EDISON

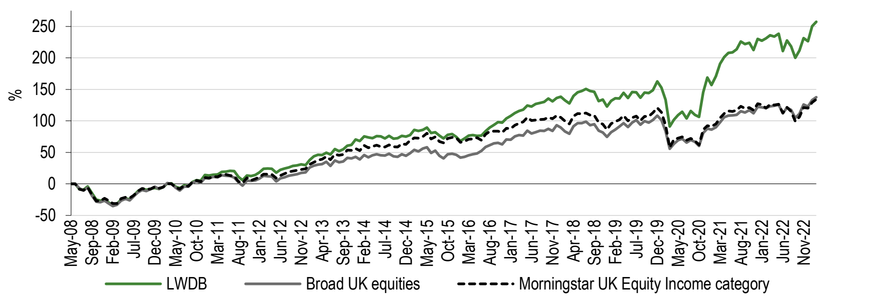
The Law Debenture Corporation

Standing the test

Investment trusts
UK equity income

In challenging conditions, The Law Debenture Corporation (LWDB) has reported robust 2022 results. IPS delivered its fifth consecutive year of growth, in line with its mid-to-high single-digit target. The extreme polarisation of equity market performance, with only a handful of large companies generating positive returns worked against the investment managers' consistent, diversified, value-driven approach in 2022. Nonetheless, LWDB's track record of outperformance over three, five and 10 years remains. The share price return was positive while DPS, held or increased for 44 years, rose 5.2% to 30.5p.

Long-term outperformance of the index and peer group



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

Why LWDB now?

The investment managers estimate that UK equities are trading at the widest discount to global equities in 25 years. This is more so across the broad equity market, where they identify significant undervaluation following the exceptional relative performance of the top 20 stocks in 2022. Low valuations are being confirmed by increasing levels of M&A across the UK market. While the relative performance of the UK equity market has begun to improve, this is yet to be reflected in fund flows. Should flows pick up, it would represent a further positive driver for UK equity performance.

The analyst's view

LWDB is a rare combination of a UK investment trust and independent professional services (IPS) operating business. IPS is growing, cash generative and relatively insensitive to short-term economic and market fluctuations. It has funded 34% of LWDB dividends in the past 10 years while accounting for 21% of 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 (1.4%) 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%). Q422 DPS increased 4.5% to 8.75p versus Q421 and aggregate 2022 DPS of 30.5p was 5.2% ahead of 2021 (29.0p).

28 February 2023

Price Ord.	**843p**
Market cap	**£1,084m**
Total assets	**£1,130m**
NAV*	831.37p
Premium to NAV	1.4%

*27 February 2023 NAV cum income at fair value. This includes debt at fair value as well as the fair value of the IPS business as at 31 December 2023.

Yield**	3.6%

**yield based on 2022 DPS of 30.5p

Shares in issue	128.6m	
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 31 December 2022	12%

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).

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Highly differentiated and unique business model

The key differentiator of LWDB is that unlike other investment trusts, alongside its investment portfolio it includes IPS, a leading provider of independent professional services. The combination is a well proven model and while the current market and business environment presents many challenges and uncertainties, LWDB has successfully navigated many such periods over its long history, which dates back to 1889. During 2022, rising interest rates and inflation and the war in Ukraine, resulted in a slowdown in global growth and volatility in financial markets.

IPS is a resilient, growing, and cash generative business. Despite a challenging environment in 2022 it delivered its fifth consecutive year of mid to high single-digit growth. Net revenue increased by 8.6% versus FY21, to £45.2m, and PBT by 8.1%, to £14.4m. The reliability of IPS reflects a diversified range of operations and income streams, significantly based on recurring income from structurally supported sectors, and others that provide attractive returns but with increased market sensitivity. Demand for governance and pensions services remains strong and there is significant scope for market share growth. IPS targets mid to high single-digit growth over the longer term and has been investing across all business lines to achieve this. The growth in IPS has contributed directly to the net asset value (NAV) growth, with its fair value increasing from c £77m at the end of 2017 to c £174m at the end of 2022. Of even greater importance is the 'outsize' revenue contribution that it makes. At the end of 2022, IPS accounted for c 21% of LWDB's fair value NAV (and the portfolio c 79%) but generated c 30% of the revenue return, in a year of strong portfolio revenue growth. Over the past 10 years IPS has funded 34% of dividends.

The investment portfolio investment managers, James Henderson and Laura Foll from Janus Henderson Investors, consistently highlight the positive impact that strong IPS cash flow has on investment returns. It provides them with the flexibility to select stocks across a variety of activities and market capitalisation, balancing the requirement for immediate income with the potential for capital growth. Unlike many trusts in the equity income sector, this includes companies with lower or zero dividend-paying shares. The flexibility also extends to the ability to avoid being forced by income requirements into high-yielding stocks that the managers may deem unattractive. Their underlying investment approach, consistently applied over many years is bottom-up, diversified by sector and geography, with a strong valuation overlay. The results are impressive. Despite a challenging 2022, LWDB has generated significant outperformance over multiple time periods versus its broad UK equity benchmark and its peer group within the AIC UK equity income sector. Over the 10 years to 31 December 2022, it has delivered a total return of 161% and increased DPS by 110%, or 8% pa.

Exhibit 1 provides a summary of the key 2022 financials. NAV, including adjustment for the fair value of debt (higher market interest rates generated a positive value) and the fair value of IPS (reflecting its assessed enterprise value rather than its IFRS balance sheet value), was 3.3% lower at 761.7p (2021: 787.8p). Total revenue return increased by 22.6%, driven by portfolio dividend income as companies continued to adjust payouts following the pandemic. The capital return swung from profit to loss as market prices fell. Ongoing charges remained attractively low at 0.49% and the moderate gearing provides headroom for further selective portfolio investment. The trust is structurally geared through four tranches of long-term debt (par value of £165m), with maturities ranging between 2034 and 2050, at a blended interest rate of c 4.0%. Net gearing at end-2022[1] was 12% vs 13% at end-2021.

[1] Net borrowings as a percent of NAV.

