EDISON

The Law Debenture Corporation

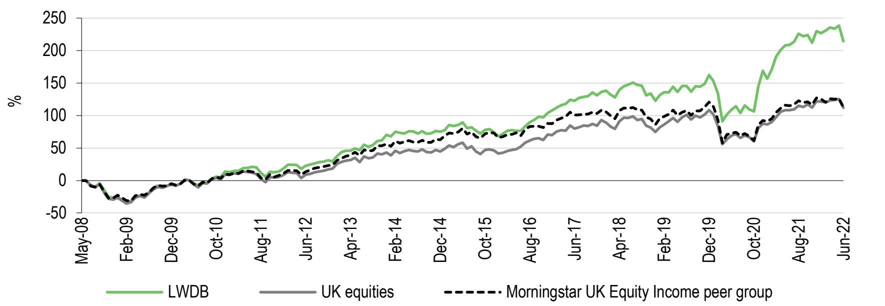
Resilient business model in testing times

Investment trusts
UK Equity Income

29 July 2022

The Law Debenture Corporation (LWDB) has reported on a robust first six months of 2022. The NAV total return was negative but ahead of the benchmark and LWDB's long track record of outperformance, over three, five and 10 years remains. The IPS business grew revenues and earnings, consistent with its mid- to high single-digit target. Additionally, in its 43rd year of maintained or increased dividends, Q122 DPS increased by 5.5% and the board seeks to at least maintain the full year DPS at the FY21 level.

Long-term outperformance of the index and peer group



Source: Refinitiv, Edison Investment Research. Note: Total returns in sterling.

Why LWDB now?

The portfolio is managed by James Henderson and Laura Foll of Janus Henderson Investors. It estimates that UK equities are trading at the widest discount to global equities in 25 years. It notes that the discount is not simply at the level of market indices but is also apparent across most sectors. Although the relative performance of the UK equity market has begun to improve, this is yet to be reflected in positive fund flows. Should flows pick up, it would represent a further positive driver for UK equity performance. LWDB offers a diversified, value-based portfolio and a highly differentiated business model, a key factor in delivering long-term outperformance.

The analyst's view

LWDB benefits from the rare combination of a UK investment trust with an attached independent professional services operating business (IPS). Into its fifth consecutive year of growth, the operational value of IPS has more than doubled since end-FY17 to reach c £163m. It is cash generative and has proven relatively insensitive to short-term economic and market fluctuations, funding 36% of LWDB dividends in the past 10 years while accounting for 19% of H122 NAV. This has supported the long-term portfolio performance by providing the managers with the freedom to select attractive lower- or non-yielding stocks, and avoid higher yielding stocks they deem unattractive, while still meeting LWDB's income objectives.

Valuation

LWDB has maintained its premium rating, both to NAV (2.6%) and to its AIC peer group (a little more than 4% discount). We attribute this to the beneficial impacts of its differentiated proposition on long-term performance and strong dividend growth (five-year CAGR: 11.7%). Q122 DPS was up 5.5% versus Q121 and for the year the board intends to at least maintain aggregate DPS at the FY21 level of 29p.

NOT INTENDED FOR PERSONS IN THE EEA

Price Ord.	**775p**
Market cap	**£982m**
Total assets	**£1,130m**
NAV*	755.38p
Premium to NAV	2.6%

* 28 July 2022 NAV cum income at fair value. This includes debt at fair value as well as the fair value of the PS business as at 30 June 2022.

Yield**		3.7%

**yield based on FY21 DPS of 29.0p

Shares in issue		126.7m
Code Ord/		LWDB/GB0031429219
Primary exchange		LSE
AIC sector		UK Equity Income
52-week high/low*	830.0p	724.0p
NAV*** high/low	808.3p	714.0p

***Including income.

Gearing

Net gearing at 18 July 2022	11%

Fund objective

The Law Debenture Corporation's investment objective is to achieve long-term capital growth in real terms and steadily increasing income. The aim is to achieve a higher rate of total return than the broad UK stock market through investing in a diversified portfolio of mainly UK equities with some international holdings. The IPS business provides a regular flow of income, which augments the dividend income from the equity portfolio.

Bull points

- Experienced management.
- IPS revenue contribution gives fund managers flexibility and security of income.
- Low ongoing charges.

Bear points

- Lower yielding than some UK income peers.
- Small- and mid-cap holdings may be more vulnerable in a risk-off environment.
- Relatively high level of structural gearing (negative in a falling market).

Analysts

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The Law Debenture Corporation is a research client of Edison Investment Research Limited

H122 summary and outlook

The sharp rise in inflation, exacerbated by the war in Ukraine, and the first significant increase in interest rates for many years, with expectations that this will continue, have created a challenging environment for financial markets so far in 2022. Global economic growth has slowed, with the prospect of recession, of unknown depth or duration, anticipated in an increasing number of economies, and equity and bond markets have weakened.

While global equity markets have fallen by c 11% in H122 in sterling terms, the broad UK equity index has performed relatively well by comparison, down 4.6%. We attribute this to the valuation support offered by UK equities compared with other global equity markets as well as the sector composition of the broad UK equity market. It has a relatively a higher weighting to those areas that have been relative beneficiaries of the current environment, such as energy and other natural resources, and a low weighting towards technology stocks.

