EDISON

The Law Debenture Corporation

Proof of proposition in challenging H120

Investment trusts
Income and growth

5 August 2020

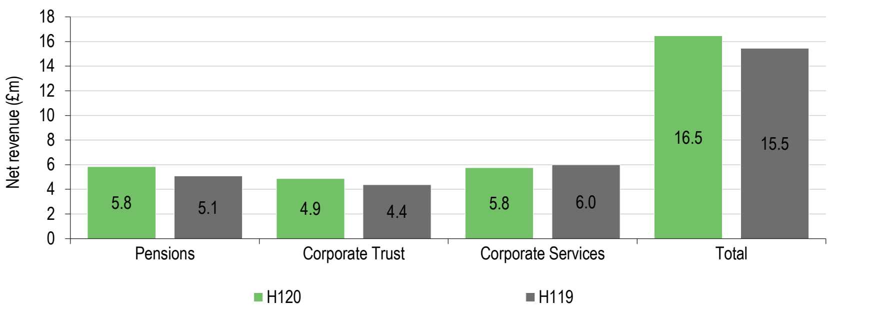
Price	**539.0p**
Market cap	**£638.4m**
AUM	**£782.9m**
NAV*	554.2p
Discount to NAV	2.7%
NAV**	517.1p
Premium to NAV	4.2%

*Excluding income, with debt at par value. **Including income, with debt at fair value. Published NAVs at 31 July 2020, including fair value of IPS business at 30 June 2020.

Yield (prospective)	4.8%
Ordinary shares in issue	118.4m
Code	LWDB
Primary exchange	LSE
AIC sector	UK Equity Income

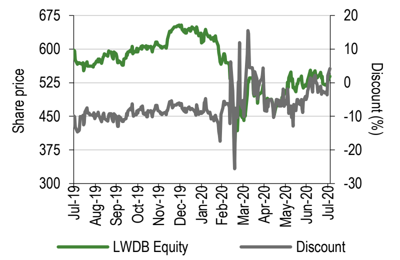
The Law Debenture Corporation (LWDB) has reported another strong set of results for its independent professional services (IPS) business in H120, with EPS growth remaining in the target mid- to high single-digit range despite a more challenging economic backdrop. With the trust's largely UK investment portfolio having been hit by the widespread stock market sell-off in February and March, IPS has provided a larger than average contribution to revenue returns. This means fund managers James Henderson and Laura Foll can continue to search for attractive total return opportunities in a broad range of sectors, while maintaining LWDB's focus on both capital appreciation and above-inflation dividend growth.

IPS businesses growing in H120 despite COVID-19

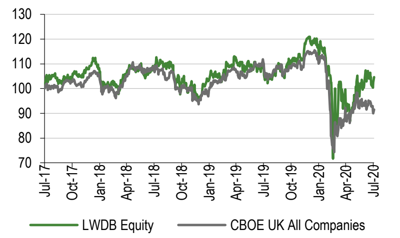


Source: The Law Debenture Corporation, Edison Investment Research

Share price/discount performance



Three-year performance vs index



52-week high/low	654.0p	374.0p
NAV** high/low	704.1p	458.8p

**Including income.

Gearing

Gross*	25.6%
Net*	19.0%

*As at 30 June 2020, based on fair value of debt

The market opportunity

The COVID-19 pandemic has had a marked impact on business and the economy, and while many share prices have recovered well from the March 2020 lows, there is still value to be found in a broad range of UK and global companies, particularly for investors who are able to look through the current round of dividend cuts.

Why consider investing in Law Debenture?

- Unique structure has proved its worth in H120, with resilient IPS business providing c 64% of revenues.
- Flexibility to invest in low- or non-yielding stocks has boosted capital performance and means the trust is well placed for a recovery in dividends.
- The board has committed to delivering a 42nd year of maintained or increased dividends in FY20 (helped by LWDB's strong revenue reserve position), with payments now made quarterly.
- Highly experienced management teams on both portfolio management and IPS business sides to help navigate through difficult market conditions.

Narrower discount and higher, more secure yield

At 3 August 2020, LWDB's shares traded at a 4.2% premium to cum-income NAV (with debt and the IPS business at fair value). Recently the discount has been much narrower than historical averages (broadly in a range of c 7–9% over one, three, five and 10 years), which may reflect a degree of market reassessment of the trust, given the contribution of IPS to total revenues and the higher quarterly dividends. Based on the current share price, LWDB has a yield of 4.8%.