Exhibit 1: 2022 financial summary

Year end 31 December	2022	2021	2022/2021
Pence per share unless stated otherwise			
Net assets			
NAV as per balance sheet	625.8	717.9	**-12.8%**
IPS fair value adjustment	116.2	111.0	
Debt fair value adjustment	19.7	(41.0)	
NAV (including debt and IPS at fair value)	**761.7**	**787.8**	**-3.3%**
Returns			
Investment portfolio revenue return	24.1	18.1	33.0%
IPS revenue return	10.4	10.0	3.7%
Total revenue return	34.4	**28.1**	**22.6%**
Capital return	(103.1)	94.6	
Total return	(68.7)	**122.7**	**N/M**
Ongoing charges	0.49%	0.50%	
Gearing	12%	13%	
NAV total return			
NAV (including debt and IPS at fair value) at start of year	787.8	666.2	
NAV (including debt and IPS at fair value) at end of year	761.7	787.8	
Change in the year	-3.3%	18.3%	
Impact of dividends reinvested	3.9%	6.8%	
Total NAV return	0.6%	25.1%	

Source: LWDB data

Significant outperformance over multiple time periods

LWDB has delivered excellent performance for investors over the past three, five and 10 years, despite a challenging 2022 (discussed below). 2023 has started well, with the fair value NAV per share up by 9.1% as of 27 February 2023, well ahead of the broad UK index return of 6.7%.

Exhibit 2: Share price and NAV total return performance, relative to indices (%)

Periods to 31 December 2022 (%)	One-year	Three-years	Five-years	10-years
NAV total return (with debt at par value)	(6.8)	16.8	30.3	141.5
NAV total return (with debt at fair value)	0.6	26.0	39.9	154.6
Broad UK equity market	0.3	7.1	15.5	88.2
Share price total return	0.4	37.7	51.6	161.2
Change in Retail Price Index	13.4	23.5	29.6	46.0

Source: The Law Debenture Corporation. Note: Data to 31 December 2022. All returns in GBP.

Over 10 years the fair value NAV return has been almost 155%, well above the broad UK equity market benchmark. The share price total return has been higher still, reflecting the closing of the earlier discount to NAV. It has been consistently strong against the sector average and the larger, close peers listed in Exhibit 3.

Exhibit 3: LWDB share price return versus peers to end-2022

Cumulative return (%)	1 year	3 years	5 years	10 years
Law Debenture	0.4	37.7	51.6	161.2
City of London	9.4	7.9	19.0	101.3
Edinburgh Investment Trust	5.5	17.4	13.9	88.6
Finsbury Growth & Income	-6.0	-0.2	20.5	164.9
Murray Income Trust	-4.1	6.8	30.8	94.5
Merchants Trust	5.5	19.4	48.6	149.8
Temple Bar	3.6	-14.8	3.4	61.0
UK equity income sector average	**-2.5**	**5.2**	**16.2**	**109.7**

Source: Morningstar

The drivers of long-term performance

We would highlight the following factors as key drivers of LWDB's long-term outperformance:

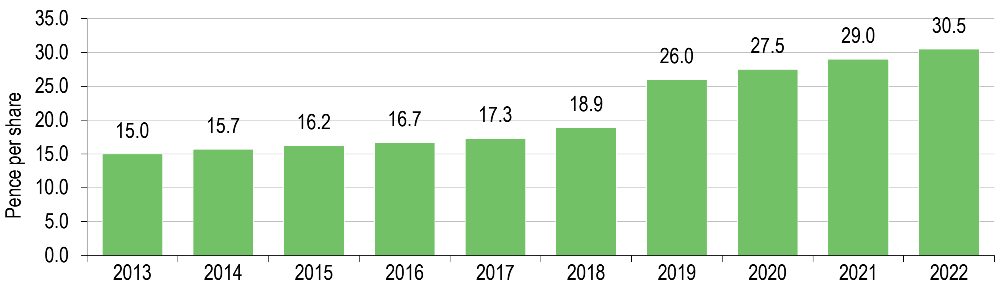
- **Experienced management**. Denis Jackson has been CEO of LWDB since January 2018, having joined the company in 2017 as chief commercial officer. He was previously director of new business enterprise at Capita, the largest business processing and professional services company in the UK, and before that he held a number of senior roles at Citigroup (formerly Salomon Brothers).

The investment managers, James Henderson and Laura Foll from Janus Henderson Investors have a combined average tenure on this fund of 15 years (Henderson: June 2003 and Foll: September 2011), which exceeds the already quite material peer group average tenure of 10 years. 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.

- **Investment flexibility**. The steady cash flow from IPS is the main differentiator for LWDB and a key contributor to long-term performance.
- **Low ongoing charges.** Investment returns benefit from low ongoing charges both in absolute terms and relative to peers. While the difference may not appear significant over short periods, the compounding of lower costs over time is a significant benefit to long-term investors. Janus Henderson Investors is paid an annual management fee of 0.30% of net assets (excluding the net assets of the IPS business), allocated 25:75 between the revenue and capital accounts, reflecting the expected split of future returns. There is no performance fee and LWDB's ongoing charges (0.49% at end-FY22) are among the lowest of any investment trust and c 0.3pp below the average for the AIC UK equity income sector.[2]

Strong commitment to consistent dividend growth. Dividends are paid quarterly, in July, October, January and April. On an annual basis, DPS has increased in each of the past 13 years, including through the pandemic, and has been held or increased for 44 consecutive years. Over the 10 years to end FY22, the dividend more than doubled, increasing by 114% or 7.9% pa. Including the rebasing to a higher level of distribution in FY19,[3] the five-year growth rate is 12.0% pa, versus a peer group average of 4.0%.[4] While the 2019 rebasing of DPS affects this comparison, LWDB's commitment to progressive, sustainable income is clear. After paying the final 2022 quarterly dividend, the company had retained earnings to pay 0.5 years of dividend payments at the current level. On the same basis, including IPS, the group has retained earnings to pay 0.9 years of dividends at the current level.

Exhibit 4: Dividends have increased by 8.3% pa in the past 10 years



Source: The Law Debenture Corporation

[2] LWDB calculates the ongoing charges ratio at 0.49% in 2022 compared with the Morningstar data for the peer group listed in Exhibit 20 of an average of 0.77%. The AIC industry average is c 1.10%.

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

[4] Morningstar data for the peers listed in Exhibit 20, excluding where negative.

Equity market polarisation created challenges in 2022

While the broad UK equity market total return was slightly positive in 2022 (+0.3%), a more significant feature was the exceptional disparity in returns by market capitalisation and by sector. Across the UK market, larger market capitalisation stocks in aggregate outperformed, in part reflecting the level of investor uncertainty and liquidity preference. The index of the top 100 stocks was the only segment of the broad market to show positive total returns but even here, while the top 20 stocks delivered a positive average return of c 16%, the average return for the other 80 stocks was a negative c 17%. Large capitalisation oil, other natural resources and arms manufacturers were very much the place to be invested. Although the LWDB portfolio was not without larger capitalisation stocks, operating in 'in-favour' sectors, this was not a market environment that favoured the investment managers.

