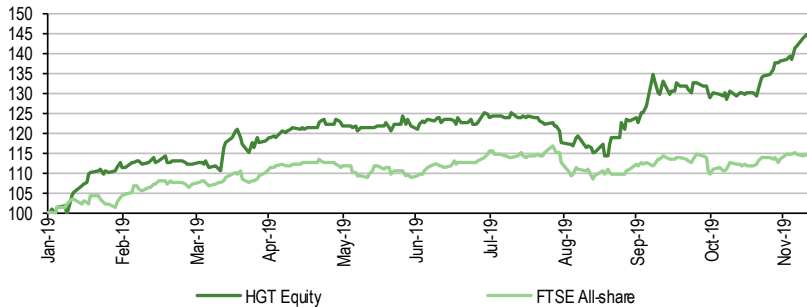


# HgCapital Trust

Good momentum continues

Hg Capital Trust's (HGT) investment activity in 2019 to end-November has been broadly in line with last year, while the volume of realisations was lower following an exceptionally strong 2018 and 2017. HGT's NAV total return (TR) to end-September 2019 was a solid 18.4%, backed by revaluations of portfolio holdings, which continue to deliver good operational performance. Following several major new and follow-on investments in 2019 (including team.blue, Transporeon, Visma, Litera Microsystems and Argus Media), HGT's coverage ratio increased to c 80% in September 2019 from 50% at end-2018. That said, HGT expects to announce further commitments to invest alongside Hg funds in early 2020.

## Outperformance of benchmark in 2019 ytd



Source: Refinitiv, Edison Investment Research

## The market opportunity

The manager, Hg, specialises in buyouts of software and service companies that offer a combination of growth and a defensive profile. It has extensive expertise in these segments and has demonstrated the strong value-creation capabilities (as can be seen by the solid increase in historical NAV) of its portfolio holdings through active involvement in their strategic development. We believe this is particularly important in the current market environment, where demanding valuations limit the returns from deals based purely on financial engineering (which has never been Hg's focus).

## Why consider investing in HGT?

1. Investment manager's extensive experience (nearly 30 years).
2. Focus on software and services companies, where HGT has a well-documented track record.
3. Solid top- and bottom-line performance of portfolio companies.
4. Value-add initiatives executed by an experienced in-house team.

## Valuation: Trading at par with net asset value

HGT's shares continue to trade at a slight 1.3% premium to the last-reported NAV per share of 249.8p, underpinned by the average uplift to book value of 40% over eight years, supported by 30 software and service businesses realisations as well as the solid performance of its existing portfolio holdings.

## Investment trusts

17 December 2019

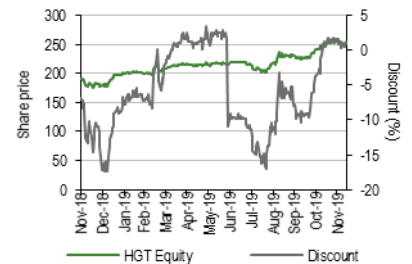
**Price** 253.00p  
**Market cap** £1,026m  
**NAV** £1,006m

NAV\* 249.8p  
 Premium to NAV 1.3%

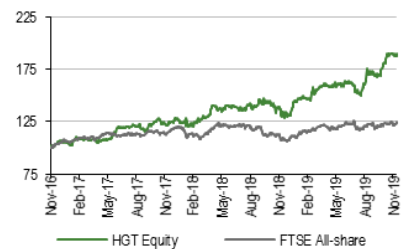
\*as at 30 September 2019.

Yield 1.9%  
 Ordinary shares in issue 406.2m  
 Code HGT  
 Primary exchange LSE  
 AIC sector Private Equity  
 Benchmark FTSE All-Share Index

## Share price/discount performance



## Three-year performance vs index



52-week high/low 254.0p 175.0p  
 NAV\* high/low 249.8p 204.8p

\*Including income.

## Gearing

Gross\* 0%  
 Net cash\* £153m

\*Liquid resources at 30 September 2019 (pro forma).

## Analysts

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[Edison profile page](#)

**HgCapital Trust is a research client of Edison Investment Research Limited**

## Exhibit 1: HGT at a glance

### Investment objective and fund background

HgCapital Trust aims to provide shareholders with consistent long-term returns in excess of the FTSE All-Share Index by investing predominantly in fast-growing, defensive unquoted companies and creating value through strategic and operational change. The company focuses on investments in software and service businesses primarily in Europe. It is able to invest in companies at enterprise values from £50m to over £1.0bn.

### Recent developments

- November/December 2019: HGT completes three minor share issues (c 2.0m shares issued in total), raising gross proceeds of £5.1m.
- 22 October 2019: HGT invests £31.6m in Argus Media.
- 9 September 2019: publication of H119 results along with an interim dividend proposal of 1.8 pence per share payable on 25 October 2019.
- 5 September 2019: HGT exits Register with realisation proceeds of £16m.
- June 2019: HGT raises £63m new equity by issuing 29.4m shares.

### Forthcoming

AGM	May 2020
Full-year results	9 March 2020
Year end	31 December
Dividend paid	Semi-annually
Launch date	1989
Continuation vote	2020

### Capital structure

Ongoing charges	1.70% (LTM)*
Net gearing	None
Annual mgmt fee	1.4% of NAV (LTM)*
Carried interest	20% of aggregate profits*
Trust life	Indefinite
Loan facilities	£80m (undrawn)

### Fund details

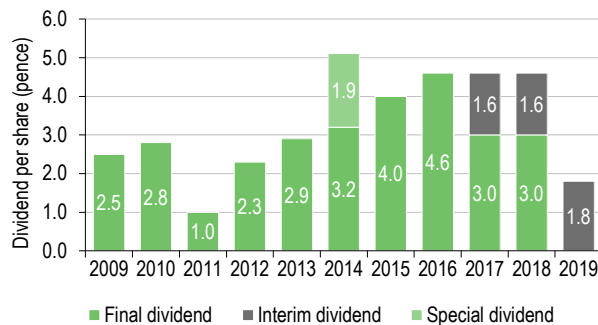
Group	Hg
Manager	Hg Pooled Management (Hg)
Address	2 More London Riverside, London SE1 2AP
Phone	+44 (0)20 7089 7888
Website	<a href="http://www.hgcapitaltrust.com">www.hgcapitaltrust.com</a>

### Dividend policy and history (2009–18)\*\*

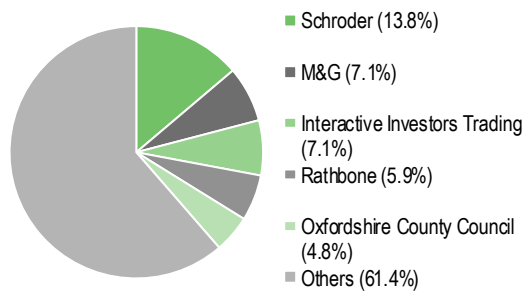
HGT's current dividend policy is to pay out an annual dividend of at least 4.6p per share was introduced in 2016. The company aims to increase dividends if the market environment remains favourable.

### Share buyback policy and history

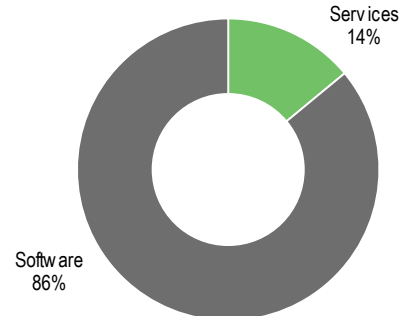
Each year HGT's directors renew the authority to buy back up to 14.99% of the issued share capital at prices below the prevailing NAV per ordinary share, although the company has never executed the right. A general authority to allot shares up to a maximum nominal amount of £3.1m was also given to directors.