Analysts

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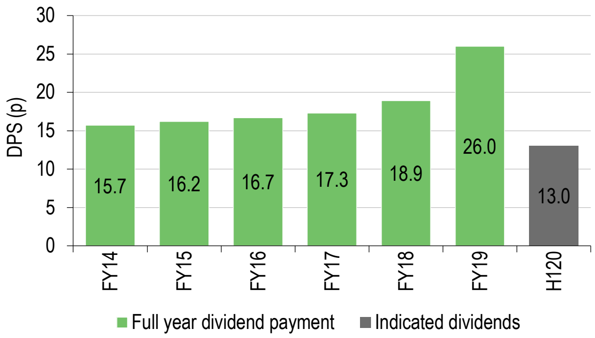
Edison profile page

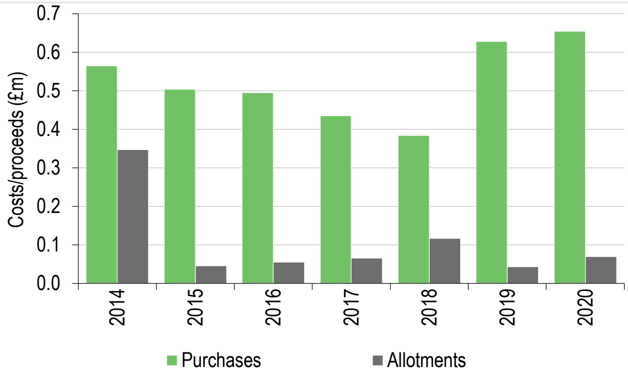
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
LWDB'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.	■ 31 July 2020: Results for the six months ended 30 June. NAV TR -16.5% (debt at par) and -18.6% (debt at fair) versus -17.5% for the broad UK stock market; share price TR -16.5%. ■ 8 June 2020: First quarterly interim dividend of 6.5p declared in respect of the year ending 31 December 2020.

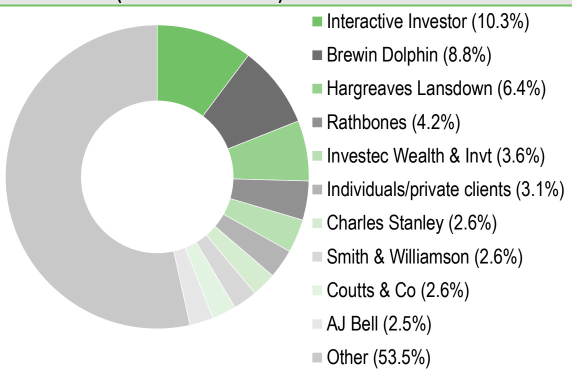
Forthcoming		Capital structure		Fund details	
AGM	April 2021	Ongoing charges	0.48% (H120)	Group CEO	Denis Jackson
Annual results	February 2021	Net gearing	19.0% (30 June)	Managers	James Henderson and Laura Foll, Janus Henderson Investors
Year end	31 December	Annual mgmt fee	0.30% of portfolio NAV	Address	Fifth floor, 100 Wood Street,
Dividend paid	Quarterly from FY20	Performance fee	None		London, EC2V 7EX
Launch date	1889	Trust life	Indefinite	Phone	+44 (0) 20 7606 5451
Continuation vote	None	Loan facilities	£115m long-term debt	Website	www.lawdebenture.com

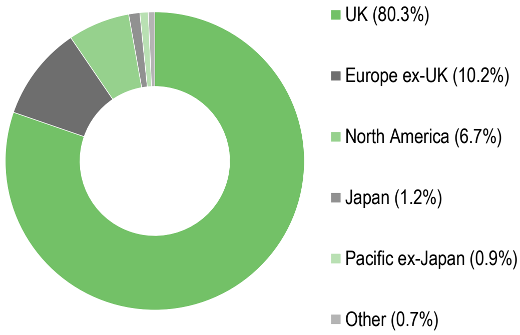
Dividend policy and history (financial years)	Share buyback policy and history (financial years)
LWDB aims to deliver steadily increasing dividends, fully covered by earnings, and has a 41-year record of increasing or maintaining its dividends. From FY20, dividends will be paid quarterly, in July, October, January and April.	LWDB has no share buyback programme in operation. Purchases and allotment of shares refer to employee share schemes.





Shareholder base (as at 30 June 2020)	Portfolio exposure by geography (as at 30 June 2020)





Top 10 holdings (as at 30 June 2020)

			Portfolio weight %	
Company	**Country**	**Sector**	**30 June 2020**	**30 June 2019**
GlaxoSmithKline	UK	Pharmaceuticals & biotechnology	3.9	2.4
Ceres Power	UK	Oil equipment services & distribution	3.1	0.9
Rio Tinto	UK	Mining	2.4	2.4
Royal Dutch Shell	UK	Oil & gas producers	2.2	4.2
RELX	UK	Media	2.0	1.9
National Grid	UK	Electricity	2.0	1.6
Severn Trent	UK	Gas, water & multiutilities	1.8	1.3
Herald Investment Trust	UK	Pooled equity investments	1.9	1.5
Dunelm	UK	General retailers	1.8	1.2
Prudential	UK	Life insurance	1.6	2.1
Top 10 (% of portfolio)			**22.7**	**22.9**

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

Fund profile: Unique structure adds income security

Founded in 1889, The Law Debenture Corporation is unusual in that it is both an investment trust and has an operating business set up to facilitate the issue of corporate debentures, an area that still provides a significant revenue stream today. At end-H120 (30 June), the diversified investment portfolio made up c 83% of fair value NAV, while the independent professional services (IPS) business, which has three divisions – pensions, corporate trusts and corporate services – accounted for c 17% of NAV. The IPS business has always provided a significant revenue stream to the company, typically c 30% of the total, although given the widespread dividend cuts as a result of the COVID-19 pandemic and the effect of lockdowns on economic activity, this rose to c 64% of revenues in H120.

