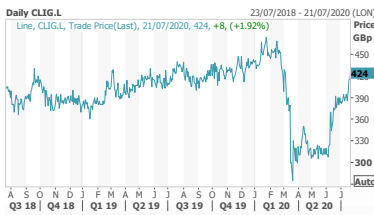


21 July 2020

**Financial Services**


Source: Refinitiv

**Market data**

EPIC/TKR	CLIG
Price (p)	416.0
12m High (p)	474.0
12m Low (p)	275.0
Shares (m)	26.6
Mkt Cap (£m)	104.9
EV (£m)	92.4
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
Head of Finance	Deepnanjan Agrawal
Chairman	Barry Aling
	+44 207 860 8312
	<a href="http://www.citlon.com">www.citlon.com</a>

**Key shareholders**

Directors & staff	18.0%
APQ Capital	6.2%
Blackrock	5.4%
Cannacord Genuity	5.0%
Eschaton Opportunities Fund Management	4.8%
Polar Capital	3.0%

**Diary**

14 Sep	Preliminary results
7 Oct	1Q FUM statement
19 Oct	AGM

**Analyst**

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# CITY OF LONDON INVESTMENT GROUP

## Market recovery boosts FUM

City of London has announced a pre-close update for FY'20. While the third quarter of the financial year was tough for markets, the final quarter saw a strong bounceback. FUM increased by 25% to \$5.50bn. After a volatile year in both directions, the net movement over the year as a whole was a 2% rise, with net inflows offsetting weak markets. The Developed Markets strategy was the standout, with inflows equal to 76% of the FUM at the start of the year. The EM strategy continued to see slow but steady outflows, although there have been signs of improvement in the second half of the year.

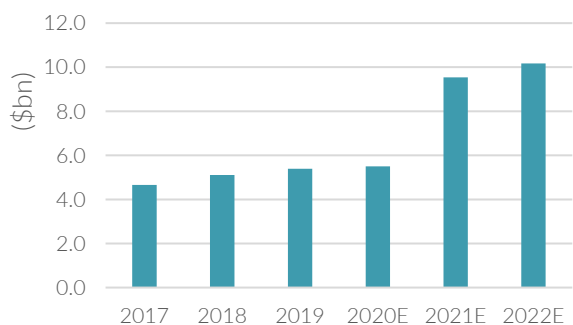
- ▶ **Performance:** Despite the market volatility and widening of discounts across the board in CEFs, the two largest strategies outperformed over the year as a whole. The smaller Opportunistic Value and Frontier strategies both underperformed.
- ▶ **Karpus:** At the general meeting, shareholders overwhelmingly approved the transaction. Completion is still expected to be on or around 1 October, as originally announced.
- ▶ **Valuation:** The 2021E P/E of 9.2x is at a discount to the peer group. The underlying 2021E yield of 7.2% 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'17 and FY'18 both saw dividend increases. With the expected EPS boost from Karpus in 2021, the prospects for future dividend increases look very good.

**Financial summary and valuation**

Year-end Jun (£m)	2017	2018	2019*	2020E	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	5.50	9.54	10.17
Revenue	31.29	33.93	31.93	32.36	51.68	60.70
Statutory PTP	11.59	12.79	11.40	8.75	24.35	30.16
Statutory EPS (p)	36.9	39.5	34.9	28.0	45.2	49.1
DPS (p)	25.0	27.0	27.0	28.0	30.0	33.0
Special dividend (p)			13.5			
P/E (x)	11.3	10.5	11.9	14.9	9.2	8.5
Dividend yield	6.0%	6.5%	9.7%	6.7%	7.2%	7.9%

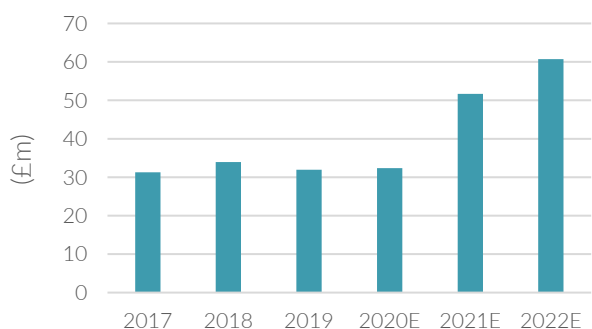
\*2019 figures include a special dividend of 13.5p; Source: Hardman & Co Research

Funds under management (FUM)



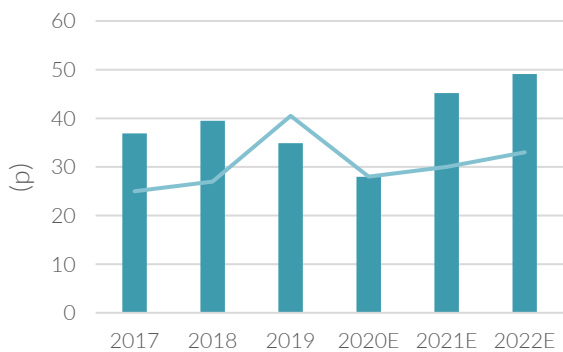
- ▶ Net inflows since 2014
- ▶ Addition of Karpus in 2021
- ▶ Market recovery in 2Q has offset the 1Q market fall
- ▶ Assumed steady new business flows and market growth of 5% p.a.