### Shareholder base (at 29 November 2019)



### Portfolio exposure by sector (at 30 September 2019)



### Top 10 holdings (at 30 September 2019)

Company	Location	Cluster/end-market	Portfolio weight	
			30 September 2019	30 September 2018***
Visma	Scandinavia	Tax and accounting/ERP and payroll	21.3%	19.0%
Sovos Compliance	North America	Tax and accounting	8.7%	10.5%
IRIS	UK	Tax and accounting/ERP and payroll	5.6%	5.2%
Access	UK	Software	5.0%	4.0%
Transporeon	Germany	ERP and payroll	4.5%	N/A
CogitalGroup	UK	Tax and accounting	4.2%	4.2%
Mobility Holding	Germany	Automotive	3.9%	N/A
Litera	North America	Legal & regulatory compliance	3.7%	N/A
Mitratech	North America	Legal & regulatory compliance	2.3%	3.0%
IT Relation	Scandinavia	SME Tech Services	2.1%	N/A
<b>Top 10 (% of holdings)</b>			<b>61.3%</b>	<b>58.4%</b>

Source: HgCapital Trust, Edison Investment Research, Bloomberg. Note: \*Please see the 'Capital structure and fees' section for further details. \*\*Adjusted for the recent share split. \*\*\*N/A where not in end-September 2018 top 10.

## Fund profile: A tech-focused, active PE investor

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HGT aims to provide shareholders with consistent long-term returns ahead of the FTSE All-Share Index by investing mainly in unquoted companies (targeting a portfolio of c 30 growth holdings beyond the venture capital stage) and creating value through strategic and operational change. Apart from outperforming the FTSE All-Share, the company has no explicit target return. However, at the level of individual investments, it aims to achieve a gross IRR of 23–25%. On average, Hg has delivered a gross IRR of around 30% for the past 30 software and service realisations over the last eight years.

HGT focuses on companies that offer software and services across Europe with enterprise values (EVs) ranging from £50m to more than £1.0bn. We note that Hg was the most active global tech private equity (PE) investor by investment volume in 2018, according to Pitchbook. Initially, its investment spectrum was broader and included direct investments in sectors such as healthcare, media, consumer and leisure, industrials and other. However, it has since narrowed its focus to become an expert in software and tech-enabled service investments.

HGT displays the characteristics of a tech conglomerate and is not a private equity fund of funds. In fact, if Hg was classified as such, it would be the fourth-largest and the fastest growing technology company in Europe with a focus on software and services by revenue (after SAP, Amadeus and Dassault Systèmes), as HGT's existing tech investments generate aggregate revenues of around £3.7bn a year while providing superior top-line growth. It must be noted that Hg's management incentive system is relatively effective, as each management team is individually incentivised to align its interest with the portfolio company through a share in business performance. In addition, unlike a traditional conglomerate, Hg will realise each investment, constantly refreshing its group with younger companies entering their high-growth phase.

## The fund manager: Hg

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### The manager's view: Well positioned in the late stage of cycle

HGT's investment manager highlights that it has an active pipeline of investments and is confident that in the current market environment, the clarity and distinctive focus of Hg's strategy provides the manager with several clear advantages as a cautious and disciplined investor. Over the last year, despite the focus on realisations, Hg has continued to invest selectively, capitalising on situations where it has a specific angle and many years of knowledge of the business and its end-market, as well as strong relationships with the founders and management teams. It believes the relative de-risking of its existing portfolio (ie increased exposure to defensive companies with a high degree of recurring revenues) gives the investment team more time and space to consider attractive new investments in core focus areas across Hg funds and the size spectrum.

Despite the relatively demanding valuations in the market, Hg continues to see attractive investment opportunities in its target clusters, just as it did in the closing stages of the last period of high valuations back in 2005–08. This has led to several new investments and further capital deployed into businesses the manager knows well, with Transporeon (announced in January 2019), Visma (April 2019), Litera Microsystems (May 2019) and Argus Media (October 2019) the most recent examples.

Moreover, Hg is driving accretive bolt-on acquisitions in its existing portfolio companies. So far this year (until early September 2019), HGT supported the M&A activity of, among others, Visma (12 acquisitions), Sovos (two), IRIS (two), Access (six), CogitalGroup (nine), Litera (one), Rhapsody (one), and team.blue (one merger and one acquisition).

Hg continues to assess the UK's forthcoming exit from the EU and believes it will have a relatively limited impact on the current portfolio given the characteristics of these businesses, their geographic profile and their relatively defensive nature.

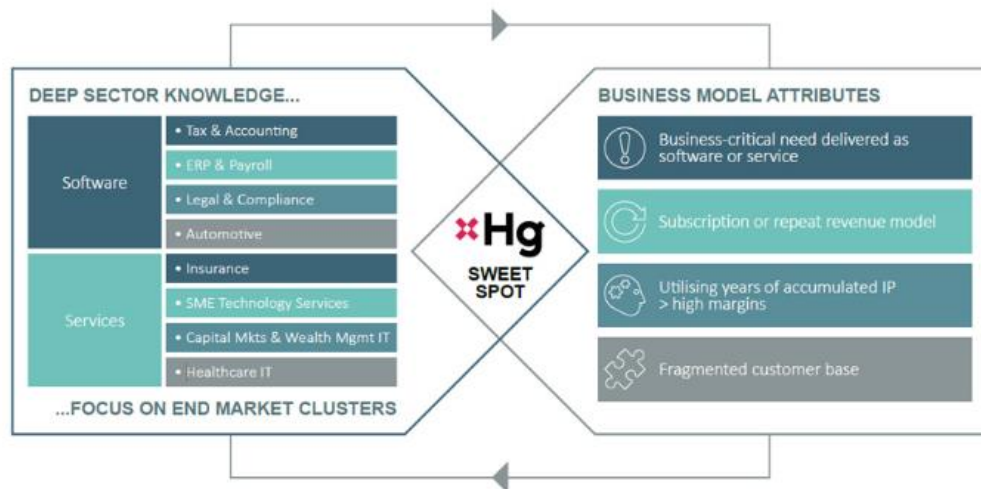
## Asset allocation

### Investment process: Active involvement to drive growth

Hg's area of expertise (the manager's 'sweet spot') represent buyouts of defensive tech growth companies operating in one of eight core end markets: tax and accounting; ERP and payroll; legal and compliance; automotive; insurance; SME tech services; capital markets and wealth management IT; and healthcare IT. These companies should display high levels of recurring and contracted revenues generated from products or services that are business critical but typically low spend. This includes solutions delivered in a cloud software-as-a-service (SaaS) setup, with several of HGT's top portfolio companies already operating in this model (eg Visma, Sovos, IRIS, Access and Allocate Software).

These businesses should be able to use their intellectual property accumulated over several years to generate high margins. Moreover, Hg is looking for companies with a high level of customer loyalty and low sensitivity to market cycles (ie with a defensive profile), as well as low customer penetration (which may be significantly enhanced using a SaaS cloud framework).

