CITY OF LONDON INVESTMENT GROUP

Good fund performance and solid results

City of London has announced its full-year results for 2024. As stated in the trading statement, FUM was $10.24bn, a 9% increase over the year. While market performance offset net outflows, there was a significant improvement in the latter in the second half, which bodes well going forward. Underlying profit before tax of $27.2m was a 0.5% increase over 2023's $27.0m. A higher effective tax rate meant that underlying EPS declined 3% from 43.4¢ to 42.2¢. As previously announced, the final dividend was unchanged, at 22p, making 33p for the year as whole. Cash balances increased, to $33.7m, from $25.9m as of 31 December 2023.

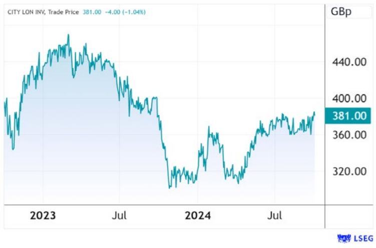
- **Funds:** Performance in the underlying funds was excellent, with the Emerging Markets strategy being the only major underperformer. Even that saw outperformance in the second half of the year. Four out of six Karpus strategies outperformed by more than 250bps, which will help marketing efforts.
- **Estimates:** Tighter fee margins and adverse exchange rate movements have led to downgrades of our earnings estimates. Our 2025E underlying EPS has decreased by 3% from 50.6¢ to 49.2¢ and our 2026E EPS has decreased by 2% from 55.5¢ to 54.1¢.
- **Valuation:** After the recent performance, the 2025E P/E of 12.5x is a noticeable discount to the peer group. A 2025E dividend yield of 8.7% 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 36% 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 ($m)	2021 (£m)	2022*	2023	2024	2025E	2026E
FUM ($bn)	11.45	9.22	9.42	10.24	10.84	11.47
Revenue	55.12	81.55	68.73	69.45	73.76	77.41
Statutory PTP	22.25	30.88	22.13	22.62	26.30	29.44
Statutory EPS (¢)	39.4	44.9	38.4	35.1	40.6	45.4
Underlying EPS (¢)	48.1	57.4	43.4	42.2	49.2	54.1
Underlying EPS (p)	48.1	44.2	36.5	33.5	36.7	40.3
DPS (p)	33.0	33.0	33.0	33.0	33.0	33.0
Special dividend (p)		13.5				
P/E (x)	9.6	11.3	13.3	14.5	12.5	11.2
Dividend yield	8.7%	12.2%	8.7%	8.7%	8.7%	8.7%

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

Financial Services



Source: LSEG. 2024

Market data

EPIC/TKR	**CLIG**
Price (p)	**380.0**
12m high (p)	403.0
12m low (p)	300.0
Shares (m)	50.7
Mkt cap (£m)	192.6
EV (£m)	167.4
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
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

18 Oct	1Q FUM statement
31 Dec	Half-year-end

Analyst

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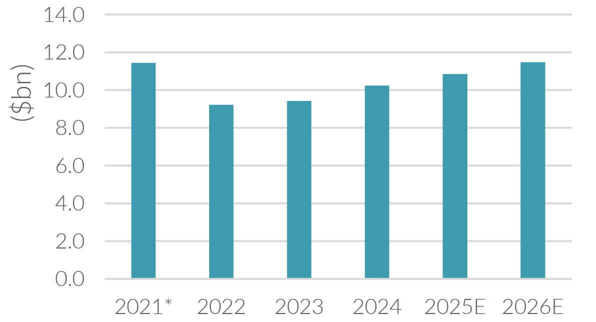
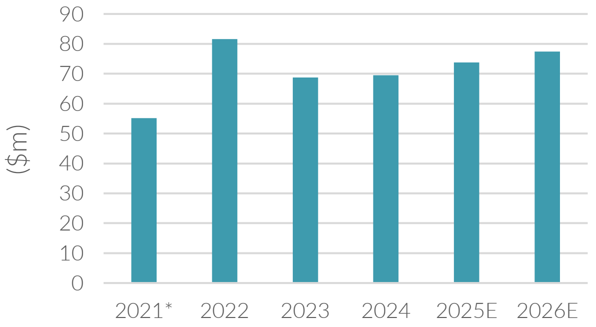
Funds under management (FUM)