The investment portfolio is managed with the aim of achieving long-term capital growth and a steadily increasing income from a portfolio of c 130–140 stocks, overseen by James Henderson and Laura Foll at Janus Henderson Investors. There is a bias towards the UK (currently just over 80% of the portfolio), although overseas stocks are also held, particularly in areas such as technology, where there may be few compelling UK-listed equivalents. The revenue contribution from the IPS business gives the managers more freedom to invest in lower-yielding stocks while still allowing the trust to keep up its long record of maintaining or increasing its annual dividend, which remains on track for a 42nd consecutive year in FY20.

LWDB is a constituent of the Association of Investment Companies' UK Equity Income sector, and measures its investment performance versus a broad UK stock market index (for comparison purposes in this note we have used the CBOE UK All Companies Index). The trust is structurally geared through two tranches of long-term debt (par value of £115m) at a blended interest rate of c 4.6%, and net gearing stood at 19.0% at 30 June 2020.

At the corporate level, LWDB is led by CEO Denis Jackson.

IPS performance and fair value

LWDB reports on its IPS business based on three divisions: pensions, corporate trusts, and corporate services. In spite of the difficult corporate and economic backdrop as a result of the COVID-19 pandemic, H120 was positive in aggregate for IPS, with net income up 6.5% year-on-year, profit before tax up 6.0% and earnings per share up 6.6%. This remains in the target range of mid- to high single-digit growth, which Jackson says is a testament to the resilience of the business.

Taking each division in turn, the **pensions** business saw the highest rate of year-on-year growth in H120, with net income up 14.5% (FY19: +11.7%). LWDB's CEO says the value proposition of the traditional pensions trustee business has come sharply into focus as sponsors deal with shifts in the asset-liability mix caused by falling equity prices and lower bond yields. He gives the example of work done recently for Premier Foods which, having grown through acquisition, had a collection of pension funds, some of which were under stress through underfunding, while another was in surplus. A restructuring of the schemes through a segregated merger was proposed, improving the funding position substantially and also reducing scheme administration costs. Premier Foods' share price has risen by 175% since the day of the announcement, and while Jackson is keen to point out that LWDB cannot take sole credit for this, he points out that by assisting the company with its pension challenge, it has contributed in part to a nearly £500m increase in Premier Foods' market capitalisation. The Pegasus side of the pensions business, which offers outsourced administrative services to both defined benefit and defined contribution schemes, also continued to grow strongly in H120.

The **corporate trusts** business (which is where LWDB began in 1889) also had a strong H120, with net revenues up 11.6% year-on-year (FY19: +7.9%). A corporate trustee acts as a bridge between the borrower/issuer of a loan or bond, and the lender/investor. The division also provides escrow services for merger and acquisition (M&A) transactions. Jackson says the COVID-19 pandemic has brought to the fore some of the countercyclical qualities of the corporate trustee business. While in 'peacetime' much of the business's revenues are contracted and the work is fairly routine, in times of stress – such as for pub companies, which had no revenues during the lockdown with which to fund bond coupon payments – LWDB can undertake ad hoc post-issue work to help renegotiate payment terms in order to avoid defaults. The CEO points out that such market stress can take time to work through, which could be positive for incremental revenues over the coming years: although the global financial crisis was at its height in 2008, the corporate trustee business saw good growth in post-issue work from 2009 to 2011.

Exhibit 2: Fair valuation of IPS business

£000s unless stated	30 June 2020	31 December 2019	30 June 2019	31 December 2018
IPS valuation				
IPS EBITDA	11,734	11,515	10,828	10,424
EBITDA multiple (x)	8.7	9.2	9.2	8.4
Operational value of IPS	102,086	105,938	99,618	87,562
IPS surplus net assets	9,970	16,367	15,962	16,844
IPS fair value	112,056	122,305	115,580	104,406
IPS fair value per share (p)	94.6	103.5	97.8	88.3
LWDB fair value				
LWDB fair value per share as per IFRS financial statements (p)	515.6	655.8	619.4	566.3
IPS fair value adjustment per share (p)	75.2	77.7	72.2	66.4
Debt fair value adjustment (p)	(40.4)	(31.3)	(27.9)	(18.6)
LWDB fair value NAV per share (p)	543.9*	702.2	663.7	614.1
IPS book value (IFRS) as % of total	3.8%	4.0%	4.1%	3.9%
IPS fair value as % total	17.4%	14.7%	14.7%	14.4%

Source: The Law Debenture Corporation, Edison Investment Research. Note: *After deducting 6.5p dividend.

