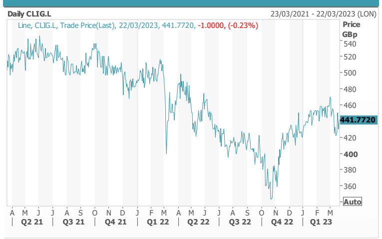
HARDMAN&CO.

22 March 2023

Financial Services



Source: Refinitiv

Market data

EPIC/TKR	**CLIG**
Price (p)	**440.0**
12m high (p)	499.0
12m low (p)	343.5
Shares (m)	50.7
Mkt cap (£m)	223.0
EV (£m)	203.9
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

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www.clig.com

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

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

Analyst

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CITY OF LONDON INVESTMENT GROUP

Solid results in volatile markets

City of London has announced its interim results for 1H'23. The headline figures were in line with those from the January trading statement. As previously indicated, weak markets meant that results were down on the year before. Gross revenue of £28.7m was 9% down, from £31.4m in 1H'22. Underlying earnings after tax were £8.99m, a decline of 25% from the previous year (note that these no longer need to be adjusted for part-years of Karpus). Underlying EPS of 18.4p represented a decline by the same percentage from 1H'22. FUM saw net inflows from a range of areas, including the KIM Institutional strategy showing a return to growth.

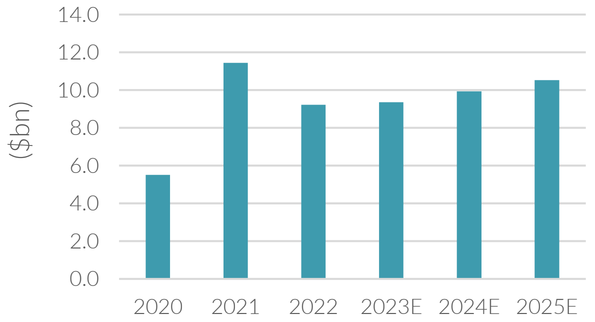
- **Operations:** While exchange rate movements were the largest factor in expense growth, City of London is also investing in growing KIM's new business capacity. Lead times mean that the benefit is more likely to be seen in FY'24 than FY'23.
- **Estimates:** Although markets have given back the early gains in this quarter, there is a slight boost to our estimates. We have increased our underlying 2023E EPS by 2%, to 34.4p, while our underlying 2024E EPS has increased by 0.5%, to 35.7p. We have also introduced a 2025E EPS of 37.8p.
- **Valuation:** After the recent performance, the 2024E P/E of 15.6x is roughly in line with the peer group. The 2024E dividend yield of 8.9% 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	9.35	9.93	10.52
Revenue	33.26	55.12	61.29	57.12	59.38	62.40
Statutory PTP	9.41	22.25	23.17	18.92	19.76	21.16
Statutory EPS (p)	30.3	39.4	36.9	27.0	28.3	30.4
Underlying EPS (p)	38.0	48.1	44.2	34.4	35.7	37.8
DPS (p)	30.0	33.0	33.0	36.0	39.0	39.0
Special dividend (p)			13.5			
P/E (x)	14.5	11.2	11.9	16.3	15.6	14.5
Dividend yield	6.8%	7.5%	10.6%	8.2%	8.9%	8.9%

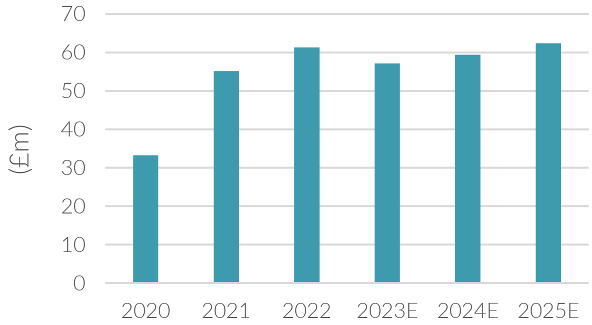
**2022 figures include a special dividend of 13.5p; Source: Hardman & Co Research*

Funds under management (FUM)