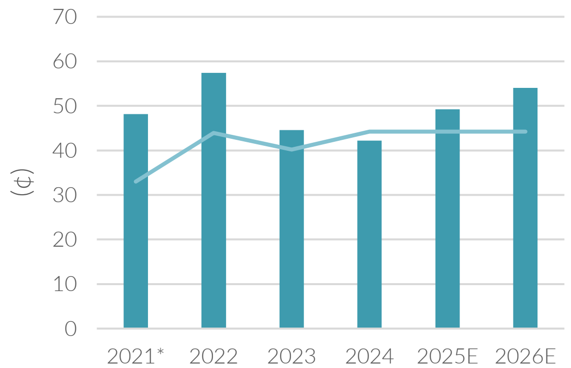
- Net outflows in 2023 and 2024, after positive 2022
- Signs of improvement in flows in 2H'24
- More normal market conditions should see a return to steadier growth
- Assumed steady net new business flows and equity market growth of 5% p.a.

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 2024				
($m)	Jun'24	Jun'23	Net flows	Other movements
Emerging Markets	3,568	3,580	(424)	413
International	2,394	1,983	153	257
Opportunistic Value	251	244	(33)	40
Frontier	10	9	0	1
Other/REIT	94	88	(12)	18
CLIM total	**6,317**	**5,904**	**(316)**	**729**
Karpus retail	2,655	2,441	(40)	254
Karpus institutional	1,269	1,079	36	154
KIM total	**3,924**	**3,520**	**(4)**	**408**
Total	**10,241**	**9,424**	**(320)**	**1,137**

Source: Hardman & Co Research

The bulk of the figures on FUM and flows were given in July's trading statement, with some extra detail added in this statement. Overall, the pattern continued to be one of positive market performance more than outweighing net outflows. However, that does not tell the full story, as there was a much-improved performance in the second half. Within CLIM, net outflows reduced from $249m in 1H'24 to $68m at the year-end, while, in KIM, they turned around, with 1H'24 outflows of $45m improving to net inflows of $42m.

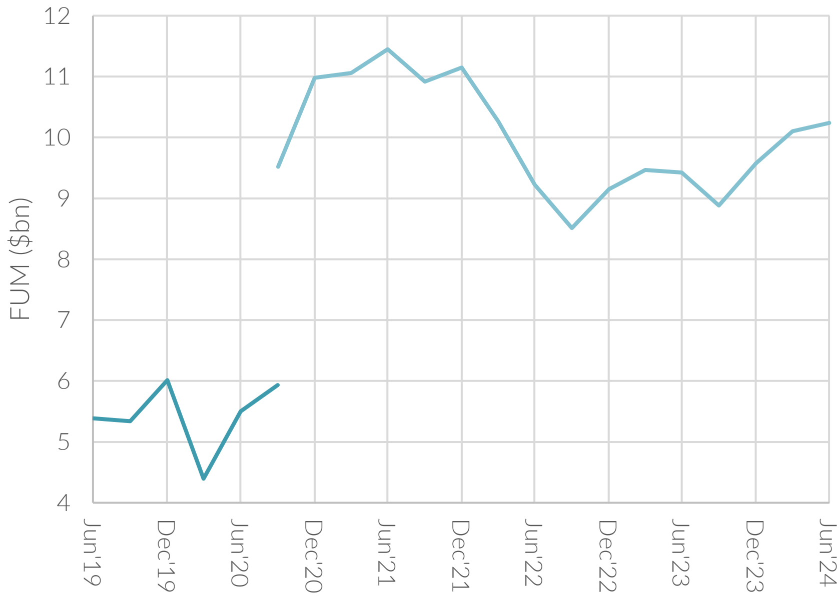
The main drag in CLIM continues to be ongoing outflows from the Emerging Markets strategy. Investors appear to have largely taken advantage of improved emerging market performance to rebalance their exposure into other areas. City of London notes one client that switched $100m from its Emerging Markets strategy to its International strategy. Nevertheless, it cites a survey that has suggested greater interest in emerging markets by investors, so there is some hope that the outflows will at least slow, and hopefully reverse.