The portfolio managers' consistent and proven valuation-driven process aims to identify market-leading, high-quality companies that are undervalued at the point of purchase. The portfolio is concentrated in UK stocks (c 83% of the total) and is highly diversified (c 150 stocks) to manage risks to capital and aid consistency of performance. The managers' strong valuation overlay seeks to utilise the investment flexibility provided by the IPS business; they have the flexibility to select investments across a variety of activities and market capitalisation, balancing the requirement for immediate income with the potential for capital growth. Unlike many trusts in the equity income sector, this includes companies with lower or zero dividend-paying shares. The flexibility also extends to the ability to avoid being forced by income requirements into high-yielding stocks that the managers may deem unattractive. This approach has driven the strong, long-term performance of the trust, but not in the polarised market of 2022. However, with the median share price for the UK down by 18% over the year, stock selection, in aggregate, appears to have been relatively successful.

Exhibit 5: Performance strongly skewed towards a handful of stocks

Performance by different market cap tiers	Performance	Market weighting*	LWDB weighting*
UK top 100	4.7%	83.3%	45.9%
- of which top 20 share constituents	15.7%	56.7%	24.0%
- of which other 80 share constituents	(17.2%)	26.6%	21.9%
UK mid-market	(17.4%)	14.2%	20.1%
UK small cap	(17.3%)	2.5%	7.3%
UK broad market	**0.3%**	**100.0%**	**100.0%**
Junior market	(30.7%)	N/A	11.8%
Overseas	N/A	N/A	14.4%
Other	N/A	N/A	0.6%

Source: The Law Debenture Corporation. Note: *Market and LWDB weightings as at 30 November 2022.

Outlook

LWDB notes that the beginning of 2023 has brought some tentative optimism from investors that inflation and the cost-of-living crisis will perhaps subside sooner than first thought. Although interest rates have risen materially from very low levels, the fall in the economy generally has not so far been as marked as some predicted. The investment managers attribute this to the period of low interest rates having not resulted in high levels of bank borrowing overall in the economy.

IPS is well placed for further growth as it benefits from organic investment and structural trends across its diverse business lines, in many cases driven by regulatory developments and outsourcing. Some of its business lines operate counter-cyclically and it has historically been relatively insensitive to market and economic conditions.

The majority of the portfolio is invested in UK equities, although many of the earnings are derived from outside the UK. The investment managers continue to believe that UK market valuations are too low and offer some attractive longer-term growth opportunities, with a lot of bad news already priced in. Their intention is to be a net buyer of equities.

IPS: Continuing growth in cash flow and valuation

Once seen as a steady but reliable and cash-generative business, 2022 was the fifth consecutive year of growth for IPS since its operational performance was reinvigorated following the appointment of Denis Jackson as CEO at the beginning of 2018. During this period, across all business lines, LWDB has invested significantly in its headcount and skills base as well as IT, to generate efficiencies, maintain and enhance service levels, and create capacity for continued growth.

Over the past five years, IPS revenues have increased by 10.7%, with growth in each business division (pensions, corporate trusts and corporate services), and PBT by 8.2%, in line with the company's mid to high single-digit target. In 2022 net revenue increased by 8.6% versus FY21 and PBT grew to £45.2m or by 8.1%. Strong investment across all business lines and, more recently, inflationary cost pressures, have seen the PBT margin narrow slightly but it remains well above 30%. The PBT margin was stable at 31.9% in FY22 (FY21: 32.1%).

A diverse source of revenue streams, organic investment and structural trends across many business lines underpin IPS's performance. The continuing drivers of regulatory developments and outsourcing bode well for a continuation of the business's growth in line with its long-term mid to high single-digit growth target. Additionally, with a strong and liquid balance sheet (group cash and equivalents of c £50m at end-FY22), we expect IPS to remain alert to further attractive external growth opportunities that may emerge.

Exhibit 6: IPS performance trend

£m except where stated	2017	2018	2019	2020	2021	2022	Five-year compound growth
Pensions	8.3	9.5	10.6	11.5	13.1	14.3	11.6%
Corporate trust	7.9	8.4	9.0	10.8	9.8	10.6	6.1%
Corporate services	11.0	11.7	12.2	12.2	18.8	20.2	13.0%
Total net revenue	**27.1**	**29.6**	**31.8**	**34.5**	**41.6**	**45.2**	**10.7%**
PBT	9.7	10.5	11.5	12.2	13.3	14.4	8.2%
PBT margin	35.9%	35.4%	36.1%	35.4%	32.1%	31.9%	
EPS (p)	7.2	7.9	8.5	9.3	10.0	10.4	7.5%

Source: The Law Debenture Corporation, Edison Investment Research

Pensions

The 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. The pension trustee business is complemented by its fast-growing Pegasus operation, launched in late 2017, providing a broad range of outsourced pensions executive services, from secretarial through to fully outsourced pension scheme management.

The pensions business continued its strong record of growth during 2022, increasing by 9.8%. Over the past five years annual growth has averaged c 12% pa.

This growth is underpinned by demand for high-quality expertise to navigate an increasing regulatory burden. Current regulatory initiatives include a UK Department of Work and Pensions consultation on new funding and investment regulations, while a new code of practice on funding is due to be in force in 2023, which LWDB expects will push schemes to consider investment strategies. Also in 2023, the UK regulator will introduce a single combined code of practice, focusing on improving governance and requiring schemes to assess the risks being run in their schemes. In addition to these regulatory developments, the liability driven investment crisis in Autumn 2022, triggered by the gilt market reaction to the UK governments autumn financial statement further highlighted the need for professionalism, good governance and the need to react quickly to significant market events.

Although LWDB is already the largest independent trustee in the UK, with a market share of no more than 5%, there is plenty of room to grow. While many large pension schemes have a professional trustee appointed to their board, around 50% of schemes in the UK (mainly small- to medium-sized companies) have not yet appointed a professional trustee. LWDB has continued to invest across all areas of the pensions business, adding capacity and consistently building its skills base.