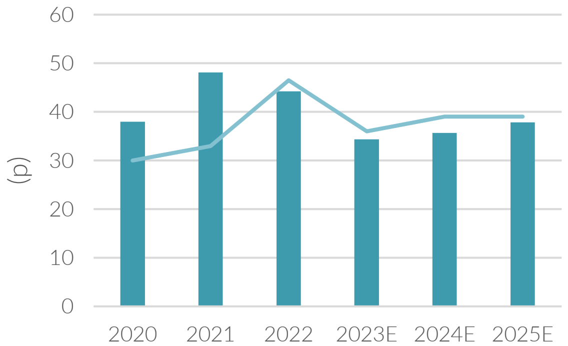
- Net inflows restored in 2022 after a weaker 2021
- Addition of Karpus in 2021 added $3.58bn
- More normal market conditions should see a return to steadier growth
- Assumed steady net new business flows and equity market growth of 5% p.a.

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

As usual, the results were in line with the January 2023 trading statement; so, in this report, we highlight information from the commentary in the interim report and a few details on the financials.

Funds

1H funds under management (FUM) movements

($m)	Dec'22	Jun'22	Net flows	Other movements
Emerging Markets	3,570	3,703	-65	-68
International	1,894	1,812	13	69
Opportunistic Value	240	193	48	-1
Frontier	8	9	0	-1
REIT/other	69	74	0	-5
CLIM total	**5,781**	**5,791**	**-4**	**-6**
KIM Retail	2,341	2,419	-108	30
KIM Institutional	1,028	1,014	6	8
KIM total	**3,369**	**3,433**	**-102**	**38**
Total	**9,150**	**9,224**	**-106**	**32**

Source: Hardman & Co Research

The figures above provide a little more detail on those available at the time of the trading statement. As previously indicated, while there were significant market movements in the half-year period being reported on, the net result was almost flat market movements in the period.

In early 2023, we saw a slight market recovery, but we note that markets have given back these early gains with the recent concerns about banks. Although City of London's FUM increased from $9.15bn at the year-end to $9.38bn at the end of February, market movements in March have eroded that gain.

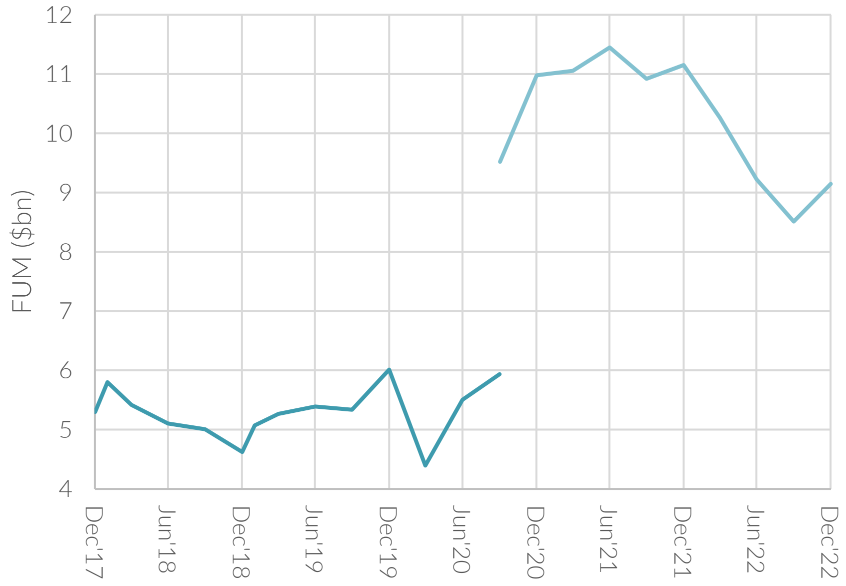
While the net inflows were also limited in aggregate, these hide much larger gross inflows and outflows. Over the half year, CLIM saw gross inflows of $190m and outflows of $194m. The figures for KIM were $108m and $210m, respectively. Although the first of these is slower than in the previous half year, it does demonstrate that City of London is winning new business. On a net basis, CLIM's International and Opportunistic Value strategies and KIM's Institutional business saw net inflows.

We note in *Operations* below that City of London has added to its new business capability. This bodes well for an improvement in inflows, although we note that the lead times for new business, particularly institutional, mean that the company will likely see more benefit in FY'24 than in FY'23.

