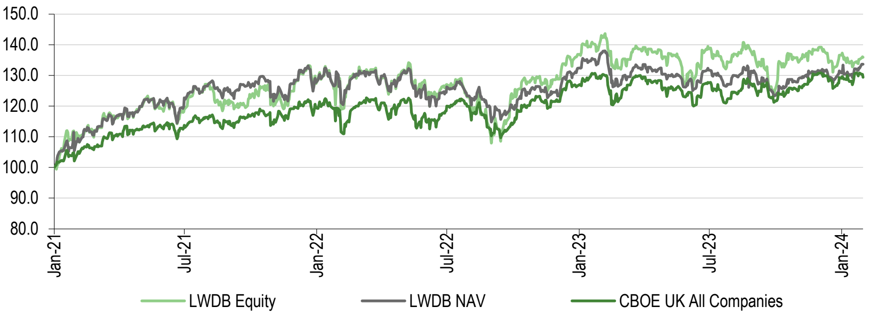
The Law Debenture Corporation

One plus one equals three

Investment trusts
UK equity income

FY23 results for The Law Debenture Corporation (LWDB) show this well-proven, rare combination of a UK investment trust and the cash-generative professional services operating business (IPS) continuing to generate strong results. Performance was ahead of the broad UK equity market benchmark, within which IPS growth was just above the upper end of its mid- to high-single digit growth target and DPS was increased by 4.9%. The results build on LWDB's long-term record of outperformance versus the benchmark and peers and above average DPS growth.

Long-term outperformance of the index and peer group



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

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.

LWDB's unique structure is a significant factor in this performance. IPS is a well-diversified, resilient and growing business, relatively insensitive to short-term economic and market fluctuations, the operational fair value of which has increased by 139% since 2017. While it accounts for 20% of fair value net asset value (NAV) its strong cash generation has funded 34% of trusts' dividends over the past 10 years. In turn, this provides the portfolio managers with much greater freedom to balance the requirements for immediate income with the goal of growing capital values over time. They have the flexibility to avoid higher-yielding stocks they deem unattractive and invest in attractive lower- or non-yielding stocks, with greater growth potential or significant, identifiable recovery potential. While this investment approach means that LWDB is not the highest paying constituent in the UK equity income sector, DPS growth is strong, increasing by an average 11.1% pa over the past five years, well ahead of the narrow peer group average of 2.0%.

The portfolio is 88% invested in UK equities, of which c 50% is in larger companies and the balance in small- and mid-cap companies. UK equity valuations are very low in absolute and relative terms. The LWDB prospective P/E is less than 10x and the portfolio yield is the highest since 2008, with much better cover. The investment managers see strong opportunities across the market but particularly in heavily sold domestic earners, especially among smaller stocks. They expect the UK economy will continue to perform better than expected as interest rates begin to fall and real income rebuilds. Regardless, they are focused on companies rather than the economy and identify many good quality, well-managed businesses, with strong prospects or recovery potential that is far from reflected in their valuations.

NOT INTENDED FOR PERSONS IN THE EEA

29 February 2024

Price Ord.	**782p**
Market cap	**£1,026m**
Total assets	**£1,192m**
NAV*	812.43p
Discount to NAV	3.7%

*27 February 2024 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**	4.1%

**Yield based on 2023 DPS of 32.0p.

Shares in issue	128.6m	
Code Ord/ISIN	LWDB/GB0031429219	
Primary exchange	LSE	
AIC sector	UK equity income	
52-week high/low	860.0	721.0
NAV*** high/low	837.8	747.9

***cum income at fair value

Gearing

Net gearing at 31 January 2024	14%

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

Highly differentiated and unique business model

LWDB comprises two distinct but complementary parts, differentiating it from other investment trusts, and underpinning its long-term performance. Alongside its investment portfolio (c 80% of NAV), it includes IPS, a leading provider of independent professional services (c 20%). IPS is a highly profitable, resilient, growing and cash-generative business comprising 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. As well as creating capital growth for LWDB, it generates income for dividends well above its share of NAV. In an often-challenging environment, IPS profits before tax have increased by a compound 8.7% pa over the past five years, and have funded around one-third of LWDB's dividends. Over the same period the operational fair value of IPS has more than doubled its valuation.

The portfolio has been consistently managed over many years by James Henderson (lead manager since 2003) and Laura Foll (since 2011) from Janus Henderson Investors. Their investment mandate is focused on both income and capital growth, and they highlight the positive impact that IPS has on meeting these goals. The consistently high level of IPS cash flow enables them the flexibility to run a multi-cap portfolio that includes a blend of stocks that can deliver more immediate income with those that can grow sales, earnings and dividends faster over time. This provides a wider pool of opportunities from which to build a diversified portfolio and avoids the need to 'chase yield'. Stock selection is selectively bottom-up with a strong valuation overlay and aims to identify market-leading, high-quality companies that are undervalued at the point of purchase. The portfolio is concentrated in UK stocks (c 88% of the total) and is highly diversified (c 150 stocks) to manage risks to capital and aid consistency of performance.

The business model has generated strong long-term results

The combination of the well-diversified and resilient IPS business with the portfolio is a well proven model that has generated strong long-term results. Supported by structural tailwinds and investment in the IPS, LWDB is confident of further medium-term growth, in line with its mid- to high-single digit growth target. For the portfolio, the investment managers view the outlook for further capital and income growth positively. In particular, we highlight:

- **Significant outperformance**. 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 2023, it has delivered an NAV total return of 111% versus a benchmark return of 68% and an average NAV return for larger-cap sector peers ('the narrow peer group')[1] of 75%. Low fees (2023 ongoing charge ratio of 0.49%) and moderate structural gearing have also supported returns.
- **Strong dividend growth.** DPS has increased in each of the past 14 years, including through the pandemic, and has been held or increased for 45 consecutive years. Including 4.9% growth in 2023, the five-year average is 11.1%, well ahead of the narrow peer group average of 2.0% (source: Morningstar). LWDB's dividend yield of 4.0% is slightly below the narrow peer average, which reflects the managers' investment strategy of balancing immediate income returns with long-term capital growth, building the asset base from which dividends can grow.
- **Consistent IPS growth and profitability.** The year 2023 was the sixth consecutive year of mid- to high-single digit earnings growth in line with LWDB's medium-term target. The reliability of its performance, against what seems a shifting source of economic and political challenges, reflects a diversified range of operations and income streams. These are significantly based on

[1] City of London, Edinburgh Investment Trust, Finsbury Growth & Income, Murray Income Trust, Merchants Trust and Temple Bar.

recurring income from structurally supported sectors, and others that provide attractive returns but with increased market sensitivity. Underlying demand for governance and pensions services remains strong and there is significant scope for market share growth. In 2023, net revenues increased by 11.8% and PBT by 10.5%, generating 11.0p per share of earnings (2022: 10.4p) or 33% of total LWDB revenue earnings.

