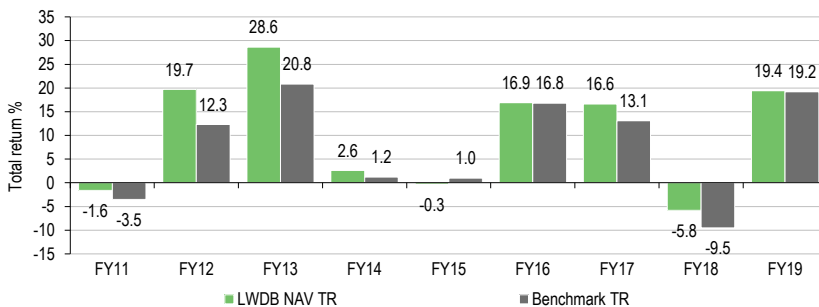


The Law Debenture Corporation

Step change in dividend supported by IPS income

The Law Debenture Corporation (LWDB) saw a NAV total return of 17.9% (cum-fair) in FY19, with its share price total return of 24.5% comfortably outstripping the broad UK stock market. As well as a c 25% increase in portfolio income, LWDB's independent professional services (IPS) businesses saw another year of good growth, providing important support for a step change in the annual dividend payment (+37.6%, with the final dividend up 50%, and moving to quarterly dividends from FY20). Portfolio managers James Henderson and Laura Foll continue to find attractive investment opportunities, particularly among unloved UK domestic stocks, while CEO Denis Jackson sees growth potential across the IPS businesses as a result of increased market focus on environmental, social and governance (ESG) issues.

LWDB has tended to outperform in up markets while protecting on the downside



Source: LWDB, Edison Investment Research. Note: NAV with debt at par value.

The market opportunity

Although world stock markets are currently in the grip of fears over the global economic impact of the COVID-19 outbreak, equities still offer a significant yield premium over bonds for income-seeking investors, and the UK remains reasonably valued in a global context. Diversifying one's sources of income could provide an additional layer of comfort in an environment of continued uncertainty.

Why consider investing in Law Debenture?

- Unique model with IPS revenues giving managers the flexibility to buy lower-yielding stocks while still growing the dividend ahead of UK inflation.
- Strong, differentiated performance under managers James Henderson and Laura Foll, capturing market upside while protecting on the downside (see chart).
- Step change in the FY19 total dividend (+37.6% on FY18), fully covered and with more than a year's dividends in reserve.
- Discount to NAV seems wider than is justified by performance.

Widening discount and growing yield

At 26 February 2020, LWDB's shares traded at a 15.7% discount to cum-fair NAV. This is wider than both short- and longer-term averages, and arguably presents investors with an opportunity, given the discount was below 5% as recently as December 2019. Based on the higher FY19 dividends, the shares now yield c 4.5%.

Investment trusts Income and growth

27 February 2020

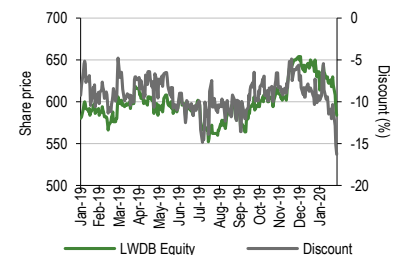
| | |
|-------------------|----------------|
| Price | 584.0p |
| Market cap | £691.6m |
| AUM | £909.9m |

| | |
|-----------------|--------|
| NAV* | 704.5p |
| Discount to NAV | 17.1% |
| NAV** | 692.6p |
| Discount to NAV | 15.7% |

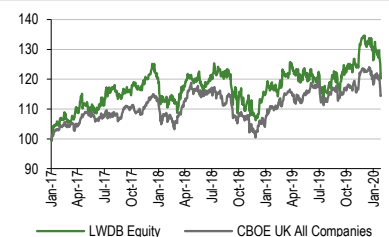
*Excluding income, with debt at par value. **Including income, with debt at fair value. Published NAVs at 21 February 2020.

| | |
|--------------------------|------------------|
| Yield (prospective) | 4.5% |
| Ordinary shares in issue | 118.4m |
| Code | LWDB |
| Primary exchange | LSE |
| AIC sector | UK Equity Income |

Share price/discount performance



Three-year performance vs index



| | | |
|------------------|--------|--------|
| 52-week high/low | 654.0p | 552.0p |
| NAV** high/low | 704.1p | 618.1p |

**Fair value including income.

Gearing

| | |
|--------|-------|
| Gross* | 14.0% |
| Net* | 10.0% |

*As at 31 January 2020.

Analyst

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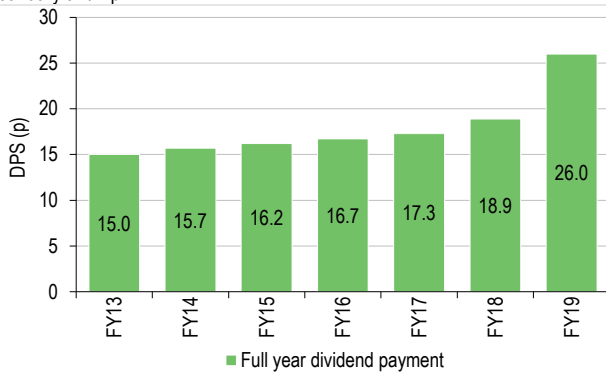
The Law Debenture Corporation is a research client of Edison Investment Research Limited

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. | | | | <ul style="list-style-type: none"> 27 February 2020: Results for the year ended 31 December 2019. NAV TR +19.4% with debt at par value (+17.9% with debt at fair value) compared with +19.2% for the broad UK stock market. Final dividend of 19.4p brings the total for the year to 26.0p, a 37.6% increase on FY18; new quarterly dividend policy. 28 August 2019: Announcement of Claire Finn's appointment as a non-executive director on LWDB's board, with effect from 2 September. | |
| Forthcoming | | Capital structure | | Fund details | |
| AGM | April 2020 | Ongoing charges | 0.48% (FY19) | Group CEO | Denis Jackson |
| Interim results | July 2020 | Net gearing | 10.0% (31 January) | 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, London, EC2V 7EX |
| Dividend paid | Quarterly from FY20 | Performance fee | None | Phone | +44 (0) 20 7606 5451 |
| Launch date | 1889 | Trust life | Indefinite | Website | www.lawdebenture.com |
| Continuation vote | None | Loan facilities | £115m long-term debt | | |