**Exhibit 2: Hg's 'sweet spot'**



Source: HgCapital Trust

Hg prefers companies that constitute a solid investment platform and allow it to implement a 'buy-and-build' strategy. It aims at acquiring businesses ranked second to fourth in their respective markets and creating the leading player through add-on acquisitions. Over the last 15 years, Hg has assisted its portfolio companies in conducting more than 200 bolt-on acquisitions. This approach seems particularly compelling in the context of current valuations in the market that are relatively demanding and call for more sophisticated PE strategies than plain financial engineering.

Hg's key competitive advantage is its strong involvement in the strategic development and value creation of its portfolio holdings. Hg's active management is executed by its in-house portfolio team (consisting of c 30 professionals), which works with the company's existing management to develop plans in focus areas around growth, technology & product, analytics, operating model & systems, talent, finance, responsible business, and reporting & communities.

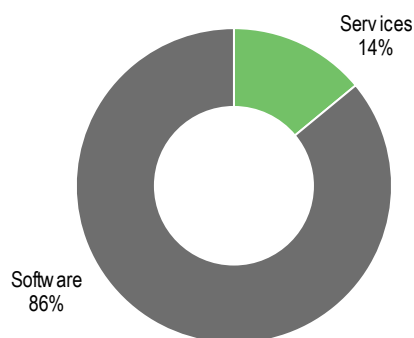
Hg's high degree of involvement supports its deal-origination process (especially in the lower mid-market segment covered by the Hg Mercury funds), as company founders that are considering selling their business normally display a cautious approach towards PE companies and are not exclusively driven by the price they can get for their stake. It is equally important for them to find an investor who will be able to successfully enhance and expand the company's operations (someone who will take proper care of their 'baby').

The operations group either becomes involved directly in the company's operations or mentors its senior management. Hg emphasises stimulating collaboration and experience sharing between management teams of its portfolio companies. This includes forums hosted by Hg (over the last year, it has organised c 30 events with more than 1,000 participants) and 15 live online communities with over 1,000 active members in Hg's trusted environment, [Hive](#).

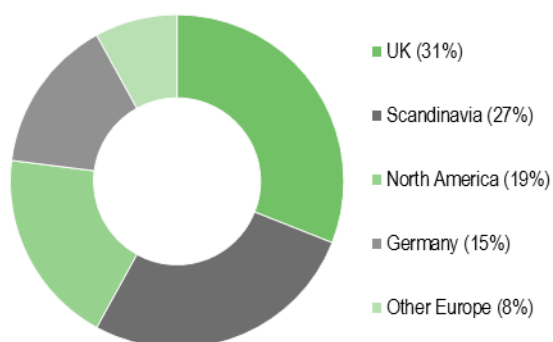
### Current portfolio positioning

HGT's portfolio at end-September 2019 consisted of investments that the company held as one of the limited partners in Hg funds or as direct co-investments with a total valuation of £869.3m. Moreover, the company holds renewable energy investments through the Asper RPP I and II funds valued at a minor c £1.9m following a partial disposal of its interest in Asper RPP II in October 2019. HGT's gross cash position at end-September 2019 was £191.7m or c 19% of total NAV, which, after accounting for provision for carried interest and net current liabilities, stands at £1,005.9m. Taking into account the new investment in Argus Media announced in October 2019, HGT's pro-forma liquid resources stood at £153m or c 15% of NAV reported as at end-September.

**Exhibit 3: Portfolio breakdown by sector**



**Exhibit 4: Portfolio breakdown by geography**



Source: HgCapital Trust, Edison Investment Research. Note: Data at 30 September 2019.

With respect to regional exposures, HGT's portfolio weighting to the UK has decreased to 31% from 36% at end-December 2018 and increased for Germany to 15% from 11%, respectively. Following the high volume of realisations and new investments in 2016–18 (see Exhibit 5), HGT's portfolio is relatively young as the 2017–19 vintages represented c 50% of the total portfolio value at end-September 2019.

HGT's portfolio is also relatively concentrated, with the top 20 investments representing c 79% of NAV. Of this, the five principal holdings constituted c 45% of NAV at end-September 2019, suggesting their performance will be an important driver of HGT's NAV. Visma alone made up 21.3% of NAV at end-September 2019, up from 16.3% at end-April 2019 partially as a consequence of a £10.9m follow-on investment concluded this year (HGT and other Hg fund investors bought out Cinven's remaining stake). It is worth noting that the company's investment policy includes a limit of a single holding on investment at 20% of gross asset value (at cost), which means Visma is currently above the limit. Nevertheless, HGT's board highlights it has identified several ways to reduce the exposure to 20% in the medium term.

Portfolio companies have continued to deliver solid performance. Value-weighted average LTM sales and EBITDA growth for top 20 holdings (representing 91% of portfolio value) at end-September 2019 were 24% and 35%, respectively (vs 26% each at end-September 2018). According to the company, this translated into an EBITDA margin of 28% at end-September 2019. In valuation terms, the average LTM EV/EBITDA multiple for HGT's top 20 holdings stood at 19.2x at end-September 2019 vs 17.3x at end-December 2018 and 15.9x at end-December 2017. Four portfolio holdings (representing c 45% of the top 20 investments) were valued at 20x to 22x. Although these multiples are high in absolute terms, they are broadly comparable with multiples for quoted European software companies (average EV/EBITDA multiple of c 20x) and relatively modest compared to US SaaS peers (30–40x) (Exhibits 8 and 9). We would highlight the following factors as support for the valuation:

1. the high growth delivered by HGT's portfolio holdings (CAGR of around 10–20% or even more at revenue and earnings levels historically), with a high proportion generated organically;
2. Hg's 'buy-and-build' strategy, as platform investments may command a valuation premium in the market as discussed above;
3. the defensive profile of portfolio companies due to a high proportion of recurring revenues generated from business-critical but typically low-spend products, coupled with strong customer loyalty; and
4. Hg bases the valuation of its portfolio companies on current market multiples based on trailing 12-month earnings, whereas the public market tends to be forward-looking. Given the growth profile of Hg's companies, it is likely that one-year forward multiples would be lower than those stated above.

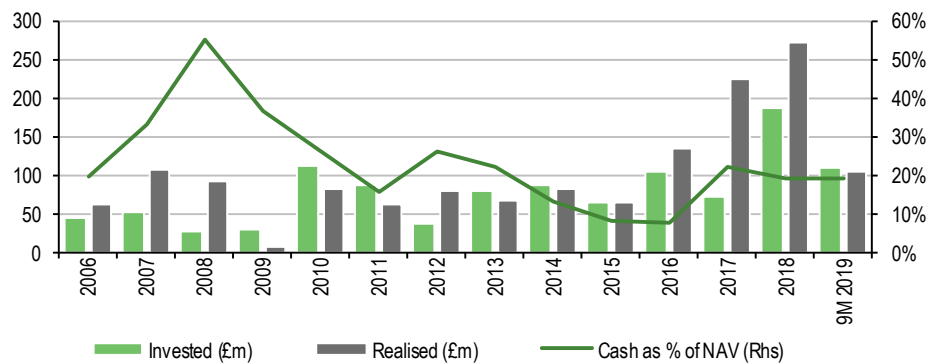
However, as the valuation of portfolio holdings is based on observable market multiples of listed peers, a potential significant market downturn would also be reflected in HGT's NAV. In contrast, strong subsequent EBITDA growth would allow it to restore value in a relatively short timeframe.

## Investments and realisations in 2019

HGT has invested c £111m in the first nine months of 2019 (Exhibit 5), with all major transactions conducted in H119, including team.blue (£23.5m), Transporeon (£42.4m including a £6m co-investment), Visma (£10.9m) and Litera Microsystems (£34.3m). Investments in Q319 were relatively minor as HGT deployed c £3.8m into two businesses well known by the manager: Rhapsody (£2.5m) and team.blue (£1.3m). In October 2019, HGT announced a £31.6m new investment in Argus Media, a global provider of energy and commodity price reporting.