Corporate services had a more difficult H120, with net revenues down by 4.0% (FY19: +3.7%). There are three main strands to this business: 'traditional' corporate services, such as acting as company secretary and providing accountancy services to special purpose vehicles; Safecall, a corporate whistleblowing service; and a service-of-process business providing a third-country legal base in cross-border transactions. Traditional corporate services is a very small business for LWDB, but saw good growth in H120. Safecall's volume of new business slowed substantially, but Jackson says it was a 'great period' in terms of demonstrating the value proposition, with a spike in the number of calls, texts and emails to the service as people adjusted to remote working or shop-floor workers raised concerns about COVID-19 safety. Safecall was able to feed these concerns back to the corporate clients, helping firms to adjust to the new operational challenges of working through the lockdown. While the first two areas grew in H120, service-of-process contracted as the pandemic clamped down on economic activity. The CEO says history suggests that while the volume of cross-border transactions tends to fall rapidly in an economic slowdown, it goes back up just as quickly in a recovery, so LWDB is investing further in this area of the business in order to benefit from future growth.

The operational value of IPS (based on LWDB's internally derived multiple) rose by 2.5% year-on-year in H120 and the fair value of IPS per share fell by 3.3%. At 94.6p per share, the fair value of IPS accounted for 17.4% of LWDB's period-end NAV per share (with debt at fair value), reflecting a fall in the value of the investment portfolio. The IFRS book value fell from 25.5p to 19.5p per share year-on-year (-23.5%) in H120; the 75.2p per share fair value adjustment was a 4.2% increase from 72.2p in H119.

The fund managers: James Henderson and Laura Foll

The managers' view: Positioned for a slow recovery

Reflecting on the six months to 30 June, LWDB's portfolio managers say they are pleased to have been able to take advantage of depressed share prices as a result of the COVID-19 induced market sell-off to add or top up holdings in good companies at attractive valuations. A net £33m was invested during the period, with Henderson and Foll increasing gearing to a historically high level of c 19%. Because of the important income contribution from the IPS business, the managers say they have had the scope to focus more on the medium to long term, and look past the widespread dividend cuts imposed by UK companies.

'We have been buying companies on very low valuations based on simple metrics such as price to sales,' says Henderson. 'Because we are starting from a lower base, it should be easier for earnings to hold up and recover better than may be the case for many income funds.'

The managers point out that many UK companies' share prices had fallen by 40–50%, which Henderson says is a fair reflection of the difficult economic outlook. 'There is a lot of government and corporate debt being raised, and it cannot continue at this rate. Unemployment will go up considerably when furlough schemes end, and the debt burden can only be a constraint on growth. It's not an easy outlook, but a lot of that is reflected in share prices.'

He adds that while corporate earnings may be in for a relatively extended period of sub-optimal growth, the LWDB portfolio is positioned for 'grinding out' returns from quality companies that are good enough at what they do to get through the current crisis and recover.

Expanding on the positive impact of the IPS contribution, Foll says that it has been 'a real help' this year given the very narrow number of sectors in which UK companies have not cut dividends. 'In our top 15 holdings there are quite a few non-income payers,' she explains. While some – such as homeware retailer Dunelm and specialist materials producer Morgan Advanced Materials – have suspended dividend payments, others, such as hydrogen power stock Ceres Power and the TMT-focused Herald Investment Trust, have never paid a dividend. 'That is pretty unusual for an income fund,' says Foll, pointing out that without the security of IPS income, it would have been very hard to let the holding in Ceres Power grow to a 3% position. LWDB's overseas holdings have also been beneficial in terms of portfolio income, as dividend cuts have been less widespread outside the UK.

Looking ahead, the managers are quietly optimistic about the prospects for their portfolio holdings. 'Most companies went into this crisis with a better balance sheet position than ahead of the global financial crisis, and in many cases with the same management team,' says Foll.

Asset allocation

Investment process: IPS income contribution gives flexibility

LWDB's investment portfolio is managed on a bottom-up basis by co-managers Henderson and Foll, aiming to provide investors with a diverse selection of quality companies, mainly made up of those listed in the UK, although up to c 20% may be invested overseas, primarily where there is no compelling UK equivalent. As with their other portfolios (which include Lowland Investment Company and Henderson Opportunities Trust), they run a relatively long list of stocks, broadly spread by sector, and market capitalisation, in order to mitigate company-specific risk. At 30 June 2020 there were 141 holdings, a slight increase on 134 at end-December 2019. The managers invest directly in the UK, North America, Japan and Europe (where James Ross is responsible for stock selection), while the small allocation to Asia Pacific ex-Japan and other markets tends to come via funds.

Investment choice is based on a rigorous assessment of company fundamentals, with a focus on finding growing businesses whose current share price does not reflect their long-term growth prospects. Henderson and Foll are able to draw on the broad global research resources of Janus Henderson Investors, which can be particularly helpful in terms of overseas stock selection.

A notable advantage for a UK-focused income fund in the current climate of COVID-19 related dividend cuts is the significant revenue contribution from the IPS business. While this has historically funded c 30% of the dividend revenue to the trust, the revenue contribution for H120 was 64.4%, reflecting both a 46.2% decline in net revenue per share from the investment portfolio, and a 6.5% increase in IPS net revenues. In normal circumstances, the managers say that having a third of LWDB's income 'in the bag' gives them the freedom to invest more in low-or non-yielding stocks where there is greater capital growth potential (Ceres Power, now the second-largest holding, is an example of this). In the current unusual circumstances, the IPS contribution means LWDB may need to draw less on its revenue reserves than some other trusts in order to continue its long record of maintaining or increasing its annual dividends.