Against this background, during the six months to 30 June 2022 (H122), LWDB's NAV total return (with debt at fair value) was -4.0% compared with the broad UK market return of -4.6% and the Morningstar UK equity income peer group return of -6.4%.[1] Long-term performance is strong and on the same basis is ahead of the broad UK market return on a three-, five- and 10-year time horizon. It is also well ahead of long-term inflation, measured by the change in the Retail Price Index.

Exhibit 1: Share price and NAV total return performance, relative to indices (%)

	Six months	One year	Three years	Five years	10 years
LWDB NAV TR (debt at fair value)	(4.0)	0.4	28.5	40.6	157.5
LWDB NAV TR (debt at par value)	(8.4)	(3.5)	23.1	34.8	155.7
LWDB share price TR	(3.8)	3.4	43.8	58.2	180.8
Broad UK Equity market	(4.6)	1.6	7.4	17.8	94.6
Change in Retail Price Index	7.0	11.8	17.4	24.9	40.6

Source: The Law Debenture Corporation. Note: Data to 30 June 2022. All returns in GBP.

During H122 there was a wide disparity of returns within the UK market, both by sector and by market capitalisation. The portfolio managers, James Henderson and Laura Foll from Janus Henderson Investors, note that the robust performance of the FTSE All-Share Index[2] during the period was concentrated at the top end of the FTSE 100 Index, reflecting the strong performance of large natural resources and other defensive sectors such as pharmaceuticals. The wider market was much weaker, with the median share in the FTSE 350 Index stock down by 19.7%. This worked against the managers' investment approach (discussed later in this report), which includes within the highly diversified portfolio a significant weighting to small and mid-cap stocks. The negative impact on portfolio performance was partly mitigated by its holdings in natural resources, but this did not offset significant price declines in some other sectors, such as retail.

Dividends have increased for 12 consecutive years and have been held or increased for 43 years. Over the 10 years to end FY21 the dividend more than doubled, increasing by 114.8%. Including the rebasing to a higher level of distribution in FY19,[3] the five-year compound rate of DPS growth is 11.7%, compared with a peer group average of 3.3%.[4] The 2019 rebasing distorts the comparison but demonstrates LWDB's commitment to progressive income distribution. The first interim DPS for FY22 increased 5.5% to 7.25p compared with Q121 and the second interim dividend will be

[1] With debt at par value, the H122 NAV total return was -8.4%.

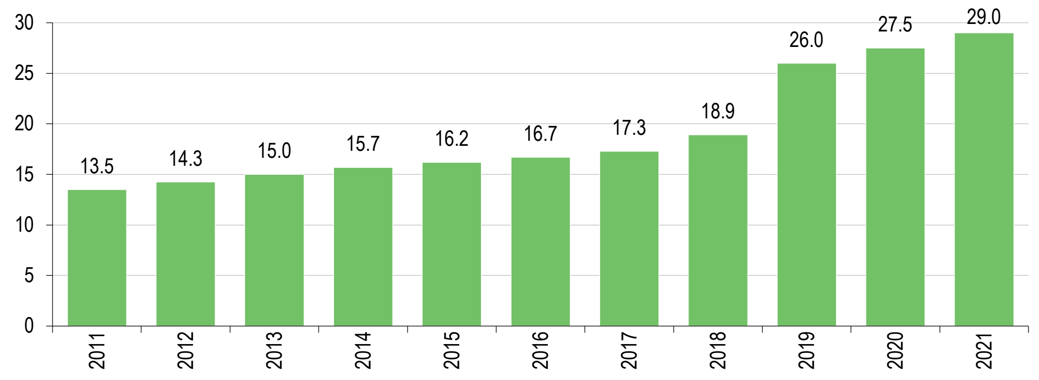
[2] Comprising the FTSE 100 Index, FTSE 250 Index, the FTSE 350 Index and the FTSE SmallCap Index.

[3] Total FY19 DPS was increased to 26.0p versus 18.9p in FY18.

[4] Morningstar data for the peers listed in Exhibit 15.

announced in September; the company is targeting aggregate FY22 DPS of at least 29.0p (FY21: 29.0p). In support of this, we note that portfolio income increased by over 55% to £18.4m, from £11.8m in H121, at the upper end of the managers' expectations and that the revenue reserve is strong at £44.9m (versus 35p per share).

Exhibit 2: Dividend per share



Source: The Law Debenture Corporation

Long-term performance benefits from relatively low charges,[5] supporting a strong track record of dividend distributions. However, a key driver of long-term dividend growth and overall returns remains LWDB's IPS business. Over the past 10 years IPS has funded 36.4% of dividends, well ahead of its c 19% contribution to fair value NAV. As we discuss below, despite facing similar headwinds to the investment portfolio, it increased H122 revenues by 11.3% compared with H121 and PBT by 5.9%, in line with the company's mid-high single-digit target.

Both Henderson and Foll continue to highlight the investment flexibility provided by the steady, cash-generative nature of LWDB's IPS business as a key contributor to long-term performance. It enables them to invest in lower- or non-yielding stocks while still meeting LWDB's investment objective of providing a steadily increasing income. The flexibility also extends to the ability to avoid being forced by income requirements into high-yielding stocks that the managers may deem unattractive.