- **Value opportunity in UK equities.** UK equity (now 88% of the portfolio[2]) valuations are low, in both absolute terms and on a relative basis, and the investment managers identify attractive prospects. The UK market forward P/E is c 11x versus the US on more than 20x, and a 10-year UK average of more than 13x (Refinitiv data). The LWDB portfolio P/E is less than 10x. The very largest stocks derive most (c 70%) of their earnings from overseas and are well insulated from lingering concerns about the pace of UK economic growth. It is among small- and mid-cap stocks, with earnings more dependent on the UK economy, where the investment managers identify the most attractive opportunities. They say there are many good quality, well-managed businesses, with strong growth prospects, that are trading at low valuations that are seemingly pricing in a much weaker than expected economy. With a stronger than expected economy there would be scope for both earnings and valuations to increase, which would represent a highly attractive investment environment. The change in investor sentiment, especially for small- and mid-cap companies, can be swift. This was well-demonstrated in 2020 as the COVID-19 vaccination programme was rolled out, providing a path to the re-opening of the economy. From March 2020 to the end of that year, the total return from the top 100 stocks was c 16% compared with c 38% for mid-cap stocks and c 56% for AIM stocks.

FY23 performance consolidated the strong long-term track record

During 2023, LWDB's NAV total return (cum income with debt at fair value, or 'NAV')[3] was 9.4%, and was 1.5% ahead of the broad UK equity market benchmark total return of 7.9%. The return included a 0.5p per share benefit from an increase in the fair value of LWDB's fixed-rate borrowings due to the increases in interest rates during the year.[4] With debt at par value rather than fair value, the NAV total return was 8.9% or 1.0% ahead of the benchmark.

The 2023 outperformance clawed back some of the underperformance from 2022 when a relatively lower exposure to the very largest companies worked against the trust,[5] such that the fair value NAV total return continues be ahead of the benchmark over one, three, five and 10 years. The cumulative 10-year NAV total return of 111.9% compares with the benchmark return of 68.2%.

The 2023 share price total return of 8.1% was slightly below the NAV return.

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2 The trust can hold up to 45% in non-UK equities, although it has consistently remained focused on UK equities. Overseas investment provides additional stock diversification opportunities, typically utilised where there is no compelling UK equivalent.

3 The 'cum-income' NAV includes all current year income, less the value of any dividends paid in respect of the period together with the value of any dividends that have been declared and marked ex dividend but not yet paid.

4 The fair value of the debt is its notional value assuming interest was paid at the current market rate. The end-2023 balance sheet debt at amortised cost was £163.9m versus the fair value of £130.7m (end-2020: £138.7m).

5 In 2022, in an unusually polarised market, the largest 20 UK stocks, more than half the weighting in the broad market index, were the only market segment to make positive returns. Other larger stocks as well as mid- and small-cap stocks strongly underperformed. With its actively managed all-cap investment strategy, LWDB was roughly half-weighted in the top 20 and top 100 stocks. The 2002 NAV total return was -6.8% versus the benchmark return of +0.3%.

In January 2024 the NAV total return was modestly negative at -0.4% but nevertheless outperformed the negative 1.3% return for the benchmark. The January share price total return was negative 2.0%.

Exhibit 1: Performance summary

Period to 31 December 2023 (%)	1 year	3 years	5 years	10 years
NAV total return (with IPS at fair value and debt at par)	8.9	22.7	51.8	101.4
NAV total return (with IPS and debt at fair value)	9.4	35.1	62.4	111.9
Broad UK equity market total return	7.9	28.1	37.7	68.2
Share price total return	8.1	30.6	85.3	120.2
Change in Retail Price Index	5.3	27.7	32.1	48.9

Source: The Law Denture Corporation, Office of National Statistics

Versus larger peers within the AIC UK equity income sector, all with market capitalisations of more than £500m, LWDB has been consistently strong against the sector average and the larger, close peers listed in Exhibit 2.

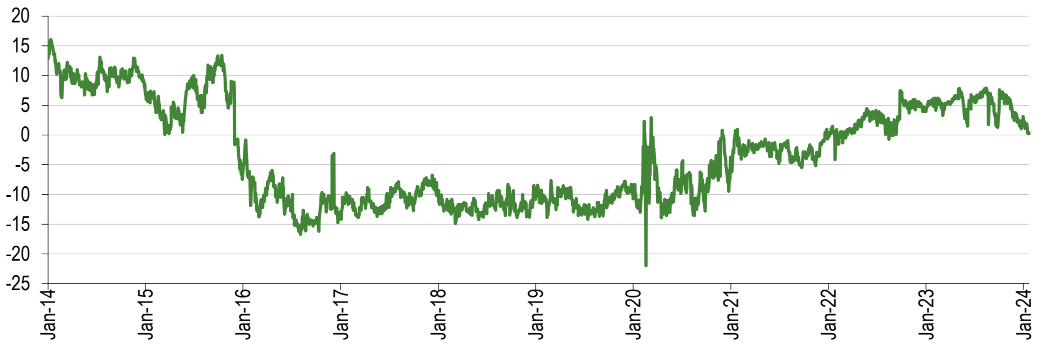
Exhibit 2: LWDB share price total return versus peers (to 31 January 2023)

	Market cap. (£'000)	1 year	3 years	5 years	10 years	25 years
Law Debenture Corporation Ord	1,009.4	8.1	30.5	85.3	120.2	812.9
City of London Ord	1,980.5	4.8	28.1	36.3	70.0	367.7
Edinburgh Investment Ord	1,013.1	12.1	42.5	44.0	71.8	331.8
Finsbury Growth & Income Ord	1,643.3	3.9	4.4	26.4	103.9	825.9
Murray Income Trust Ord	875.7	7.3	17.4	47.1	69.5	438.7
Merchants Trust Ord	775.7	4.7	45.8	60.6	86.5	405.8
Temple Bar Ord	675.9	12.5	39.9	28.8	41.5	481.9
Simple average	**1,160.7**	**7.6**	**29.7**	**40.5**	**73.9**	**475.3**
LWDB position	**4**	**3**	**4**	**1**	**1**	**2**

Source: Morningstar

With debt at par value, the shares traded, on average, at a c 5% premium to NAV during 2023 with a peak premium to NAV of c 8%, a five-year high. On average over the past five years, the shares have traded at a discount of c 3%, with the discount increasing to a little more than 20% during the pandemic. LWDB has one of the strongest P/NAVs in the UK equity income sector.