Since it was launched in late-2017, Pegasus has grown strongly. Its c £4m of revenues now represent more than one-quarter of total pensions revenues and we expect this to increase further. It provides outsourced pensions executive services, including pensions management, scheme secretarial and specialist support, as well as acting as an interim or permanent pension fund trustee or corporate pensions executive arm. Its services are especially relevant to smaller or closed/legacy pensions schemes where regulation and complexity are an even greater burden on available in-house resources.

Corporate trust

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 both performing and non-performing debt issues. 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 8.7% in 2022 and have risen by c 6% pa over the past five years. Although market conditions remain challenging, this was a strong rebound from 2021, when revenue decreased by 9.4%. The majority of revenues (c two-thirds) are significantly recurring, 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. Fee uplifts are spread across the year and the rapid rise in inflation since mid-2021 is increasingly feeding through to revenue. For performing debt issues, LWDB earns additional fees for less predictable activities, such as documentation changes.

Levels of new debt issuance are volatile and subject to rapid change, Issuance has recently been weak due to economic uncertainty and challenging conditions in financial markets, evidenced by a 14% decline in European primary debt issuance in 2022 (Dealogic). LWDB has nonetheless completed some notable transactions, including the appointment as trustee for SEGRO's €1.15bn senior unsecured Green Bond issue. Meanwhile, LWDB is seeking to leverage its position as the UK's leading independent (non-bank) corporate trustee, with no financial involvement in transactions to broaden and deepen its relationships with clients, law firms and financial institutions and to raise its market profile.

Ad hoc post-issuance work can generate significant additional revenue and has historically displayed a strong economic counter-cyclicality. It includes additional work generated by debt restructuring or the renegotiation of payment terms, which often continues well after economic recovery is underway. Positively for LWDB's issuer clients there has been little evidence of corporate distress, although this may change with slower economic growth and the upwards turn in the interest rate cycle.

As an established business, with a strong reputation and solid, liquid balance sheet, LWDB is well-placed to offer **escrow services,** which continues to build momentum and broaden its offering. 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. During the pandemic, LWDB supported NHS trusts in the purchase of personal protective equipment from around the world, and in 2022 the escrow product was used to support the Tyson Fury versus Dillon White world title boxing event.

Corporate services

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

- **Company secretarial services.** Within this business, **managed services** provides global entity management services to more than 350 clients, acting as a single point of contact to ensure that overseas legal 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's qualified governance professionals.
- **Structured finance** provides accounting and administrative services to special service vehicles and other corporate structures set up to acquire assets. Typical buyers would include financial institutions such as boutique asset managers, hedge funds or challenger banks wishing to gain risk exposure to a particular asset type, for example aircraft leases or mortgages, or companies being established as part of a corporate acquisition.
- **Specialist external whistleblowing** services via Safecall.
- **Service of process**, where LWDB acts as local agent for third parties not otherwise represented in that jurisdiction.

Revenues in the corporate services business increased by 7.7% in 2022 (including an additional one-month contribution from the late-January 2021 acquisition of the corporate secretarial services business of Eversheds Sutherland LLP for £20m). Over the past five years revenue has grown by c 13% pa.

Client demand remained strong across **the company secretarial business** but in some areas was constrained by an inability to offer appropriate resourcing, particularly in the interim and corporate governance areas. To a large extent this reflects the success of the Eversheds acquisition, which was successfully integrated and has continued to grow strongly. With the acquisition, 46 people joined LWDB and by end-2022 this had increased to 64. LWDB continues to increase capacity further, seeking to hire and develop the right people, skills, technology and infrastructure that are required to grow the business without sacrificing the quality of service, a key driver of success across most IPS businesses.

Managed services appointments vary in scale and coverage, ranging from a single legal entity in one country at its simplest to over 300 subsidiaries in 50 countries at its most complex. LWDB is paid a fixed annual fee to deliver annual compliance and corporate records maintenance. It may also earn incremental revenues from additional projects, such as incorporations and dissolutions, the co-ordination of global corporate change projects and performing entity validation work. Strong workflow management and IT are critical to be able to compete effectively in this space and LWDB continues to invest in these areas.

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**.** LWDB is a relatively small player in the market for **structured finance** company secretarial services, which is dominated by the larger providers with long-established relationships. LWDB is therefore seeking to leverage the acknowledged quality of its offering by raising its profile with a broader universe of clients. 2022 was challenging for capital markets new issuance but LWDB's quotes for new business and wins were both new records. It was particularly pleased with the level of repeat appointments that it received from a number of names operating in the sector, along with an increasing number of professional firms referring business to it.

As with many other IPS businesses, the whistleblowing service provider, **Safecall,** has the benefit of structural tailwinds, from an acceleration of the emerging regulatory frameworks and standards. Although the comprehensive EU Whistleblowing Directive will not apply in the UK, there is an expectation that it will have an impact on extending the scope of existing UK legislation. For employers, the opportunities include being able to demonstrate good governance to stakeholders and identify misconduct within the organisation. With the whistleblowing concept understood and widely discussed, LWDB continues to experience a growing demand for its products and services, broadening out from larger companies to smaller and mid-sized companies. The number of reports to clients increased by 20% in 2022 and revenues from 134 new clients taken on during the year (including EDF Renewables, WHSmith, The Entertainer and CFC Underwriting) set a new record. Given the positive market dynamics, it is unsurprising that competition is increasing and Safecall continues to invest in maintaining the quality of its service and to add capacity for further growth.

LWDB acts as an agent for **service of process** for thousands of clients from all over the world. It has well over 50,000 appointments on its books at any one time but, given the short-term nature of many of these, it typically enters into around 10,000 new appointments each year. Thus, it has the lowest recurring contractual revenue base of all the IPS businesses and is one of the most sensitive to global macroeconomic trends. It nonetheless generates highly attractive returns for LWDB over time. The first half of 2022 benefitted from the post-pandemic recovery but with primary capital markets activity, a key source of appointments, revenues ended the year broadly flat. LWDB continues to invest in the business, exploiting the new technology platform introduced last year to streamline and scale up capacity, and to capitalise on its extensive referral partner network.

IPS is continuing to create value

IPS is a high-margin, cash-generative business that in addition to enabling it to provide the portfolio managers with greater investment flexibility, has steadily grown its operational fair value[5] in recent years. The operational value has more than doubled since end-FY17 (1.25x) through a combination of earnings growth[6] and an increasing valuation multiple. The multiple is based on external professional advice from PwC, and we believe that it remains prudent.