This should be aided by continued good performance. Within CLIM, all the strategies with meaningful external assets outperformed, led by NAV performance of the underlying closed-ended funds. City of London notes that discounts remain wide; while they could get wider, it does suggest some potential should they close at all.

At KIM, outperformance was seen in both the Balanced and Fixed Income strategies, which are followed by the majority of KIM's assets. The main source of outperformance was exposure to municipal fixed income funds.

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

With profit figures in line with those previously announced, the main interest is in the detail. Gross revenues, as would be expected from market movements, fell by 9%, to £28.7m. The decline was offset by a strengthening US dollar against sterling.

Expenses were 12% higher than in the same period last year. About three quarters of this can be attributed to currency movements. However, City of London has also expanded its new business team and systems, particularly in KIM. This has had some cost implications, but should pay back in due course.

There was a positive benefit of £0.17m from unrealised gains on the seed investments held on the balance sheet.

As usual, cash conversion was excellent, with cash from operations at £11.3m, versus operating profit (plus intangible amortisation) of £11.6m.

Cash balances remain strong, at £19.1m, plus £7.6m of other financial assets (mostly the seed fund investments).

Dividend

As announced in the January trading statement, the interim dividend is unchanged, at 11p per share.

Estimate updates

We have made only minor adjustments to our estimate assumptions. Given the expense growth, we have increased our assumed growth rate from 2% to 4%. The higher average FUM this quarter has led to small net upgrades to our figures. Our underlying 2023E EPS has increased by 2%, to 34.4p, while our underlying 2024E EPS has increased by 0.5%, to 35.7p.

As usual at this time of year, we introduce new forecasts – this time for FY'25. We have not made any changes to our core underlying assumptions for markets or inflows. We do note that our assumption of $80m p.a. of net inflows to KIM has not been achieved, but, hopefully, the new investment will lead to an improvement. Our 2025E underlying EPS is 37.8p.

As before, 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 in the next couple of years 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	**2020**	**2021**	**2022***	**2023E**	**2024E**	**2025E**
FUM ($bn)	5.50	11.45	9.22	9.35	9.93	10.52
P&L (£m)						
Revenue	33.26	55.12	61.29	57.12	59.38	62.40
Expenses	21.66	31.55	37.34	38.61	39.89	41.52
Operating profit	11.60	23.57	23.95	18.51	19.49	20.89
Statutory PTP	9.41	22.25	23.17	18.92	19.76	21.16
Earnings	7.37	16.99	18.09	13.23	13.88	14.94
Statutory EPS (p)	30.3	39.4	36.9	27.0	28.3	30.4
Underlying EPS (p)	38.0	48.1	44.2	34.4	35.7	37.8
Total DPS (p)	30.0	33.0	46.5	36.0	39.0	39.0

Key metrics						
	2020	**2021**	**2022***	**2023E**	**2024E**	**2025E**
Growth						
FUM		108.1%	-19.4%	1.4%	6.1%	6.0%
Revenue		65.7%	11.2%	-6.8%	4.0%	5.1%
Operating profit		103.2%	1.6%	-22.7%	5.3%	7.2%
Underlying EPS		26.7%	-8.1%	-22.3%	3.8%	6.1%
DPS (excl. special div.)		10.0%	0.0%	9.1%	8.3%	0.0%
Operating margins						
Net FUM fee margin	0.75%	0.75%	0.73%	0.73%	0.72%	0.71%
Operating margin	34.9%	42.8%	39.1%	32.4%	32.8%	33.5%
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	0.7	0.7	0.8
Rolling 5-year cover (x, excl. special div.)	1.2	1.3	1.2	1.1	0.9	0.9
Rolling u/l 5-year cover (x, excl. special div.)	1.2	1.3	1.3	1.2	1.2	1.1

Underlying EPS sensitivity			
	2023E	**2024E**	**2025E**
No net new business			
Underlying EPS (p)	34.2	34.9	36.4
change	-0.3%	-2.1%	-3.9%
0% market growth (was 5% p.a.)			
Underlying EPS (p)	34.2	33.7	33.3
change	-0.4%	-5.6%	-12.0%

**2022 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research*
£1=$1.20

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