Over the short term, the managers expect inflation to remain elevated and interest rates to rise further, but for both to later ease as the significant impact on annual inflation from this year's rise in energy and other commodity prices falls away. The governor of the Bank of England has signalled the potential for taking stronger action to bring down inflation, interpreted by many as a 0.5% increase in base rate, to 1.75% in August. Financial markets appear to be pricing in an increase to c 3.0% by around the end of the year, before easing. The managers note that the general fall in UK equity prices leaves the UK market valuation at a low level and that it would require a decline of at least 20% in average company earnings to bring this back to average historical levels. They argue that corporate balance sheets are conservatively positioned to weather the economic downturn and that operating performance may come to be seen as surprisingly robust. While they expect earnings downgrades to come through, they anticipate that much of this may have been priced in. Reflecting this outlook, the managers continue to identify attractive investment opportunities and continue to be selective buyers of a diversified list of well-run companies that have strong leadership and low valuations.

In the following section of this report we provide an update on developments with IPS before examining the portfolio strategy in greater depth and updating on the trust valuation.

[5] LWDB calculates the ongoing charges ratio at 0.48% in H122 compared with the 1.09% Association of Investment Companies (AIC) industry average.

IPS: Continuing growth in cash flow and valuation

LWDB's IPS business, comprising the pensions, corporate trust and corporate services divisions, demonstrated its resilience in H122, with each business line increasing revenues year-on-year despite an increasingly challenging and uncertain economic and political backdrop. Over longer periods, this same resilience reflects a diversified range of operations, significantly based on recurring income from structurally supported sectors, and others that provide attractive returns but with increased market sensitivity.

Once seen as a steady but reliable and cash-generative business, operational performance was reinvigorated following the appointment of Denis Jackson as CEO in 2017 and it is now into its fifth consecutive year of growth in revenues and earnings. H122 revenue increased by 11.3% compared with H121 and PBT by 5.9%, in line with the company's mid-high single-digit target. Although lower than in recent periods, PBT margin remains strong at 29.0% (H121: 30.5% and an average 35% in the five years to end-FY21). The primary impact on margin in the period was staff costs, c one-third of total costs. This reflected a continued increase in headcount, part of IPS' investment in its skills base, technology and capacity for growth, and pressure on remuneration resulting from intense competition for skilled staff across many parts of the financial and professional services industries. The success of IPS is largely built on the quality of service that it delivers, and it cannot be immune from these competitive pressures.

With new business momentum continuing, the company expects that revenue growth will follow investment. It also has some scope to pass through inflationary cost increases to revenues, including from revenue streams that benefit from contractual inflation uplifts. Additionally, with a strong and liquid balance sheet (group cash and equivalents of c £72m at end-H122) we expect IPS to remain alert to attractive external growth opportunities that may emerge.

Exhibit 3: IPS performance trend

£m unless stated otherwise	H122	H121	H122 v H121	2021	2020	2019	2018	2017
Pensions	7.0	6.5	7.9%	13.1	11.5	10.6	9.5	8.3
Corporate Trust	5.2	4.9	5.0%	9.8	10.8	9.0	0.0	7.9
Corporate Services	9.5	8.1	17.9%	18.8	12.2	12.2	0.0	11.0
Total net revenue	**21.7**	**19.5**	**11.3%**	**41.6**	**34.5**	**31.8**	**9.5**	**27.1**
PBT	6.3	5.9	5.9%	13.3	12.2	11.5	10.5	9.7
EPS (p)	4.55	4.39	3.6%	10.00	9.35	8.54	7.87	7.21*

Source: The Law Debenture Corporation, Edison Investment Research. Note: *Excludes 2.72p of non-recurring realisation gains.

LWDB's **pensions** business was established more than 50 years ago, initially as a pensions trustee where it remains the largest, as well as the longest established, independent pension trustee in the UK. In 2021 it launched a similar offering in the Republic of Ireland. The pension trustee business is complemented by its fast-growing Pegasus operation, launched in late 2017, providing a broad range of services, from secretarial through to fully outsourced pension scheme management.

Revenues in the pensions business increased by 7.9% in H122, and growth in the past four years has averaged 12.1% pa. This continues to be underpinned by demand for high-quality expertise to navigate an increasing regulatory burden. Over shorter periods, events such as the coronavirus pandemic and, more recently, increased volatility in financial markets can place additional stresses on pension schemes and their sponsors, increasing the requirements for governance work. The strong upwards move in bond yields in recent months and weakness in other assets will have had a significant impact on scheme assets and liabilities.

Although the largest independent trustee in the UK, it continues to win new clients. With a market share of less than 5% there is plenty of room for this to continue and LWDB continues to invest in the business in anticipation of this. Since it was launched in late-2017, Pegasus has grown strongly.

Its c £3m of revenues in FY21 represented almost a quarter of the pensions total. It grew strongly again in H122, and management expects this to continue.

The **corporate trust** business is the UK's leading independent (non-bank) corporate bond trustee, with many decades of experience and deep market connections, operating internationally to provide trustee services to a broad range of debt issuance markets. It acts as a bridge between the issuer and the investor, earning recurring revenues from debt issuance until maturity. It also undertakes post-issuance work, including for performing debt issues and non-performing. The business also provides escrow services with a broad range of applications that are typically applied where two parties wish to move or transfer an asset based on certain conditions being met.

