The Law Debenture Corporation

Firing on all cylinders

Investment trusts

30 July 2018

The Law Debenture Corporation (LWDB) is unusual among investment trusts in that it runs a long-established independent professional services (IPS) business alongside its investment portfolio of global equities. With the corporate entity having refreshed its management team, growth in the IPS business has been strong in H118, and income from the businesses (which include corporate trusts, pension services, corporate services and whistleblowing) provided 30% of LWDB's net revenue per share, in spite of accounting for only 13.5% of fair value NAV. Meanwhile, the investment trust portfolio has produced strong long-term NAV total return performance versus its FTSE All-Share benchmark, and managers James Henderson and Laura Foll continue to find attractively valued opportunities in the UK, which remains severely out of favour among professional investors.

12 months ending	Share price (%)	NAV* (%)	FTSE All-Share (%)	FTSE 250 (%)	FTSE World (%)
30/06/14	10.9	20.7	13.1	16.8	10.0
30/06/15	1.4	3.1	2.6	14.5	9.9
30/06/16	(1.5)	(2.3)	2.2	(4.6)	14.6
30/06/17	21.2	26.9	18.1	22.2	22.9
30/06/18	7.3	10.3	9.0	10.6	9.3

Source: Thomson Datastream. Note: All % on a total return basis in pounds sterling. *NAV including income and with debt at fair value, restated for periods before 29 February 2016.

Investment strategy: Structure gives income flexibility

LWDB's investment portfolio is diversified across c 130–140 stocks, with a bias to the UK (typically 70–75% within an allocation range of 55–80%). The managers invest across the market capitalisation spectrum in stocks where valuations do not reflect the long-term prospects for the business, and their ability to look across the globe allows them to access attractive business areas that may be under-represented in the UK market. Asia Pacific (ex-Japan) investments are typically made through collective funds. The significant income contribution from the IPS business gives the managers greater flexibility in stock selection than would typically be the case for a fund with a focus on steadily increasing dividends.

Market outlook: Better value amid volatility

After a year of strong equity market returns and historically low volatility in 2017, global stock market performance has been more mixed in 2018, partly in response to fears over a global trade war and the possibility of a less benign global economic backdrop. This has led to forward P/E valuations declining from what in some cases were very extended levels, suggesting better value opportunities than hitherto.

Valuation: Wider-than-average discount

At 27 July 2018, LWDB's shares traded at a 10.2% discount to cum-income NAV (with debt at fair/market value). This was wider than both short- and long-term averages (a range of 6.2% to 9.2% over one, three, five and 10 years), probably reflecting a lack of investor appetite for UK-focused investments. LWDB's dividend yield of 2.9% is among the highest in the AIC Global sector, and is supported by the income contribution from the IPS business.

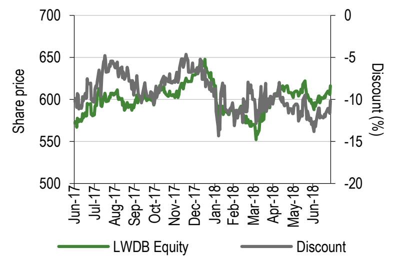
Price	**616.0p**
Market cap	**£729.1m**
AUM	**£951.0m**

NAV*	695.7p
Discount to NAV	11.5%
NAV**	685.9p
Discount to NAV	10.2%

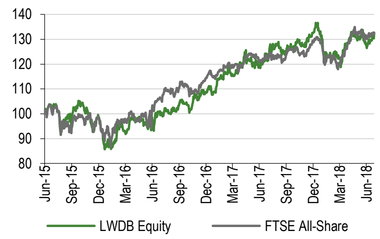
*Excluding income, with debt at par value. **Including income, with debt at fair (market) value. As at 20 July 2018.

Yield	2.9%
Ordinary shares in issue	118.4m
Code	LWDB
Primary exchange	LSE
AIC sector	Global
Benchmark	FTSE All-Share index

Share price/discount performance



Three-year performance vs index



52-week high/low	648.0p	552.0p
NAV** high/low	692.8p	625.7p

**Including income.

Gearing

Gross*	14.0%
Net*	5.0%

*As at 30 June 2018.

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Exhibit 1: Trust at a glance

Investment objective and fund background

LWDB's investment objective is to achieve long-term capital growth in real terms and steadily increasing dividend income to shareholders. The aim is to achieve a higher rate of total return than the FTSE All-Share index through investing in a global portfolio, diversified both geographically and by industry. LWDB's IPS business provides a regular flow of income, which augments the dividend income from the equity portfolio.

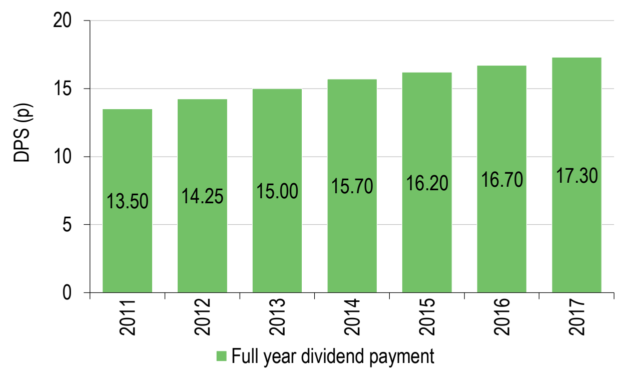
Recent developments

- 26 July 2018: Results for the six months ended 30 June. NAV TR +4.7% versus +1.7% for the FTSE All-Share. Share price TR -3.3%. Interim dividend of 6.0p declared, a 9.1% increase on H117.
- 4 June 2018: Katie Thorpe joined Law Debenture as chief financial officer, taking over from Richard Goss, who had undertaken the role on an interim basis since the retirement of Tim Fullwood in December 2017.
- 11 April 2018: All resolutions passed at AGM.