Realisations to end-September 2019 reached £104m, including full exit from Foundry (£28m), partial exit from Raet (£10m), and a refinancing at A-Plan (£14m), which we covered in our [initiation note](#) in June 2019. In Q319 alone, HGT conducted transactions that returned £39.2m to the company.

**Exhibit 5: HGT's investments and realisations 2006–9M19**



Source: HgCapital Trust, Edison Investment Research

In September 2019, HGT completed a full exit from Register, a provider of digital services for professionals and SMEs, following its takeover by team.blue, a mass hosting provider offering web enablement solutions to SMEs across Europe. This valued the investment at £26.5m, representing a c 33% uplift from Register's book value of £19.9m at end-June 2019. team.blue has been HGT's portfolio company since March 2019 and at end-September (following the takeover of Register) it was HGT's 12th largest investment holding, representing 2.0% of its NAV. Notably, after the transaction, team.blue became the third largest shared hosting business in Europe with more than two million customers across 10 countries, according to Hg.

Also in September 2019, HGT made a partial exit from Asper RPP II, one of its two renewable energy fund investments. The transaction returned an initial £11m to the company, which compares with total valuation of the two funds at £23.2m as of end-August 2019. The company highlights that additional consideration is deferred and due to HGT on the anniversary of the sale. The Asper funds are run by a specialist team that was formerly part of Hg and moved to a newly created independent investment management company in November 2017. Moreover, HGT completed £10m of refinancings in Q319, including Commify (£9m) and EidosMedia (£1m).

## Market background: SaaS market spotlight

To understand HGT, it is helpful to look at the prospects and performance of its underlying markets as well as the top-level track record of the holding company.

As we have mentioned previously, in SaaS terms, the US markets are more mature than the European markets with a far wider universe of pure SaaS businesses. Tracking these has now become easier with the launch of the BVP Nasdaq Emerging Cloud Index, which highlights the performance of a range of 49 US SaaS stocks on an equal weighted basis (rather than weighted by market capitalisation, which would skew the index towards a small number of large constituents).

As can be seen in Exhibit 6, following a sell-off from its peak in late summer, buying interest has now returned to the US SaaS sector with the index climbing steadily back towards its summer peak. At its summer peak, companies on the BVP Nasdaq Emerging Cloud Index were trading at an average of 12x forward revenue (against historical norms closer to 6–8x). Based on Bessemer Ventures data, the index is trading at an average of c 10x forward revenue today, justifiable on the basis of strong sales growth of 30%+.

Supporting these valuations, investors consider that SaaS companies have good defensive characteristics (visible revenue streams, long-term contracts, sticky clients, flexible cost bases) and therefore are expected to perform well in a downturn. Additionally, even on a buy and hold basis, assuming growth rates are sustainable, multiples would fall swiftly as companies continue to grow sales and EBITDA.

**Exhibit 6: BVP Nasdaq Emerging Cloud Index**



Source: [indexes.nasdaqomx.com/Index/History/EMCLOUD](https://indexes.nasdaqomx.com/Index/History/EMCLOUD)

As SaaS companies increase in size, adding incremental revenue at sustainably high growth rates becomes more challenging. Late-stage cloud companies are likely to need to thoroughly qualify the opportunities in their pipelines and focus on cross-selling to their existing customer base to sustain revenue growth. Whereas, medium-sized companies are able to focus on managing their pipeline, targeting qualified new customers and paying sensible multiples for acquisitions.

Despite the growing maturity of the SaaS sector, Matt Holleran, general partner at Cloud Apps Capital Partners, still believes there is a period of further growth to come: 'The horizontal cloud application market is expanding globally across the small, medium, large, and enterprise markets. The vertical cloud business application market is also now a global market across many customer size segments. The global scale of these horizontal and vertical markets is creating the opportunity for more entrepreneurs to build global category leaders that can become public scale companies.' Although we are at a late stage in the cycle, as Hg recognises, there is still good visibility on continuing growth for the SaaS sector.

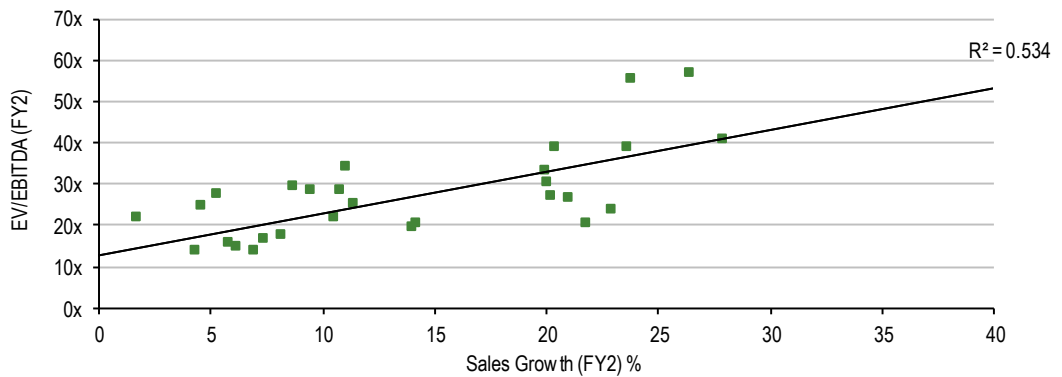
In this context, Visma, HGT's largest holding, does not look out of place. In Q319, Visma reported revenue growth of 28% and EBITDA growth of 21%, with cloud annualised revenue reaching NOK11.2bn, which represents year-on-year growth of 31%. M&A remains a key part of the strategy with Hg characterising Visma as 'Europe's leading software M&A machine' – Visma made six acquisitions during the quarter, three of them driving expansion in the Netherlands as Visma builds out its European footprint.

## Framework for valuation of software/SaaS companies

As a framework, the two key factors affecting the valuation of a SaaS business are public market multiples and how fast the business is forecast to grow relative to its peers. Based on a (limited) universe of UK and European software businesses and US SaaS businesses (Exhibits 8 and 9), we have derived a scatter chart (Exhibit 7) setting out the impact of these two key variables, using consensus EV/EBITDA (FY2) multiples against expected sales growth (FY2), with a line of best fit.



**Exhibit 7: Prospective EV/EBITDA multiple vs growth for a basket of SaaS businesses**



Source: Refinitiv (at 13 December 2019), Edison Investment Research

This line of best fit suggests an EV/EBITDA range of 28–34x for sales growth in the 15–20% range. Of course, a true valuation will depend on the specifics of the company and what potential buyers are willing to pay. Hence, one of Hg’s key strategic pillars is to identify potential buyers as part of the initial investment process to ensure strong relationships are established with them as the asset is held and matures in Hg’s portfolio.

Hg also highlights that successful and sustainable ‘buy-and-build’ strategies attract a significant market premium over non-serial acquirors, potentially attracting a 20–30% premium over equivalent market multiples (c 4–6x added to the EBITDA multiple). Both horizontal (broadening the product range) and vertical expansion, integrating new areas of the enterprise software stack, are clear drivers of M&A deals as acquirors see large gains from adding new offerings to their existing marketing channels. The vast majority of Hg’s investments follow an active buy-and-build strategy.