Corporate trust revenues increased by 5.0% in H122 despite very challenging conditions for new debt issuance, typically volatile and subject to rapid change. Amid a sharp increase in inflation and interest rates, and war in Ukraine, Dealogic estimates that European debt capital issuance was 27% lower in H122 compared with H121 and European high yield issuance was even weaker (down 69%). Although new debt issuance has been weak, revenues are significantly recurring (c two-thirds of the total), providing a good level of visibility. For regular duties such as acting as a point of contact between the issuer and investor, and for receiving certain financial, security and covenant information from the issuer, LWDB is usually paid recurring fees that benefit from annual inflation-linked increases until maturity. Ad-hoc post-issuance work generates additional fees. For performing debt issues this includes activities such as documentation changes. In more challenging economic circumstances, LWDB is well placed to benefit from countercyclical work, such as debt restructuring or the renegotiation of payment terms, which often continue well after recovery is underway. Unlike previous economic downturns, the pandemic had little impact, with corporate bankruptcy maintained at a modest level by the unprecedented level of financial support offered to corporates around the world. Given the constraints on government balance sheets, pressure on the real disposal incomes of consumers and rising debt costs, it is tempting to think that the normal credit cycle may be at an early stage of re-establishing itself.

As an established business, with a strong reputation and solid, liquid balance sheet, LWDB is well-placed to offer **escrow services.** These are increasingly used to support corporate merger and acquisition (M&A) transactions, corporate disposals, litigation, global trading and property transactions, but the range of applications is wide. In 2020, during the pandemic, LWDB supported NHS trusts in the purchase of personal protective equipment from around the world, and in H122 the escrow product was used to support the Tyson Fury versus Dillon White world title boxing event.

The **corporate services** business consists of a broad range of activities that further enhance the diversification of IPS. The key activities are:

- **Company secretarial services**. This includes 'managed services' whereby LWDB acts as a single point of contact to ensure that the legal entities of a client's international entities are kept in good order with respect to compliance and corporate records; corporate governance services, providing all aspects of board and committee support; and interim resourcing by LWDB qualified governance professionals.
- **Service of process**, where LWDB acts as local agent for third parties who are otherwise not represented in that jurisdiction.
- **Structured finance**, provides accounting and administrative services to special service vehicles (SPVs), typically used by boutique asset managers, hedge funds and challenger banks, to warehouse and provide long-term funding for a wide range of assets such as credit card receivables, mortgages, real assets and infrastructure projects.
- **Specialist external whistleblowing** services via Safecall.

Revenues in the corporate services business increased by 17.9% in H122, including an additional one-month contribution from the late-January 2021 acquisition of the corporate secretarial services business of Eversheds Sutherland LLP for £20m. Taking each activity in turn:

The January 2021 acquisition transformed LWDB's small existing **company secretarial** offering. It was successfully integrated during 2021, with 99% of its client base retained and new clients won, and LWDB says the combined business is already producing high-quality, repeatable revenues. Meanwhile, it has been investing significantly in headcount, skills, technology and infrastructure to ensure that it can provide the quality of service, and has the capacity, to further grow the business. Supporting the growth prospects is the need for corporates to keep abreast of constantly changing government rules and frameworks and the trend towards outsourcing. As corporates examine their cost bases and seek to optimise capital allocation, large in-house company secretarial departments are increasingly outsourced.

LWDB acts as an agent for **service of process** for thousands of clients from all over the world with the lowest recurring contractual revenue base of all the IPS businesses. As a result, it is the most sensitive of all the IPS businesses to global macroeconomic trends. 2021 saw a recovery from 2020, as the pandemic lockdowns eased, and economic growth began to recover. Despite increased levels of global economic and political uncertainty, it nonetheless increased revenues by 5.2% in H122. LWDB says that although revenues are volatile the over-the-cycle returns are excellent and it has continued to invest, exploiting the new technology platform introduced last year to streamline and scale up capacity, and to capitalise on its extensive referral partner network.

The UK securitisation market is one of the largest and most developed securitisation markets in Europe and an important source of finance for UK businesses**. Structured finance services** continued to gain new business in H122, supporting newly structured SPVs. Revenues increased 21% and have increased by an average 11.6% pa over the past four years.

Safecall continued its growth in H121 despite the difficult economic conditions in Europe, adding new clients and handling increased volume of cases.

IPS is continuing to create value

IPS is a high-margin, cash-generative business that has historically proven relatively insensitive to short-term economic and market fluctuations. In addition to generating substantial distributable income, thereby providing the portfolio managers with greater investment flexibility, the growth in the operational fair value of IPS[6] in recent years has also contributed to LWDB's NAV growth. IPS operational value has more than doubled since end-FY17 through a combination of earnings growth[7] and an increasing valuation multiple. The multiple is based on external professional advice from PwC, and we believe that it remains prudent. Although H122 earnings continued to increase, this was offset by a reduction in the valuation multiple from 10.8x to 10.5x, driven by market trends and peer multiples. Nonetheless, the 141.3p per share fair value of IPS at 30 June 2022 compared with an IFRS book value per share of 35.2p. Management initiatives aimed at generating further growth in IPS, along with the scope for further increase in the EBITDA multiple are positive indicators for continuing growth in fair value.