Forthcoming		Capital structure		Fund details	
AGM	April 2019	Ongoing charges	0.43%	Group CEO	Denis Jackson
Annual results	February 2019	Net gearing	5.0%	Manager	James Henderson & Laura Foll, Janus Henderson Investors
Year end	31 December	Annual mgmt fee	0.30% of portfolio NAV	Address	Fifth Floor, 100 Wood Street, London, EC2V 7EX
Dividend paid	September, April	Performance fee	None		
Launch date	1889	Trust life	Indefinite	Phone	+44 (0)20 7606 5451
Continuation vote	No	Loan facilities	£115m long-term debt	Website	www.lawdeb.com

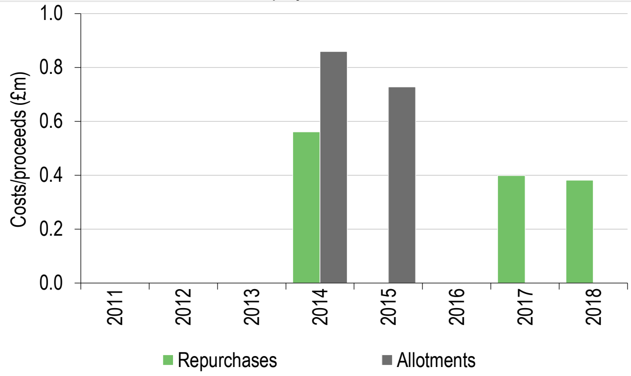
Dividend policy and history (financial years)

LWDB aims to deliver steadily increasing dividends, fully covered by revenue earnings, and has a 42-year record of raising or holding steady its dividend.

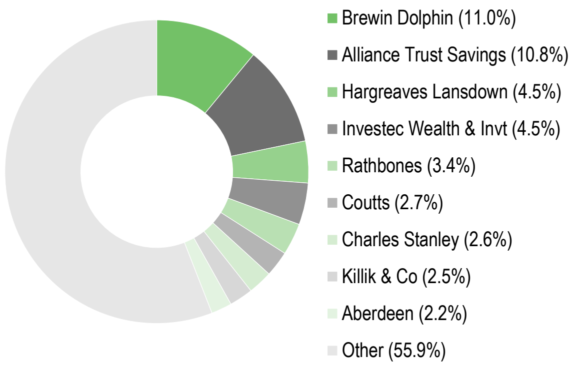


Share buyback policy and history (financial years)

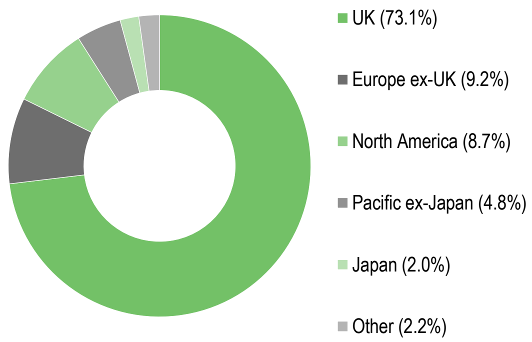
LWDB has no share buyback programme in operation. Purchases and allotment of shares relate to an employee share scheme.



Shareholder base (as at 29 June 2018)



Portfolio exposure by geography (as at 30 June 2018)



Top 10 holdings (as at 30 June 2018)

			Portfolio weight %	
Company	**Country**	**Sector**	**30 June 2018**	**30 June 2017**
Royal Dutch Shell	UK	Oil & gas producers	4.4	3.1
HSBC	UK	Banks	2.4	2.6
BP	UK	Oil & gas producers	2.4	1.9
Senior	UK	Aerospace & defence	2.3	1.8
Stewart Investors Asia Pacific	Asia Pacific	Open-ended fund	2.1	2.1
Rolls Royce	UK	Aerospace & defence	2.1	2.3
GlaxoSmithKline	UK	Pharmaceuticals & biotechnology	2.1	1.7
Rio Tinto	UK	Mining	2.0	1.7
Baillie Gifford Pacific	Asia Pacific	Open-ended fund	1.7	2.4
Prudential	UK	Life insurance	1.7	1.8
Top 10 (% of portfolio)			**23.2**	**21.7**

Source: The Law Debenture Corporation, Edison Investment Research, Bloomberg.