The managers tend to build and exit positions gradually, with an average starting position of c 0.3% of the portfolio (with c 140 stocks, the overall average position size is c 0.7%). Portfolio turnover is relatively low, at an annualised c 22% for H120 compared with c 17.9% for FY19; while both these figures are higher than in the previous two financial years (partly as a result of being net investors through deploying gearing), it still implies a holding period of five or more years. The managers will gently trim positions that have done well, and may also sell out of holdings where there has been a deterioration in fundamentals.

Current portfolio positioning

LWDB had 141 holdings at 30 June 2020, an increase from 134 at the start of the year. The managers have been active investors during the market dislocation in March and April 2020, taking profits from strongly performing stocks in the US (where long-held positions in Microsoft and Johnson & Johnson were fully exited) and buying into quality companies at depressed valuations in the UK and, to a lesser extent, Europe (Exhibit 3).

Exhibit 3: Portfolio geographic exposure vs allocation guidelines (% unless stated)

	Portfolio end-June 2020	Portfolio end-June 2019	Change (pp)	Allocation guidelines
UK	80.3	76.4	3.9	55-85
Europe ex-UK	10.2	8.2	2.0	0-20
North America	6.7	9.0	(2.3)	0-10
Japan	1.2	1.0	0.2	0-10
Pacific ex-Japan	0.9	4.1	(3.2)	0-10
Other	0.7	1.3	(0.6)	0-10
	100.0	**100.0**		

Source: The Law Debenture Corporation, Edison Investment Research

New UK-listed positions during H120 include mining stock Anglo American, retailers Marks & Spencer and Tesco, mobile payments specialist Boku and engineering consultancy Ricardo, as well as German chemicals company Linde. The managers say there is deliberately no common theme to these purchases, which were largely funded by an increase in the trust's net gearing from c 10% to c 19% over the period. The purchase of Marks & Spencer – a stock that many managers, including Henderson and Foll themselves, have viewed as a value trap (that is, 'cheap for a reason') in the past – underlines the rigour of the investment process and the constant reappraisal of potential opportunities. 'It was a shock to me to want to buy M&S,' Henderson admits. 'But you can have a good crisis – after 30 years of decline, they are using the opportunity of COVID-19 to strip out some bureaucratic management committees, reduce prices and improve the online business. Quite a lot of the real hard work has been done, and M&S will be a leaner, better company coming out of this, and well placed for a recovery on the high street,' he adds.

Exhibit 4: Portfolio sector exposure (% unless stated)

	Portfolio end-June 2020	Portfolio end-June 2019	Change (pp)
Financials	23.1	21.2	1.9
Industrials	21.2	24.1	(2.9)
Oil & gas	10.4	10.4	0.0
Consumer services	9.6	9.5	0.1
Health care	8.6	7.6	1.0
Basic materials	8.6	7.4	1.2
Consumer goods	6.0	4.5	1.5
Utilities	4.7	3.7	1.0
Pooled equity invts	4.4	6.8	(2.4)
Technology	2.0	3.1	(1.1)
Telecommunications	1.4	0.3	1.1
	100.0	**100.0**	

Source: The Law Debenture Corporation, Edison Investment Research

In sector terms (Exhibit 4), there has been little significant movement over the past 12 months. The largest changes have been a 2.9pp fall in the industrials weighting (largely as a result of performance), a 2.4pp fall in the allocation to funds (broadly mirroring the decline in Pacific ex-Japan exposure) and a 1.9pp increase in financials, which reflects additions to insurance and property stocks rather than banks, which made up only 4.8% of the portfolio at end-June 2020. While the oil & gas weighting is outwardly unchanged, its make-up has been altered by falling share prices at oil majors such as Shell and BP, while hydrogen power stocks Ceres Power and ITM Power, which technically sit in the oil & gas sector, have surged in value. Neither holding was topped up during H120; in fact, some profits were taken from Ceres Power, but the two positions together made up 4.2pp of the 10.4% oil & gas weighting at 30 June 2020, up from 1.8pp at 31 December 2019.

Performance: Recovering well from COVID-19 setback

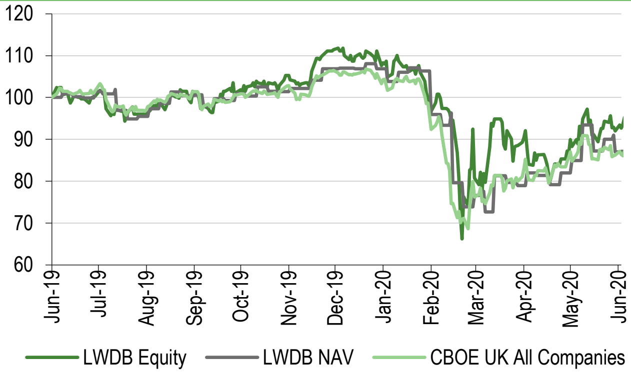
Exhibit 5: Five-year discrete performance data