Exhibit 7: Calculation of IPS fair value

	2021		2022	
	£m	Pence per share	£m	Pence per share
EBITDA	15.4		16.6	
Multiple	10.8		10.5	
Gross fair value of IPS business	166.0	135.6	174.2	136.4
IPS net assets attributable to IPS valuation	4.0	3.3	27.6	21.6
Fair valuation of IPS business	**170.0**	**138.9**	**201.7**	**158.0**
Removal of IPS net assets included in group net assets	(34.1)	(27.9)	(53.4)	(41.8)
Fair value uplift for IPS business	**135.9**	**111.0**	**148.4**	**116.2**

Source: The Law Debenture Corporation

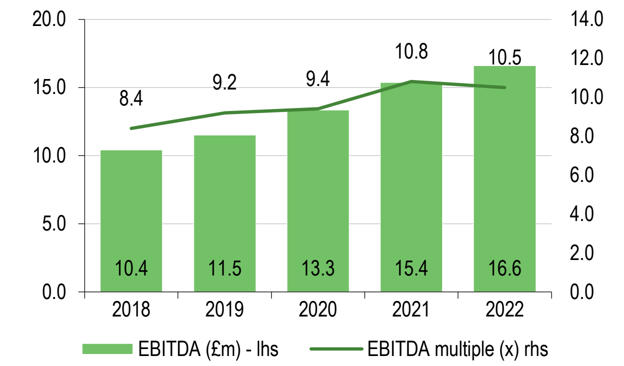
Although FY22 EBITDA continued to increase, this was offset in part by a reduction in the valuation multiple from 10.8x to 10.5x, driven by a prudent assessment of market trends and peer multiples. Nonetheless, the 158.0p per share fair value of IPS at 31 December 2022 compared with an IFRS book value per share of 41.8p. Management initiatives aimed at generating further growth in IPS,

[5] 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.

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

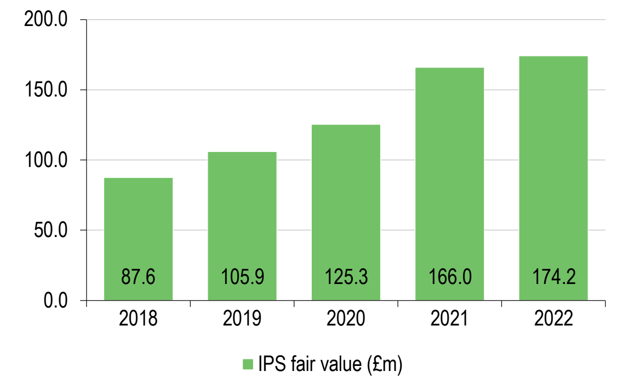
along with the scope for some further increase in the EBITDA multiple are positive indicators for continuing growth in fair value.

Exhibit 8: Valuation driven mainly by EBITDA growth



Source: LWDB data, Edison Investment Research

Exhibit 9: IPS fair value has doubled



Source: LWDP, Edison Investment Research

As there is no direct comparator to the make-up of the IPS business, PwC and LWDB have worked together over several years 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 for the board to select a valuation that it believes to be both fair and sustainable. M&A activity amongst many of the core comparators that have previously been included in the valuation comparison[7] has provided an additional challenge in 2022, building a premium into the companies that are most like IPS. Where this is the case, these have been excluded. While the remaining group of companies presented in the table have some likeness to IPS, further work was undertaken in producing a multiple that the board considers reflective of the fair value to attribute to IPS, validating it with discounted cash flow incorporating an externally advised WACC.

The selected 10.5x EBITDA multiple used to value the IPS business is slightly lower than 2021 (10.8x), but unchanged on H122. This is a discount to the average 11.4x multiple for the comparators with broadly similar historical revenue growth.

Exhibit 10: Recent performance and valuation of IPS comparators

	12-month trailing revenues	12-month trailing EV/EBITDA	2018–2022* revenue CAGR	12-month trailing EBITDA margin
	£m	(x)	(%)	(%)
Law Debenture IPS	45	10.5	11.0	35.0
SEI Investments Company	1,827	11.9	9.4	28.3
SS&C Technologies Holdings	4,702	10.1	15.0	33.9
EQT Holdings	63	13.2	6.3	37.8
Perpetual	425	6.2	8.9	23.7
Mean for core comparators	**1,659**	**11.4**	**10.4**	**33.8**

Source: The Law Debenture Corporation. Note: *Publicly available results on a 12-month trailing basis.

Long-term, bottom-up, diversified and valuation focused

The portfolio managers are focused on long-term returns, with investment decisions driven by a selective, bottom-up approach to stock selection. Their experience is that by staying close to companies, they can invest with conviction and better add value than would be the case by relying

[7] [7] Sanne Group was acquired by Apex Group in August 2022, at an EBITDA multiple of 30x. Intertrust was acquired by CSC in late 2022 at an EBITDA multiple of 12–13x (Source: LWDB).

on top-down macroeconomic forecasting. The variables involved in macroeconomic forecasting are numerous and often difficult to predict, whereas Henderson and Foll argue that a careful and selective stock-driven approach provides opportunities to generate added value almost regardless of what is happening in the wider economy. As a result, there is no common theme to stock selection, which is driven by the search for companies that are 'good at what they do' with 'forward looking, dynamic management teams', but not at any price. Although different metrics are used across sectors, the managers are very conscious of valuation, aiming to invest when companies appear to be undervalued, and recycle capital into more attractive opportunities when valuations have increased materially, or where the investment case has fundamentally changed. The revenue generated by the IPS business provides the opportunity to select from a wide pool of potential investments which, unlike many trusts in the equity income sector, includes those with lower or zero dividend-paying shares. This could be selected early-stage businesses with attractive growth potential and the potential to deliver long-term capital and income growth, or those that are larger and more established and in a process of recovery and dividend restoration.

Given the focus on stocks rather than index weightings, diversification of the portfolio holdings, by business activity, market capitalisation and risk profile, is deliberately targeted, to enhance the consistency of performance and protect capital over the long term. While the portfolio remains very focused on UK equities, overseas investment provides additional stock diversification opportunities, typically utilised where there is no compelling UK equivalent.

2022 portfolio performance reflected market trends

As we have noted above, UK equity market performance in 2022 was marked by a unusually wide disparity in returns across sectors and by market capitalisation. An index of the top 100 UK stocks rose by 4.7% versus a c 17% decline for mid-market stocks and a c 30% decline for the smallest. Even within the top 100 index, the top 20 stocks by market capitalisation increased by an average c 16% versus an average c 17% decline for the other 80.