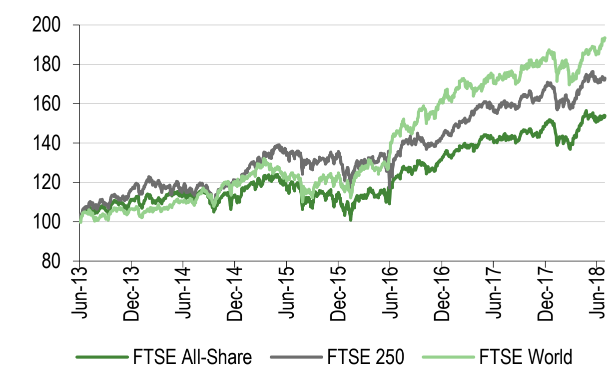
Market outlook: Valuations more favourable

A benign global economic backdrop, strong corporate earnings and a historically low level of market volatility helped to propel world equity markets ahead in 2017, resulting in forward P/E multiples that in many cases looked extremely extended versus history. The Datastream US and World indices both reached their highest forward P/E valuation since before the global financial crisis in the early part of 2018. But while most markets (with the exception of Japan) remain at forward P/E multiples above their 10-year average (see Exhibit 2, right-hand side), an increase in market volatility since the turn of the year – exacerbated by fears of a global trade war – has arguably increased valuation headroom, suggesting that greater opportunities now exist for longer-term investors to find attractively valued stocks.

As shown in the left-hand chart, equity market returns for UK investors have surged ahead since Britain's EU referendum in June 2016. The weakening in sterling following the vote to leave the trading bloc has helped the FTSE World index to outperform the UK (measured by the FTSE All-Share). However, the mid-cap FTSE 250 index – more representative of companies with domestic earnings than the All-Share, which is dominated by the multinationals of the FTSE 100 – has almost matched the World index performance. This suggests that investors who took a multi-cap, global approach to equity investment would have been better rewarded than those who stuck to the headline UK index. Meanwhile, with the possible exception of the US – where Treasury yields now exceed the dividend yield on equities – dividends continue to provide an important support to total returns from equities. This contribution may gain in relative importance if recent market wobbles develop into a more sustained period of lacklustre share price performance.

Exhibit 2: Market performance and valuation

UK all-cap and mid-cap indices versus FTSE World over five years



Datastream market indices valuation metrics

	12m fwd P/E (x)	10-year high (x)	10-year avg (x)	Last as % of average	Dividend yield (%)
UK	13.4	15.8	12.3	109	3.6
World	14.9	16.3	13.3	112	2.4
US	17.2	19.0	14.9	115	1.8
Europe	13.6	15.6	12.0	113	3.2
Japan	13.8	23.6	14.4	95	2.0
Asia ex-Japan	12.9	14.3	12.2	106	2.4

Source: Thomson Datastream, Edison Investment Research. Note: Valuation data at 27 July 2018.

Fund profile: Differentiated global equity fund

LWDB began life in 1889 as a limited company set up to facilitate the issue of corporate debentures (still a key part of the business today). Its history differentiates it from the majority of investment trusts, most of which were launched as investment vehicles. The company operates as two distinct businesses – an investment trust with a diversified but UK-biased portfolio of global equity investments, and a provider of independent professional services (IPS) through a group of subsidiaries operating across four business areas (see IPS performance and fair value, below). While the investment trust accounts for the majority of LWDB's net assets (c 86.5% at 30 June 2018), the earnings contribution from IPS provides an important supplement to the dividends received by the investment trust portfolio (IPS accounted for 30% of net revenue per share in H118), helping to support LWDB's own dividend, and giving the fund managers greater flexibility in the selection of holdings. The fact that IPS is an operating business also means there is a tax synergy for LWDB as a whole, as it is able to offset unrelieved tax losses in the investment trust portfolio against the taxable earnings of IPS. The introduction of base erosion and profit sharing (BEPS) rules in April 2017 has reduced the magnitude of the tax benefit, although the effective tax rate for IPS of c 12% in H118 is still well below the main UK corporation tax rate of 19%.

The investment portfolio is managed by James Henderson and Laura Foll (currently on maternity leave until September 2018) at Janus Henderson Investors, assisted by other members of the Janus Henderson global equity team. Henderson and Foll also manage the Lowland Investment Company and Henderson Opportunities Trust. While the portfolio may be up to 45% (in practice rarely more than 30%) invested overseas, and the trust is a member of the Association of Investment Companies' Global sector, the performance benchmark is the FTSE All-Share index. LWDB's objective is to outperform the benchmark in total return terms, through providing capital growth and steadily increasing dividends. Gearing is permitted up to 20% and currently stands at 5% (net).

At a corporate level, LWDB is led by CEO Denis Jackson, who took up his role in January 2018 having joined the business in July 2017 as chief commercial officer. Chief financial officer Katie Thorpe joined from RIT Capital Partners (also an investment trust with a slightly unusual structure) in June 2018.

IPS performance and fair value

LWDB's IPS businesses cover four main areas: corporate trusts, pension services, corporate services and whistleblowing services. All four areas outperformed internal targets in H118, leading to a 12.7% increase in revenues (net of cost of sales) compared with H117, and a 10.7% increase in profit after tax. This is in line with the new management team's goal of materially increasing net earnings for the IPS businesses in FY18 (after seven years of broadly flat returns), while maintaining quality of product and service. Initiatives include a greater focus on cross-selling services, and investing in IT systems to enable staff to work more efficiently.

The **corporate trusts** business provides a bridge between borrowers and lenders in bond and loan issues, with income coming from a mixture of upfront acceptance fees and annuity-type fees over the life of the bond or loan. The business is increasingly specialising in niche areas such as infrastructure, social housing and aircraft leasing, and has recently hired a new salesperson.