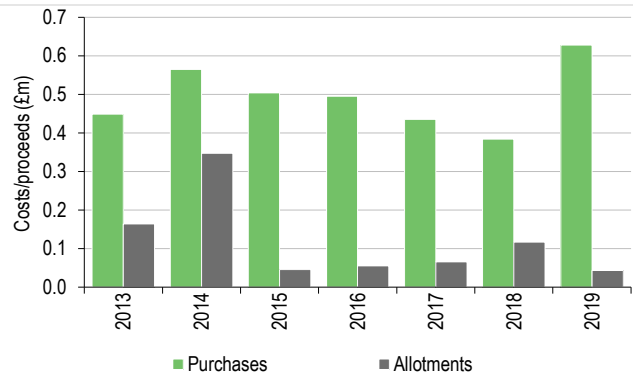
Dividend policy and history (financial years)

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, subject to AGM approval, dividends will be paid quarterly, in July, October, January and April.

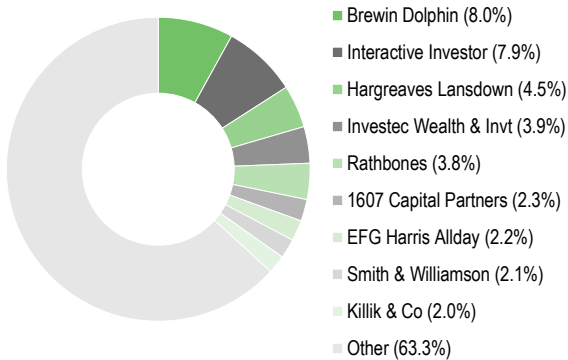


Share buyback policy and history (financial years)

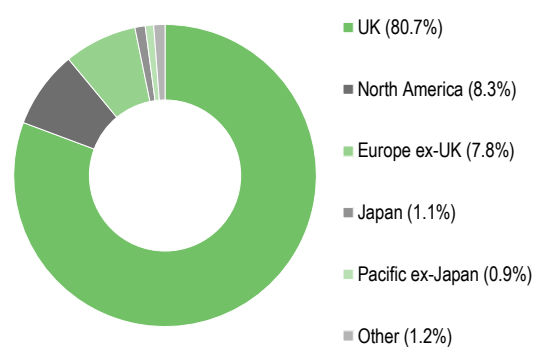
LWDB has no share buyback programme in operation. Purchases and allotment of shares refer to employee share schemes.



Shareholder base (as at 31 December 2019)



Portfolio exposure by geography (as at 31 December 2019)



Top 10 holdings (as at 31 December 2019)

| Company | Country | Sector | Portfolio weight % | |
|--------------------------------|---------|---------------------------------|--------------------|------------------|
| | | | 31 December 2019 | 31 December 2018 |
| GlaxoSmithKline | UK | Pharmaceuticals & biotechnology | 3.6 | 2.6 |
| Royal Dutch Shell | UK | Oil & gas producers | 3.4 | 4.4 |
| Rio Tinto | UK | Mining | 2.1 | 2.1 |
| HSBC | UK | Banks | 1.9 | 2.6 |
| BP | UK | Oil & gas producers | 1.8 | 2.4 |
| RELX | UK | Media | 1.7 | 1.8 |
| Johnson Service | UK | Support services | 1.7 | 1.5* |
| AstraZeneca | UK | Pharmaceuticals & biotechnology | 1.7 | 1.6* |
| Prudential | UK | Life insurance | 1.6 | 2.0 |
| National Grid | UK | Electricity | 1.6 | 1.6* |
| Top 10 (% of portfolio) | | | 21.1 | 23.8 |

Source: The Law Debenture Corporation, Edison Investment Research, Bloomberg, Morningstar. Note: *Outside the top 10 holdings at 31 December 2018.

Fund profile: IPS differentiates and enhances income

The Law Debenture Corporation was founded in 1889 in order to facilitate the issue of corporate debentures, a business area that still provides a significant revenue stream today. Although structured as an investment trust, LWDB operates in two distinct parts: a diversified investment portfolio (c 85% of fair value NAV at end-FY19), and an independent professional services business (c 15% of fair value but c 28% of FY19 revenues) with three divisions: pensions, corporate trusts and corporate services. The investment portfolio is managed by James Henderson and Laura Foll at Janus Henderson Investors, with the aim of achieving long-term capital growth and a steadily increasing income from a portfolio of c 130–140 stocks. There is a bias towards the UK (currently just over 80% of the portfolio), although overseas stocks are also held. The important contribution of the IPS business to total revenues means the managers have the freedom to invest in lower-yielding stocks while remaining confident in their ability to sustain LWDB's 41-year record of maintaining or increasing its annual dividend, which the board intends to grow ahead of UK inflation.

LWDB 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) and is a constituent of the Association of Investment Companies' UK Equity Income sector, having moved from the Global sector during 2019. 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 10.0% at 31 January 2020.

At the corporate level, LWDB is led by CEO Denis Jackson and CFO Katie Thorpe, who are both executive directors on the LWDB board.

Further IPS growth and increased fair value

LWDB's IPS business is split into three divisions: pensions, corporate trusts and corporate services. FY19 has marked another year of good progress for the business as a whole, following several years of broadly flat returns until end-FY17. Top-line revenue growth (net of cost of sales) of 7.5% was around the midpoint of the mid- to high single-digit growth target for the year, while profit after tax, up 8.5%, was towards the higher end of the target range. Jackson says LWDB has invested significantly in IPS this year and is driving its businesses forward, recycling old supplier relationships into better ones. Thorpe adds: 'We are maintaining our margins and reinvesting, both in people and technology. If we can be smart users of technology, we can invest for the future while maintaining our growth trajectory'.

Looking at each division in turn, the **pensions** business – as in FY18 – saw the strongest net revenue growth, up 11.7% (FY18: +14.7%). LWDB is the UK's largest independent pension trustee, acting for more than 200 defined benefit (DB) schemes with over £350bn of assets and three million members. Jackson comments that the 51-year-old business continues to benefit from regulatory drives to professionalise pensions governance. 'It is a growing business with regulatory support and should be really resilient in a downturn as the work still has to get done', says the CEO. With a finite number of independent trustees to go around the UK's c 5,500 DB schemes, there is an opportunity for small schemes to gain purchasing power through consolidating within a master trust structure, where the individual scheme assets remain segregated but there is a pooled layer of expert governance. Since 2017 LWDB has also offered Pegasus, an outsourced service for companies with defined contribution (DC) schemes, offering an end-to-end menu of services – 'everything from minute-taking to completely outsourcing pension scheme management', says Jackson. The CEO says the pensions business has continued a strong year of hiring, adding significant capacity in H219, which has helped drive the division's higher returns. 'The biggest constraint is hiring quality people to meet the demand', he adds.