Exhibit 3: NAV at par discount/premium history (%)



Source: Refinitiv

The 8.9% 2023 NAV total return comprised a 5.4% increase in NAV and a 3.5% impact from the reinvestment of dividends. Revenue earnings of 33.4p per share were slightly down year-on-year (2022: 34.4p) with 6% growth from IPS offset by lower, irregular special dividends received. Regular dividend payments from UK portfolio companies of £29.8m, with a further £3.7m from overseas companies, were at a similar level to 2022, but with special dividends of £1.4m versus £3.4m in 2022, which included material payments from banks and mining stocks. The investment managers see an encouraging outlook for future portfolio dividend income, not least because the UK corporate payout ratio of c 45% is well below pre-pandemic levels of almost 70%. They also see opportunities for continuing special dividends. Ongoing charges remained attractively low at

0.49%.[6] Net gearing as defined by the company was c 12.6% at end-December 2023 versus 11.8% at end-2022.

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 as defined by the company[7] was c 12.6% at end-December 2023 compared with 11.8% at end-2022, well below the c 30% limit set by the board. Gearing is one of the benefits of the investment trust structure and allows the fund to continue to be a net investor during periods of market volatility when the managers may not wish to sell other holdings. As income investors, there is often an immediate 'carry' in using borrowings at relatively low rates of interest to invest into higher yielding assets.

Exhibit 4: Financial performance summary

Period ending 31 December (p/share unless stated otherwise)	2023	2022	2023/2022	2021
Net assets				
Net asset value as per balance sheet	654.1	625.8	4.5%	717.9
IPS fair value adjustment	123.2	116.2		111.0
Debt fair value adjustment	25.5	19.7		(41.0)
Net asset value (including debt and IPS at fair value)	**802.7**	**761.7**	**5.4%**	**787.8**
Revenue return				
Investment portfolio revenue return	22.4	24.1	-6.9%	18.1
IPS revenue return	11.0	10.4	6.3%	10.0
Total revenue return	**33.4**	**34.4**	**-2.9%**	**28.1**
Capital return	**24.5**	**(103.1)**		**94.6**
Total return	**57.9**	**(68.7)**	**N/M**	**122.7**
Ongoing charges	0.49%	0.49%		0.50%
Gearing	13%	12%		13%
NAV total return				
Net asset value (including debt and IPS at fair value) at start of year	761.7	787.8		666.2
Net asset value (including debt and IPS at fair value) at end of year	802.7	761.7		787.8
Change in the year	5.4%	-3.3%		18.3%
Impact of dividends reinvested	4.0%	3.9%		6.8%
Total NAV return	**9.4%**	**0.6%**		**25.1%**

Source: The Law Denture Corporation data, Edison Investment Research

Reflecting the premium to NAV that was in place throughout much of the period, LWDB was able to satisfy investor demand by issuing shares under its authority at an accretive average premium. Approximately 3.0m shares were issued, raising net proceeds of £24.2m for ongoing investment (2022: 5.2m shares raising net proceeds of £41.4m).

Strong commitment to consistent dividend growth

Dividends are paid quarterly, in July, October, January and April, and on annual basis increased by 4.9% to 32.0p in 2023, comprising interim payments of 7.625p and a final payment of 9.125p, to be paid on 11 April 2024 to holders on the register as at 8 March 2024.

In line with its policy in previous years, it is the board's intention for each of the first three interim dividends for 2024 to be equivalent to a quarter of the 2023 dividend, or 8.0p per share, a 4.9% increase on the 2022 equivalent.

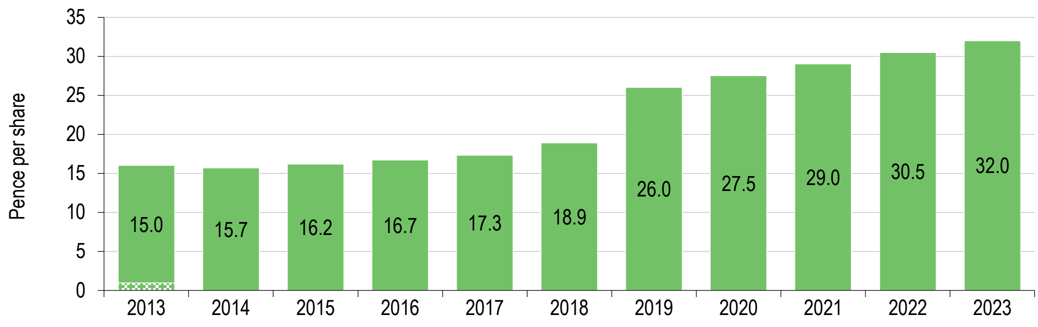
After deduction of the three interim and final dividends, amounting to £41.9m (2022: £38.9m), the consolidated revenue reserves increased by £1.5m, sufficient to cover half a year of payments at the current level.

6 Janus Henderson management fees are paid at an annual 0.30% of NAV and there is no performance fee.

7 The excess of investments held at fair value through the profit and loss account, or 'the investment portfolio' (A) over net assets (B). Thus gearing equals (A/B -1)%.

Over the past 10 years, DPS has increased by 113% or 7.9% pa. Over five years the growth is 69% or 11.1% pa, well ahead of the c 2% growth for the narrow peer group. Both the five- and 10-year DPS growth for LWDB includes the benefit of a significant step up in 2019.[8] Nonetheless, three-year growth of 5.2% pa continues to outstrip peers (c 3%).