For LWDB, with its diversified approach to stocks across all market capitalisation ranges, balancing the immediate requirement for income with the opportunities to grow capital and income for the longer term, this was challenging, in contrast to its historical consistent performance.

The five largest contributors to portfolio performance were UK top 100 constituents and included those exposed to rising commodity prices (natural resources companies such as BP, Glencore and Rio Tinto), increased defence spending, significantly driven by the war in Ukraine (BAE Systems) or rising interest rates (Standard Chartered).

Exhibit 11: Top five contributors to 2022 performance

Stock	Share price total return (%)	Contribution (£m)
BP	43.7	8.2
BAE Systems	54.3	5.4
Glencore	58.7	3.9
Rio Tinto	18.5	3.4
Standard Chartered	38.3	3.3

Source: The Law Debenture Corporation, Edison Investment Research

The main detractors to portfolio performance were a combination of early-stage growth companies (Accsys Technologies, Ceres Power and, indirectly, IP Group), Marks & Spencer, due to broad concerns over consumer spending, and 'developer to rent', Watkin Jones, which was affected by cost pressures and the impact of increased capital costs on purchasers. In most cases, the market capitalisation trend was a significant factor, reinforced by stock-specific performance issues.

Exhibit 12: Top five detractors from 2022 performance

Stock	Share price total return (%)	Contribution (£m)
Accsys Technologies	(68.0)	(10.7)
Ceres Power	(67.7)	(8.8)
Marks & Spencer	(47.8)	(6.8)
IP Group	(54.9)	(6.2)
Watkins Jones	(61.7)	(6.0)

Source: The Law Debenture Corporation, Edison Investment Research

To a great extent, in 2020, the smaller the stock the weaker the performance was. Despite being some of the strongest contributors to performance in recent years, this was very much the case for LWDB's selected early-stage companies. In a portfolio context they bring the potential for above average long-term capital and income growth opportunities, while providing diversification away from the value/income positions that make up most of the portfolio. However, they come with higher risks. In most cases, profits are yet to emerge, increasing the sensitivity to rising capital costs. When market sentiment is poor, any disappointments with company performance are compounded by a general retreat to safety, as was the case in 2022.

Accsys Technologies is a producer of sustainable building products, for which revenues continue to grow strongly, but capacity additions have taken longer than expected, at an increased cost. Ceres Power and other alternative energy investments (AFC Energy and ITM Power) have made a positive contribution to performance over five years, supported by favourable structural trends, despite notable weakness in 2022. The investment managers had begun incrementally reducing positions on valuation grounds and in hindsight, would doubtless have done so more aggressively. In part, the 2022 performance also reflected various performance issues, which in turn may be seen as growing pains. The managers view recent management changes at all three of these companies positively and with valuations much reduced, have more recently been adding to positions in Ceres and AFC Energy.

Building on the medium-term success of its alternative energy investments, the managers made an investment in BritishVolt, an unlisted company with plans to manufacture batteries for EV cars. The expected follow-on funding failed to materialise in challenging market conditions and the company eventually went into administration, costing LWDB c £5m (all recognised in 2022). The managers note that 'this mistake' illustrates the sector challenge of raising capital to fund the investment that will be required for EV car manufacturing to flourish in the UK.

The only remaining unquoted investment of note is Oxford Science Innovation, which assists the development of early-stage businesses emerging from Oxford University. It has been a successful investment, with the NAV up over 60% since it was made.

Portfolio activity reflects opportunities to recycle capital

Portfolio turnover is generally relatively low, averaging c 20% pa. Changes in the portfolio holdings are typically stepped, building and exiting positions incrementally, thereby minimising the impact of market timing. Given the polarity of 2022 market performance, the managers continue to take advantage of opportunities to recycle capital from among the few UK companies that have been in favour with investors, and where valuations have increased. UK examples from the second half of the year include the sales of Relx, Convatex, and Euromoney Institutional Investor (which received a takeover approach) and reductions in the Centrica holding. On the flip side, several existing positions were added to, in addition to Ceres Power and AFC Energy. These included Morgan Advanced Materials, Phoenix Group, Halfords and Marshalls. A new position was added in Applied Materials.

Taking advantage of what the managers identified as extended valuations in the US in the early part of 2022, Schlumberger and Applied Materials were sold. Applied Materials fell as economic slowdown concerns surfaced, allowing the repurchase of stock towards the end of the year.

Focused on the UK where valuations are favourable

The LWDB investment portfolio continues to be very much focused on UK-listed investments. UK valuations are low by historical standards and the market has lagged global stock markets, despite around half of earnings from the top 100 companies derived from outside the UK. Portfolio holdings increased by c £40m during the year, while reducing exposure to US-listed stocks by c £16m. This was achieved by deploying the c £41m proceeds of accretive share issuance while simultaneously reducing gearing, providing the flexibility for further net investment as opportunities arise.

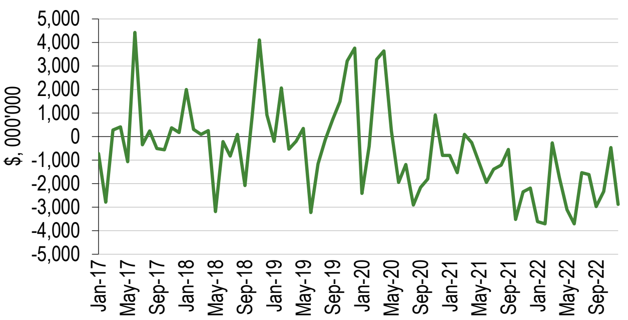
Exhibit 13: Portfolio geographic exposure at 31 December 2022

	Portfolio weight (%)		Change (PP)	Allocation guideline (%)
	31 December 2022	31 December 2021		
UK	83.2	82.6	0.6	55-100
North America	5.1	5.4	-0.3	0-20
Europe	10.6	10.0	0.6	0-20
Japan	1.1	1.1	0.0	0-10
Other Asia-Pacific		0.7	-0.7	0-10
Other*		0.2	-0.2	0-10
Total	**100.0**	**100.0**		

Source: The Law Debenture Corporation, Edison Investment Research. Note: *Collective investment funds.