Beginning in 1889, the **corporate trusts** business is the foundation of LWDB, acting as a bridge between the borrower/issuer of a loan or bond, and the lender/investor, as well as providing escrow service for merger and acquisition (M&A) transactions. Net revenue growth of 7.9% in FY19 was an improvement on 5.8% in FY18 against a tough market backdrop for investment banking in Europe. ‘We have fought hard to gain market share. It is a competitive space and we are content with these results; investment banking fees are down, so we are happy to be up’, says Jackson, adding that the business is diversifying away from its traditional client base of banks and law firms, and building more relationships with boutique asset managers. ‘Since the global financial crisis, increasing numbers of fund managers are making purchasing decisions and until recently we haven’t been out there getting the business’, he explains. Because of its specialist focus, Jackson says the division is able to act much more quickly than the large banks in giving a decision on whether or not it will act as trustee in a particular issue.

| Exhibit 2: Fair valuation of IPS business | | | | |
|-------------------------------------------------------------------|-----------------------------|-------------------------|-----------------------------|-----------------------------|
| £000s unless stated | 31 December 2019 | 30 June 2019 | 31 December 2018 | 31 December 2017 |
| IPS valuation | | | | |
| IPS EBITDA | 11,515 | 10,828 | 10,424 | 9,797 |
| EBITDA multiple (x) | 9.2 | 9.2 | 8.4 | 7.9 |
| Operational value of IPS | 105,938 | 99,618 | 87,562 | 77,396 |
| IPS surplus net assets | 16,367 | 15,962 | 16,844 | 17,176 |
| IPS fair value | 122,305 | 115,580 | 104,406 | 94,572 |
| IPS fair value per share (p) | 103.5 | 97.8 | 88.3 | 80.0 |
| LWDB fair value | | | | |
| LWDB fair value per share as per IFRS financial statements (p) | 655.7 | 619.4 | 566.3 | 633.3 |
| IPS fair value adjustment per share (p) | 77.7 | 72.2 | 66.4 | 61.6 |
| Debt fair value adjustment (p) | (31.2) | (27.9) | (18.6) | (25.4) |
| LWDB fair value NAV per share (p) | 702.2 | 663.7 | 614.1 | 669.5 |
| IPS book value (IFRS) as % of total | 4.0% | 4.1% | 3.9% | 3.0% |
| IPS fair value as % total | 14.7% | 14.7% | 14.4% | 12.0% |
| Source: The Law Debenture Corporation, Edison Investment Research | | | | |

Corporate services is the largest division by net revenues (£12.2m of the £31.8m total), but saw the lowest rate of growth in FY19, up 3.7% compared with a 6.9% increase in FY18. This business is split into two parts, with a long-established role in helping clients establish and maintain legal entities such as special purpose vehicles, as well as a specialist Sunderland-based whistleblowing service, Safecall, which LWDB has owned since 2007. The core business, which provides company secretarial, governance, accounting and administrative services, is highly linked to the structured finance new issue market, and Jackson says the level of issuance has still not bounced back to 2007 (pre-financial crisis) levels. In addition, competition is very fierce, with many private equity-backed businesses in the space. ‘This still has to work its way through’, says Jackson. LWDB also offers a service of process business, with offices around the world servicing international companies that may, for example, favour the English legal system but otherwise have no need for a UK office. ‘We have great relationships and high-quality people, and we will stick to our knitting’, says Jackson. Regarding Safecall, the LWDB CEO notes that revenues are up c 20% this year on top of a 15.4% increase in FY18, meaning ‘this little business is no longer quite so little’. He says that growth is being driven by investment in technology (‘we have the best voice product and we want the best digital product too’), as well as regulatory tailwinds. In the UK, the Office of the Whistleblower Bill, which aims to set up a government body, one of whose duties would be to ‘form and maintain a panel of accredited legal firms and advisory bodies to advise and support whistleblowers’, had its first reading in the House of Lords on 28 January; if enacted, the office would be up and running within 12 months. Meanwhile, EU member states have until December 2021 to implement the new European Directive on protection of whistleblowers. While Safecall has historically been mainly a UK business (although it does have some blue-chip European clients),

Jackson says: 'If you look at the number of businesses in Europe that will need solutions under the new directive, it's another big growth opportunity in a growing market'.

The operational value of IPS (based on LWDB's internally derived multiple) rose by 21.0% in FY19 and the fair value of IPS per share rose by 17.0%, outstripping growth of 13.1% and 10.3% respectively in FY18. At 103.5p per share (the first time it has been above £1), the fair value of IPS accounted for 14.7% of LWDB's NAV per share (with debt at fair value), a similar level to both end-FY18 and end-H119. The IFRS book value rose from 21.8p to 26.0p per share (+19.2%) in FY19; the 77.7p per share fair value adjustment was a 17.0% increase from 66.4p in FY18.

Opportunities from greater market focus on ESG

In the past 12 to 18 months there has been a massive increase in focus on environmental, social and governance (ESG) issues, both within investment markets and in wider society. Jackson says LWDB is well-placed to benefit from this trend through its various IPS divisions. 'What we provide in ESG terms is a lot of the G and increasingly more of the E and S. As a pension trustee, we sit between the assets and the pensioners and look to get the right outcome for them. The regulator is demanding certain actions – for example, an updated statement of investment principles that considers the environmental impact for every pension fund we work on. It's a growing market that needs to be served, supported both by regulation and pensioners – particularly the younger scheme members'. The CEO adds that pensions minister Guy Opperman 'is quite evangelical on ESG', meaning that this agenda could drive additional pensions work, on top of any changes to the pensions regime introduced by new Chancellor of the Exchequer Rishi Sunak: 'Chancellors love tinkering with pensions, and every time somebody changes the rules, that has to be implemented', he explains.