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[6] The IFRS consolidation of the IPS business fails to recognise the full value added by the business and to address this, from 31 December 2015, LWDB has published an operational fair value for the standalone IPS business.

[7] The valuation is based on earnings before interest, depreciation and amortisation (EBTDA).

Exhibit 4: Fair value of IPS business and LWDB NAV at fair value calculation

	30-Jun-22	31-Dec-21	31-Dec-20	31-Dec-19	31-Dec-18	31-Dec-17
	H122	FY21	2020	2019	2018	2017
IPS valuation						
IPS EBITDA (£m)	15.6	15.4	13.3	11.5	10.4	9.8
EBITDA multiple	10.5	10.8	9.4	9.2	8.4	7.9
Operational value of IPS (£m)	163.3	166.0	125.3	105.9	87.6	77.4
IPS surplus net assets (£m)	15.1	4.0	10.6	16.4	16.8	17.2
IPS fair value (£m)	178.4	170.0	136.0	122.3	104.4	94.6
IPS fair value per share (p)	141.3	138.9	115.1	103.5	88.3	80.0
LWDB fair value						
LWDB fair value per share as per IFRS financial statements (p)	624.2	717.9	615.2	655.8	566.3	633.3
IPS fair value adjustment per share (p)	106.1	111.0	95.1	77.7	66.4	61.6
Debt fair value adjustment (p)	(3.6)	(41.0)	(44.2)	(31.2)	(18.6)	(25.3)
LWDB fair value NAV per share (p)	726.74	787.83	666.15	702.3	614.1	669.5
IPS book value (IFRS) as % of total	5.6%	3.9%	3.1%	4.0%	3.9%	2.9%
IPS fair value as % total	19.4%	17.6%	17.3%	14.7%	14.4%	12.0%

Source: The Law Debenture Corporation, Edison Investment Research

As there is no direct comparator to the make-up of the IPS business, PwC and LWDB have worked together to identify a range of companies that to varying degrees share similar business units, customer bases and market dynamics. From a valuation analysis, based on market data and adjusted differences between the companies in respect of size, liquidity and margin growth, PwC provides a range of valuations that it believes to be appropriate. The board then selects the multiple to be applied, seeking a valuation of the IPS business that is both fair and sustainable.

The comparator companies used in this analysis are shown in Exhibit 5. Within the broader list we show separately the four companies that LWDB considers to be its core comparators, of which three are under offer or engaged in ongoing M&A discussions. For this reason, the chosen multiple has relied more on the broad comparator group and at 10.5x the chosen multiple for IPS is at a 19.8% discount to mean multiple of this group.

Exhibit 5: Valuation comparators

	12-month trailing revenues (£m)	12-month trailing EV/EBITDA (x)	2018-2022* revenue CAGR (%)	12-month trailing EBITDA margin (%)
Sanne Group	204	22.6	16	29
Intertrust NV	489	12.5	2	28
Link Administration Holdings	621	11.6	(2)	10
JTC	148	18.2	25	17
Mean for core comparators	**365.5**	**16.2**	**10**	**21**
SEI Investments Company	1,555	10.1	5	33
SS&C Technologies Holdings	3,889	10.4	10	37
EQT Holdings Limited	58	12.0	4	38
Perpetual Limited	403	7.8	8	25
Begbies Traynor Group	99	12.6	17	10
Christie Group	61	N/A	(5)	5
Mean for all comparators	**752.7**	**13.1**	**8**	**23**
Law Deb. IPS	**46**	**10.5**	**12**	**33**

Source: The Law Debenture Corporation, Edison Investment Research. Note: *2022 data.

Portfolio positioning and drivers of performance

Long-term, bottom-up, and value driven

The portfolio managers are focused on long-term returns, with investment decisions driven by a selective, bottom-up approach to stock selection, deliberately diversified by sector and geography. The stock selection process is valuation-driven, aiming to identify high-quality companies that are undervalued at the point of purchase. This includes ‘out of favour’ equities that may be standing at valuation discounts to their long-term historical averages, giving rise to a mildly contrarian style of management. Similarly, stocks where valuations have increased materially, or where the investment case has fundamentally changed, are considered for sale with the proceeds recycled into more attractively valued opportunities.

The wide disparity in returns during H122, across sectors and by market capitalisation, has been the key driver of returns and of portfolio activity. Mirroring market trends, the best performing stocks in the portfolio were either exposed to rising commodity prices (natural resources companies such as Shell, i3 Energy and BP), the prospects for increased defence spending, significantly driven by war in Ukraine (BAE Systems), or rising interest rates (HSBC).

Exhibit 6: Top five contributors to H122 performance

Stock	Share price total return (%)	Contribution (£m)
Shell	31.5	6.4
BAE Systems	51.0	5.0
HSBC	19.4	3.8
i3 Energy	94.3	3.5
BP	17.5	3.3

Source: The Law Debenture Corporation, Edison Investment Research

The managers have been adding to domestic banks, Barclays and NatWest, where performance has been less strong. The managers do not expect the positive impact of rising interest rates to be offset by increased bad debt provisioning in a slowing economy, noting increased capital strength and conservative lending since the last downturn.