Revenue



- ▶ Revenue linked strongly to FUM
- ▶ Ongoing decrease in revenue margins from new business
- ▶ Karpus revenue margin higher than City of London's
- ▶ 2020E growth affected by reduction of revenue margins, as well as volatile markets

EPS (bar) and DPS (line)



- ▶ Profitability historically maintained by cost flexibility
- ▶ Exceptional transaction costs affect 2020E
- ▶ Special dividend of 13.5p in 2019
- ▶ Dividend increased in 2017, 2018 and 2020 (interim); we believe our forecasts for 2021 and 2022 are conservative

Source: Company data, Hardman & Co Research

## Commentary

Funds under management (FUM)				
(\$m)	Jun'20	Mar'20	Net flows	Other movements
Emerging Markets	3,828	3,237	-89	680
Developed Markets	1,244	774	284	186
Opportunistic Value	256	231	-5	30
Frontier Markets	175	153	0	22
Total	5,503	4,395	190	918

Source: Hardman & Co Research

With the strong recovery in equity markets during the past quarter, City of London's FUM have recovered strongly from the end-March levels. Of the 25% increase, almost 21% was due to markets. Net inflows were positive as well, with the Developed Markets strategy being the biggest beneficiary. Although the EM strategy saw continued outflows, we note that the rate in the second half of the financial year was slower than in the first half.

City of London has provided commentary on performance on a full-year basis. Both the EM and Developed Market strategies outperformed over the year. After the challenging markets in February and March, it is positive to see they finished the year well. City of London attributes the outperformance to good country allocation.

The smaller Opportunistic Value and Frontier strategies underperformed over the year. The former suffered weaker allocation effects, while the latter experienced weak NAV performance, especially in Argentina.

We note that EM exposure has dropped below 70% for the first time. The benefit of the diversifying strategies continues, even before the Karpus transaction.

## Estimate updates

We have made some minor adjustments to our forecasts. While FUM came in slightly ahead of our year-end forecast, the US Dollar exchange rate has weakened a little since our last report. Also, since our last report, the full prospectus for the Karpus transaction has been published. The greater detail has allowed us to tweak several numbers, the biggest of which being that we are now using a lower net revenue figure for Karpus of 80bps.

Our 2020E EPS is left unchanged at 28.0p. Our other earnings estimates have come down a bit, with our 2021E down 4% to 45.2p and 2022E down 5% to 49.1p. With management intending to at least maintain the dividend for 2020, we have left our dividend forecasts unchanged. However, we remind investors that the target dividend cover of 1.2x is on a rolling five-year basis, not for any individual year.

# Financials

Summary financials						
Year-end Jun	2017	2018	2019*	2020E	2021E	2022E
FUM (\$bn)	4.66	5.11	5.39	5.50	9.54	10.17
<b>P&amp;L (£m)</b>						
Revenue	31.29	33.93	31.93	32.36	51.68	60.70
Expenses	19.79	21.40	21.43	20.63	27.34	30.56
Operating profit	11.51	12.53	10.50	11.73	24.34	30.15
Statutory PTP	11.59	12.79	11.40	8.75	24.35	30.16
Earnings	9.14	10.06	9.05	7.00	19.48	24.13
Statutory EPS (p)	36.9	39.5	34.9	28.0	45.2	49.1
DPS (p)	25.0	27.0	40.5	28.0	30.0	33.0

Key metrics						
	2017	2018	2019*	2020E	2021E	2022E
<b>Growth (%)</b>						
FUM		9.6	5.5	2.1	73.3	6.6
Revenue		8.4	-5.9	1.3	59.7	17.5
Operating profit		8.8	-16.2	11.7	107.5	23.9
EPS		7.0	-11.6	-19.9	61.6	8.6
DPS (excluding special div.)		8.0	0.0	3.7	7.1	10.0
<b>Operating margins (%)</b>						
Net FUM fee margin	0.84	0.80	0.76	0.75	0.75	0.75
Operating margin	36.8	36.9	32.9	36.3	47.1	49.7
Tax rate	21.1	21.4	20.6	20.0	20.0	20.0
Dividend cover (x, excluding special div.)	1.5	1.5	1.3	1.0	1.5	1.5
Rolling 5-year cover (x, ex special div.)	1.1	1.2	1.3	1.2	1.3	1.4

EPS sensitivity			2021E	2022E
<b>No net new business</b>				
EPS (p)			44.3	47.0
change			-1.9%	-4.3%
<b>0% market growth (was 5% p.a.)</b>				
EPS (p)			43.5	44.8
change			-3.7%	-8.7%

\*2019 figures include a special dividend of 13.5p; Source: Company data, Hardman & Co Research  
£1=\$1.24

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