The corporate trust side, acting as a bridge between institutions and bondholders, is benefiting from the growth in green bonds and real asset-type investments, which can be complicated security structures. 'We are good at green energy – solar and wind – and we are also strong in UK social housing', says Jackson. 'Everyone realises that social housing is a critical sector, but it is dealing with complex, long-dated real assets and it needs a good trustee'. Meanwhile, in corporate services, Safecall, which sits between whistleblowers and management, 'is firmly in the middle of the ESG debate'. The CEO adds: 'We think we have the opportunity to grow our market share further in a growing market for all our products'.

The fund managers: James Henderson and Laura Foll

The managers' view: Still cautiously optimistic on the UK

During the course of FY19, the managers have increased LWDB's UK weighting to 80.7% (versus a guideline maximum of 85.0%), a move Foll explains has been driven by valuations. 'At the end of 2018, there was no clarity on Brexit or UK politics generally, and the UK was at the bottom of all the sentiment and asset allocation tables. It meant it was a difficult time to be an investor, but there was a clear valuation discount that has not closed to any meaningful degree despite there being more political clarity', she says. 'Looking at the soft data now – consumer confidence, PMIs, house prices, employment – there is growing evidence of an inflection, and it looks like it will be a better year ahead for the UK economy. The whole portfolio P/E is c 12.5x, which still seems reasonable both on an absolute basis and relative to the rest of the world'.

In particular, Henderson and Foll have been finding value in UK domestic companies – for example, adding to Royal Bank of Scotland (a new position in H119), which they explain has a new CEO and a very strong capital ratio. 'It has excess cash that will come back somehow, but RBS would rather buy its stock back from the government than pay a special dividend', says Foll. 'The new

management team is setting out long-term guidance assuming a 25bp interest rate cut and then no increases for three years – it's a very bearish set of assumptions for a bank. Its valuation is low, it has a strong balance sheet, and we think it will be a strong total return position for our portfolios as that cash comes back and we see a re-rating'.

However, Henderson adds that domestic UK stocks are not the whole story, giving the example of Flutter (formerly Paddy Power Betfair), which is positioning for the newly liberalising US market. 'It was a new position in FY18 and we have built it up since', he says. 'Gambling in the US has always been a miserable experience, and we think the companies that are good at marketing should prosper in the more open environment'.

As an income fund with more of a focus on achieving total returns than buying high-yielding stocks, Henderson points out that the significant contribution to revenues from LWDB's IPS business allows the managers to think differently, including high-growth but non-yielding stocks like Ceres Power, as well as investing further down the market capitalisation spectrum. 'We are finding large-, mid- and small-cap opportunities, but selectively', he says. Foll adds that as well as being a good year for IPS revenue growth (up 7.5%), investment income was up 25%, including higher special dividends from energy firm IOG, RBS and materials stock Rio Tinto. 'These are specials funded from strong balance sheets; they are not capital distributions', she points out, adding that the work she and Henderson have done on forecasting future revenues suggests LWDB's portfolio dividends are more sustainable than those of the index as a whole. 'We have been very conservative in forecasting specials; our forecasts are probably unrealistically low, and even then we see like-for-like dividend growth that gives us confidence in our forecast', she says.

Henderson adds that the full benefit of increasing the trust's gearing in FY19 will begin to be seen in the revenue account in the coming year, as dividends come in from the companies in which they invested a net £100m. The managers have marginally increased the gearing since the turn of the year, investing a further net £10m. 'Buying will continue in a modest way where opportunities come up', says Foll. 'We are not taking a particular view on markets – it is all stock-driven – and the pace of investment is likely to be more moderate than it was last year'.

Asset allocation

Investment process: Diversified portfolio with value tilt

LWDB's portfolio managers aim to provide investors with a diversified portfolio of quality listed companies, primarily in the UK but with up to c 20% overseas where Henderson and Foll can find no compelling UK-listed equivalent. In order to mitigate company-specific risk, the managers hold a relatively long list of stocks (132 at end-December 2019), spread across all industry sectors. Although LWDB has more of a large-cap bias than the managers' other funds (which include Lowland Investment Company and Henderson Opportunities Trust) – with more than half of the UK names drawn from the 100 largest companies – it still features a significant number of mid-cap and smaller companies. The overseas holdings tend to be in larger companies, with funds used to gain exposure to Asia (ex-Japan) and emerging markets, where LWDB rarely invests directly.

Henderson and Foll sit within the global income team at Janus Henderson Investors, and are able to draw on the ideas and research of the wider team when constructing the LWDB portfolio. James Ross is responsible for European stock selection. Investments are chosen on a bottom-up basis, 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.

Although LWDB is a member of the AIC UK Equity Income sector, the significant revenue contribution from the IPS business (27.8% of total income in FY19) allows the managers to hold lower- or non-yielding stocks where they feel this is justified by superior capital appreciation

potential, while still achieving LWDB's overall objective of providing long-term growth with a steadily growing income. The portfolio yield in FY19 (based on dividend income received and average net assets) was c 4.0%, but when deploying the gearing, the managers will look to invest in stocks that are yielding more than the cost of borrowing (c 4.6%) and can thus provide immediate upside. In particular, in recent years they have built a portion of the portfolio in lower-beta (less correlated with equity markets), absolute return-type investments such as Hipgnosis Songs Fund (music royalties, current yield of 4.7%), Urban Logistics REIT (distribution warehouses, 4.8% yield) and Foresight Solar Fund (renewable energy, current yield of 5.9%).

The managers tend to build and exit positions gradually, with an average starting position of c 0.3% of the portfolio (with c 130 stocks, the overall average position size is c 0.8%). Henderson comments that the traditional income fund discipline of selling winning stocks as their yields fall, and recycling the proceeds into high-yielding stocks, has been challenging in the momentum-driven markets of recent years. As such, the managers are tending to 'run their winners' for longer; the important contribution to total income from the IPS business facilitates this. Portfolio turnover has remained relatively low, at c 17.9% for FY19; while this is higher than in the last two financial years (primarily as a result of being net investors through deploying gearing), it still implies a holding period of more than five and a half years. As well as gently trimming positions that have done well, the managers may also sell out of holdings where there has been a deterioration in fundamentals.