Exhibit 5: Dividends continue to increase



Source: The Law Debenture Corporation

IPS: Creating value and generating cash flow

Despite the challenging economic and financial market environment, IPS saw strong growth in 2023, with some areas benefiting directly from high inflation and volatile financial markets. Net revenues increased by 11.8% and PBT by 10.5%, slightly above LWDB's mid to high single-digit medium-term growth target.

Consistent growth over the past six years corresponds with the appointment of Denis Jackson as CEO. He joined LWDB from Capita, where he was director of new business enterprise, having previously been with Citigroup (formerly Salomon Brothers) for 20 years in a range of treasury and financial market roles. During these six years the business has developed a greater strategic focus and has invested significantly, in people, technology and platforms, to broaden and enhance its offering and deliver sustainable growth. Despite this strong investment across all business lines and, more recently, inflationary cost pressures (particularly for high-calibre staff), IPS has maintained a high level of profitability with the PBT margin constantly above 30%.

A fresh five-year business plan was formulated during 2023, which aims to repeat the broadly doubling of earnings and dividends of the past six years over the next six. LWDB expects this to be primarily organically driven but, with a strong and liquid balance sheet, remains open to acquisition opportunities where it believes this could add value to clients and shareholders.[9]

For those less familiar with the range of IPS activities we provide further details on page 15, focusing in this section on the key developments in 2023.

[8] Total 2019 DPS was increased to 26.0p versus 18.9p in 2018.

[9] In January 2021 LWDB acquired the corporate secretarial services business of Eversheds Sutherland LLP for £20m in a cash transaction.

Exhibit 6: IPS performance summary

£m unless stated otherwise	2017	2018	2019	2020	2021	2022	2023	2023/2022	5-year compound growth to 2023
Pensions	8.3	9.5	10.6	11.5	13.1	14.3	17.4	21.2%	12.9%
Corporate trust	7.9	8.4	9.0	10.8	9.8	10.6	12.5	17.4%	8.3%
Corporate services	11.0	11.7	12.2	12.2	18.8	20.2	20.6	2.1%	12.0%
Total net revenue	**27.1**	**29.6**	**31.8**	**34.5**	**41.6**	**45.2**	**50.5**	**11.8%**	**11.3%**
PBT	**9.7**	**10.5**	**11.5**	**12.2**	**13.3**	**14.4**	**15.9**		**8.7%**
PBT growth	10.6%	7.6%	9.4%	6.6%	9.1%	8.1%	10.5%		
PBT margin	35.9%	35.4%	36.1%	35.4%	32.1%	31.9%	31.6%		
EPS (p)	7.2	7.9	8.5	9.3	10.0	10.4	11.0	6.2%	7.0%

Source: LWDB

The rate of growth in net revenues in LWDB's **pensions business** has increased in each of the past six years, reaching 21% in 2023. Structurally, this growth is underpinned by the need for high-quality expertise to assist pension schemes to navigate an increasing legislative and regulatory burden and the steady move towards increased professionalism across the sector. LWDB's traditional 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. Revenues in the pensions business are significantly recurring in nature, although the liability driven investment crisis in autumn 2022, triggered by the gilt market reaction to the UK government's autumn financial statement, created further activity during 2023, with many schemes recognising the need to review their funding and investment strategies. This creates a high bar coming into 2024 but we have no doubt about the structurally driven medium-term growth trends for the business.

The **corporate trust** business also performed very strongly in the year, with net revenues increasing by 17%. Although bond issuance remained subdued in 2023 and remains well below 2019 levels, there were patches of improvement and LWDB participated in a number of notable new transactions. However, while deal flow is important, the majority of revenues (around two-thirds) are recurring in nature, generated from serving the existing book of business, built up over many years. The servicing fees for performing bonds are mostly inflation-linked, with a clearly positive impact on 2023. Defaulted bonds generate additional ad hoc revenues, which have historically displayed a strong economic counter-cyclicality, which can often continue well after economic recovery is underway. With bankruptcies rising from historically low levels in the UK, LWDB's main market, post-issuance work increased modestly during the year. Included within the corporate trust business, escrow services continued to grow steadily and LWDB was appointed a well-diversified range of transactions.

Corporate services is itself a diverse collection of businesses, including whistleblowing (Safecall), structured finance services, company secretarial services (CSS) and service of process (SoP). Collectively, net revenues increased by 2.2%, masking strong progress at Safecall and in structured finance. CSS was largely flat, and economically sensitive SoP had a difficult year.

Safecall is growing strongly, driven by whistleblowing legislation, an increasing recognition that the provision of such services represents best business practice, and investments in enhancing capability, functionality and capacity. During the year, a significant number of new client relationships were added, with the number of reports provided up by 22% to a new record. Although a relatively small part of the business, **Structured finance** made good progress despite challenging conditions for many of the financial institutions (asset managers, hedge funds and challenger banks) that are active in the market. LWDB continues to successfully leverage the acknowledged quality of its offering by raising its profile with a broader universe of clients.

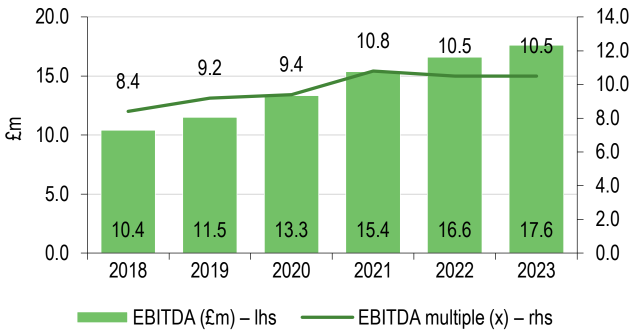
In **SoP**, LWDB handles many thousands of appointments in a year, many of which are short duration, with a low level of repeat business relative to LWDB's other activities. More challenging economic conditions, particularly in developed markets, are currently weighing on the level of activity. However, it is a well-established business, and while revenues can vary significantly from one year to the next, it generates highly attractive returns for LWDB over time.