12 months ending	Share price (%)	NAV* (%)	CBOE UK All Companies (%)	CBOE UK 250 (%)	MSCI World (%)
30/06/16	(1.5)	(0.9)	1.7	(4.1)	15.1
30/06/17	21.2	25.9	18.3	22.5	22.3
30/06/18	7.3	9.9	9.5	11.5	9.9
30/06/19	2.6	(0.8)	0.3	(6.0)	10.9
30/06/20	(7.3)	(12.8)	(13.6)	(13.9)	6.5

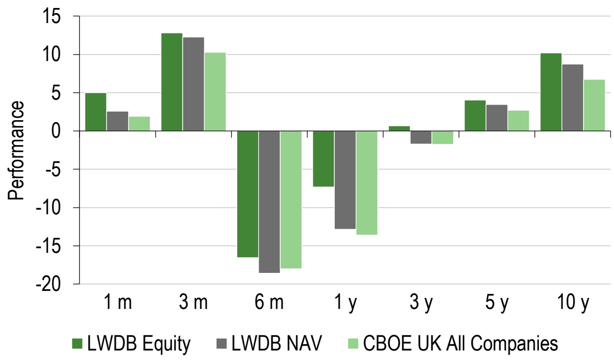
Source: Refinitiv. Note: All % on a total return basis in pounds sterling. *Cum income NAV with debt and IPS business at fair value.

Exhibit 6: Investment trust performance to 30 June 2020

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



Price, NAV and index total return performance (%)



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

Based on the restated 30 June 2020 NAV (which includes the updated fair value of IPS), LWDB saw NAV (with debt at fair value) and share price total returns of -12.8% and -7.3% over the 12 months to 30 June, slightly ahead of the broad UK stock market on a NAV basis, but some way behind the global market (Exhibit 5), where returns for UK-based investors have been boosted by sterling weakness. For the six months ended 30 June (H120), a period dominated by the coronavirus-driven global market declines and subsequent partial recovery, LWDB's NAV and share price total returns of -18.6% and -16.5% were broadly in line with the decline in the benchmark.

The largest contributors to portfolio performance over the six months to end-June were two hydrogen power stocks, Ceres Power and ITM Power, whose share prices rose by 103% and 275% respectively over the period. That these companies – which are relatively small and do not pay dividends – are in the portfolio of a UK equity income fund at all is testament to the contribution of LWDB's IPS revenues to its total income, affording the fund managers greater freedom to invest in non-yielding stocks. Rounding out the top five positive contributors were Flutter Entertainment (formerly Paddy Power Betfair), Microsoft (a longstanding position that was exited during the period), and Cellnex Telecom. Together the top five contributors added £22.9m to performance, with an average share price gain of 92.7%.

The largest detractor from performance in H120 was Royal Dutch Shell, which suffered as a result of the collapse in the oil price. The other four of the top five detractors have all been affected in one way or another by the COVID-19 pandemic: Hammerson owns shopping centres, which were closed for much of the period; Rolls-Royce and Senior are involved in civil aerospace and were hit by the grounding of aircraft fleets worldwide, and Carnival is a cruise line operator. Together these five stocks (which were all top 40 positions at end-FY19) cost LWDB £39.6m over the period, with an average share price decline of 62.0%.

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

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to CBOE UK All Companies	3.0	2.3	1.8	7.3	7.5	6.7	37.4
NAV relative to CBOE UK All Companies	0.6	1.8	(0.7)	0.9	0.2	3.8	20.1
Price relative to CBOE UK 250	4.6	(0.3)	12.1	7.7	13.0	14.9	10.5
NAV relative to CBOE UK 250	2.2	(0.7)	9.4	1.3	5.3	11.8	(3.3)
Price relative to MSCI World	2.2	(6.0)	(17.6)	(13.0)	(21.4)	(33.3)	(20.2)
NAV relative to MSCI World	(0.2)	(6.4)	(19.6)	(18.2)	(26.8)	(35.1)	(30.2)

Source: Refinitiv, Edison Investment Research. Note: Data to end-June 2020. Geometric calculation.

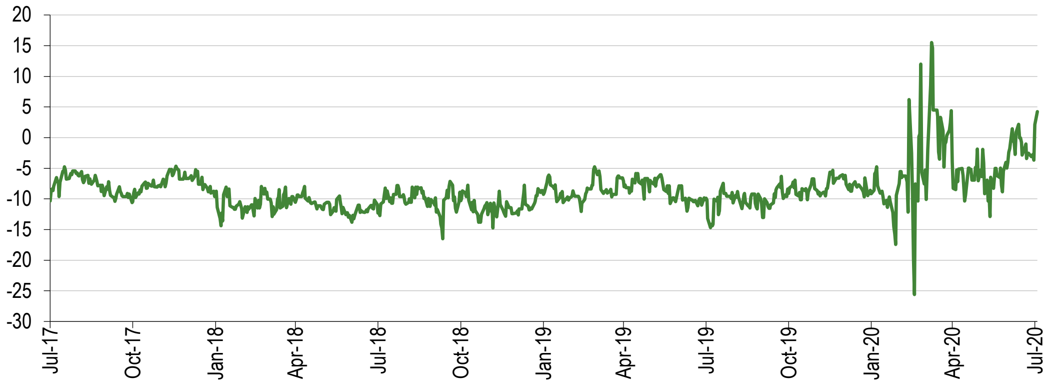
As shown in Exhibit 6 and 7, LWDB's longer-term returns remain positive in both absolute and relative terms, with annualised NAV and share price total returns of c 9% and c 10% respectively, compared with c 7% pa for the benchmark index over the last 10 years.