LWDB is the longest-established and largest provider of independent **pension trustee services** in the UK, servicing more than half of the FTSE 100 companies as well as over 100 smaller pension schemes. Services are billed on an hourly basis, and chargeable hours rose by 17.4% in H118 compared with H117. LWDB points out that with 6,000 defined benefit schemes in the UK and an increasing number of defined contribution schemes, there is significant growth potential for this business. The business also reports good growth in its recently launched outsourced pension administration service, Pegasus.

The **corporate services** business helps clients establish and maintain legal entities such as special purpose vehicles (SPVs). Much of the business is cross-border but may require an agent in the UK for process serving. The business has offices in London, Jersey, Dublin, New York, Delaware and Hong Kong. It is focusing on building its service of process business in Latin America and Asia, where provision of documents in Spanish and Mandarin Chinese is key to accessing local markets.

Whistleblowing services are provided by Sunderland-based subsidiary Safecall, largely staffed by former police officers, who are experienced in establishing facts, listening, asking questions and producing reports. Jackson comments that after a year that has seen the #MeToo movement, revelations of inappropriate behaviour by charity aid workers and the mishandling of a complaint against a senior staff member at Barclays Bank, whistleblowing has become front-page news.

Safecall has seen significant new business in H118, much of it coming through the firm's revamped website, which offers a secure, discreet and user-friendly digital channel.

Exhibit 3: Fair valuation of IPS business

£000s unless stated	30 June 2018	31 December 2017	30 June 2017	31 December 2016
IPS valuation				
IPS EBITDA	10,440	9,797	9,880	9,880
EBITDA multiple (x)	8.4	7.9	8.3	8.1
Operational value of IPS	87,696	77,396	82,004	80,028
IPS surplus net assets	22,800	17,176	16,730	9,908
IPS fair value	110,496	94,572	98,734	89,936
IPS fair value per share (p)	93.5	80.0	83.6	76.1
LWDB fair value				
LWDB fair value per share as per IFRS financial statements (p)	638.21	633.28	599.96	560.73
IPS fair value adjustment per share (p)	70.08	61.59	65.99	62.37
Debt fair value adjustment (p)	(20.00)	(25.32)	(24.85)	(24.62)
LWDB fair value NAV per share (p)	688.29	669.53	641.10	598.48
IPS book value (IFRS) as % of total	3.8%	3.0%	3.0%	2.3%
IPS fair value as % total	13.6%	12.0%	13.0%	12.7%

Source: The Law Debenture Corporation, Edison Investment Research

IPS is carried in LWDB's statutory IFRS financial statements at book value, which is substantially below the businesses' estimated fair value. As a way of providing greater clarity for investors over the fair value of LWDB, the management provides an independently assessed estimate of IPS fair value, which adheres to guidelines supplied by the International Private Equity and Venture Capital Association (IPEV) and is based on an appropriate multiple of historical EBITDA. As shown in Exhibit 3 above, the EBITDA multiple has been roughly 8x for the past two-and-a-half years, and was raised to 8.4x at end-H118 following strong performance from the underlying businesses. With few, if any, direct comparators available for the IPS businesses, the multiple is based on observed market valuations for an undisclosed basket of broadly similar companies, adjusted for differences in size, liquidity, margins and growth rates. The operational value of IPS rose by 12.5% during H118 and the fair value of IPS per LWDB share rose by 16.7%. At 93.5p per share, IPS accounts for 13.6% of LWDB's net assets at 30 June 2018, up from 12.0% at 31 December 2017 and reflecting a 70.1p per share fair value uplift to its 23.4p per share IFRS book value, itself an increase of 33% over the book value at 30 June 2017.

The fund managers: James Henderson and Laura Foll

The managers' view: Cautiously optimistic on unloved UK

Henderson points out that the UK remains severely out of favour with professional investors, ranking as the most underweight investment area versus historical positioning in the March 2018 Bank of America Merrill Lynch global fund manager survey, and the region voted least likely to outperform in Q218 in a poll by Barclays. Domestically focused UK stocks in the FTSE 350 have performed poorly since the EU referendum in June 2016, driven by a weaker pound (which inflates the value of overseas earnings) as well as fears over the impact of Brexit on the UK economy. As a contrarian investor with a focus on value, Henderson has moderately increased the LWDB portfolio's allocation to the UK (see current positioning), although he admits that, with hindsight, he and Foll should have had a lower UK weighting in the run-up to the Brexit vote. Conversely, US exposure has been gradually reduced on the back of strong performance, as Henderson says it is increasingly hard to find value there.

While the benign backdrop of synchronised global economic growth in 2017 may have fractured into a more uncertain picture across regions, Henderson points out that purchasing managers' indices, key indicators of economic health, remain in expansionary territory, albeit below their recent highs. He comments that the reduction in industrial stocks in the LWDB portfolio (mainly those in the US) has been on valuation grounds rather than fears over a downturn in manufacturing. However, he says he has modestly de-risked the portfolio to offset the moderately higher level of gearing, selling down some more cyclical names in favour of higher-yielding and lower-beta stocks such as Severn Trent and John Laing Infrastructure Fund. He continues to be a gradual net buyer into price weakness in stocks such as Renold.

Looking ahead, Henderson is encouraged by the level of growth in both company earnings and dividends, and says that while concerns remain about the health of the UK economy, he believes the portfolio's collection of proven, dynamic businesses can find a way forward amid the uncertainty.