CSS is well advanced with its significant investment in the right people, skills and systems to further exploit the growing need for outsourced governance solutions; however, this is yet to filter through to revenues. Against a supportive backdrop, where in most developed counties there is a continuing statutory and regulatory drive for enhanced corporate governance standards, LWDB remains confident that the business will generate sustainable growth over time.

IPS continues to build value

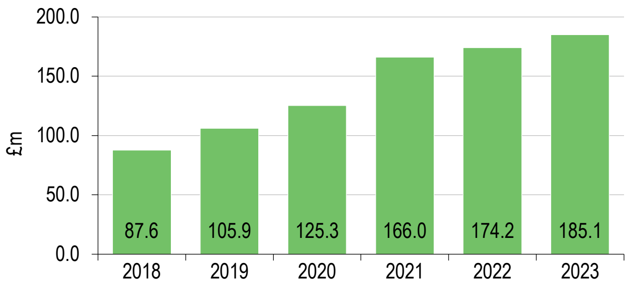
The operational fair value of the IPS business[10] continued to increase in 2023 (+6%), driven by growth in earnings (EBITDA[11]) with an unchanged valuation multiple of 10.5x. Since end-2017 the operational fair value has increased by 139%, of which EBITDA growth accounts for c 80% with the balance reflecting a steady increase in the valuation multiple from a modest 7.9x to 10.5x.

Exhibit 7: IPS fair value change has been driven mainly by EBITDA growth



Source: LWDB data, Edison Investment Research.

Exhibit 8: The IPS fair value has increased by 130% since 2017 (£m)



Source: LWDB, Edison Investment Research

LWDB has published an operational value of the standalone IPS business since 2015 to address the fact that the IFRS consolidation fails to recognise the full value added. On a fair value basis, the 2023 IPS value was £210.8m, comprising the operational value of £185.1m and attributable net assets of £25.7m, or 161.4p per share. This was £160.8m more than the £50.0m IFRS valuation shown in the balance sheet, representing a fair value uplift of 123.2p.

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. In our view, the multiple has remained conservative, and a full explanation of the methodology is provided in the annual report.

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

[11] Earnings before interest, tax, depreciation and amortisation.

Exhibit 9: Calculation of IPS fair value

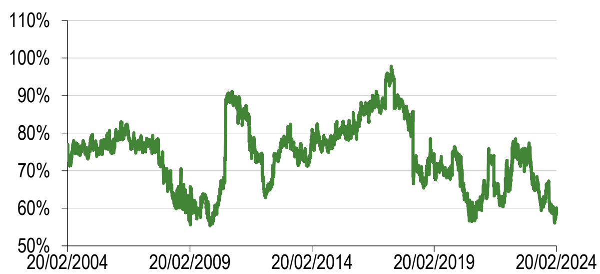
	2023		2022	
	£m	Pence per share	£m	Pence per share
Trailing 12-month EBITDA	17.6		16.6	
EBITDA multiple (x)	10.5		10.5	
Gross fair value of IPS business, excluding net assets	**185.1**	**141.7**	**174.2**	**136.4**
IPS net assets attributable to IPS valuation	25.7	19.7	27.6	21.6
Fair valuation of IPS business	**210.8**	**161.4**	**201.7**	**158.0**
Removal of IPS net assets included in group net assets	(50.0)	(38.3)	(53.4)	(41.8)
Fair value uplift for IPS business	**160.8**	**123.2**	**148.4**	**116.2**

Source: The Law Debenture Corporation

UK equity opportunity

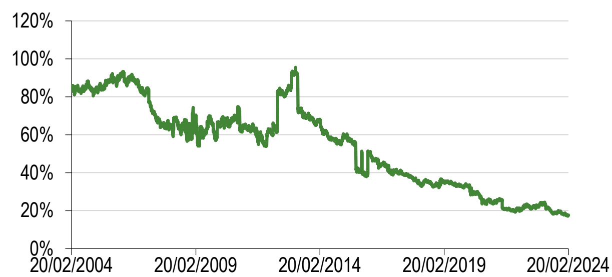
UK equities have been strongly out of favour with investors since Brexit and remain so. That the UK market is lowly valued in absolute terms and relative to other global markets is not new, but the investment managers point out that a prospective P/E for the portfolio of 9.8x at the end of 2023 is substantially lower than its 10-year average of 13.3x, while the 12-month forward portfolio yield (c 4.2%) has not been so high since the 'distressed highs' going into the 2008 banking crisis. If that were not enough, they add that dividend cover is relatively high and earnings forecasting remains 'cautious'. This is especially the case for domestically focused small and mid-caps and this is where they see particular value. There may be no immediate catalyst for a re-rating of the UK market but as investors wait, the relatively high yield supports returns, and the low P/E should mitigate against adverse economic or global equity market corrections.

Exhibit 10: UK trailing P/E ratio versus US



Source: Refinitiv

Exhibit 11: UK P/book value versus World



Source: Refinitiv

Many investor concerns, such as geopolitical tensions, are not specific to the UK, where the differentiating factor is perhaps the level of pessimism about the domestic economy. Having performed more robustly through 2023 than was widely expected at the beginning of the year, preliminary data indicate that in the final quarter of the year the UK economy 'technically' entered a recession, defined as two consecutive quarters of negative growth.

It could be that activity is indeed softening in response to the significant rise in borrowing costs and cost of living pressures for consumers. However, looking more broadly, recent snapshots from the economy have shown a rebound in consumer confidence since the start of this year, buoyed by the prospect of interest rate cuts as inflationary pressures cool. Moreover, GDP estimates are subject to often significant revision as more data become available and that would be consistent with the overall more positive signals that the investment managers are getting from their interaction with many companies. It is probably fair to say that the UK economy is for now continuing to flatline, as it has since early 2022. The investment managers see the potential for a better UK economic development than is widely forecast (the Bank of England expects the rate of GDP to reach just 0.5% by early 2025). They note that with a combination of nominal wage growth and declining inflation, consumers are finally seeing their real incomes grow and this should lend support to the economy.