Current portfolio positioning

At 31 December 2019, there were 134 names in the LWDB portfolio, down from 139 at end-FY18. This included five collective investment funds making up 3.9% of the total (FY18: seven funds and 6.9% of the total). The top 10 holdings accounted for 21.2% of the portfolio, a slight decrease in concentration from 23.8% at end-FY18. All of the top 10 positions have been held for at least a year.

| Exhibit 3: Portfolio geographic exposure vs allocation guidelines (% unless stated) | | | | |
|--------------------------------------------------------------------------------------------|------------------------------------|------------------------------------|--------------------|------------------------------|
| | Portfolio end-December 2019 | Portfolio end-December 2018 | Change (pp) | Allocation guidelines |
| UK | 80.7 | 74.5 | 6.2 | 55-85 |
| North America | 8.3 | 9.9 | (1.6) | 0-20 |
| Europe ex-UK | 7.8 | 8.6 | (0.8) | 0-10 |
| Japan | 1.1 | 1.1 | 0.0 | 0-10 |
| Pacific ex-Japan | 0.9 | 4.5 | (3.6) | 0-10 |
| Other | 1.2 | 1.4 | (0.2) | 0-10 |
| | 100.0 | 100.0 | | |

Source: The Law Debenture Corporation, Edison Investment Research

As shown in Exhibit 3, the biggest change in geographical weighting during the course of FY19 was a 6.2pp increase in the UK. However, the managers are keen to stress that this was not driven by the move from the AIC's Global sector to the UK Equity Income peer group, but instead resulted from a large number of attractively valued investment opportunities among UK-listed stocks, particularly those that are more exposed to the domestic economy. Henderson and Foll increased LWDB's gearing from 3% to 9% during the year, investing a net c £100m, mainly in the UK. The biggest decrease was in Pacific ex-Japan, where a 0.9% position in Scottish Oriental Smaller Companies is now the only holding, following the sale of two open-ended Asia Pacific funds. All other regional exposures remain largely unchanged; in total there are 39 overseas-listed holdings in the portfolio, with the largest positions being Microsoft (1.2% of NAV) and Toyota (1.1%).

In sector terms (Exhibit 4), the portfolio remains well diversified, with the largest change over the course of FY19 being a 4.3pp increase in financials. This was principally a result of new investments during H119 in Lloyds Banking Group and Royal Bank of Scotland (together 2.4% of the portfolio at the year-end), as well as doubling the size of the position in insurer Direct Line. Consumer services increased by 2.8pp, partly due to a c 130% rise in the share price of homeware

retailer Dunelm (now just outside the top 10) during the year. A new position added since the year-end is Linde, a German gas and chemicals company.

Exhibit 4: Portfolio sector exposure vs benchmark (% unless stated)

| | Portfolio end-December 2019 | Portfolio end-December 2018 | Change (pp) | Index weight | Active weight vs index (pp) | Trust weight/index weight (x) |
|---------------------|-----------------------------|-----------------------------|-------------|--------------|-----------------------------|-------------------------------|
| Financials | 25.0 | 20.7 | 4.3 | 27.1* | (2.1)* | 0.9* |
| Industrials | 23.2 | 24.8 | (1.6) | 11.6 | 11.6 | 2.0 |
| Oil & gas | 9.7 | 10.8 | (1.1) | 11.8 | (2.1) | 0.8 |
| Consumer services | 10.2 | 7.4 | 2.8 | 12.0 | (1.8) | 0.8 |
| Healthcare | 8.9 | 8.9 | 0.0 | 9.3 | (0.4) | 1.0 |
| Basic materials | 6.4 | 7.3 | (0.9) | 7.5 | (1.1) | 0.8 |
| Consumer goods | 5.2 | 4.5 | 0.7 | 14.0 | (8.8) | 0.4 |
| Pooled equity invts | 3.9 | 6.9 | (3.0) | N/A | N/A | N/A |
| Utilities | 4.0 | 3.6 | 0.4 | 3.0 | 1.0 | 1.3 |
| Technology | 2.4 | 3.7 | (1.3) | 1.1 | 1.3 | 2.2 |
| Telecommunications | 1.1 | 1.4 | (0.3) | 2.5 | (1.4) | 0.4 |
| | 100.0 | 100.0 | | 100.0 | | |

Source: The Law Debenture Corporation, Edison Investment Research. Note: *Index weight in financials includes pooled equity investments.

The biggest sales during the year were the two Asia Pacific funds – Baillie Gifford Overseas Growth and Stewart Investors Asia Pacific Leaders – while pub company Greene King and property business A&J Mucklow left the portfolio as a result of takeover bids. Henderson and Foll have also taken some profits in strong performers such as Marshalls (hard landscaping) and Johnson Service Group (linen rental).

Performance: Strong medium- and long-term record

Exhibit 5: Five-year discrete performance data

| 12 months ending | Share price (%) | NAV* (%) | CBOE UK All Companies (%) | CBOE UK 250 (%) | MSCI World (%) |
|------------------|-----------------|----------|---------------------------|-----------------|----------------|
| 31/01/16 | (11.3) | (5.4) | (5.3) | 4.9 | 1.1 |
| 31/01/17 | 23.7 | 23.8 | 20.9 | 13.8 | 32.8 |
| 31/01/18 | 18.6 | 14.7 | 11.3 | 14.5 | 11.9 |
| 31/01/19 | (2.7) | (2.7) | (3.9) | (6.5) | 1.6 |
| 31/01/20 | 9.5 | 9.8 | 10.5 | 18.3 | 18.2 |

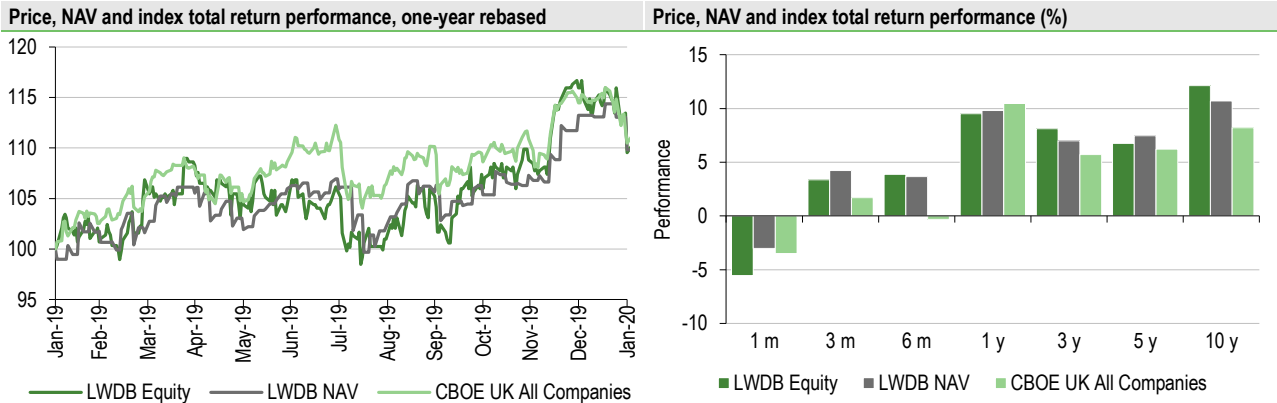
Source: Refinitiv. Note: All % on a total return basis in pounds sterling. *Cum income NAV with debt and IPS business at fair value.

