



21 February 2020

## Financial Services



Source: Refinitiv

## Market data

EPIC/TKR	CLIG
Price (p)	456.0
12m High (p)	474.0
12m Low (p)	388.0
Shares (m)	26.6
Mkt Cap (£m)	121.1
EV (£m)	108.6
Market	LSE

## Description

City of London is an investment manager specialising in using closed-ended funds to invest in emerging and other markets.

## Company information

CEO	Tom Griffith
CFO	Tracy Rodrigues
Chairman	Barry Aling
	+44 207 860 8346
	<a href="http://www.citlon.com">www.citlon.com</a>

## Key shareholders

Directors & staff	18.6%
Blackrock	10.1%
APQ Capital	5.5%
Cannacord Genuity	5.0%
Eschaton Opportunities	4.8%
Fund Management	
Polar Capital	3.7%

## Diary

21 Apr	3Q FUM announcement
14 Jul	Pre-close update
14 Sep	Preliminary results
7 Oct	1Q FUM announcement

## Analyst

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## CITY OF LONDON INVESTMENT GROUP

## Interim results validate good first half performance

City of London has announced its interim results for 1H'20. Several of the key figures were announced in the January trading statement, so the main interest is in the underlying figures. With FUM growth supported by positive markets and net inflows, revenue growth was good at 11% compared with the same period last year. Despite the helpful conditions, City of London maintained its excellent cost control and the net result was a 23% increase in profit after tax to \$5.06m. Cash conversion, as always, was excellent, with operating cashflow at 107% of earnings.

- **Performance:** Further detail was provided on fund performance over the period. The Developed strategy outperformed by an average of 3.5% and Opportunistic Value by an average of 2.2%. EM averaged 0.75% as well and all have strong quartile placings over multiple timescales.
- **Earnings estimates:** As the main figures were given in January, there are only small adjustments to the Hardman & Co earnings estimates. We have introduced a 2022E EPS of 54.5p. A further dividend increase is also assumed, but strong markets may see another one before then.
- **Valuation:** The 2021E P/E of 9.2x is at a significant discount to the peer group. The underlying 2020E yield of 6.6% is attractive, in our view, and should, at the very least, provide support for the shares in the current markets.
- **Risks:** Although emerging markets can be volatile, City of London has proved to be more robust than some other EM fund managers, aided by its good performance and strong client servicing. Further EM volatility could raise the risk of such outflows, although increasing diversification is also mitigating this.
- **Investment summary:** Having shown robust performance in challenging market conditions, City of London is now reaping the benefits in a more supportive environment. The valuation remains reasonable. FY'18 and 1H'20 both saw dividend increases and, unless there is significant market disruption, more should follow in the next few years.

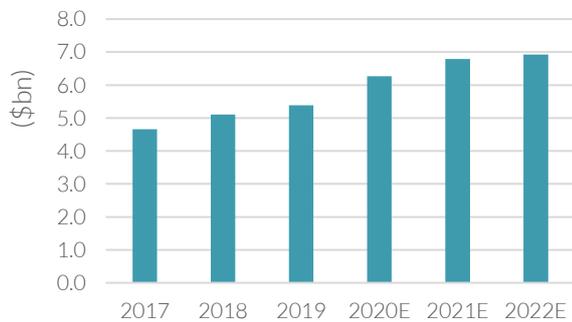
## Financial summary and valuation

Year-end Jun (£m)	2017	2018	2019*	2020E	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	6.27	6.79	6.92
Revenue	31.29	33.93	31.93	35.13	38.56	41.43
Statutory PTP	11.59	12.79	11.40	13.56	15.59	17.04
Statutory EPS (p)	36.9	39.5	34.9	43.4	49.8	54.5
DPS (p)	25.0	27.0	27.0	30.0	30.0	33.0
Special dividend (p)			13.5			
P/E (x)	12.4	11.5	13.1	10.5	9.2	8.4
Dividend yield	5.5%	5.9%	8.9%	6.6%	6.6%	7.2%

\*2019 figures include a special dividend of 13.5p; Source: Hardman & Co Research