Asset allocation

Investment process: Diverse selection for value and growth

LWDB's investment portfolio is built on a bottom-up basis, within set geographical parameters (see Exhibit 4) but without constraint on sector allocation. The aim is to mitigate investment risk by holding a diversified portfolio with a bias towards the UK, but offering exposure to a broad spread of countries and industries. For the core UK portfolio, Henderson and Foll look for growing businesses across the market capitalisation spectrum, trading at valuations that do not reflect their long-term growth prospects. Outside of the UK, the managers are mainly seeking exposure to areas where there are no compelling UK equivalents (for example, technology makes up only 0.9% of the FTSE All-Share index but was 3.0% of the LWDB portfolio at 30 June 2018, with US tech giant Microsoft accounting for the greater part of that exposure). European stock selection is the responsibility of Janus Henderson's director of European equities, Tim Stevenson, who has a slightly more growth-orientated investment style than Henderson and Foll, whose slant in the UK is towards value and income. Exposure to the higher economic growth potential of the Asia Pacific region is mainly through UK-domiciled collective funds (either open- or closed-ended), which offer easier settlement than individual stocks, as well as giving access to a broad range of underlying opportunities.

The LWDB stock list is relatively long (c 130–140 names, not including underlying fund holdings), partly to ensure diversification but also because Henderson and Foll tend to build and exit positions gradually, with new holdings typically coming into the portfolio at a weighting of 0.5% or less. The bottom-up, industry-agnostic approach, as well as the fact that LWDB is a global portfolio with a UK benchmark, means sector exposures may differ markedly from the index.

There is no specific portfolio income requirement, and the managers may buy stocks that do not pay a dividend. This is facilitated by the income coming from the IPS business, which supports LWDB's own dividends. However, the managers do tend to target higher-yielding investments when deploying LWDB's gearing; with a blended cost of borrowing of c 4.6%, any relatively defensive investment with a higher yield can provide immediate upside.

Positions may be reduced and ultimately sold where strong returns have led to valuations becoming stretched. Selling down gradually over time reduces the risk of a poorly timed exit.

Current portfolio positioning

At 30 June 2018, there were 139 holdings in the LWDB investment portfolio (including 10 collective funds), up from 135 (including nine funds) at 30 June 2017. The top 10 holdings (including funds) made up 23.2% of the total, a slight increase in concentration compared with 21.7% a year earlier (see Exhibit 1). As shown in Exhibit 4, UK and European exposure increased slightly over the 12 months, while North American and Pacific ex-Japan exposure decreased slightly. Other areas and

Japan were broadly unchanged. UK and European weightings are towards the higher end of their allocation guidelines, while all other areas are below the mid-point of their allocation range.

Exhibit 4: Portfolio geographic exposure vs allocation guidelines (% unless stated)

	Portfolio end-June 2018	Portfolio end-June 2017	Change (pp)	Allocation guidelines
UK	73.1	71.8	1.3	55–80
Europe ex-UK	9.2	8.5	0.7	0–10
North America	8.7	10.3	(1.6)	0–20
Pacific ex-Japan	4.8	5.5	(0.7)	0–10
Other	2.2	2.1	0.1	0–10
Japan	2.0	1.8	0.2	0–10
	100.0	**100.0**		**100.0**

Source: The Law Debenture Corporation, Edison Investment Research

In sector terms (Exhibit 5), exposure to industrials saw the biggest reduction over 12 months to 30 June 2018 (-4.5pp), although it remains both the largest absolute weighting and the biggest overweight versus the FTSE All-Share. A major factor in the reduction was the sale of GKN (a 2% position at the 31 December 2017 year-end), which was exited following an agreed takeover bid by Melrose in February. Consumer goods exposure was also reduced (-3.1pp), and is the biggest underweight versus the index. The biggest increase in weighting (+2.7pp) was in oil & gas, although only one new stock in this sector (Tullow Oil) was added over the period.

Exhibit 5: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-June 2018	Portfolio end-June 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Industrials	25.5	30.0	(4.5)	11.4	14.1	2.2
Financials	18.6	17.2	1.4	25.7	(7.1)	0.7
Oil & gas	11.0	8.3	2.7	14.2	(3.2)	0.8
Pooled equity invts	10.0	10.3	(0.3)	N/A	N/A	N/A
Consumer services	8.3	7.9	0.4	11.8	(3.5)	0.7
Healthcare	8.2	8.4	(0.2)	8.8	(0.6)	0.9
Basic materials	6.9	6.4	0.5	7.8	(0.9)	0.9
Consumer goods	3.8	6.9	(3.1)	13.8	(10.0)	0.3
Utilities	3.3	1.6	1.7	2.7	0.6	1.2
Technology	3.0	2.3	0.7	0.9	2.1	3.3
Telecommunications	1.4	0.7	0.7	2.9	(1.5)	0.5
	100.0	**100.0**		**100.0**		

Source: The Law Debenture Corporation, Edison Investment Research

Other recent purchases include John Laing Infrastructure Fund, Urban Logistics REIT, brewer and pub operator Greene King, and early-stage technology and healthcare incubator Allied Minds. The managers have also added to holdings in Severn Trent, engineering firm Renold (Henderson feels its recovery potential is under-appreciated) and life science fund Syncona. Where gearing has been used to fund purchases, the managers (who have been net buyers of stock in H118) have tended to concentrate on those areas offering relatively secure income, such as infrastructure, industrial real estate and utilities. Purchases in Europe since the year-end include building materials firms Geberit (Switzerland, sanitaryware) and Assa-Abloy (Sweden, door furniture and security); Swiss pharmaceutical giant Roche; and Irish consumer names Ryanair and Paddy Power Betfair.