Based on our universe (Exhibits 8 and 9), it is notable that there is a range of pure SaaS businesses listed in the US. However, in the UK and Europe there are no pure SaaS businesses, so we have had to focus on software businesses with partial exposure to SaaS revenues. Looking at high-level valuations, we would identify the persistent higher revenue growth exhibited by the US companies (20–25%) versus their UK (7–15%) and European peers (14–15%) compared to the higher margins in the UK (c 30%) and Europe (c 38%) versus the US (c 22%).

US investors appear to prioritise higher growth over short-term profitability, whereas in the UK and Europe investors favour profitability and are prepared to sacrifice some level of future growth for short-term returns.

**Exhibit 8: Basket of US SaaS companies**

	Name	Quoted ccy	EV (\$m)	Sales growth 1FY (%)	Sales growth 2FY (%)	EBITDA margin 1FY (%)	EBITDA margin 2FY (%)	EV/Sales 1FY (x)	EV/Sales 2FY (x)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
CRM.N	Salesforce.Com Inc	US\$	139,616	28.0	23.0	28.9	28.4	8.2	6.7	28.5	23.5	55.6	51.9
INTU.OQ	Intuit Inc	US\$	65,754	10.9	10.5	36.9	36.8	8.7	7.9	23.7	21.5	34.3	30.4
NOW.N	ServiceNow Inc	US\$	50,699	32.2	27.9	28.1	28.5	14.7	11.5	52.4	40.3	84.1	65.0
WDAY.OQ	Workday Inc	US\$	35,819	28.1	20.4	20.7	21.3	9.9	8.2	47.8	38.6	88.9	72.7
TEAM.OQ	Atlassian Corporation	US\$	28,340	29.9	26.4	25.3	25.1	18.0	14.3	71.3	56.8	118.0	93.4
PAYC.N	Paycom Software Inc	US\$	14,933	29.7	23.6	42.4	42.5	20.3	16.4	47.9	38.6	75.2	60.0
OKTA.OQ	Okta Inc	US\$	13,705	43.7	31.4	N/M	N/M	23.9	18.2	N/M	N/M	N/M	N/M
TWLO.N	Twilio Inc	US\$	12,023	71.7	31.6	3.5	5.7	10.8	8.2	N/M	N/M	N/M	N/M
COUP.OQ	Coupa Software Inc	US\$	8,856	46.2	27.6	9.4	11.3	23.3	18.2	N/M	N/M	N/M	N/M
ZEN.N	Zendesk Inc	US\$	8,540	36.0	29.9	7.4	9.7	10.5	8.1	N/M	N/M	240.2	132.9
PCTY.OQ	Paylocity Holding Corp	US\$	6,122	21.5	20.1	29.0	29.9	10.8	9.0	37.1	30.0	66.2	54.6
PFPT.OQ	Proofpoint Inc	US\$	6,103	23.2	20.0	17.5	17.4	6.9	5.8	39.4	33.1	65.3	58.8
HUBS.N	HubSpot Inc	US\$	5,853	30.5	23.9	12.7	12.7	8.7	7.1	68.8	55.4	103.5	92.9
AVLR.N	Avalara Inc	US\$	5,149	37.8	25.2	N/M	N/M	13.7	11.0	N/M	N/M	N/M	N/M
BLKB.OQ	Blackbaud Inc	US\$	4,328	5.7	4.6	20.6	19.0	4.8	4.6	23.4	24.2	35.1	34.8
CSOD.OQ	Cornerstone OnDemand	US\$	3,324	6.5	14.2	22.2	24.9	5.8	5.1	26.1	20.4	51.6	36.2
QLYS.OQ	Qualys Inc	US\$	3,000	15.3	14.1	42.8	42.0	9.3	8.2	21.8	19.5	37.2	34.0
MIME.OQ	Mimecast Ltd	US\$	2,618	24.4	20.3	17.3	19.1	6.2	5.1	35.7	26.9	94.0	64.7
BOX.N	Box Inc	US\$	2,503	14.1	11.4	8.3	13.0	3.6	3.2	43.5	24.9	N/M	58.1
LPSN.OQ	LivePerson Inc	US\$	2,475	16.6	20.6	N/M	2.6	8.5	7.0	N/M	N/M	N/M	N/M
KXS.TO	Kinaxis Inc	C\$	1,885	25.9	11.1	28.6	26.3	9.9	8.9	34.7	34.0	60.3	59.0
	<b>Mean</b>			<b>27.6</b>	<b>21.3</b>	<b>21.9</b>	<b>21.7</b>	<b>11.3</b>	<b>9.2</b>	<b>40.5</b>	<b>32.4</b>	<b>82.1</b>	<b>62.7</b>
	<b>Median</b>			<b>28.0</b>	<b>20.6</b>	<b>21.4</b>	<b>21.3</b>	<b>9.9</b>	<b>8.2</b>	<b>37.1</b>	<b>30.0</b>	<b>66.2</b>	<b>58.9</b>

Source: Refinitiv, Edison Investment Research. Note: Priced at 13 December 2019.

**Exhibit 9: Basket of UK and European software businesses**

	Name	Quoted ccy	EV (\$m)	Sales Growth 1FY (%)	Sales Growth 2FY (%)	EBITDA margin 1FY (%)	EBITDA margin 2FY (%)	EV/Sales 1FY (x)	EV/Sales 2FY (x)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
<b>UK</b>													
SGE.L	Sage Group PLC	GBp	11,153	1.8	5.8	25.7	25.7	4.2	4.0	16.5	15.6	24.5	22.7
AVV.L	AVEVA Group PLC	GBp	9,790	9.6	5.3	29.0	30.6	8.7	8.3	30.1	27.1	42.1	37.5
AVST.L	Avast PLC	GBp	6,906	7.8	7.0	55.0	55.1	7.9	7.4	14.4	13.5	18.8	17.2
MCRO.L	Micro Focus International	GBp	6,672	-29.0	-5.3	40.5	41.6	2.0	2.1	4.9	5.0	7.3	6.9
SOPH.L	Sophos Group PLC	GBp	3,750	7.1	9.5	15.5	15.8	4.9	4.5	31.8	28.4	44.4	38.7
GBGP.L	GB Group PLC	GBp	1,980	36.8	10.9	24.0	24.1	7.6	6.8	31.5	28.3	42.7	38.4
LTGL.L	Learning Technologies	GBp	1,126	38.5	8.2	33.8	34.3	6.5	6.0	19.2	17.5	27.7	25.5
EMISG.L	EMIS Group PLC	GBp	901	4.8	4.4	30.0	30.1	4.3	4.1	14.4	13.7	22.4	21.3
PRSMB.L	Blue Prism Group PLC	GBp	880	79.1	72.3	N/M	N/M	6.7	3.9			N/M	N/M
CRWL	Craneware PLC	GBp	801	7.3	8.7	32.9	32.9	10.5	9.6	31.7	29.3	48.4	45.1
ALFAAL.L	Alfa Financial Software	GBp	373	-8.6	1.8	19.4	19.5	4.3	4.2	22.3	21.7	39.5	37.6
	<b>Mean</b>			<b>14.1</b>	<b>11.7</b>	<b>30.6</b>	<b>31.0</b>	<b>6.1</b>	<b>5.5</b>	<b>21.7</b>	<b>20.0</b>	<b>31.8</b>	<b>29.1</b>
	<b>Median</b>			<b>7.3</b>	<b>7.0</b>	<b>29.5</b>	<b>30.4</b>	<b>6.5</b>	<b>4.5</b>	<b>20.8</b>	<b>19.6</b>	<b>33.6</b>	<b>31.5</b>
<b>Europe</b>													
SAPG.DE	SAP SE	€	181,586	11.7	7.4	32.8	33.9	5.9	5.5	18.1	16.3	25.0	22.9
DAST.PA	Dassault Systemes SE	€	39,031	16.5	21.8	36.2	35.3	8.7	7.1	23.9	20.1	40.0	34.5
AMA.MC	Amadeus IT Group SA	€	38,439	13.1	6.2	40.3	40.7	6.2	5.8	15.4	14.3	26.3	24.4
TEMN.S	Temenos AG	CHF	12,364	16.4	21.1	40.5	39.7	12.6	10.4	31.2	26.3	44.7	38.6
	<b>Mean</b>			<b>14.4</b>	<b>14.1</b>	<b>37.4</b>	<b>37.4</b>	<b>8.4</b>	<b>7.2</b>	<b>22.1</b>	<b>19.3</b>	<b>34.0</b>	<b>30.1</b>
	<b>Median</b>			<b>14.8</b>	<b>14.2</b>	<b>38.2</b>	<b>37.5</b>	<b>7.4</b>	<b>6.5</b>	<b>21.0</b>	<b>18.2</b>	<b>33.1</b>	<b>29.5</b>