The main detractors to portfolio performance were a combination of technology (Herald Investment Trust), consumer (Marks & Spencer) and early-stage growth companies (Accsys Technologies).

Exhibit 7: Top five detractors from H122 performance

Stock	Share price total return (%)	Contribution (£m)
Accsys Technologies	(38.3)	(6.0)
Marks & Spencer	(41.8)	(5.9)
Ceres Power	(45.1)	(5.9)
Herald Investment Trust	(36.1)	(5.4)
IP Group	(45.5)	(4.9)

Source: The Law Debenture Corporation, Edison Investment Research

More generally, exposure to early-stage companies has been a drag. These are businesses that the managers believe have the potential to become substantially larger over time. However, they are not without risk and when market sentiment is poor, they suffer from a retreat to safety. While painful in the short term, these names have historically added value to LWDB investor returns and provided diversification away from the value/income positions that make up the majority of the portfolio.

Consumer discretionary companies have seen valuations fall across the market, but the managers identify opportunities to selectively add to existing holdings. They say that portfolio exposure is largely in companies that have undergone significant 'self-help' in recent years and that this has not been reflected in current valuations. They note that Marks & Spencer's efforts to address legacy store issues and its success in regaining market share have not been recognised in valuation and have added to the holding. The managers also observe that while consumer confidence and disposable income is broadly under pressure, there are consumers that were able to build material savings during the pandemic. They believe this is likely to insulate spending in certain areas such as repair, maintenance and home improvement, and have added to positions in Halfords, Vertu Motors, Marshalls and Ibstock.

Other investments in the period included the addition of positions in Cranswick, the pre-eminent UK pork supplier, to retailers, ITV and newspaper and magazine publisher, Reach. The managers expect the strength and durability of Cranswick's brands and relationships with the major supermarkets put the company in a strong position to pass through input cost inflation. For ITV and Reach, they feel that the market has become too pessimistic about the outlook for terrestrial TV and online print advertising.

With the valuations of many ‘defensive’ companies at high levels, the managers have taken advantage of the opportunity to recycle capital with sales including RELX, Urban Logistics and Severn Trent.

Further focus on the UK where valuations are favourable

The LWDB investment portfolio continues to be very much focused on UK listed investments and has recently been adding to this. In H122, an additional c £30m was invested into UK equities, mainly funded by stock sales in Europe and the United States. Net portfolio divestment was c £12m, with the UK purchases not fully offsetting the disposals during the period. The most significant sale was of the US oil services group Schlumberger on valuation grounds after a strong share price performance. European-listed basic materials companies Linde (industrial gases and engineering) and Glencore (mining) were also sold. Partly offsetting this, a position was taken in Bayer (pharmaceuticals and life sciences) where the managers are positive about agro-chemical fundamentals as well as the potential for its late-stage pharmaceutical pipeline. More generally, overseas holdings are in companies where there is no compelling UK equivalent. As the UK equity market has been hugely out of favour with global investors for a number of years, with valuations remaining low in an international context, this is where the managers continue to identify the most attractive opportunities.

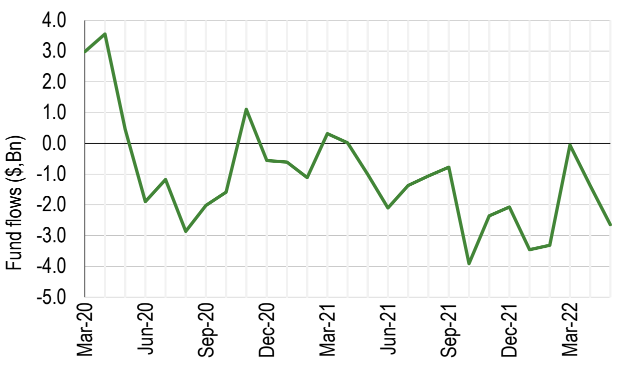
Exhibit 8: Portfolio geographic exposure (% unless stated) at 30 June 2022

	Portfolio end-June 2022	Portfolio end-December 2021	Change (pp)	Allocation guidelines
UK	84.7	82.6	2.1	55–100
Europe ex-UK	8.7	10.0	(1.3)	0–20
North America	5.4	5.4	0.0	0–20
Japan	1.2	1.1	0.1	0–10
Pacific ex-Japan	0.0	0.7	(0.7)	0–10
Other	0.0	0.2	(0.2)	0–10
	100.0	**100.0**		

Source: The Law Debenture Corporation, Edison Investment Research

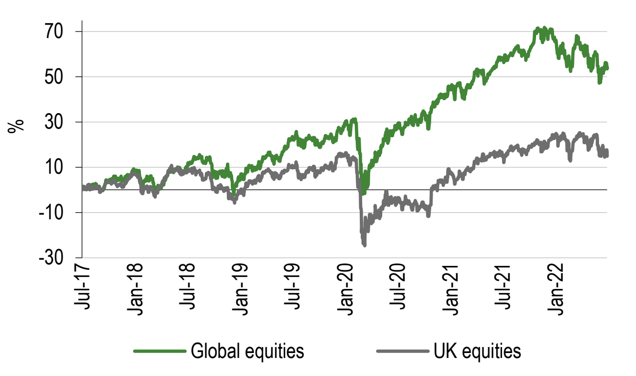
Janus Henderson Investors estimates that UK equities are trading at the widest discount to global equities in 25 years. They note that the discount is not simply at the level of market indices but is also apparent across most sectors. Although the relative performance of the UK equity market has begun to improve, this is yet to be reflected in positive fund flows. Should flows pick up it would represent a further positive driver for UK equity performance.