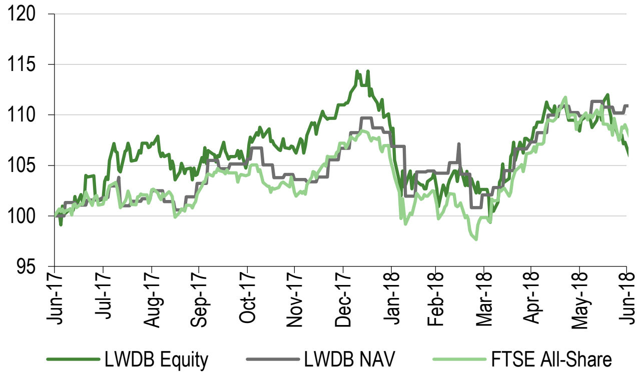
Since the half-year end, the manager has also invested in the IPO of Hipgnosis Songs Fund, a music royalty vehicle with assets including the worldwide Rihanna hit ‘Umbrella’. The fund came to market in early July 2018, raising c £200m.

Recent sales include reductions in industrial stocks Caterpillar and John Deere, and semiconductor firm Applied Materials. These are all US stocks where strong performance has led to valuations that suggest future upside may be more limited.

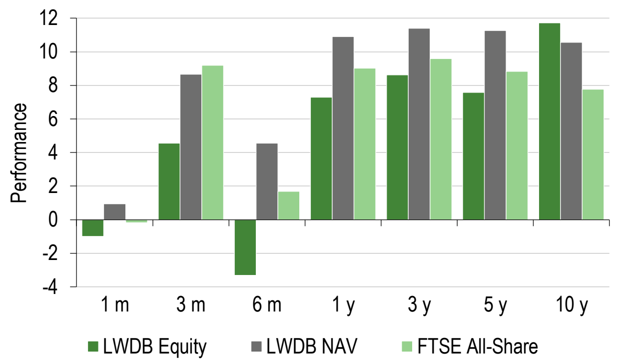
Performance: Strong record of NAV outperformance

Exhibit 6: Investment trust performance to 30 June 2018

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 7: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All-Share	(0.8)	(4.2)	(4.9)	(1.6)	(2.6)	(5.7)	43.5
NAV relative to FTSE All-Share	1.1	(0.5)	2.8	1.7	5.0	11.7	29.2
Price relative to FTSE 250	(1.1)	(3.2)	(5.1)	(3.0)	(0.5)	(16.4)	0.7
NAV relative to FTSE 250	0.8	0.5	2.6	0.3	7.3	(1.0)	(9.3)
Price relative to FTSE World	(1.4)	(2.4)	(5.6)	(1.9)	(16.8)	(22.6)	6.1
NAV relative to FTSE World	0.5	1.4	2.1	1.4	(10.2)	(8.3)	(4.4)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-June 2018. Geometric calculation.

LWDB has a strong long-term record of NAV performance (based on cum-income NAV with both IPS and debt at fair or market value), providing annualised total returns of c 10-11% over one, three, five and 10 years, and outperforming the benchmark FTSE All-Share index over all these periods (Exhibit 6). Share price total return performance has tended to be more volatile, and has underperformed the benchmark over most periods shown above, with negative returns over one and six months. LWDB's NAV total return has also outperformed both the mid-cap UK FTSE 250 index and the FTSE World index over one, three, six and 12 months to 30 June 2018 (Exhibit 7). Outperformance of the World index from such a heavily UK-biased portfolio is notable, given the broad UK market remains out of favour with investors. The overweight position in industrial companies was a key driver of NAV performance in H118 (ending 30 June), with the largest positive contribution coming from GKN, which exited the portfolio after it was bid for by US company Melrose. Aerospace and defence stocks Senior and Rolls-Royce also made a significant contribution to returns. Industrial companies also proved some of the biggest detractors (albeit on a smaller scale), with negative returns coming from engineering firms Cummins (US) and Renold (UK).

Exhibit 8: NAV total return performance to 30 June 2018 (%) with debt at par value and fair value

	One month	Three months	Six months	One year	Three years	Five years	10 years
NAV ex-income, debt at par value	0.3	6.8	4.4	9.2	38.7	71.7	179.4
NAV cum-income, debt at fair value	0.9	8.7	4.7	10.3	36.8	70.2	168.8