Discount: Tighter level suggests market reassessment

At 3 August 2020, LWDB's shares traded at a premium to cum-income NAV of 4.2% (with both debt and the IPS business at fair value). This is an appreciable shift from the long-term discount range of c 5–15% (Exhibit 8), and while it partly reflects a rise in the fair value of the debt as bond yields have fallen further, the move to a small premium may also indicate a degree of reassessment by the market, possibly as a result of the more secure income stream from the IPS business and the change in dividend policy. The current rating compares to a relatively tight range of both short- and longer-term average discounts, standing at 6.9%, 8.6%, 8.5% and 6.9% respectively over one, three, five and 10 years. (Longer-term averages are based on restated NAVs reflecting the fair value of IPS, which were not reported prior to the beginning of 2016.)

In common with most investment trusts, volatility in the rating has picked up during the coronavirus pandemic, with the discount first ballooning out to a 10-year high of 25.6% at the nadir of the market sell-off in March, before bouncing back to a decade-highest premium of 15.5% on 7 April, as the share price outran the recovering NAV. The large swings seen in Exhibit 8 are partly a function of the share price moving daily, while NAVs are reported weekly. While LWDB's board has the authority to repurchase up to 14.99% of the shares, or allot shares up to 5% of the issued share capital, there is no formal discount control policy, and in practice all allotments and repurchases in recent years (see Exhibit 1) have been in respect of LWDB's employee share ownership scheme.

Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

Capital structure and fees

LWDB is structured as a conventional investment trust, with one class of share. At 3 August 2020, there were 118.4m ordinary shares in issue. The trust is structurally geared via two tranches of long-term debt: £40m of 6.125% guaranteed bonds maturing in 2034, and £75m of 3.77% senior secured bonds maturing in 2045. Because of the current low level of bond yields compared with the higher coupons on LWDB's debt, the fair or market value of the debt is currently £162.7m, compared with £115.0m for the par value. Using the fair value of the debt, gross gearing currently stands at 25.6%, with net gearing of 19.0% at end-June 2020 reflecting a small amount of cash offsetting some of the borrowings. Gearing is permitted up to 50% of net assets, but in practice has rarely exceeded 20% on a net basis.

Janus Henderson Investors, which manages LWDB's investment portfolio, is paid an annual management fee of 0.30% of net assets (excluding the net assets of the IPS business). This was previously charged 100% to the revenue account, but since the start of FY19 has been 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 (0.48% at end-H120) are among the lowest of any investment trust.

Dividend policy and record

LWDB has recently revamped its dividend policy in order to provide shareholders with a higher, more regular income and greater certainty over the level of payments. From the beginning of FY20 (1 January 2020), the trust is paying dividends quarterly rather than semi-annually, in July, October, January and April. So far this year, one quarterly dividend of 6.5p has been declared, and the board has stated that it intends to pay another 6.5p in respect of each of Q2 and Q320, with the final dividend being at or above this level, in order to ensure the FY20 payout at least matches FY19's total dividend of 26.0p. The FY19 dividend represented a step change in the level of payments, being c 38% higher than in FY18. Annual dividends have been increased or maintained in each of the last 41 years, with a compound annual growth rate of 10.6% pa from FY14 to FY19.

LWDB has the advantage of deriving around one-third of its income from the IPS business, and although portfolio income fell by 39.8% in H120 versus H119 (from £15.1m to £9.1m), revenues from the IPS business have continued to rise (+6.5% year-on-year in H120). The trust also has a healthy revenue reserve of £52.0m or 43.9p a share (£36.6m and 30.9p after deducting the H120 dividends), equivalent to c 1.7x or c 1.2x the FY19 total dividend.

Based on the current share price and the forecast FY20 total dividend (which is equal to the FY19 dividend), LWDB has a prospective dividend yield of 4.8%.