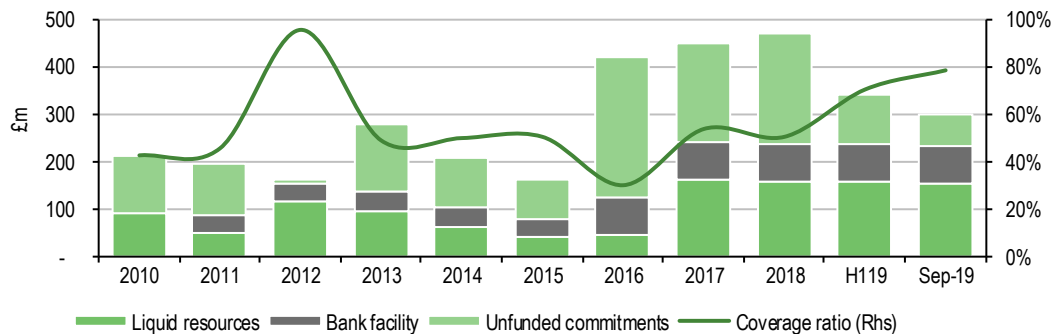
Source: Refinitiv, Edison Investment Research. Note: Priced at 13 December 2019.

## Financial resources: Coverage ratio above past average

HGT's outstanding investment commitments at end-June 2019 stood at £340.6m (see Exhibit 10), down from £470.8m at end-December 2018, predominantly as a result of the investments in Combell, Transporeon, Visma and Litera Microsystems. The company's liquid resources amounted to £158.8m and it had an undrawn £80.0m standby facility, which was extended to 2022. Following the £31.6m investment in Argus Media announced on 22 October 2019, commitments have declined further to c £298m and liquid resources amounted to £153m, implying a coverage ratio of 78%. This is visibly ahead of the company's average levels since 2010. Having said that, the company expects it will announce further commitments to Hg funds in early 2020. HGT's current

commitments should be drawn down over the next 12–18 months and be partially funded by prospective cash inflows from portfolio realisations and refinancing.

**Exhibit 10: HGT's historical coverage ratio**



Source: HgCapital Trust, Edison Investment Research. Note: Last column at end-September 2019 (pro-forma).

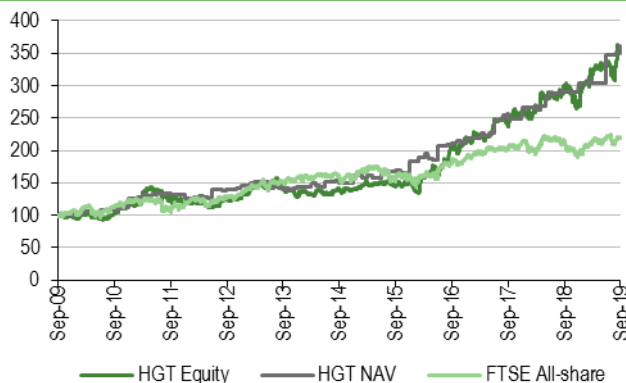
Importantly, in the case of all of the above-mentioned investment commitments, the board of HGT has negotiated a right to 'opt out' without suffering any penalties if it is not able to fund its commitments. However, HGT has not exercised this right so far, as investors could see it as a sign that it is not able to effectively manage its liquidity. It is considered more as 'disaster insurance' in order to protect the balance sheet.

## Performance: Well ahead of public benchmark

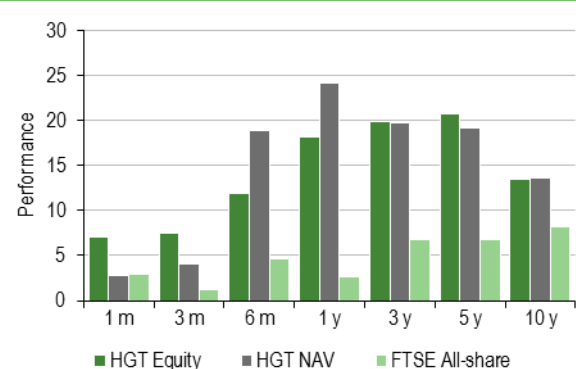
Hg's expertise is demonstrated by the HGT's historical share price and NAV performance. The company has achieved an NAV total return over the last 10 years of 13.7% per year at end-September 2019, well ahead of the FTSE All-Share Index at 8.3% pa. Moreover, HGT is clearly ahead of the FTSE All-Share Index over one, three and five years as illustrated in Exhibit 11. This is also true for other relevant indices, such as the FTSE SmallCap, STOXX Europe Small 200, STOXX Europe 600 Technology and FTSE techMark Focus Index. HGT's NAV TR to end-September 2019 stood at 18.4%, assisted by portfolio revaluations (£124m in H119 alone) despite the £63m capital increase completed in June 2019. Portfolio companies continue with their operating progress, as illustrated by value-weighted average LTM sales and EBITDA growth for the top 20 holdings (representing 91% of the portfolio) at end-September 2019 of 24% and 35%, respectively. Solid NAV progression was accompanied by a c 42% share price increase to 15 December 2019.

**Exhibit 11: Investment company performance to 30 September 2019**

Price, NAV and index total return performance, 10-year rebased



Price, NAV and index total return performance (%)



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

**Exhibit 12: 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 FTSE All Share	4.0	6.2	7.1	15.1	41.7	85.1	60.5
NAV relative to FTSE All Share	(0.2)	2.8	13.7	20.9	40.9	73.3	63.2
Price relative to FTSE SmallCap Index	4.1	8.8	12.3	28.1	57.8	95.3	52.8
NAV relative to FTSE SmallCap Index	(0.1)	5.3	19.1	34.6	56.8	82.8	55.4
Price relative to STOXX Europe Small 200 Index	6.1	7.1	3.8	16.0	30.9	51.4	38.2
NAV relative to STOXX Europe Small 200 Index	1.9	3.6	10.1	21.8	30.1	41.7	40.6
Price relative to STOXX Europe 600 Technology Index	6.3	9.8	2.2	12.7	22.9	28.3	20.0
NAV relative to STOXX Europe 600 Technology Index	2.0	6.3	8.4	18.4	22.2	20.1	22.0
Price relative to FTSE techMark Focus Index	5.0	3.6	(1.4)	1.7	32.8	44.7	(12.9)
NAV relative to FTSE techMark Focus Index	0.8	0.2	4.7	6.8	32.1	35.4	(11.4)

Source: Refinitiv, Edison Investment Research. Note: Data to end-September 2019; geometric calculation.