If the economic environment does indeed turn out to be more favourable than expected, it is likely to strongly favour mid- and small-cap UK stocks in general, given that they are on average more exposed to the domestic economy relative to the very largest companies. However, the investment managers are not simply backing their more positive economic assessment, even though they note that for many economically sensitive companies, earnings performance has outstripped low expectations. They are attracted to mid- and small-cap stocks, where growth is driven by capturing market share within large end-markets or creating new markets, mitigating any impact from general economic conditions. These companies have the capacity to increase revenues, earnings and dividends strongly over time and their shares can often be acquired at attractive valuations. There are also large companies with recovery plans in place that if successfully implemented will see a return to paying dividends, most likely at considerably higher share prices.

The portfolio: Long-term, bottom-up, diversified and valuation focused

The investment portfolio is managed with the aim of achieving long-term capital growth and a steadily increasing income. There is a strong focus on UK stocks (88% at end-2023), although there is flexibility to invest in overseas stocks, most usually exercised when there is no compelling UK equivalent. Holdings are spread across large, medium-sized and smaller companies, across a variety of activities, balancing the requirement for immediate income with the potential for capital growth. Reflecting the prospects of faster long-term growth in sales, earnings and dividends from mid-caps and small caps, these are significantly overweighted in the portfolio compared with the all-market benchmark. Selective holdings in larger companies can meet the needs for immediate income, albeit with the likelihood of slower growth, are more established and hence less 'risky', and for much of the time since the Brexit vote in 2016 have been preferred by investors for having more internationally focused businesses with less exposure to the UK economy.

Investment decisions are driven by bottom-up stock selection with a strong valuation overlay. Quite simply, across the broad equity market, the investment managers are seeking to identify well managed, high-quality companies with a strong competitive advantage in their chosen market segments, at attractive prices. With a focus on long-term returns, they are prepared to take a contrarian position and do not shy away from stocks that have fallen out of favour, perhaps because they have disappointed on earnings, have balance sheet issues, or there are concerns over management. Crucially, the managers do not invest on valuation alone and must be able to identify a resolution to whatever the issue may be and a route to growth in revenues, earnings and dividends.

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. There are usually c 150 holdings in the portfolio with a maximum of 175. Further underlining the level of stock diversification within the portfolio, particularly among mid- and small-cap stocks, at the end of 2023, the top 10 holdings, nine of which are top 100 companies, represented 25% of the total portfolio and the other c 140 holdings c 75%.

Exhibit 12: Top 10 holdings

Company	Sector	Portfolio weight (%)			Change since	
		31-Dec-23	30-Jun-23	31-Dec-22	30-Jun-23	31-Dec-22
Rolls Royce	Aerospace and defence	3.9	3.2	0.99	0.7	2.9
Shell	Oil and gas producers	3.3	2.1	3.27	1.3	0.1
HSBC	Banks	2.9	2.9	2.52	-0.1	0.3
BP	Oil and gas producers	2.8	2.8	3.05	-0.1	-0.3
Rio Tinto	Mining	2.3	2.0	2.44	0.2	-0.2
Marks & Spencer	Consumer services	2.3	1.7	0.97	0.6	1.3
Flutter Entertainment	Travel and leisure	2.2	2.7	1.96	-0.4	0.3
GlaxoSmithKline	Pharmaceuticals	2.1	2.1	2.24	0.0	-0.2
Barclays	Banks	2.0	2.1	2.19	-0.1	-0.2
Senior	Industrials	1.6	1.6	1.20	-0.1	0.4
Total*		**25.2**	**23.2**	**20.8**	**2.0**	**4.4**
Weight of actual top 10 holdings**		**25.2**	**23.2**	**22.8**	**2.0**	**2.4**

Source: The Law Debenture Corporation. Note: *The total weighting in those stocks comprising the top 10 holdings at 31 December 2023. **The total weighting in the actual top 10 holdings at each point in time.

Exhibit 13 shows the overweighting to mid- and small-cap stocks and the underweighting of the very largest stocks. Compared with 2022, when the top 20 stocks were the only segment of the market to generate positive returns, performance by market segment was much less polarised in 2023. The 2022 total return of the AIM index was -6.4% compared with -30.5% in 2022.

Exhibit 13: Performance strongly skewed towards a handful of stocks

Market cap segment	Performance		LWDB weighting at 31 December 2023	UK market weighting at 31 December 2023
	2023	2022		
UK top 100	7.9%	4.7%	48.3%	83.7%
– of which top 20 share constituents	3.5%	15.7%	23.7%	55.1%
– of which other 80 share constituents	16.7%	-17.2%	24.6%	28.6%
UK mid-market	7.9%	-17.5%	22.7%	11.1%
UK small cap	6.7%	-13.6%	7.2%	2.9%
UK broad market	7.9%	0.3%	78.2%	2.2%
Other UK*	N/A	N/A	10.3%	N/A
Overseas	N/A	N/A	11.3%	N/A

Source: LWDB, Refinitiv, Edison Investment Research. Note: *Other UK is predominantly AIM-listed stocks. In 2023 the AIM index total return was -6.4% and in 2022 it was 30.5%.

Sector weightings represent an output from stock selection rather than being a target in themselves, although they do show that the portfolio is tilted towards more cyclical stocks. In underlying terms, the portfolio holdings have an above average exposure to the domestic economy. More generally, the portfolio had an ungeared beta of 1.1 as at the end of 2023, which, combined with the trust's use of gearing, would suggest likely outperformance in a rising market. Compared with the broad UK equity market, LWDB has a larger exposure to industrials (by c 14 percentage points), matched by a lower exposure to consumer sectors.

Exhibit 14: Sector exposure

	Portfolio weight (%)			Benchmark weight (%)	Change in portfolio weight since (pp*):	
	31-Dec-23	30-Jun-23	31-Dec-23	31-January 2024	31-Dec-23	30-Jun-23
Financials	27.4	26.6	27.4	26.0	0.8	0.0
Industrials	25.6	23.1	21.7	11.7	2.5	3.9
Energy	10.3	10.9	10.9	10.8	(0.6)	-0.6
Consumer goods	7.8	10.3	7.7	14.4	(2.5)	0.1
Basic materials	6.0	6.7	8.7	7.1	(0.7)	-2.7
Health care	6.0	7.7	8.1	11.3	(1.7)	-2.1
Consumer services	10.4	7.4	9.0	12.5	3.0	1.4
Utilities	3.1	3.2	3.2	3.7	(0.1)	-0.1
Telecommunications	1.9	2.1	2.0	1.1	(0.2)	-0.1
Technology	1.5	2.0	1.3	1.4	(0.5)	0.2
Total	100.0	100.0	100.0	100.0	0.0	0.0

Source: The Law Debenture Corporation, Edison Investment Research. Note: *Percentage points.