Peer group comparison

Since May 2019, LWDB has been a constituent of the Association of Investment Companies' UK Equity Income sector. Previously it was in the Global sector, although it has always had a high UK weighting and a focus on income as well as growth. The UK Equity Income sector is a diverse peer group of 24 funds, with LWDB currently being the fourth largest. Performance has been challenging for UK income funds as a result of the COVID-19 pandemic and associated corporate dividend cuts, and the vast majority of the peer group has seen returns fall into flat or negative territory over both one and three years. LWDB's NAV total returns are well above the peer group average over one, three, five and 10 years (although negative in absolute terms over one and three years), ranking 10th, eighth, seventh and fifth respectively. Ongoing charges are the joint lowest in the group, and there is no performance fee. On an ex-par basis, LWDB's share price discount to NAV is somewhat wider than the average, although using its cum-fair NAV (which is lower because the low level of bond yields means the fair value of the company's debt is currently greater than its par value), the discount is narrower than average. Net gearing is among the highest in the peer group. The trust's 5.0% dividend yield is somewhat below average, ranking 15th, but it is important to note the significant income advantage LWDB enjoys as a result of its revenue stream from the IPS business, meaning its yield is arguably more secure than for those funds that rely solely on corporate dividends for their portfolio income.

Exhibit 9: AIC UK Equity Income sector as at 28 July 2020*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield
Law Debenture Corporation	**615.8**	**(14.3)**	**(6.9)**	**18.6**	**114.9**	**0.4**	**No**	**(3.4)**	**119**	**5.0**
Aberdeen Standard Equity Inc Trust	133.0	(25.3)	(27.5)	(17.2)	58.2	0.9	No	(9.2)	113	7.5
BlackRock Income and Growth	35.8	(12.6)	(7.9)	10.8	77.0	1.1	No	(8.2)	102	4.5
BMO Capital & Income	276.4	(20.2)	(10.8)	18.2	86.4	0.6	No	0.9	107	4.5
BMO UK High Income Units	101.3	(14.2)	(11.1)	9.6	74.8	1.0	No	(9.8)	107	4.9
Chelverton UK Dividend Trust	22.8	(35.5)	(42.5)	(27.7)	122.2	2.1	No	(7.3)	159	8.8
City of London	1,380.4	(16.7)	(9.6)	8.2	101.8	0.4	No	(1.4)	110	5.7
Diverse Income Trust	297.9	0.5	0.8	21.6	--	1.2	No	(7.9)	100	4.4
Dunedin Income Growth	382.3	(3.6)	7.9	32.6	111.6	0.6	No	(7.3)	109	4.9
Edinburgh Investment Trust	808.7	(16.7)	(23.0)	(5.4)	106.2	0.6	No	(12.9)	110	6.2
Finsbury Growth & Income	1,813.7	(8.1)	19.9	61.3	255.1	0.7	No	0.2	101	2.0
Invesco Income Growth	134.7	(16.1)	(11.9)	3.1	97.2	0.7	No	(13.1)	104	5.1
Investment Company	13.0	(7.0)	(0.7)	4.7	97.1	2.4	No	(14.1)	100	4.5
JPMorgan Claverhouse	323.5	(19.4)	(12.7)	9.7	87.8	0.7	No	(5.9)	112	5.3
JPMorgan Elect Managed Income	68.4	(16.2)	(13.3)	2.9	77.9	0.9	No	(5.1)	104	5.5
Lowland	252.9	(25.2)	(29.0)	(11.4)	97.8	0.6	Yes	(8.0)	114	6.4
Merchants Trust	414.6	(22.0)	(16.1)	1.5	74.5	0.6	No	(4.3)	117	7.8
Murray Income Trust	509.1	(6.3)	5.4	33.0	112.0	0.7	No	(4.9)	105	4.5
Perpetual Income & Growth	466.2	(25.1)	(32.2)	(24.0)	63.0	0.7	No	(15.2)	111	6.9
Schroder Income Growth	163.6	(18.6)	(12.4)	5.9	93.0	0.9	No	(3.2)	109	5.3
Shires Income	69.4	(9.6)	(4.1)	22.6	122.7	1.0	No	(2.7)	120	5.9
Temple Bar	490.2	(35.1)	(31.3)	(15.3)	51.0	0.5	No	(11.1)	109	7.0
Troy Income & Growth	250.2	(9.3)	1.2	22.7	120.3	0.9	No	(0.5)	100	3.8
Value and Income	73.6	(20.8)	(18.4)	(4.6)	55.3	1.3	No	(34.3)	137	7.5
Sector average (24 funds)	**379.1**	**(16.6)**	**(11.9)**	**7.6**	**98.2**	**0.9**		**(7.9)**	**112**	**5.6**
LWDB rank in sector	**4**	**10**	**8**	**7**	**5**	**23=**		**7**	**4**	**15**

Source: Morningstar, Edison Investment Research. Note: *Performance to 27 July 2020 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

The board

There are currently seven directors on LWDB's board. The five independent non-executive directors are Robert Hingley (appointed 2017, chairman since 2018), Robert Laing (appointed 2012, senior independent director), Mark Bridgeman (appointed 2014, chairman of the audit committee), Tim Bond (appointed 2015), and the newest director, Claire Finn, who joined the board in September 2019. There are also two executive directors, Law Debenture Corporation chief executive officer Denis Jackson (appointed to the board in 2018) and chief financial officer Katie Thorpe (appointed to the board in 2019). On 14 May 2020, the board announced that Thorpe would be leaving the company to take up a new position at the end of October. The directors have a broad range of professional expertise, including investment management and distribution, corporate finance, law and accountancy.

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