HGT is also outperforming the above equity indices on a risk-adjusted basis, as illustrated by the Sharpe ratios presented in Exhibit 13.

**Exhibit 13: Sharpe ratios for HGT and selected equity indices**

Time period	HGT price	HGT NAV	FTSE All-Share	FTSE Small Cap	STOXX Europe Small 200	STOXX Europe 600 Technology	FTSE techMark
1 year	1.09	1.66	0.17	-0.77	0.08	0.24	1.11
3 years	1.40	1.76	0.64	0.26	0.89	0.80	0.75
5 years	1.28	1.60	0.65	0.52	1.04	0.95	0.97
10 years	0.82	1.16	0.65	0.52	0.57	0.60	1.19

Source: Refinitiv, Edison Investment Research. Note: Based on monthly data at end-September 2019.

## Discount: Trading close to NAV

Over the last 10 years, HGT's shares have traded at an average discount to NAV of c 10%, occasionally moving deeper into the double-digit discount territory, which has usually coincided with major UK stock market corrections (such as the December 2018 correction). Subsequently, however, the discount has narrowed relatively quickly (see August 2019). Over the last two to three years, the discount has generally remained within 0–10%, with a few instances when shares traded at a single-digit premium, which is currently the case (1.3% premium).

**Exhibit 14: Share price discount to NAV over 10 years (diluted at par)**


Source: Refinitiv, Edison Investment Research

## Capital structure and fees

HGT pays a priority profit share corresponding to a base management fee that is specific to each of the Hg funds and calculated in respect of either HGT's commitments to or capital invested alongside the respective Hg fund (see our [initiation note](#) for further details). HGT's LTM priority

profit share (between end-June 2018 and end-June 2019) was £11.1m and equalled c 1.4% of HGT's average NAV in the period (vs £11.7m and 1.5% in FY18, respectively).

HGT is charged a performance fee in the form of carried interest payable to Hg's investment manager once a certain level of repayments has been made to HGT. The company's investments alongside Hg Saturn are subject to a carried interest at 12% of aggregate profits after the repayment of capital invested by HGT (and the priority profit share) and a preferred return of 8% per year, which increases to 20% once the fund's performance surpasses a preferred return of 12% per year (with full catch-up). The company's investments alongside all remaining Hg funds are subject to a carried interest at 20% of aggregate profits after the repayment of capital invested by HGT (and the priority profit share) and a preferred return of 8% per year. In FY18, the company recognised a net-carried interest charge of £14.4m (equating to c 2% of its average NAV in 2018). In cash terms, HGT paid £55.0m in carried interest in FY18. However, it must be noted this was paid on sizeable realisations (based on several years of accumulated profits), generating £271.8m in gross proceeds (vs a 10-year average value of gross proceeds from realisations at c £108m). Moreover, it is important to highlight the 14.3% NAV total return in FY18 was already net of carried interest.

Neither the priority profit share nor carried interest is applicable to any co-investment made alongside Hg5, Hg6, Hg Mercury, Hg Genesis 7, Hg Mercury 2, Hg Genesis 8 and Hg Saturn in excess of the company's pro rata commitment. These investments yielded a 1.8x multiple on cost so far and at end-December 2018 represented 14% of HGT's NAV. It is also important to note that, apart from the administration fee of 0.1% per year on the company's NAV, there are no separate fees charged at the HGT level. Together with other operating expenses (such as legal and audit expenses or directors' remuneration), HGT's LTM total ongoing charges as a percentage of NAV at end-June 2019 were 1.7% compared to 1.9% in FY18 amid broadly stable total operating expenses of c £2.5m coupled with an increase in average NAV.

In terms of leverage, the company had no borrowings at end-June 2019. Last year, HGT extended its £80m multi-currency revolving credit standby facility, which will expire on 30 June 2022 and remained undrawn. The interest rate on the amount drawn from the facility stands at LIBOR plus a margin of 2.15%. HGT pays a commitment fee on the undrawn part of the facility of 0.9% per year. The company may add a further £80m to the facility subject to the bank's approval.

HGT may make tactical use of the above-mentioned credit facility to fully exploit investment opportunities across the investment cycle. The company anticipates it will enter new commitments at the beginning of FY20. HGT usually applies leverage at its underlying investment level, which is serviced using the entity's own cash flows. The average net debt to LTM EBITDA ratio across the company's top 20 holdings was 6.2x at end-September 2019 versus 5.6x at end-2018. The number is somewhat higher than the median (gross) debt to EBITDA ratio for global PE deals in 2018 at 5.5x, according to McKinsey Global Private Markets Review 2019 (based on PitchBook data). It is important to note that the good visibility associated with a high proportion of recurring revenues generated by HGT's portfolio companies allows for a higher leverage level in comparison to some other sectors where other PE funds invest.

HGT completed a 1:10 share split on 28 May 2019, which resulted in a rise in number of shares by 335.9m from 37.3m at end-December 2018. The aim was to attract more investors and improve the company's trading volume. Moreover, the company conducted a £63.2m capital increase in June 2019, issuing 29.4m shares at a price of £2.15 each. In November and December 2019, HGT completed five minor share issues at £2.53 per share (issuing of 3.6m shares in total) under its block listing facility, raising gross proceeds of c £9.0m.

## Dividend policy and record

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HGT does not follow an official dividend policy as it is primarily a long-term capital appreciation vehicle rather than an income trust. Still, since 2016 it has aimed to pay out an annual dividend of at least 4.6p per share (adjusted for the recent stock split). For 2018, the company paid an interim dividend of 1.6p per share and a final dividend at 3.0p per share. In October 2019, HGT paid out an interim dividend of 1.8p per share, which translates into an LTM dividend yield of 1.9%. Interestingly, HGT designates (where possible) all dividends as interest distributions, which are treated as a tax deduction against taxable income. The company aims to increase dividends if the market environment remains favourable. That said, HGT's annual distributable income may be subject to some variation, depending on returns on the liquid resources and realisations.

## Peer group comparison

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Although HGT's specialisation in the software and services sectors makes it difficult to select comparable listed PE companies, we have combined a set of potential peers (Exhibit 15). We consider Altamir to be HGT's closest peer among the selected companies, as it primarily invests through affiliated Apax funds and has a relatively high (and growing) exposure to the TMT sector (53% at end-June 2019). However, there are several differences compared to HGT including regional exposure (France is the main market), a significant position in non-tech sectors and an investment strategy that also covers growth capital.

Moreover, our peer group includes three PE funds that mostly follow a direct investment strategy in the buyout market (NB Private Equity Partners, Oakley Capital Investments and Princess Private Equity), although none has a focus on the technology sector. There are also certain differences in terms of regional split; for example, NB Private Equity invests mostly in North America, whereas Oakley has 23% of its portfolio in the German-speaking (DACH) region. Finally, we have added three PE players that are mainly funds of funds (BMO Private Equity, ICG Enterprise and Standard Life Private Equity), although we acknowledge they are more remote peers.