Even without that client switch, it was another positive year for flows into the International strategy. At $2.4bn, it now makes up 23% of assets and is comfortably the second-largest strategy. This highlights the potential of introducing new strategies, even if they don't always work.

Despite good performance, the new REIT strategies have failed to attract adequate institutional interest (we understand investors are wedded to managers who own and manage properties directly). In December 2024, the track record for the seeded Global strategy will reach three years, at which point marketing to investors will begin. While we wouldn't expect huge inflows immediately, it's a large enough category to be potentially meaningful for City of London. There has also been some investor interest in the private equity strategy. This is very small and, while positive, we do not expect large fund flows, even if this interest develops further.

As we noted in our reports on the past couple of trading statements, the investment into better marketing for Karpus appears to be producing results. We can see that the institutional business received net inflows for the year as a whole. The retail business was marginally positive in the second half too (net inflows of $444k). Both of these bode well and hopefully we'll see more net inflows going forward.

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

Fund performance

As indicated in the July trading statement, the Emerging Markets strategy was the only underperformer within CLIM. This was due to unfavourable country allocation and weak NAV performance in the underlying funds. City of London notes that the past few months have seen better performance. In CLIM's other main strategies:

- International performance was driven by good country allocation, benefitting from out-of-benchmark exposure to the US, and underweight Europe ex-UK somewhat offset by underweights in emerging markets and overweights in mid/smallcap.
- Opportunistic Value benefited from some high-conviction, event-driven situations, most significantly the bid for Hipgnosis Songs.

Within Karpus, four out of its six strategies outperformed by more than 250bps in the year and all outperformed their benchmarks.

We have noted several times over the past couple of years that discounts on closed-end funds are at historical highs. On average, there was a slight narrowing over the year, which aided fund performance. Nevertheless, they remain close to these historical highs: in its accounts, City of London highlights the UK, which, ignoring the past 12 months, last saw discounts of this size when Lehman Brothers went under in 2008.

There are good signs that the closed-end fund industry is looking to address this situation. Capital is being retired from the sector, boards are feeling pressure from an increasing presence of active investors on shareholder registers and an increase in M&A all suggest a narrowing of discounts going forward. While we have commented before how it wasn't clear what would trigger a narrowing of discounts, catalysts now seem to be in place. This should bode well for City of London performance, and for fund flows, if it can persuade investors that the stars are aligning for discount narrowing.

Finances

As previously noted, this is the first year that City of London is presenting its results entirely in US dollars, although the past couple of years have been translated for comparison.

Positive market and FUM growth meant fee income was slightly ahead of our forecast, at $69.4m. However, the fee margin continues to decline as (higher-margin) Emerging Markets strategy assets are replaced by lower-margin strategies. The average fee rate decreased to 69bps, from 72bps, slightly behind our estimate.

Expenses grew by 3%, slightly more than we expected, with most of the increase due to higher employee costs. There was also a negative impact from a weaker US dollar: 32% of expenses are in sterling and, to a lesser extent, Singapore dollars. Exchange rate movements account for 1% of the expense rise.

Investment gains were positive for the year, at $1.05m, compared with $689m in 2023. The bulk came from realised profits on the seed investments in the REIT funds, which are being discontinued. Interest income also increased on the back of higher interest rates.