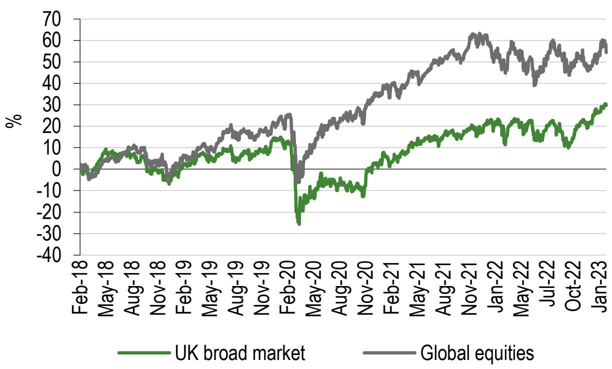
The UK equity market has been hugely out of favour with global investors for a number of years, reflecting recurrent concerns over domestic politics and Brexit, as well as market composition, such as the rise of the US mega-cap technology sector. More recently, as interest rates have increased around the world, investors have paid more attention to the high valuations of many 'growth' companies. We also note that the relative weakness of sterling has a positive translation impact on overseas earnings and that favourable valuations within the UK market have attracted increasing M&A activity. This has recently been the case among mid-market companies

Exhibit 14: Demand for UK equity funds remains low



Source: Morningstar. Note: Globally domiciled UK equity strategies.

Exhibit 15: UK equity market underperformance



Source: Morningstar

While the demand for UK equity funds remains low, the performance gap between UK and global equities has narrowed somewhat over the past year. Janus Henderson research indicates that UK equities are trading at their largest discount to global equities[8] in more than 25 years. It notes that this is not simply at the level of market indices, but is apparent across most sectors. Although reflecting a shorter time period, it is supported by the data in Exhibit 16.

[8] Based on MSCI data.

Exhibit 16: UK valuation stands out

Forward price earnings ratios (x)	Last	High	Low	10-year avg	Last as % 10-year ave.
UK	11.1	15.6	9.4	13.5	82%
US	18.6	23.4	14.1	17.7	105%
Europe	12.9	17.8	11.0	14.4	90%
Japan	12.9	18.5	11.1	14.3	90%
Asia ex Japan	12.7	18.0	11.1	13.1	97%
World	15.1	19.9	12.5	15.4	98%

Source: Refinitiv

Diversification balances risk

Diversity is a key element of the investment strategy and there were 150 stocks in the LWDB portfolio at 31 December 2022 compared to 149 a year earlier and the board has sanctioned an increase in the upper limit to 175. This will facilitate capital recycling, particularly into developing companies where the managers often make a small initial investment, increasing it when those companies require additional capital for suitably attractive new projects.

At the core of the portfolio, the top 10 holdings are all UK top 100 stocks and six of these are within the current top 20. Concentration in the top 10 holdings increased to 22.8% vs 18.6%, primarily driven by strong valuation gains, particularly in the oil and gas and resources sectors (see Exhibit 18), but remains relatively low. The balance of the portfolio represented an average stock weighting of c 0.6%. In the table we have compared the 2022 top 10 stock weightings with their weights in 2021, such that the aggregate does not correspond to the actual 2022 total top 10 weighting of 18.6%.

Exhibit 17: Top 10 holdings (at 31 December 2022)

			Portfolio weight (%)		Change
Company	Country	Sector	31 December 2022	31 December 2021	(pp)
Shell	UK	Oil & gas producers	3.3	2.0	1.3
BP	UK	Oil & gas producers	3.0	1.9	1.1
HSBC	UK	Banks	2.5	2.0	0.5
RioTinto	UK	Mining	2.4	1.9	0.5
GlaxoSmithKline	UK	Pharmaceuticals	2.2	2.7	(0.5)
Barclays	UK	Banks	2.2	2.0	0.2
Flutter Entertainment	UK	Travel & leisure	2.0	0.9	1.1
NatWest	UK	Banks	1.9	1.4	0.5
Anglo American	UK	Mining	1.6	1.4	0.3
Direct Line Insurance	UK	Non-life insurance	1.6	1.4	0.2
Total top 10 holdings*			**22.8**	**18.6**	**4.2**

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. Compared with the broad UK equity market, LWDB has a larger exposure to industrials (by c 10%), matched by a lower exposure to consume sectors.

Exhibit 18: Portfolio sector exposure (at 31 December 2022)

	Portfolio weight (%)		Change
	31 December 2022	31 December 2021	(pp)
Financials	27.4	27.5	(0.1)
Industrials	21.7	20.7	1.0
Oil & gas	10.9	10.1	0.8
Consumer services	9.0	8.8	0.2
Basic materials	8.7	9.7	(1.0)
Health care	8.1	7.2	0.9
Consumer goods	7.7	7.4	0.3
Utilities	3.2	4.4	(1.2)
Telecommunications	2.0	2.6	(0.6)
Technology	1.3	1.6	(0.3)
Total	**100.0**	**100.0**	

Source: The Law Debenture Corporation, Edison Investment Research

LWDB’s approach to ESG

LWDB approaches ESG issues in a variety of ways. On the investment side, the investment managers consider ESG matters as part of their fundamental analysis. They focus on the ability of companies to identify and manage key ESG issues and risks, especially those that may have a significant impact on their financial or operating performance. The investment team proactively engages with the senior management of companies to identify ESG issues and risks and to monitor progress with measures to address these. The approach to investment is not proscriptive and the managers will consider investment in companies with weaker ESG risk profiles, provided that there is a process of improvement under way. At the same time, they are prepared to exit positions where the expected improvements are not delivered. Additionally, the investment managers continue to support companies, in many cases early stage, that provide innovative and immediate ESG benefits. We would particularly highlight investments in the renewable energy and sustainable building materials sectors.

In its oversight position, the board regularly reviews the ESG profile of the portfolio to ensure that it continues to deliver against the commitments made to shareholders. For this, more quantitative ESG metrics informs the discussion and, as the quality and consistency of the data that underlies ESG ratings systems evolve, this is likely to play an increasing role in investment policy.

While investment trusts would not normally have employees or physical infrastructures, this is not the case for LWDB with its IPS business. Many of the IPS operational areas are built upon the provision of independent governance services. Although this is relatively small, the firm monitors its carbon footprint and within the IPS business itself. The move to a new ‘green’ head office building in 2020 allowed for the digitisation of decades of paperwork and a move to new, more carbon efficient, paperless ways of working. Building on the experience of the pandemic, virtual meeting solutions are used where this appropriate. As part of its commitment to the ESG agenda, LWDB has voluntarily chosen to adopt the Task Force on Climate-Related Financial Disclosures (TCFD).

