

31 January 2024

Financial Services



Source: LSEG

Market data

EPIC/TKR	CLIG
Price (p)	360.0
12m high (p)	470.0
12m low (p)	301.0
Shares (m)	50.7
Mkt cap (£m)	182.4
EV (£m)	159.9
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
Chair	Rian Dartnell
	+44 (0)207 711 0771
	www.clig.com

Key shareholders

George Karpus	31.5%
Hargreaves Lansdown	8.1%
Aberforth Partners	7.1%
Interactive Investor	6.3%
AJ Bell	3.1%
Other directors & staff	10.0%

Diary

23 Feb	Interim results
28 Mar	Interim dividend paid
22 Apr	3Q FUM statement

Analyst

Brian Moretta bm@hardmanandco.com

CITY OF LONDON INVESTMENT GROUP

Bounce back in FUM after strong quarter

City of London has announced its trading statement for 2Q'24. Both developed and emerging markets bounced back from a weak 1Q'24 and posted gains for the six-month period. Over 1H'24, the MSCI Emerging Markets TR Index increased 4.7% while the MSCI All World ex US Index increased by 5.6%. These led to a strong increase in FUM, which was \$9.58bn at 31 December 2023. This is a 2% increase over the 30 June figure, but 8% over the total at the end of 1Q'24. Across the strategies there was some outperformance, notably in Opportunistic Value and Fixed Income offset by some net outflows.

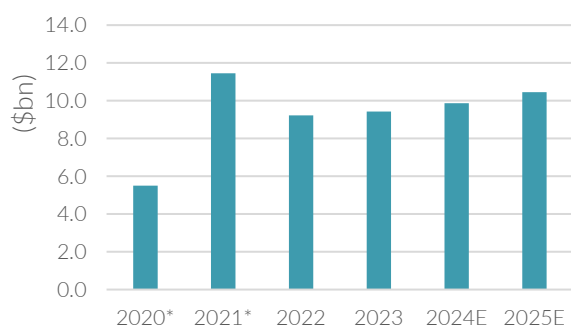
- **Operations:** Given market conditions, City of London has announced some cost reductions. It has identified ca. \$2.5m p.a. of reductions with the full effect in FY2025. It announced estimated profit before amortisation and taxation for 1H'24 of \$13.8m, a 1% increase over last year.
- **Estimates:** The increase in FUM and cost savings have led to significant upgrades to our estimates. Our 2024E EPS has increased by 6% from 40.0¢ to 42.1¢ and our 2025E EPS has increased by 11% from 41.8¢ to 46.6¢. We have left our dividend forecasts unchanged.
- **Valuation:** After the recent performance, the 2024E P/E of 13.7x is a noticeable discount to the peer group. A 2024E dividend yield of 9.2% 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)	2020 (£m)	2021 (£m)	2022*	2023	2024E	2025E
FUM (\$bn)	5.50	11.45	9.22	9.42	9.86	10.45
Revenue	33.26	55.12	81.55	68.73	67.74	72.17
Statutory PTP	9.41	22.25	30.88	22.13	21.71	24.61
Statutory EPS (¢)	30.3	39.4	44.9	38.4	33.5	37.9
Underlying EPS (¢)	38.0	48.1	57.4	44.5	42.1	46.6
Underlying EPS (p)	38.0	48.1	44.2	36.5	33.1	36.7
DPS (p)	30.0	33.0	33.0	33.0	33.0	33.0
Special dividend (p)			13.5			
P/E (x)	11.9	9.1	10.2	11.9	13.7	12.0
Dividend yield	8.3%	9.2%	12.9%	9.2%	9.2%	9.2%