Although the investment policy allows non-UK investment of up to 45%, the focus on UK equities has recently increased (from 84% in June 2023 to 88% at year-end). It is in the lowly valued UK market where the investment managers see the most attractive opportunities, particularly among domestic earners and especially in the mid- and small-cap segments.

Exhibit 15: Portfolio geographic exposure at 31 December 2023

	Portfolio weight (%)			Change since (%):		Allocation guideline (%)
	31-Dec-23	30-Jun-23	31-Dec-22	30-Jun-23	31-Dec-22	
UK	88.2	83.8	83.2	4.4	5.0	55–100
North America	3.2	5.5	5.1	-2.3	-1.9	0–20
Europe	7.4	9.6	10.6	-2.2	-3.2	0–20
Japan	1.2	1.1	1.1	0.1	0.1	0–10
Other Asia-Pacific					0.0	0–10
Total	**100.0**	**100.0**	**100.0**			

Source: The Law Debenture Corporation, Edison Investment Research

Performance drivers in 2023

Compared with the highly polarised market of 2022, when from a market capitalisation perspective, the largest 20 stocks were the only area to deliver a positive total return, there are signs of a broadening out of returns in 2023.

Exhibit 16: Portfolio weightings and market performance by market cap segments

Performance by different market cap tiers	Performance	Market weighting	LWDB weighting*
UK top 100	3.2%	84.1%	48.5%
– of which top 20 share constituents	1.3%	56.0%	22.7%
– of which other 80 share constituents	7.2%	28.1%	25.8%
UK mid-market	-0.6%	13.6%	19.6%
UK small cap	0.7%	2.2%	5.6%
UK broad market	2.6%	100.0%	73.7%
Junior market	-8.5%	N/A	11.8%
Overseas	N/A	N/A	14.4%

Source: The Law Debenture Corporation, Refinitiv

The top five stock portfolio gainers during 2023 included two 'self-help' recovery holdings, Marks & Spencer and Rolls Royce. Both have seen a recent change in management that has proved a catalyst for improved operational and financial performance and share price recovery. It is worth noting that Rolls Royce is yet to return to the dividend list and the Marks & Spencer yield is low. While the investment managers expect both to increase payouts over time, it would be difficult for a traditional income fund to hold significant positions in such stocks. Earlier in 2023 as their conviction in the investment increased, the investment managers had added to both Rolls Royce and Marks & Spencer, both of which are now large holdings, among the top 10.

The ongoing recovery in the aerospace market had a positive impact on Rolls Royce and also on aerospace components maker Senior. While HSBC generated significant appreciation based on the positive margin effects of rising interest rates, it was actually a detractor from the overall performance as LWDB's position was less than the index weight. Hill & Smith is an industrial conglomerate with significant exposure to the growth in US infrastructure spending.

Exhibit 17: Top five gains in 2023

£m	2022 valuation	Purchases	Sales	Appreciation	2023 valuation
Rolls Royce	8.8	3.2		25.2	37.3
Marks & Spencer	8.6	1.6		11.6	21.8
HSBC	22.4			5.2	27.6
Hill & Smith	7.8			4.9	12.7
Senior	10.7			4.4	15.1
Total	**58.3**	**4.8**	**0.0**	**51.4**	**114.4**

Source: The Law Debenture Corporation

Within the top five losses, Anglo American was negatively affected by some challenging operating conditions, particularly for diamonds, as well as some self-inflicted issues such as material downgrades to its copper production targets. Its ability to benefit from decarbonisation and the supply of copper for use in electric vehicles and renewable energy is key to the investment rationale, along with the company's leadership within the mining sector on environmental targets. It was on this basis that LWDB added to its position during the first half of 2023.

Although the share price has been weak in the past two years, Ceres Power remains one of the top contributors to LWDB's performance over five years. The managers took profits into the strong rise in the share price and valuation in 2020, but remained positive about the long-term growth prospects and were rebuilding the position on price weakness during 2023. They expect the company's fuel cell technology to play an important role in the move away from fossil fuels, but in the past year investors were disappointed by slower than hoped for progress with large licensing deals.

A normalisation of many commodity prices following the Ukraine war-inspired spike, including natural gas, had a negative impact on i3 Energy and Indus Gas.

NatWest failed to benefit from the positive impact of higher interest rates on banking margins and was negatively affected by the 'de-banking' affair and subsequent departure of the CEO.

Exhibit 18: Top five losses in 2023

£m	2022 valuation	Purchases	Sales	Depreciation	2023 valuation
Anglo American	14.5	2.2		(5.9)	10.8
Ceres Power	7.9	4.5		(5.6)	6.9
i3 Energy	7.7			(4.1)	3.6
NatWest	17.2			(3.0)	14.3
Indus Gas	4.2			(3.0)	1.2
Total	**51.6**	**6.7**	**0.0**	**(21.5)**	**36.7**

Source: The Law Debenture Corporation

In terms of new investments, the managers have highlighted stocks such as Workspace and Shaftesbury in the real estate sector and insurer Beazley, each with leadership positions in chosen markets.

Workspace is a well-established business with a strong record of growth in providing flexible office space in and around London. Shaftesbury owns a portfolio of prime properties in London's West End. In both cases the shares were trading at a material discount to NAV while operating trends (such as rental values) have remained encouraging.

Beazley writes insurance across a range of end markets and has been a leader in the development of cyber breach insurance. At the time of purchase, it was trading on a lower-than-average valuation with good prospects to return excess capital in the form of increased dividends or share buy-backs.

When prices have been weak, the investment managers have continued to add to existing positions such as Marshalls, a building materials supplier, and Watkin Jones, a developer of build to rent residential properties and student accommodation. Both companies have long experience in their respective end markets and while trading conditions are currently challenging, the investment managers see a good potential for substantial earnings recovery on an improvement in demand.

Current valuation and performance metrics

In Exhibit 2 above we show a comparison of the LWDB share price total return performance versus its six larger peers within the AIC UK equity income sector.