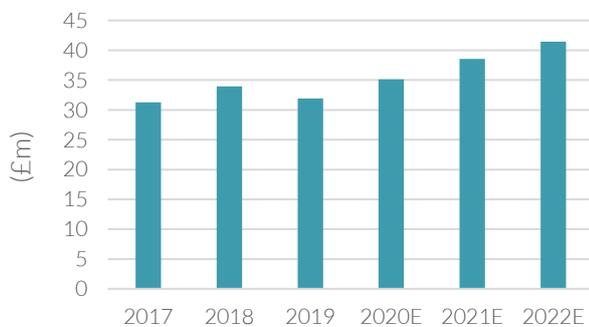
## City of London Investment Group

### Funds under management (FUM)



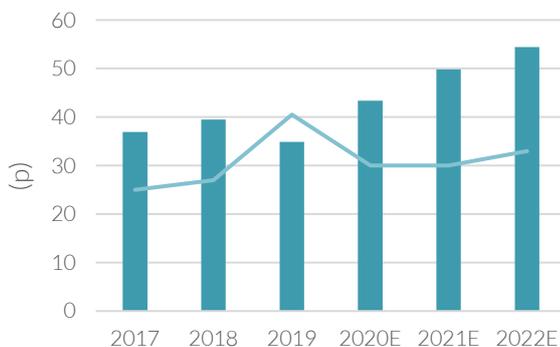
- ▶ Net inflows since 2014
- ▶ Market recovery in 3Q'19 completely offset weakness in preceding quarter
- ▶ 2020 seeing a similar pattern so far
- ▶ Assumed steady new business flows and market growth of 5% p.a.

### Revenue



- ▶ Revenue linked strongly to FUM
- ▶ Ongoing decrease in revenue margins from new business
- ▶ Some currency effects, particularly from a strong US dollar, between 2015 and 2017
- ▶ 2020E growth affected by reduction of revenue margins, as well as volatile markets

### EPS (bar) and DPS (line)



- ▶ Profitability historically maintained by cost flexibility
- ▶ Currency movements led to step change in 2017 EPS
- ▶ Special dividend of 13.5p in 2019
- ▶ Dividend increased in 2017, 2018 and 1H'20; however, with recent market volatility, now forecasting flat dividend in 2021, excluding the special dividend

Source: Company data, Hardman & Co Research

## Results commentary

With most of the main figures having been revealed in the January trading statement, the main interest in the interim results was some of the underlying figures.

The revenue increase reflects the growth in FUM over the past year, with good inflows and markets mostly moving in a positive direction. Averaging the quarterly FUM, the average grew 13% to \$5.58bn, which underpinned an 11% growth in revenue. New business is generally lower margin than the back-book, which together with currency effects, accounts for most of the difference.

Staff and other administrative costs grew 7%, although much of this was driven by the formulaic increase in the profit share and EIP. Custody fees increased in line with the growth in assets, but commissions fell sharply. The latter will run off entirely this year.

Interest receivable was boosted by unrealised gains on investments, which are primarily the seed investments in the new REIT strategy. The tax rate of 20.1% was in line with expectations and net profit of £5.06m was a 23% increase over the same period last year.

### Cash

As usual, cash conversion was excellent with cash generated from operating activities at 107% of earnings. Cash and equivalents on the balance sheet declined from £13.8m to £12.5m. The two biggest cash payment items were the dividend payment of £4.50m and purchases for the employee benefit trust of £2.04m. The latter is a significant increase over previous periods, with management highlighting that staff participation in share schemes has proved very popular.

There were some other changes due to the adoption of IFRS 16, which alters how leases are accounted for. While not insignificant, they do not materially affect the areas that most investors will be interested in.

### Other items

Management notes that, given the largely US client base, Brexit is unlikely to have any direct effect on the business. However, as negotiations progress there may be some exchange rate volatility as a stronger US dollar is beneficial to City of London, while the converse is also true.