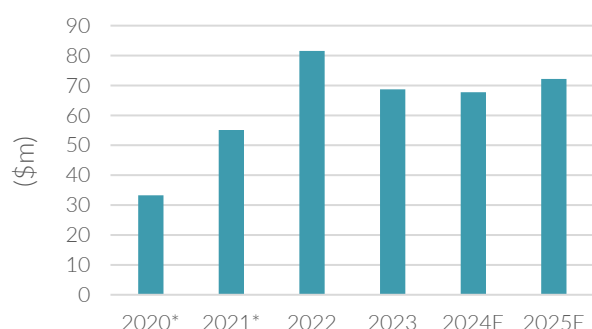
*2022 figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



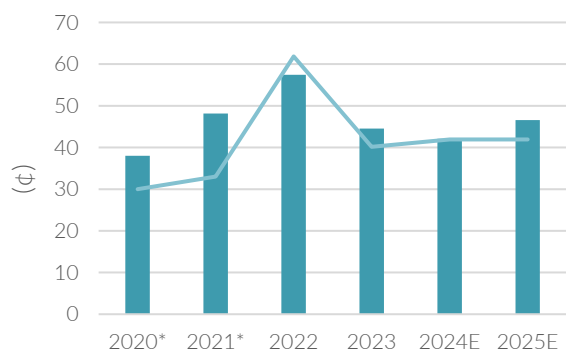
- ▶ Net outflows in 2023, after positive 2022
- ▶ Addition of Karpus in 2021 added \$3.58bn
- ▶ More normal market conditions should see a return to steadier growth
- ▶ Assumed steady net new business flows and equity market growth of 5% p.a.

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

* 2020 and 2021 figures in GBP. Source: Company data, Hardman & Co Research

Commentary

Funds

Funds under management (FUM) movements during 2Q'24				
(\$m)	Dec'23	Sep'23	Net flows	Other movements
Emerging Markets	3,578	3,398	(118)	298
International	2,004	1,830	(19)	193
Opportunistic Value	278	239	15	24
Other	98	88	1	9
CLIM total	5,958	5,555	(121)	524
KIM total	3,618	3,326	(21)	313
Total	9,576	8,881	(142)	837

Source: Hardman & Co Research

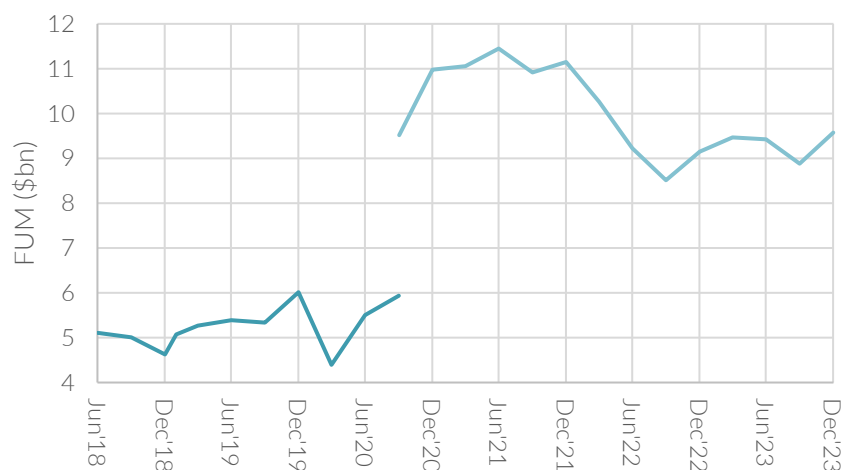
Global markets rebounded significantly in the last quarter of the calendar year, more than making up for the weakness in the preceding quarter. City of London also experienced some outperformance offset by more net outflows. In aggregate, FUM increased by 8% over 2Q'24.

Within the CLIM strategies, the Opportunistic Value strategy outperformed and International was neutral while Emerging Markets slightly underperformed. The KIM fixed income strategies outperformed. The main driver was a part reversal of some of the widening of discounts that had been seen earlier in the year. NAV performance was also a positive.

Net outflows slowed a little from the first quarter (\$142m versus \$152m). The Opportunistic Value strategy saw some net inflows, while the net outflows from the International strategy were much reduced. KIM's private clients usually experience outflows as the calendar/tax year finishes, although the \$21m was a slight improvement on 1Q'24.