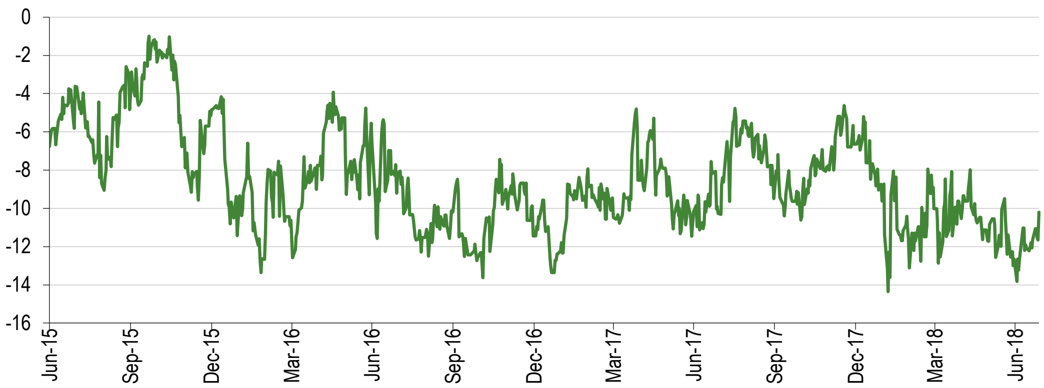
Source: The Law Debenture Corporation, Morningstar, Edison Investment Research

Because LWDB has some relatively high-cost debt (its secured bonds maturing in 2034 have a coupon of 6.125%), the market value of its debt (given the low level of prevailing interest rates) is higher than its par value. This means the NAV with debt at fair value is lower than with debt at par value. However, an environment of rising bond yields in recent months has seen the fair value of the debt reduce (to £137.8m at 30 June 2018 compared with £144.0m at 31 December 2017), meaning the NAV with debt at fair value has outperformed the NAV with debt at par value over periods of one year and less (Exhibit 8).

Discount: Wider than short- and long-term averages

At 27 July 2018, LWDB's shares traded at a 10.2% discount to cum-income NAV (with both debt and the IPS business at fair value). Historically, the shares traded at a premium to NAV because the IPS businesses were included in the NAV at cost rather than at fair value, while the share price included the implied value of these businesses. LWDB began reporting the fair value of the IPS business at the start of 2016, and has restated its NAVs for the 10 years prior to the change. The current discount is wider than the averages (based on restated NAVs) over one, three, five and 10 years (9.2%, 8.6%, 6.2% and 8.8%, respectively), but narrower than the 12-month high of 14.4% seen in February. The wider-than-average discount is arguably a result of the UK (which makes up c 70% of LWDB's investment portfolio) being out of favour with investors; at 27 July 2018, the average discount for trusts in the AIC UK All Companies sector was 7.9%, compared with 0.8% for the AIC Global sector. This would imply there is scope for the discount to narrow should sentiment towards the UK improve.

Exhibit 9: Share price discount to fair value NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

LWDB has a single share class, with 118.4m ordinary shares in issue at 27 July 2018. The board has the authority to repurchase up to 14.99% of shares and allot new shares up to 5.00% of the issued share capital each year, provided allotments do not exceed 7.50% over a three-year period. However, there is no formal discount control mechanism and, in practice, repurchases and allotments (c 64.5k shares repurchased and no new shares issued in the past year) have tended to be in respect of deferred bonuses through the employee share ownership scheme.

LWDB is permitted to gear up to 20% of net assets. It has long-term borrowings with a nominal value of £115m and a book value of £114.1m at end-H118, made up of c £39.5m of guaranteed secured bonds, issued in 1999 with a coupon of 6.125% and maturing in 2034; and c £74.5m of senior secured notes, issued in 2015 with a coupon of 3.77%, and maturing in 2045. The fair or market value of the debt at 30 June 2018 (which is higher than the book value because the current low level of interest rates means higher-coupon debt is more valuable) is £137.8m, which equates to available gearing (based on cum-fair NAV) of 17.0%. Actual net gearing at 30 June 2018 was 5.0%.

Janus Henderson Investors (JHI) is paid an annual management fee of 0.30% for managing LWDB's investment portfolio, with no performance fee. The investment management agreement may be terminated at six months' notice on either side. Unlike many investment trust management agreements, Law Debenture's contract with JHI does not include custody and administration, activities that are carried out by the depositary and the company respectively. Ongoing charges for FY17 were 0.43% (FY16: 0.45%), making LWDB one of the lowest-cost investment trusts in the AIC universe.

Dividend policy and record

LWDB pays dividends twice a year, with an interim paid in September and a final dividend approved at the AGM in April and paid shortly afterwards. The revenue from the IPS businesses forms an important part of the total available for distribution, and has helped to ensure that LWDB's dividend is covered and able to grow year-on-year (in the past 42 years the dividend has increased in all but three years, when it was held steady). While the level of IPS income was largely flat for the six years from FY11 to FY16, at between 6.7p and 7.7p per share, FY17 saw the beginning of a recovery, with IPS revenue earnings up 29% to c 9.9p per share, while revenue earnings for the investment portfolio rose 6.7%. LWDB's new management team is keen to improve the profitability of the IPS businesses, and in H118, IPS revenues of 3.6p per share were 10.4% higher than in H117. IPS revenue returns are weighted to the second half of the year, whereas revenue returns from the investment portfolio are skewed towards the first half.

Total dividends paid for FY17 were 17.3p, an increase of 3.6% on the previous year. LWDB's dividends have grown at a compound annual rate of 4.0% over five years to end-FY17, above the rate of UK inflation. The H118 interim dividend of 6.0p is 9.1% higher than in H117, and the board intends that the increase will be sustained for the full year and looking ahead. Based on the current share price, LWDB has a trailing dividend yield of 2.8% and a prospective yield of 2.9%.