Exhibit 9: Demand for UK equity funds remains low



Source: Morningstar. Globally domiciled UK equity strategies.

Exhibit 10: UK equity market underperformance



Source: Morningstar

Exhibit 11: Valuation metrics at 30 June 2022					
	Last	High	Low	10-year average	Last as a % of average
UK P/E (X)	10.3	15.7	9.4	13.4	76.8
World P/E (X)	13.6	19.9	10.6	15.3	0.89
UK P/B (X)	0.9	1.9	0.7	1.2	70.7
World P/B (X)	2.2	2.6	1.4	1.9	116.0
UK dividend yield (%)	4.0	6.4	2.7	3.5	114.0
World dividend yield (%)	2.5	3.4	1.8	2.4	101.4

Source: Refinitiv, Edison Investment Research

High diversification balances risks

At end-June 2022, there were more than 140 stocks in LWDB's investment portfolio. Concentration in the top 10 holdings remains relatively low but increased to 23.2% compared with 18.6% for the top ten at end-FY21, primarily driven by strong valuation gains in core holdings such as GlaxoSmithKline, Shell, HSBC and BP. In Exhibit 12, the 31 December 2021 weightings refer to the H122 top 10 holdings and in aggregate do not represent the 31 December top 10 holdings.

Exhibit 12: Top 10 holdings (at 30 June 2022)

			Portfolio weight %		
Company	Country	Sector	30 June 2022	31 December 2021	Change (pp)
GlaxoSmithKline	UK	Pharmaceuticals & biotechnology	3.5	2.7	0.8
Shell	UK	Oil & gas producers	3.1	2.0	1.1
HSBC	UK	Banks	2.7	2.0	0.7
BP	UK	Oil & gas producers	2.6	1.9	0.7
Barclays	UK	Banks	2.2	2.0	0.2
Rio Tinto	UK	Mining	2.2	1.9	0.3
NatWest	UK	Banks	1.8	1.4	0.4
BAE Systems	UK	Aerospace & defence	1.8	1.0	0.8
Direct Line Insurance	UK	Nonlife insurance	1.7	1.4	0.3
National Grid	UK	Gas, water & multiutilities	1.6	1.5	0.1
Top 10 (% of holdings)			**23.2**	**17.8**	**5.4**

Source: The Law Debenture Corporation, Edison Investment Research

Changes in sector weights during the period are not particularly material and predominantly relate to performance, net investment flows and the stock selection activity referred to above, rather than being a 'target' in themselves.

Exhibit 13: Portfolio sector exposure (% unless stated)

	Portfolio end-June 2022	Portfolio end-December 2021	Change (pp)
Financials	27.0	27.5	(0.5)
Industrials	20.3	20.7	(0.4)
Oil & gas	11.1	10.1	1.0
Basic materials	7.0	9.7	(2.7)
Consumer services	7.6	8.8	(1.2)
Consumer goods	7.9	7.4	(0.5)
Healthcare	10.7	7.2	3.5
Utilities	4.5	4.4	0.1
Telecommunications	3.3	2.6	0.7
Technology	0.6	1.6	(1.0)
	100.0	**100.0**	

Source: The Law Debenture Corporation, Edison Investment Research

Discount and peer group comparison

At 28 July 2022 LWDB's shares traded at a premium of c 2.6% to cum-income NAV (with both debt and the IPS[8] business at fair value), maintaining the re-rating that occurred during the pandemic and well above the previous long-term discount range of c 5–15%. In common with most of the investment trust sector, LWDB saw significant volatility in its rating during the early part of the

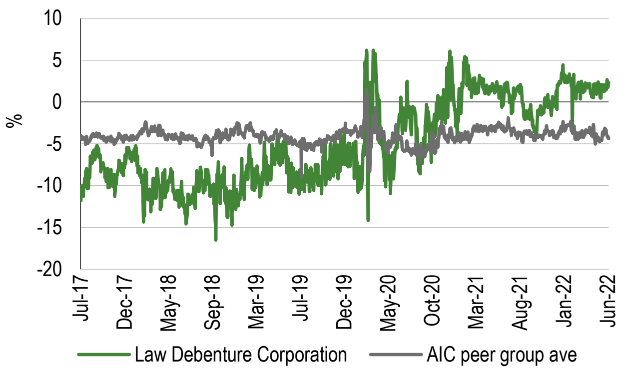
[8] Includes the IPS fair valuation at 30 June 2022.

coronavirus pandemic but, as trading conditions normalised, lockdowns were lifted and the economy bounced back through 2021, the rating steadily improved. It is likely that this in part reflected investors' appreciation of the more secure income stream from the IPS business amid deep and widespread UK dividend cuts affecting most equity income funds. Some of the re-rating has recently eroded, although the shares have continued to trade above the historical discount range.