City of London notes a pick-up in marketing and sales activity in January. There are potential new mandates across the asset classes and management highlight that the small reversal of discounts still leaves them at historic highs and presenting good value.

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

Both the average fee income across the group and monthly “fixed” costs are unchanged on the preceding quarter at 70bps and \$3.2m respectively. Although FUM have increased, the current run-rate for operating profit before profit share based on the last month of the quarter and, in Karpus, billing is based on FUM at the start of the quarter. So this run rate can lag FUM movements and is slightly down at \$3.2m per month from \$3.4m at the end of 1Q’24.

While we would expect markets to generally rise over time, the last quarter does not remove the effects of the previous couple of years. Given the environment is not as positive as it would like, City of London has announced some cost reductions. It has initiated actions that should reduce costs by ca. \$2.5m p.a. or 6% of the current cost base, with the full effect to be seen in FY’25.

Historically, City of London has demonstrated a good ability to control costs when market conditions are challenging and it is good to see this is continuing.

The half year profit before amortisation and taxation for 1H’24 is estimated at \$13.9m, a 1% increase over the 1H’23 figure of \$13.8m (restated using average exchange rates). Curiously, 1H’23 saw a similar market pattern, with a weak 1Q and bounce back in 2Q.

Total cash and equivalents stood at \$28.8m as of 31 December 2023, compared with \$28.6m six months earlier. Given the final dividend was paid in the period, this shows that City of London’s ability to generate cash remains good.

Dividend

In line with our forecast, City of London has announced an unchanged interim dividend of 11p. This will be paid on 28 March 2024.

Estimate updates

The positive movement in FUM and the benefit of the expense decreases have led to significant upgrades in our estimates, albeit the weaker US Dollar was a slight offset. We have assumed a small expense improvement in 4Q’24, with the full effect in FY’25. Our 2024E underlying EPS has seen an upgrade of 5% from 40.0¢ to 42.1¢ and our 2025E EPS is also increased by 11% from 41.8¢ to 46.6¢.

To enable easier comparison with the dividend, we have added underlying EPS estimates in sterling. These are 33.1p for 2024E and 36.7p in 2025E.

Financials

Summary financials						
Year-end Jun	2020	2021	2022*	2023	2024E	2025E
FUM (\$bn)	5.50	11.45	9.22	9.42	9.86	10.45
P&L (\$m)						
Revenue			81.55	68.73	67.74	72.17
Expenses			49.63	47.82	46.73	48.26
Operating profit			31.92	20.90	21.01	23.91
Statutory PTP			30.88	22.13	21.71	24.61
Earnings			24.11	17.50	16.35	18.53
Statutory EPS (¢)			44.9	38.4	33.5	37.9
Underlying EPS (¢)			57.4	44.5	42.1	46.6
Underlying EPS (p)	38.0	48.1	44.2	36.5	33.1	36.7
Total DPS (p)	30.0	33.0	46.5	33.0	33.0	33.0
Key metrics						
	2020	2021	2022*	2023	2024E	2025E
Growth						
FUM		108.1%	-19.4%	2.2%	4.6%	6.0%
Revenue		65.7%	47.9%	-15.7%	-1.4%	6.5%
Operating profit		103.2%	35.4%	-34.5%	0.5%	13.8%
Underlying EPS (¢)		26.7%	19.3%	-22.5%	-5.5%	10.6%
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%	0.70%	0.70%
Operating margin	34.9%	42.8%	39.1%	30.4%	31.0%	33.1%
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 (¢)					42.0	45.7
change					-0.3%	-1.9%
0% market growth (was 5% p.a.)						
Underlying EPS (¢)					41.7	43.6
change					-0.9%	-6.3%

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

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research@hardmanandco.com

1 Bonhill Street
London
EC2A 4DJ

www.hardmanandco.com