LWDB's par value NAV total return (which is seen as a fairer reflection of the managers' skill, given they do not influence the market value of the debt) was 19.4% in FY19 (ending 31 December), a shade ahead of the 19.2% benchmark return, while the fair value NAV total return was 17.9%. The share price total return was 24.5%, reflecting a narrowing of the discount in the last quarter of the year. Markets have fallen back somewhat in the early part of 2020 as a result of fears over the impact of the COVID-19 coronavirus on the global economy, and over 12 months to end-January 2020, LWDB's cum-fair NAV total return of 9.8% and share price total return of 9.5% compare with a return of 10.5% from the broad UK stock market (measured here by the CBOE UK All Companies Index). As shown in Exhibit 6 (right-hand side), LWDB has outperformed the index in both share price and NAV terms over three and six months, as well as over three, five and 10 years. (All figures are adjusted for the restated 31 December cum-fair NAV per share of 702.2p.)

During FY19, the largest positive contributions to performance came from Johnson Service Group, Dunelm, Marshalls, Microsoft and Ceres Power. Together these stocks added £26.9m to returns, with an average share price gain of 80.3%. While the first three are very much UK domestic stocks, the presence of Microsoft in the list underlines the importance of being able to hold overseas names, while Ceres Power (an AIM-listed fuel cell company) illustrates the potential benefits to LWDB investors of holding both smaller companies (until recently the company's market cap was

below £500m) and stocks that do not pay a dividend. Ceres Power's share price has risen by a further 64.2% since 31 December (on top of a 59.8% rise during 2019) and it is now among LWDB's largest holdings.

Exhibit 6: Investment trust performance to 31 January 2020



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

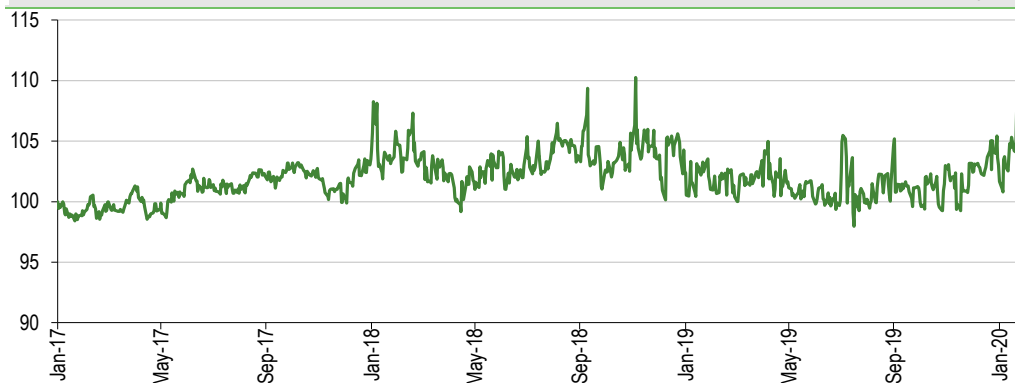
Exhibit 7: Share price and NAV total return performance, relative to indices (%)

| | One month | Three months | Six months | One year | Three years | Five years | 10 years |
|-----------------------------------------|-----------|--------------|------------|----------|-------------|------------|----------|
| Price relative to CBOE UK All Companies | (2.1) | 1.6 | 4.2 | (0.9) | 7.0 | 2.5 | 42.7 |
| NAV relative to CBOE UK All Companies | 0.5 | 2.5 | 4.0 | (0.6) | 3.6 | 6.0 | 25.7 |
| Price relative to CBOE UK 250 | (2.3) | (3.3) | (6.2) | (7.4) | (0.2) | (8.3) | (1.5) |
| NAV relative to CBOE UK 250 | 0.3 | (2.5) | (6.4) | (7.2) | (3.3) | (5.1) | (13.2) |
| Price relative to MSCI World | (5.5) | (0.0) | 3.3 | (7.3) | (5.9) | (23.2) | (4.7) |
| NAV relative to MSCI World | (2.9) | 0.8 | 3.1 | (7.1) | (8.9) | (20.5) | (16.0) |

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

The biggest losers in FY19 were Eddie Stobart Logistics, Kier Group, Rolls-Royce, Tullow Oil and IP Group. Together they detracted from LWDB's returns by a total of £17.4m. Shares in Eddie Stobart Logistics were suspended from trading between late November 2019 and late February 2020 as a result of accounting irregularities identified by its auditor. Henderson says this has reinforced for him the importance of good governance, as the investigation suggests 'a culture of shortcuts that runs through the company'. Kier's share price suffered on investor fears over its level of debt; it is addressing this by divesting its housing division and refocusing on its core construction and infrastructure businesses. Meanwhile, Rolls-Royce was hit by the continued grounding of the 737 Max jet by Boeing, one of its biggest customers. Since the turn of the year, Kier Group has bounced back somewhat (+35.0% compared with its 76.1% decline in 2019), while Rolls-Royce and IP Group have seen single-digit percentage moves (respectively downwards and upwards). Tullow Oil (less than 0.2% of the LWDB portfolio at 31 December 2019) has fallen by a further 45% after test drilling at one of its assets revealed that no hydrocarbons were present.

Exhibit 8: NAV TR performance relative to CBOE UK All Companies index over three years



Source: Refinitiv, Edison Investment Research

Thorpe points out that LWDB’s share price and par value NAV total returns in FY19 show that the portfolio is capable of outperforming, even in a strongly rising market. As shown in the chart on the front page, on a par value basis LWDB’s NAV total return has outperformed the benchmark in all but one of the years since FY11 (FY15, when it declined by 0.3% compared with a 1.0% return from the benchmark), effectively capturing more than 100% of the upside in positive years and only c 50–60% of the downside in negative years. ‘It is not a closet tracker by any means’, she says.

