28.6m, reflecting the payment of the larger part of the dividend in the period.

The report makes reference to shareholders expressing increased interest in cost control and cash management. Historically, City of London has been proactive in reducing costs in market downturns. As announced in January, it intends to make cost reductions of ca.$2.5m p.a. These will have little effect in the current financial year, with most of the effect coming in FY'25.

ESG

With ESG becoming more prominent in investors' minds, City of London has highlighted some progress over the past few months. Electricity to London and Rochester is supplied via contracts that use renewable energy. From February 2024, the Pennsylvania office will also be powered by renewable resources. Although the increase in marketing has led to more travel, with the emissions associated with that, City of London has made its first purchase of carbon offsets to help mitigate this.

Board

The interim statement included a couple of changes to the board. Jane Stabile is departing due to increased commitments from her primary business. She will be replaced by Sarah Ing with effect from 1 March 2024. Sarah is a former financials equity analyst with several financial services directorships.

Dividend

As indicated in the January trading statement, the interim dividend is unchanged at 11p. This will be paid on 28 March 2024.

Estimate updates

The additional detail has only led to minor tinkerings to our estimates and our underlying EPS estimates have increased slightly from 42.1¢ to 42.3¢ (2024E) and 46.6¢ to 47.8¢ (2025E).

As usual with the interim results, we are introducing estimates for a new financial year, 2026. In making these estimates, we have assumed the continuation of most of the major trends in our existing assumptions. These include ongoing outflows from the Emerging Markets strategy and inflows elsewhere in CLIM. We still assume slow inflows into KIM, believing the extra marketing efforts will show benefits soon. We also assume equity market growth of 5%. The main change is that we are assuming a return to expense growth, with a 2% increase over 2025 levels. This gives a 2026E underlying EPS of 52.6¢, or 41.4p.

We assume a flat dividend in 2026. Should our estimates prove accurate, then City of London will have added meaningfully to its cash resources and there may be scope for an increased dividend or special dividend.

Financials

Summary financials						
Year-end Jun	2021	2022*	2023	2024E	2025E	2026E
FUM ($bn)	11.45	9.22	9.42	9.86	10.45	11.07
P&L ($m)						
Revenue		81.55	68.73	67.74	72.17	75.79
Expenses		49.63	47.82	46.68	47.53	48.05
EBITDA		38.20	27.34	26.66	30.23	33.33
Operating profit		31.92	20.90	21.06	24.64	27.74
Statutory PTP		30.88	22.13	21.76	25.34	28.44
Earnings		24.11	17.50	16.39	19.08	21.41
Statutory EPS (¢)		44.9	38.4	33.6	39.1	43.9
Underlying EPS (¢)		57.4	44.5	42.3	47.8	52.6
Underlying EPS (p)	48.1	44.2	36.5	33.3	37.6	41.4
Total DPS (p)	33.0	46.5	33.0	33.0	33.0	33.0

Key metrics						
	2021	2022*	2023	2024E	2025E	2026E
Growth						
FUM		-19.4%	2.2%	4.6%	6.0%	5.9%
Revenue		47.9%	-15.7%	-1.4%	6.5%	5.0%
Operating profit		35.4%	-34.5%	0.8%	17.0%	12.6%
Underlying EPS (¢)		19.3%	-22.5%	-5.1%	13.1%	10.0%
DPS (excl. special div.)		0.0%	0.0%	0.0%	0.0%	0.0%
Operating margins						
Net FUM fee margin	0.75%	0.73%	0.72%	0.70%	0.70%	0.70%
Operating margin	42.8%	39.1%	30.4%	31.1%	34.1%	36.6%
Tax rate	23.6%	24.0%	24.0%	24.7%	24.7%	24.7%
U/I dividend cover (x, incl. special div.)	1.5	1.0	1.1	1.0	1.1	1.3
Rolling u/I 5-year cover (x, excl. special div.)	1.3	1.3	1.3	1.2	1.2	1.2

Underlying EPS sensitivity			
	2024E	2025E	2026E
No net new business			
Underlying EPS (¢)	41.9	45.3	47.6
change	-0.8%	-5.2%	-9.5%
0% market growth (was 5% p.a.)			
Underlying EPS (¢)	41.9	44.9	46.6
change	-0.9%	-6.1%	-11.4%

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

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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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