## Past performance

The interim report gave a little more detail on the performance of the individual strategies over the past six months:

- ▶ EM strategies outperformed the peer average by an average of 75bps., driven by discount narrowing and good NAV performance. This strategy remains first or second quartile over one, five, ten and fifteen years.
- ▶ Developed markets outperformed by an average of 3.5%, with discount effects, country allocation and NAV performance all contributing positively. This strategy is first quartile over one, three and five years.
- ▶ Opportunistic Value outperformed by an average of 2.2%, with NAV performance and discount narrowing also contributing. It, too, is top quartile over one, three and five years.

- ▶ The Frontier strategy was the one weak point, underperforming by 5%, with country allocation and discount widening the primary contributors. No information was provided on the peer group, but this was always an area with limited capacity: both Developed and Opportunistic Value will remain much more significant for fund flows going forward.
- ▶ Both the new REIT strategies also posted positive performance, both in relative and absolute terms.

With positive performance in the largest areas, new business prospects should be good. However, rebalancing continues to affect EM with outperformance in the area being offset by clients making sure their exposure to the area stays within strict limits.

## Management

Several changes that were flagged earlier have taken place, most notably the retirement of Barry Olliff. We note that his intention to sell 500,000 shares at each of 450p, 475p and 500p remains in place. The share price has been above 450p for much of the close period and, if it remains there, we would expect that sale to take place when sufficient liquidity is available. We note on 21 February a sale of 110,529 shares took place.

## Estimate updates

As key figures are in line with expectations, we have not made many adjustments to the Hardman & Co earnings estimates. Although City of London noted that FUM declined to \$5.8bn at the end of January, markets have recovered somewhat since then. Therefore, no adjustment has been made for market movements.

The flow of new business into the new strategies has been stronger than expected. We have increased the assumed flow rate to \$200m p.a. This may prove conservative, but is offset by the assumption of no net flows for the EM strategy. We have also made minor increases to the rate of expense growth.

The net result is an upgrade of our EPS estimates, with 2020 increasing 1% to 43.4p and 2021E up 2% to 49.8p. As usual at this time of year, we have introduced a further year of forecasts, with 2022E EPS at 54.5p. We also forecast another dividend increase that year, to 33p, although if markets continue to be strong that may be conservative. Nevertheless, given the sensitivity of our forecasts to market movements, it seems prudent to be cautious.

## Financials

Year-end Jun	2017	2018	2019*	2020E	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	6.27	6.79	6.92
<b>P&amp;L (£m)</b>						
Revenue	31.29	33.93	31.93	35.13	38.56	41.43
Expenses	19.79	21.40	21.43	21.58	22.98	24.41
Operating profit	11.51	12.53	10.50	13.55	15.58	17.02
Statutory PTP	11.59	12.79	11.40	13.56	15.59	17.04
Earnings	9.14	10.06	9.05	10.85	12.47	13.63
Statutory EPS (p)	36.9	39.5	34.9	43.4	49.8	54.5
DPS (p)	25.0	27.0	40.5	30.0	30.0	33.0

Key metrics						
	2017	2018	2019*	2020E	2021E	2022E
<b>Growth (%)</b>						
FUM		9.6	5.5	16.3	8.3	2.0
Revenue		8.4	-5.9	10.0	9.8	7.4
Operating profit		8.8	-16.2	29.0	15.0	9.3
EPS		7.0	-11.6	24.2	15.0	9.3
DPS (excluding special div.)		8.0	50.0	-25.9	0.0	10.0
<b>Operating margins (%)</b>						
Net FUM fee margin	0.84	0.80	0.76	0.75	0.74	0.74
Operating margin	36.8	36.9	32.9	38.6	40.4	41.1
Tax rate	21.1	21.4	20.6	20.0	20.0	20.0
Dividend cover (x) (excluding special div.)	1.5	1.5	0.9	1.4	1.7	1.7

EPS sensitivity				
		2020E	2021E	2022E
<b>No net new business</b>				
EPS (p)		43.1	48.0	50.7
change		-0.6%	-3.8%	-6.9%
<b>0% market growth (was 5% p.a.)</b>				
EPS (p)		42.9	46.1	46.8
change		-1.0%	-7.4%	-14.0%

\*2019 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research  
£1=\$1.30

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The full detail is on page 26 of the full directive, which can be accessed here: <http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf>

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