Exhibit 9: NAV total return performance to 31 January 2019 (%) with debt at par value and fair value

| | One month | Three months | Six months | One year | Three years | Five years | 10 years |
|------------------------------------|-----------|--------------|------------|----------|-------------|------------|----------|
| NAV ex-income, debt at par value | -2.4 | 6.8 | 6.2 | 12.5 | 25.5 | 46.9 | 183.5 |
| NAV cum-income, debt at fair value | -3.0 | 4.2 | 3.7 | 9.8 | 22.5 | 43.4 | 176.6 |

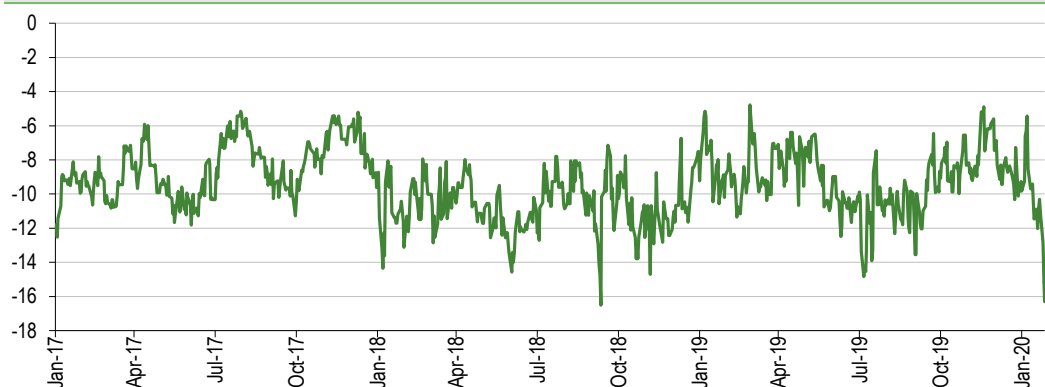
Source: The Law Debenture Corporation, Morningstar, Edison Investment Research

Discount: Narrowing until recent market wobble

At 26 February 2020, LWDB’s shares traded at a 15.7% discount to cum-income NAV (with both debt and the IPS business at fair value). The discount broadly narrowed over the second half of 2019, from 14.7% on 5 August to 4.8% on 19 December, but has since widened again as fears over the spread of the COVID-19 coronavirus disease have weighed on market sentiment. The current discount is appreciably wider than the averages over one, three, five and 10 years, which stand at 9.2%, 9.4%, 8.8% and 7.4% respectively. (Longer-term averages are based on restated NAVs reflecting the fair value of IPS, which were not reported prior to the beginning of 2016.) It is also much wider than the 5.4% average discount for the AIC UK Equity Income peer group.

Notwithstanding the current bout of market volatility, Thorpe says the recent narrowing of the discount has come through a mixture of good portfolio performance and a more proactive approach to communicating the LWDB model. The board is hopeful that the higher dividend yield that will result from the recent step change in the annual dividend will provide a further reason for the discount to NAV to resume its narrowing trend.

Exhibit 10: Share price discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research. Note: Chart adjusted for restated 31 December 2019 NAV.

Capital structure and fees

Structured as a conventional investment trust with one class of share, LWDB had 118.4m ordinary shares in issue at 26 February 2020. The board has authority to repurchase up to 14.99% of the shares, or allot shares up to 5% of the issued share capital, each year. However, 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.

Gearing, which is permitted up to 50% of net assets but in practice is unlikely to be higher than 20%, comes via two tranches of long-term fixed rate debt. Together these have a nominal value of £115m, with £40m of guaranteed secured bonds (6.125% coupon) maturing in 2034, and £75m of senior secured notes (3.77% coupon) maturing in 2045. Because the current low level of interest rates means high-coupon debt is deemed more valuable, the market or fair value of the debt is higher than the nominal value, and stood at £151.2m at 31 December 2019. At fair value, the borrowings equate to available gearing of 17.4% of fair value NAV at end-FY19. However, LWDB retains a significant amount of cash on its balance sheet (£71.2m at 31 December 2019), which partially offsets the gearing, and net gearing at 31 January 2020 was 10.0%, according to the AIC.

The manager of LWDB's investment portfolio, Janus Henderson Investors, receives an annual management fee of 0.30% of net assets (excluding net assets of the IPS business), charged 25% to revenue and 75% to capital since the start of FY19 (previously 100% to revenue). The change in fee allocation brings LWDB more into line with peers. There is no performance fee. Ongoing charges for FY19 were 0.48%, a 5bp increase on FY18, but still among the lowest in the AIC universe and well below the 0.90% average for the UK Equity Income peer group.

Dividend policy and record

LWDB has historically paid two dividends a year, with an interim payment in September and a larger final dividend in April. From FY20 (beginning 1 January 2020), it will move to quarterly payment of dividends, with three equal interims and a higher final payment. The FY19 final dividend of 19.4p a share represents a significant step change for LWDB, up c 50% on the FY18 final payment, bringing the total for the year to 26.0p, an increase of c 38%. The board does not anticipate future increases to be of a similar magnitude, but sees the new level as being more attractive to shareholders at the same time as building a sustainable platform from which to continue LWDB's unbroken 41-year record of increasing or maintaining its dividend. The intention in future years is to continue to grow the dividend, which is fully covered by income, ahead of the rate of annual UK inflation. By paying three equal interim dividends, investors will have greater certainty over their level of income from the year, as the sum of the first three payments can be derived from the first. The new quarterly dividends will be paid in July, October and January, with the final payment still coming in April following approval at LWDB's AGM.

Thorpe points out that LWDB has the advantage of deriving an appreciable part of its income from the IPS business – which is showing good year-on-year growth – as well as having a healthy revenue reserve of £62m or 52.8p a share (£39.5m and 33.4p if the FY19 final dividend is deducted), equivalent to 2.0x or 1.3x the FY19 total dividend. The change in cost allocation (from 100% charged to revenue to a 25:75 split between revenue and capital) has facilitated the payment of a higher dividend, and revenues from both IPS (+7.5% on FY18) and investment portfolio dividends (+25% on FY18) have risen healthily year-on-year.

Based on the current share price and the FY19 total dividend, LWDB has a prospective dividend yield of 4.5%; the board aspires for it to remain close to or above 4.0%.