In aggregate, this led to profit before tax and intangibles of $28.2m, an increase of 2% over 2023's $27.7m. Higher tax led to a decline in statutory profit after tax of 2% to $17.1m.

On an underlying basis (stripping out intangible amortisation and investment gains), PBT grew 0.5% to $27.2m, while profit after tax declined 3% to $20.6m.

Cash

As usual, cash generation was excellent. It was aided by small, but positive, movements in working capital and came in at 101% of underlying earnings. With a smaller dividend payment in the second half, this led to a healthy improvement in the cash balance to $33.7m, from $25.9m as of 31 December 2023. City of London's balance sheet remains strong for a company of its size.

Management

As previously announced, Chief Investment Officer Mark Dwyer retired at 30 June 2024. The CLIM investment process is set up so that it is not dependent on a single person. While he will be missed on a personal level, we see no reason why the company's investment process will be affected.

Dividend

As indicated in the July trading statement, the final dividend is unchanged at 22p, bringing the total to 33p for the year. This will be paid on 7 November 2024.

Estimate updates

There are several moving parts in our estimates. We had already allowed for higher-than-expected FUM after the trading update. Now we have trimmed our revenue fee margin slightly. A further strengthening of sterling has also increased our expense estimates, although this is a smaller effect than the fee margin.

City of London management is optimistic that, with the US now being in the cutting part of the rate cycle, emerging markets will outperform other markets in the near future. We have kept our forecast for equity market growth at 5% for all markets. However, if City of London is correct, then our forecast of slow, ongoing fee decline may be conservative.

Together, these moving parts have prompted us to reduce our earnings estimates. We have lowered our 2025E underlying EPS by 3%, from 50.6¢ to 49.2c, and our 2026E EPS has decreased by 2%, from 55.5¢ to 54.1¢. With the exchange rate movement, the change in sterling terms is slightly larger: 2024E decreases from 39.2p to 36.7p and 2025E from 43.0 to 40.3p.

We continue to assume a flat dividend through to 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	2024	2025E	2026E
FUM ($bn)	11.45	9.22	9.42	10.24	10.84	11.47
P&L ($m)						
Revenue		81.55	68.73	69.45	73.76	77.41
Expenses		49.63	47.82	48.96	48.15	48.67
EBITDA		38.20	27.34	27.07	31.21	34.34
Operating profit		31.92	20.90	20.49	25.61	28.74
Statutory PTP		30.88	22.13	22.62	26.30	29.44
Earnings		24.11	17.50	17.12	19.81	22.17
Statutory EPS (¢)		44.9	38.4	35.1	40.6	45.4
Underlying EPS (¢)		57.4	43.4	42.2	49.2	54.1
Underlying EPS (p)	48.1	44.2	36.5	33.5	36.7	40.3
Total DPS (p)	33.0	46.5	33.0	33.0	33.0	33.0

Key metrics

	2021	2022*	2023	2024	2025E	2026E
Growth						
FUM		-19.4%	2.2%	4.6%	8.7%	5.9%
Revenue		47.9%	-15.7%	-1.4%	1.1%	6.2%
Operating profit		35.4%	-34.5%	0.8%	-2.0%	25.0%
Underlying EPS (¢)		19.3%	-22.5%	-5.1%	-5.2%	16.6%
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%	0.69%	0.69%	0.69%
Operating margin	42.8%	39.1%	30.4%	29.5%	34.7%	37.1%
Tax rate	23.6%	24.0%	24.0%	24.3%	24.7%	24.7%
U/I dividend cover (x, incl. special div.)	1.5	1.0	1.1	1.0	1.1	1.2
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

	2025E	2026E
No net new business		
Underlying EPS (¢)	48.8	52.8
change	-1.0%	-2.4%
0% market growth (was 5% p.a.)		
Underlying EPS (¢)	47.7	49.4
change	-3.1%	-8.5%

**2022 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research £1=$1.34*

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