Peer group comparison

Exhibit 10: AIC Global Sector as at 27 July 2018*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (ex-par)	Discount (cum-fair)	Net gearing	Dividend yield
Law Debenture Corporation	**729.1**	**7.4**	**38.9**	**63.5**	**182.2**	**0.4**	**No**	**(11.5)**	**(10.2)**	**105**	**2.8**
Alliance Trust	2,626.7	9.9	57.2	79.8	170.7	0.6	No	(6.2)	(6.1)	105	1.7
Bankers	1,101.0	12.1	52.4	82.7	187.0	0.4	No	(1.6)	(1.9)	103	2.1
British Empire	864.4	9.5	55.2	65.1	135.7	0.9	No	(8.2)	(8.4)	106	1.6
Brunner	336.0	6.6	40.2	60.6	126.4	0.7	No	(9.1)	(10.0)	116	2.2
Caledonia Investments	1,581.7	6.3	33.4	71.8	109.4	1.2	No	(15.9)	(16.9)	100	2.0
Edinburgh Worldwide	529.5	36.9	84.2	138.2	285.3	0.9	No	4.9	5.0	103	0.0
EP Global Opportunities	139.6	7.5	43.7	66.8	163.2	0.9	No	(4.4)	(5.8)	100	1.6
F&C Global Smaller Companies	851.2	12.4	54.5	92.0	303.9	0.6	No	(1.9)	(2.3)	106	1.0
F&C Investment Trust	3,887.4	12.6	57.2	89.4	189.7	0.5	No	0.7	0.1	106	1.5
Independent IT	426.6	20.5	97.4	158.0	341.0	0.3	No	17.4	16.3	100	0.8
JPMorgan Elect Mgd Growth	274.4	13.9	42.9	77.2	197.1	0.6	No	(2.2)	(2.4)	100	1.4
Lazard World Trust Fund	130.8	4.0	42.0	72.7	104.5	1.4	Yes	(3.3)	(4.1)	100	3.4
Lindsell Train	230.5	24.1	100.0	179.2	532.7	0.9	Yes	47.5	39.5	100	1.9
Majedie Investments	155.5	4.2	31.2	61.6	37.7	1.1	No	(12.5)	(12.0)	110	3.5
Martin Currie Global Portfolio	227.8	10.5	53.1	76.3	161.1	0.7	Yes	(0.2)	(0.8)	100	1.6
Mid Wynd International	195.2	13.3	59.5	105.0	220.1	0.7	No	2.8	1.8	100	1.0
Monks	1,897.6	17.5	80.8	102.4	156.9	0.5	No	3.7	3.7	105	0.2
Scottish Investment Trust	688.1	11.0	50.6	67.7	150.9	0.5	No	(10.8)	(9.1)	104	2.3
Scottish Mortgage	7,879.0	32.5	103.9	200.3	396.3	0.4	No	3.4	3.9	108	0.6
Witan	1,999.8	9.4	51.4	81.1	210.1	0.8	Yes	(1.2)	(1.0)	114	2.0
Sector average	**1,273.8**	**13.4**	**58.6**	**94.8**	**207.7**	**0.7**		**(0.4)**	**(1.0)**	**104**	**1.7**
LWDB rank in sector	**10**	**17**	**19**	**19**	**11**	**19**		**19**	**19**	**8**	**3**

Source: Morningstar, Edison Investment Research. Note: *Performance to 26 July 2018. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

LWDB is a member of the Association of Investment Companies' Global sector. This offers an imperfect basis for comparison, given the trust's high UK weighting (only Independent IT, Lindsell Train and Majedie Investments have similar or higher UK exposure; the majority of peers have less than 30% in the UK), but is arguably still the most appropriate peer group. LWDB's maximum UK exposure of 80% is the minimum threshold for inclusion in a UK sector, and its 2.8% dividend yield, while at the higher end of the Global sector range, is well below the 4.0% average for the Global Equity Income peer group (at 27 July 2018). Performance in Exhibit 10 above is based on ex-par NAVs to ensure a consistent comparison (as opposed to cum-fair NAVs elsewhere in this report). On this basis, LWDB's NAV total returns are below the sector average over one, three, five and 10 years (most likely reflecting its low exposure to North America, which has performed strongly), although in absolute terms, returns have been solid. The trust has the third-lowest ongoing charges in the peer group, and, in common with most peers, does not charge a performance fee. The discount to NAV is towards the wider end of the sector, and LWDB's net gearing is slightly above average, although more than one-third of peers have no gearing at present. Assisted by the income stream from the IPS businesses, LWDB has the third-highest yield in the peer group.

The board

LWDB has five directors, four of whom are non-executive and independent of the manager. The one executive director is Denis Jackson, who was appointed CEO of the Law Debenture Corporation in January 2018, having joined the company as chief commercial officer in July 2017. He took over as CEO from Tim Fullwood (previously chief financial officer), who had acted as CEO on an interim basis following the resignation of Michael Adams in October 2017. Robert Hingley, the non-executive chairman, took up his role in April 2018 having joined the board in October 2017 as part of a succession plan to replace the previous chairman, Christopher Smith, who retired at the 2018 AGM after serving on the board for nine years. The other directors and their years of appointment are Robert Laing, senior independent director (2012), Mark Bridgeman, chairman of the audit committee (2014), and Tim Bond (2015). The directors have professional backgrounds in investment management, corporate finance and law.

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