Peer group comparison

During 2019, LWDB moved from the AIC's Global peer group to the UK Equity Income sector, which is shown below in Exhibit 11. The sector guidelines state that a UK weighting of c 80% justifies inclusion in the group, and many of the peers also invest a portion of their assets overseas, although none shares LWDB's unique structure or the benefit of deriving c 30% of its income from the IPS business. In performance terms, LWDB ranks 17th of 24 funds over one year, ninth over

three years, eighth over five years and fourth (of 23 funds) over 10 years, with above-average returns over all but the most recent one-year period. Of interest is that another of Henderson and Foll's funds, Lowland Investment Company (LWI), is in the same sector; LWDB has a more diversified portfolio with a higher overseas weighting and less in smaller companies, and has performed better than LWI over the past one, three and five years. (Note: these performance figures do not include the audited 31 December 2019 NAV and subsequent uplifts.)

LWDB's ongoing charges of 0.48% are the third lowest in the group, and it is not liable for a performance fee. Its discount is 10pp wider than the sector average and its level of gearing is also a little above average. The dividend yield of 3.2% is based on dividends paid in the last 12 months and is currently the second lowest in the peer group. Using the FY19 total dividend of 26.0p a share, the yield would rise to 4.3% (calculated on the share price at 21 February), which is above the 4.2% sector average.

Exhibit 11: AIC UK Equity Income sector as at 24 February 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 | 720.0 | 10.6 | 23.0 | 41.2 | 177.3 | 0.5 | No | (15.2) | 111 | 3.2 |
| Aberdeen Standard Equity Income | 183.5 | 4.3 | 10.0 | 19.4 | 125.9 | 0.9 | No | (10.5) | 113 | 5.5 |
| BlackRock Income and Growth | 45.5 | 11.6 | 17.5 | 32.7 | 116.6 | 1.1 | No | (1.8) | 103 | 3.6 |
| BMO Capital & Income | 357.9 | 18.1 | 31.1 | 59.2 | 152.2 | 0.6 | No | 1.3 | 102 | 3.4 |
| BMO UK High Income Units | 123.4 | 15.6 | 16.7 | 32.0 | 121.9 | 1.0 | No | (9.4) | 105 | 4.1 |
| Chelverton UK Dividend Trust | 41.9 | 12.5 | 8.7 | 42.5 | 335.0 | 2.0 | No | (7.6) | 135 | 4.8 |
| City of London | 1,691.9 | 11.9 | 20.2 | 34.2 | 162.6 | 0.4 | No | 1.9 | 109 | 4.5 |
| Diverse Income Trust | 347.3 | 8.9 | 17.3 | 40.2 | -- | 1.2 | No | (6.8) | 100 | 4.0 |
| Dunedin Income Growth | 441.6 | 20.7 | 30.3 | 40.4 | 144.3 | 0.6 | No | (2.9) | 105 | 4.2 |
| Edinburgh Investment Trust | 1,020.1 | 3.8 | 3.8 | 20.2 | 163.5 | 0.6 | No | (11.4) | 104 | 4.9 |
| Finsbury Growth & Income | 1,835.8 | 15.1 | 42.9 | 73.6 | 342.9 | 0.7 | No | (0.4) | 101 | 1.9 |
| Invesco Income Growth | 171.0 | 15.4 | 20.1 | 30.7 | 162.4 | 0.7 | No | (12.5) | 102 | 4.1 |
| Investment Company | 16.3 | 16.5 | 24.9 | 25.2 | 147.6 | 2.4 | No | (9.2) | 100 | 4.4 |
| JPMorgan Claverhouse | 420.8 | 15.9 | 23.7 | 43.4 | 157.4 | 0.7 | No | (1.5) | 109 | 3.9 |
| JPMorgan Elect Managed Income | 88.6 | 10.8 | 14.2 | 28.6 | 129.0 | 0.9 | No | (2.5) | 100 | 4.4 |
| Lowland Investment Company | 375.6 | 7.7 | 8.1 | 24.7 | 207.9 | 0.6 | Yes | (4.0) | 113 | 4.3 |
| Merchants Trust | 586.5 | 16.8 | 26.7 | 38.9 | 150.4 | 0.6 | No | 1.0 | 115 | 5.2 |
| Murray Income Trust | 595.0 | 20.1 | 30.9 | 47.0 | 155.6 | 0.7 | No | (2.4) | 103 | 3.9 |
| Perpetual Income & Growth | 674.8 | 7.7 | 3.6 | 9.5 | 135.2 | 0.7 | No | (13.2) | 114 | 4.8 |
| Schroder Income Growth | 204.0 | 10.9 | 17.8 | 32.7 | 147.9 | 0.9 | No | (2.7) | 115 | 4.3 |
| Shires Income | 84.5 | 18.0 | 26.0 | 41.7 | 175.8 | 1.4 | No | (1.8) | 119 | 4.8 |
| Temple Bar | 889.4 | 9.7 | 17.6 | 34.9 | 145.7 | 0.5 | No | (1.4) | 109 | 3.9 |
| Troy Income & Growth | 275.5 | 15.0 | 22.7 | 44.6 | 158.3 | 0.9 | No | 1.2 | 100 | 3.3 |
| Value And Income | 118.4 | 8.0 | 12.5 | 22.5 | 117.8 | 1.3 | No | (17.4) | 129 | 4.7 |
| Sector average (24 funds) | 471.2 | 12.7 | 19.6 | 35.8 | 166.7 | 0.9 | | (5.4) | 109 | 4.2 |
| LWDB rank in sector | 5 | 17 | 9 | 8 | 4 | 22 | | 23 | 9 | 23 |

Source: Morningstar, Edison Investment Research. Note: *Performance to 21 February 2020 based on cum-fair NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

The board

LWDB has seven directors: five independent, non-executive directors, and two non-independent executive directors. Robert Hingley, the chairman since April 2018, was appointed to the board in October 2017. Senior Independent Director Robert Laing is the longest-serving board member, having been appointed in April 2012, with Mark Bridgeman (chairman of the Audit Committee) joining in March 2014, and Tim Bond in April 2015. The appointment of the newest independent director, Claire Finn, was announced in August 2019. The two executive directors are Denis Jackson, CEO of The Law Debenture Corporation, appointed to the board in January 2018, and CFO Katie Thorpe, appointed in January 2019. The directors have professional backgrounds including investment management and distribution, corporate finance, law and accountancy.

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