At the corporate level, LWDB has made significant progress in the area of diversity and inclusion. It has established a balanced gender pay gap position and has strong female representation both at board and senior executive level, with women making up 47% of the senior leadership team.

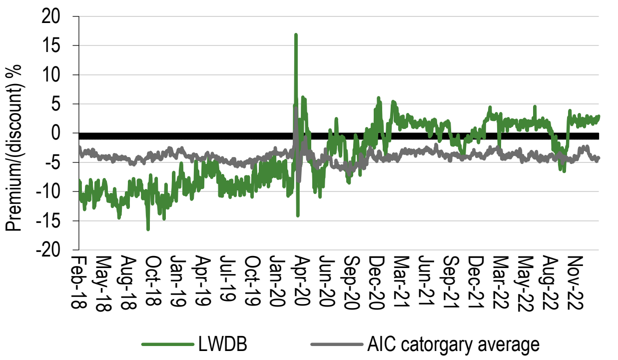
Discount and peer group comparison

As at 28 February, LWDB shares traded at a c 1.4% premium to the last published cum-income NAV (with both debt and the IPS business at fair value), similar to the average for 2022 despite a dip around October. On a longer perspective, the shares have re-rated over the past three or four years from a typical 10–15% discount. The re-rating began around the time of the 2019 dividend re-basing and has since been sustained. Notwithstanding the short-term volatility in markets in early 2020, at the height of pandemic uncertainty, the ability of LWDB to continue progressive dividend payments throughout the pandemic, supported by the IPS revenue contribution, contrasted with most UK income funds which were more negatively affected by deep and widespread UK dividend cuts.

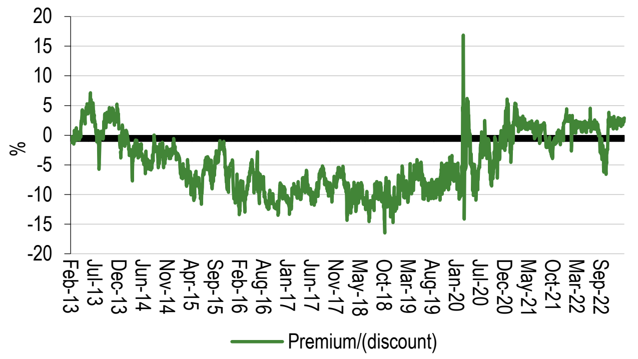
Reflecting the premium to NAV that was in place throughout much of 2022, LWDB was able to satisfy investor demand by issuing shares under its authority at an accretive average premium. Approximately 5.2m shares were issued, raising gross proceeds of c £41m for ongoing investment.

Exhibit 19: Share price premium to NAV and peer group

Law Debenture versus the AIC peer group average



10-year discount



Source: Morningstar, Edison Investment Research

Current valuation and performance metric

LWDB is one of largest constituents by market capitalisation and has one of the lowest ongoing charges. The most recent Morningstar peer group data are yet to reflect the uplift to the IPS fair value included in the final 2022 results (published 28 February 2023) and the increased annual DPS (30.5p). However, based on the last available data, compared with the peer group LWDB ranks very highly on long-term total return performance (first or second over three, five and 10 years). As the managers seek to balance immediate income returns with long-term capital growth, its dividend yield is towards the bottom of the peer group. However, it has grown dividends around three times faster than the peer group over the past five years, and the above-average share price to net asset ratio on which the shares trade has the effect of depressing the LWDB yield versus the peer average by c 20–30bp.

Exhibit 20: Selected UK equity income peer group at 25 February 2023*

Percentages unless stated otherwise	Market Cap.	NAV TR 1-year	NAV TR 3-years	NAV TR 5-years	NAV TR 10-years	Ongoing Charge	(Discount)/premium (Cum Fair))	Net gearing	Dividend yield
Law Debenture Corporation Ord**	1,063	4.9	29.7	45.0	142.1	0.49	1.9	112	3.5
abrdn Equity Income Trust Ord	166	1.9	1.2	0.4	62.4	0.86	-0.7	114	6.5
BlackRock Income and Growth Ord	40	8.9	13.8	28.8	92.8	1.17	-10.4	103	3.8
Chelverton UK Dividend Trust Ord	38	-8.1	2.8	0.1	128.7	2.02	1.4	147	6.4
City of London Ord	2,034	8.1	11.6	28.8	92.6	0.37	1.7	106	4.7
CT UK Capital and Income Ord	331	4.2	2.2	23.1	90.8	0.59	-2.5	107	3.8
CT UK High Income Units	111	5.5	0.3	14.4	60.9	0.98	-6.1	102	4.7
Diverse Income Trust Ord	337	-9.1	11.1	16.8	121.9	1.07	-2.6	97	4.1
Dunedin Income Growth Ord	440	8.0	8.4	36.5	83.7	0.56	-3.2	105	4.3
Edinburgh Investment Ord	1,116	7.2	17.0	23.6	88.8	0.52	-8.2	108	3.8
Finsbury Growth & Income Ord	1,857	8.6	9.3	38.9	160.4	0.60	-4.6	102	2.0
Invesco Select UK Equity Ord	123	1.4	14.2	27.7	118.4	0.75	-7.4	101	3.8
JPMorgan Claverhouse Ord	413	4.0	4.5	21.1	94.7	0.67	-5.7	111	4.8
Lowland Ord	343	1.8	5.9	8.1	72.7	0.62	-9.4	101	4.8
Merchants Trust Ord	831	6.4	26.8	48.5	108.4	0.55	0.9	110	4.6
Murray Income Trust Ord	991	6.5	9.4	39.4	94.8	0.48	-6.5	108	4.2
Schroder Income Growth Ord	220	9.3	15.7	30.8	106.1	0.74	0.2	113	4.2
Shires Income Ord	82	4.3	10.6	26.8	101.6	0.98	-3.0	122	5.2
Temple Bar Ord	755	6.1	3.0	17.0	70.4	0.48	-7.1	108	3.9
Troy Income & Growth Ord	193	-0.5	-6.0	14.0	72.5	0.90	-1.5	102	2.8
Average	574	4.0	9.6	24.5	98.2	0.77	-3.6	109	4.3
LWDB rank	4	10	1	2	2	3	1	3	18

Source: Morningstar, Edison Investment Research. Note: *Performance at 25 February 2023 based on cum-fair NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. LWDB calculates gearing as net borrowing as a percent of shareholders' funds.

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