In the table below we show a range of additional data and include a wider list of 20 sector constituents. The most recent Morningstar peer group data used are yet to reflect the uplift to the IPS fair value included in the final 2023 results (published 27 February 2024) and the increased annual DPS (to 32.0p). LWDB ranks very highly versus both close peers and the wider group on all measures other than dividend yield. The lower yield reflects the investment strategy of balancing immediate income returns with long-term capital growth, compensated for by much faster dividend growth and well-above average capital growth. Not surprisingly, LWDB's discount to NAV is one of the lowest in the sector and the shares have traded at a modest premium for much of the past year.

Exhibit 19: Selected UK equity income peer group at 28 February 2024

Percentages unless stated otherwise	Market cap (£m)	NAV TR 1-year	NAV TR 3-years	NAV TR 5-years	NAV TR 10-years	Premium/ (discount)	Ongoing charge	Net gearing	Dividend yield	5-year div growth
Law Debenture Corporation	1,025	0.4	23.7	46.7	101.0	(3.5)	0.5	114	4.1	11.1
City of London	1,958	0.2	30.3	26.7	63.1	(1.8)	0.4	107	5.2	2.6
Edinburgh Investment	1,011	3.4	29.1	25.5	64.0	(10.1)	0.5	108	4.0	(0.3)
Finsbury Growth & Income	1,639	2.4	15.8	28.8	118.0	(7.1)	0.6	102	2.2	4.4
Murray Income Trust	879	2.1	19.7	34.3	71.7	(9.5)	0.5	107	4.6	2.4
Merchants Trust	767	(8.3)	27.4	35.7	60.5	(1.1)	0.6	112	5.3	2.2
Temple Bar	673	(1.3)	24.3	12.4	41.2	(6.9)	0.5	110	4.1	0.5
Average core	**1,154**	**(0.3)**	**24.4**	**27.2**	**69.8**	**(6.1)**	**0.5**	**108**	**4.2**	**2.0**
LWDB core position	**3**	**4**	**5**	**1**	**2**	**3**	**6**	**1**	**5**	**1**
abrdn Equity Income Trust	133	(14.5)	1.7	(10.3)	8.4	(5.0)	0.9	114	8.2	3.5
BlackRock Income and Growth	37	(1.2)	22.5	26.4	67.8	(11.8)	1.3	106	4.1	1.4
Chelverton UK Dividend Trust	31	(14.7)	(9.3)	1.4	33.6	0.9	2.4	159	8.6	6.8
CT UK Capital and Income	315	3.7	20.8	25.2	73.1	(3.5)	0.7	107	4.0	2.1
CT UK High Income Units	107	3.0	11.7	19.5	43.0	(6.7)	1.0	112	4.9	2.5
Diverse Income Trust	261	(7.4)	(8.9)	12.8	47.7	(5.7)	1.1	97	5.0	3.6
Dunedin Income Growth	397	3.0	13.3	35.8	66.1	(10.5)	0.6	107	4.8	1.6
Invesco Select UK Equity	105	1.2	25.6	33.3	74.7	(15.7)	0.8	111	4.5	2.7
JPMorgan Claverhouse	375	(0.8)	15.7	23.2	54.5	(6.3)	0.7	109	5.3	4.6
Lowland	304	(3.0)	15.9	14.1	33.3	(14.3)	0.6	113	5.6	3.0
Schroder Income Growth	183	(4.6)	19.9	23.6	59.8	(9.0)	0.8	115	5.2	3.2
Shires Income	87	(5.5)	10.9	24.2	62.0	(13.0)	1.0	119	6.8	1.8
Troy Income & Growth	161	4.8	14.6	13.3	59.4	(3.7)	1.0	101	3.0	(5.6)
All sector average	**522**	**(1.3)**	**17.1**	**22.0**	**57.3**	**(10.3)**	**0.8**	**111**	**5.1**	**1.6**
LWDB all-sector position	**3**	**9**	**6**	**1**	**2**	**4**	**19**	**5**	**15**	**6**

Source: Morningstar, Edison Investment Research. Note: *Performance 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.

Law Debenture'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 there is a process of improvement underway. 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 portfolio's ESG profile including recent engagement examples. As the quality and consistency of data that underlies ESG ratings systems evolves, this is likely to play an increasing role in investment policy.

While investment trusts would not normally have employees or physical infrastructure, 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 appropriate. As part of its commitment to the ESG agenda, LWDB has voluntarily chosen to adopt the Task Force on Climate-Related Financial Disclosures.

At the corporate level, LWDB has made significant progress in the areas of diversity and inclusion.

The IPS businesses

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. It provides a broad range of outsourced pensions executive services, from secretarial through to fully outsourced pension scheme management, which are especially relevant to smaller or closed/legacy pensions schemes where regulation and complexity are an even greater burden on available in house resources.

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.

Corporate trust

The corporate trust business is the UK's leading independent (ie non-bank with no financial involvement in transactions) 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. LWDB is seeking to leverage its independence to broaden and deepen its relationships with clients, law firms and financial institutions and to raise its market profile.

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 M&A transactions, corporate disposals, litigation, global trading and property transactions, but the range of applications is wide.

Corporate services

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

- **CSS**, the demand for which is underpinned by the worldwide efforts of law makers and regulators to continually raise the bar for corporate governance standards. 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** provides a complete range of board and committee support from full outsourced company secretarial support to attending and minuting meetings, board evaluations and governance reviews; and **interim resourcing** provides immediate access to qualified governance professionals, whether on-site or remote, full time or part time, as required by the client.
- **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. Although new issuance has recently been challenged by market conditions, 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 this market, 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.

- **Specialist external whistleblowing** services via Safecall, which, as with many other IPS businesses, has the benefit of structural tailwinds, from an acceleration of the emerging regulatory frameworks and standards. Early adopters were often larger entities, but smaller and mid-sized employers are increasingly seeing the value of an independent and trusted partner to deliver this service, where Safecall is positioned as a premium provider of a high-quality product.
- **SoP**, where LWDB acts as local agent for third parties all over the world that are not otherwise represented in that jurisdiction. It is a high-volume business, with well over 50,000 appointments on the books at any one time, but given the short-term nature of many of these, SoP 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.

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