HGT has outperformed the peer group average in terms of NAV total return performance over one, three, five and 10 years. Importantly, it was also the top performer among the peer group over these horizons. At the same time, we note that HGT is the largest in terms of market capitalisation in our peer group, which allows it to pursue larger deals. As highlighted earlier, HGT's LTM total ongoing charge ratio was 1.7%, which is broadly in line with the peer group. Interestingly, PE peers trade at a high single-digit to low double-digit discount to reported NAV, as opposed to HGT, which is traded at a slight premium. HGT's dividend yield of 1.9% is below the peer average of 3.6%.

**Exhibit 15: Comparison of HGT vs peers**

	Form of investments	Strategy by stage/size	Sector exposure	Regional exposure
<b>HgCapital Trust</b>	Direct through Hg's funds and co-investments	Small-, mid- and large buyouts	Software and tech-enabled services	UK (31%), North America (19%), Scandinavia (27%), Germany (15%), Other Europe (8%)
<b>Altamir</b>	Alongside Apax Partners SAS and Apax Partners LLP, occasionally co-investments	Buyouts / growth capital	At end-June 2019: TMT (53%), Services (22%), Consumer (20%), Healthcare (5%)	At end-June 2019: France (32%), Other (68%)
<b>NB Private Equity Partners</b>	Predominantly direct equity investments (86% of portfolio as at end-October 2019)	Buyouts	At end-October 2019: IT (21%), Industrials (14%), Healthcare (16%), Consumer Discretionary (16%), Business Services (13%), Financial Services (9%), Comm. / Media (6%), Energy (2%), Transport (2%)	At end-October 2019: North America (76%), Europe (20%), Asia / RoW (4%)
<b>Oakley Capital Investments</b>	Investments in the Oakley Capital Private Equity funds and through co-investments (NAV split at end-June 2019: Oakey Fund investment – 49%, Debt and Equity co-investment – 36%, Cash and other assets/liabilities – 15%)	Buyouts in the high-growth mid-market	At end-June 2019: Consumer (38%), TMT (31%), Education (31%)	At end-June 2019: DACH (23%), UK (23%), North America (15%), Italy (15%), France (8%), Spain (8%), Norway (8%)
<b>Princess Private Equity</b>	Direct private equity investments, as well as co-investments with other managers and direct senior or subordinated investments. Direct investments represented 91% of portfolio at end-September 2019	Predominantly small- and mid-market buyouts (61% at end-September 2019)	At end-September 2019: Consumer discretionary (36%), IT (15%), Healthcare (13%), Consumer staples (8%), Industrials (7%), Financial (9%), Materials (6%), Energy (3%), Utilities (2%), Telecom (1%)	At end-September 2019: Europe (53%), North America (33%), Asia-Pacific (7%), RoW (7%)
<b>BMO Private Equity</b>	Fund of funds (58%) and direct co-investments (42%)	Predominantly buyout funds, but also a small proportion of venture capital and mezzanine funds	N/A	At end-December 2018: UK (47%), Europe (35%), US (16%), Global (1%), Emerging (1%)
<b>ICG Enterprise</b>	Fund of funds and direct. ICG-managed (21.4% at end-July 2019), third-party direct co-investments (16.7%), third-party secondary (4.6%), third-party primary (57.3%)	At end-July 2019: large buyouts (47.6%), mid-market buyouts (43.9%), small buyouts (5.3%), other (3.3%)	At end-July 2019: Healthcare and education (22.1%), Industrials (20.3%), Consumer goods and services (14.3%), Business services (13.5%), TMT (12.7%), Leisure (8.1%), Financials (5.8%), Other 3.2%	At end-July 2019: Continental Europe (37.3%), UK (29.3%), North America (29.3%), RoW (4.1%)
<b>Standard Life Private Equity</b>	Fund of funds. At end-March 2019: primary buyout funds (85%), buyout funds acquired via secondary market (13%), co-investments (1%), other funds (1%)	Buyouts, in particular in the mid-market	At end-March 2019: Industrials (21%), Consumer Services (20%), Healthcare (16%), Consumer goods (14%), Tech (14%), Financials (10%), Other (5%)	At end-March 2019: Scandinavia (16%), France (17%), Benelux (16%), UK (14%), North America (13%), Germany (10%), Other (14%)

Source: Company data, Edison Investment Research

**Exhibit 16: Peer group comparison at 15 December 2019**

	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge (%)*	Perf. fee	Net gearing	Dividend yield (%)
<b>HgCapital Trust</b>	1,025.6	24.1	71.4	140.7	260.8	1.3	1.7	Yes	90	1.9
Altamir	510.4	18.8	32.3	95.0	166.2	(31.6)	2.9	No	100	4.7
BMO Private Equity Trust	268.4	9.5	35.5	77.5	160.8	(5.5)	1.2	Yes	114	3.9
ICG Enterprise Trust	676.4	14.7	52.6	92.2	236.3	(16.1)	1.9	Yes	94	2.1
NB Private Equity Partners	516.0	5.6	28.9	96.9	N/A	(23.2)	2.8	Yes	N/A	3.6
Oakley Capital Investments	513.6	23.3	54.6	74.0	165.9	(18.7)	0.8	Yes	85	1.8
Princess Private Equity	600.2	11.8	39.5	83.7	179.0	(12.1)	1.7	Yes	96	5.7
Standard Life Private Equity	527.3	6.8	40.1	96.5	220.5	(20.5)	1.1	No	86	3.2
<b>Average (excl. HG Capital)</b>	<b>516.0</b>	<b>12.9</b>	<b>40.5</b>	<b>88.0</b>	<b>188.1</b>	<b>(18.3)</b>	<b>1.8</b>	<b>N/A</b>	<b>96</b>	<b>3.6</b>
<b>HGT's rank in sector</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>5</b>	<b>N/A</b>	<b>5</b>	<b>7</b>

Source: Morningstar, Edison Investment Research. Note: Performance to 30 September 2019. TR: total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. Ongoing charge excludes carried interest. \*Please note that in the case of some of the peers, the ongoing charge may not fully capture the charges levied on the underlying funds.

## The board

HGT's board consists of six non-executive directors, all of whom are independent from the investment manager. One board member (Mark Powell) retired in April 2018, whereas two new

directors (Jim Strang and Guy Wakeley) joined the board in March 2018. Jim Strang leads the business in the EMEA region for the PE firm Hamilton Lane and has more than 15 years of experience across the PE market and deal structures. Guy Wakeley is the CEO at Equiniti Group, a provider of processing, share dealing and payments platforms and services to large businesses in UK and the US. He brings additional expertise in understanding the tech and tech-enabled businesses, as well as international M&A and large-scale operational leadership and transformation to HGT's board. The company's chairman is Roger Mountford who has been on HGT's board since 2004. He is a former managing director in the corporate finance department of Hambros and worked as corporate treasurer of a global communications company. The remaining three board members are Richard Brooman (chairman of the audit and valuation committee), Peter Dunscombe (chairman of the management engagement committee) and Anne West (who is senior independent director).

Richard Brooman was a qualified chartered accountant with Price Waterhouse with prior experience at Mars (where he held senior operational and financial positions) and SmithKline Beecham (as CFO of the global consumer healthcare business), as well as VCI (group finance director) and Sherwood International (CFO). He has served on HGT's board since 2007. Peter Dunscombe has experience in senior management positions of several pension funds, such as the Imperial Tobacco pension fund and the BBC Pension Trust. He has been on HGT's board since 2014. Anne West joined HGT's board in 2014 after a career as equity investment manager at Cazenove Capital Management, where she spent 23 years and rose to the position of CIO. Anne has significant experience in the wealth management sector, providing the board with insights into the decision-making process of the company's shareholders and potential investors.



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