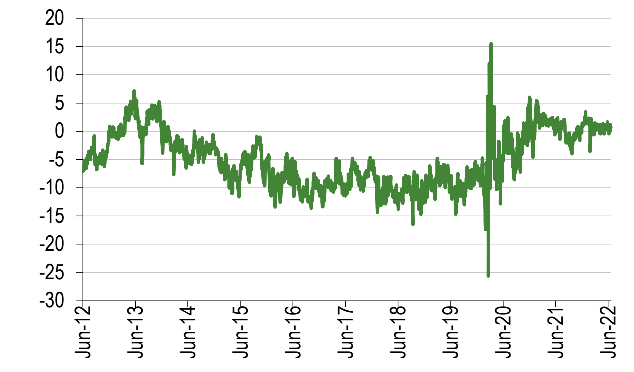
During H122, LWDB was able to satisfy investor demand by issuing shares under its authority at an accretive average premium to NAV. Approximately 3.8m shares were issued at an average price of 799p, representing gross proceeds of c £30m.

Exhibit 14: Share price discount has moved markedly over 5 years

Law Debenture vs the AIC peer group



10-year discount



Source: Morningstar, Edison Investment Research

LWDB has delivered excellent performance for investors, especially within the context of the AIC Equity Income peer group (Exhibit 15). This has been helped in part by the low management fees that investors pay here resulting in a share price that has remained closer to its NAV than many of its peers. When comparing with its AIC UK equity income peers (which is a diverse cohort of 21 funds), it is noticeable too that the average market capitalisation of holdings in the fund, at around £7bn, is much lower that the AIC category average of £13bn. Henderson and Foll are well known for managing multi-cap portfolios and the utilisation of at times less liquid smaller but faster growing companies plays to the advantage of the closed ended structure.

While the managers will look overseas to provide diversification and exposure to sectors not easily found in the UK, the non-UK allocation of 15.4% at the end of June 2022 is not dissimilar to its peers, on average. The AIC sector classification stipulates that over 80% of the portfolio should be invested in UK quoted shares, however the use of non-UK domiciled names in UK equity income portfolios has become more of a feature in portfolios over the past 10 years or more.

Lastly, fund managers Henderson and Foll have a combined average tenure on this fund of almost 15 years (Henderson: June 2003 and Foll: September 2011) which exceeds the already quite material peer group average tenure of 10 years.

Exhibit 15: Selected UK Equity Income peer group at 26 July 2022*

% 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 (cum-fair)	Net gearing	Dividend yield
Law Debenture Corporation Ord*”	978	4.9	30.2	41.6	163.2	0.50	No	1.6	110	3.8
abrdn Equity Income Trust Ord	153	-2.6	-1.8	-4.2	84.6	0.87	No	-10.6	114	6.8
BlackRock Income and Growth Ord	40	1.7	7.8	14.0	100.6	1.21	No	-5.1	103	3.8
Chelverton UK Dividend Trust Ord	36	-23.0	5.9	-5.6	185.5	2.02	No	-0.6	148	6.4
City of London Ord	1,895	7.6	10.3	20.1	115.5	0.38	No	2.2	107	4.8
CT UK Capital and Income Ord	335	-1.4	6.5	19.1	113.7	0.59	No	-2.0	107	3.7
CT UK High Income Units	107	-7.6	2.0	5.4	77.5	0.98	No	-9.9	102	4.9
Diverse Income Trust Ord	349	-9.6	21.7	22.7	189.6	1.06	No	-5.0	96	3.9
Dunedin Income Growth Ord	425	-6.4	10.7	23.3	99.5	0.56	No	-2.8	108	4.5
Edinburgh Investment Ord	1,044	2.5	10.4	2.1	103.7	0.52	No	-6.6	109	4.1
Finsbury Growth & Income Ord	1,837	-5.8	-0.7	31.2	195.5	0.62	No	-4.1	102	2.1
Invesco Select UK Equity Ord	122	1.2	16.3	21.5	155.7	0.91	No	-9.9	111	4.0
JPMorgan Claverhouse Ord	411	-3.8	4.3	13.0	128.0	0.67	No	0.1	107	4.7
JPMorgan Elect Managed Inc Ord	73	-3.1	5.4	8.9	92.1	0.78	No	-2.4	103	4.8
Lowland Ord	324	-4.0	5.0	-0.4	99.2	0.59	No	-8.0	114	5.1
Merchants Trust Ord	754	13.7	32.5	43.3	156.9	0.55	No	1.2	111	4.9
Murray Income Trust Ord	980	-2.9	13.1	26.6	109.6	0.46	No	-7.4	109	4.1
Schroder Income Growth Ord	204	0.0	9.1	17.2	122.6	0.79	No	-2.3	111	4.4
Shires Income Ord	76	-4.3	9.6	16.0	120.9	0.98	No	-3.4	123	5.6
Temple Bar Ord	713	4.2	-3.7	2.3	84.7	0.48	No	-5.3	107	3.8
Troy Income & Growth Ord	215	-3.0	-1.0	10.3	90.9	0.92	No	-1.9	99	2.7
Simple Average	505	-2.3	8.2	14.3	121.3	0.80	No	-4.2	110	4.4
LWDB rank in peer group	5	3	2	2	4	4		2	8	18

Source: Morningstar, Edison Investment Research. Note: *Performance at 26 July 2022 based on cum-fair NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. **The 28 July 2022 NAV cum income fair value was 755.38p and the premium was 2.6%.

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