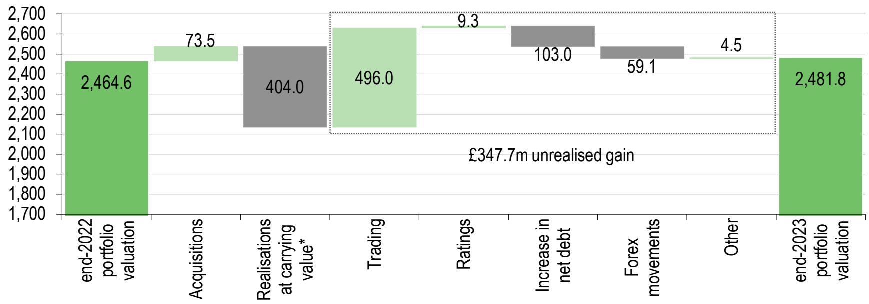
HgCapital Trust

Strong earnings growth and realisations in FY23

HgCapital Trust (HgT) posted an 11.1% NAV total return in FY23 (based on final audited numbers), which allowed it to sustain strong five- and 10-year returns of 20.4% and 18.4% pa, respectively. This has been mostly driven by robust earnings momentum across its portfolio. HgT defied the tough private equity exit environment, generating £345.9m of total realisation proceeds excluding carried interest in FY23. Moreover, it has a healthy commitment coverage ratio of 73% (based on current pro forma figures). The market has rewarded HgT through a narrowing discount to NAV, which now stands at c 6% (vs c 22% at end-2022).

HgT's FY23 return primarily supported by portfolio earnings momentum



Source: HgCapital Trust. Note: *based on end-2022 carrying values and gross of carried interest.

Secular digitalisation trend continues

HgT's portfolio has benefited from the structural trend towards digitalisation of business processes for many years now, with accelerated adoption following the COVID-19 pandemic. According to Hg's (HgT's investment manager's) head of research, software spending continues to grow significantly, even in advanced economies (where IT spending in relation to GDP is already high versus less developed countries), suggesting that the sector will not reach saturation any time soon. This seems to agree with Gartner's forecast, released in January 2024, of global software spending growth of 12.7% in 2024 after 12.4% in 2023, as enterprises prioritise spending to capture a competitive edge through increased productivity, automation and other software-driven transformation initiatives.

Strong organic EBITDA growth in 2023

Hg highlighted that sales and EBITDA growth across HgT's top 20 holdings was 25% and 30% in 2023, respectively. This included 19% organic EBITDA growth, ahead of the 12% posted by listed US software and services businesses, which Hg believes was due to higher emphasis on margin and the superior quality of HgT's portfolio compared to the average listed US software and service company. As this translated into an average margin of 31% across the top 20 holdings, HgT's portfolio continues to fulfil the 'Rule of 40' (see our previous note for details). Growth was further assisted by high 'buy-and-build' activity, which benefited earnings growth and supported returns through a considerable multiples arbitrage.

Investment trusts
Private equity funds

22 March 2024

Price	**468.5p**
Market cap	**£2,144m**
NAV	**£2,291m**
NAV per share*	500.5p
Discount to NAV	6.4%

*At end-2023.

Yield		1.4%
Shares in issue		458.1m
Code/ISIN		HGT/GB00BJ0LT190
Primary exchange		LSE
AIC sector		Private equity
52-week high/low	468.5p	320.5p
NAV high/low	500.5p	450.9p

Gearing

Net gearing at end-H123	0.0%

Fund objective

HgT's investment objective is to provide shareholders with consistent long-term returns in excess of the UK All-Share Index by investing predominantly in unquoted companies where value can be created through strategic and operational change.

Bull points

- Focus on resilient software and services companies with broad client bases.
- Portfolio companies continue to deliver both solid top- and bottom-line performances.
- Experienced investment team with a strong long-term track record.

Bear points

- Investor rotation away from tech could resume in the event of increasing risk aversion.
- The impact of a worsening macroeconomic environment on SMEs may result in reduced net client additions across HgT's portfolio.
- High net leverage of portfolio companies (7.4x EBITDA for top 20 holdings on average) but supported by high share of recurring revenues, strong earnings growth and high cash generation.

Analysts

Milosz Papst	+44 (0) 20 3077 5720
Katherine Thomson	+44 (0) 20 3077 5720

investmenttrusts@edisongroup.com

Edison profile page

HgCapital Trust is a research client of Edison Investment Research Limited

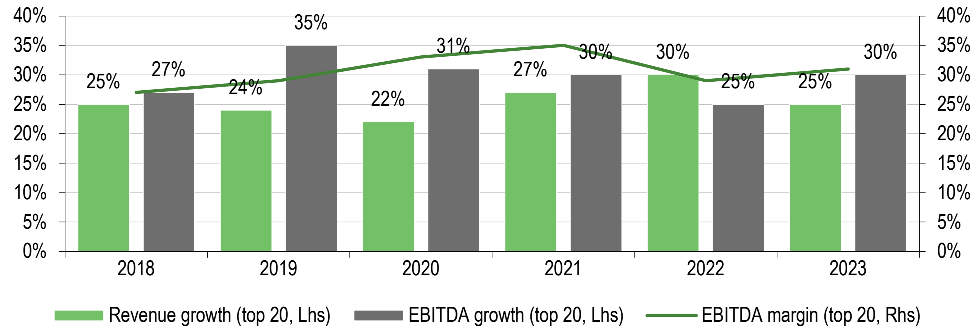
Earnings growth remains key return driver

Organic growth of top 20 holdings above listed software sector

HgT posted an 11.1% NAV total return (TR) in FY23, which was mostly driven by sustained strong earnings growth across its portfolio (resulting in £496m of unrealised gains in FY23, or c 20% of opening portfolio value). Its top 20 holdings recorded last 12-month (LTM) revenue and EBITDA growth of 25% and 30% in 2023, respectively. Importantly, organic EBITDA growth across the portfolio was a high at 19% in 2023 (even above the c 10–15% pa historically on average according to Hg), assisted primarily by cross- and up-selling, and to a lesser extent new SME client wins (as CIOs of companies, including SMEs, have become more cautious in terms of new initiatives/technology partners lately, as noted by Gartner). Growth across HgT's portfolio was ahead of the 12% organic EBITDA growth for listed US software and service businesses (according to Hg based on FactSet data). Hg believes that this is due to a higher emphasis on margin and a better quality of holdings on average versus the US software and service sector.

We note that this solid earnings growth was achieved at an average 31% EBITDA margin across HgT's top 20 holdings (vs 29% in 2022, see Exhibit 1). This means that HgT's portfolio continues to fulfil the 'Rule of 40' (ie displaying combined revenue growth and an EBITDA margin above 40%), which warrants a valuation premium versus the broader private IT sector (see our previous note for details). The average net debt to EBITDA across HgT's top 20 holdings stood at 7.4x at end-2023 (down from 8.0x at end-2022), with an equity cushion of more than 70%. We also note that interest on 75% of the debt is hedged for an average duration of 1.7 years.

Exhibit 1: LTM revenue and EBITDA growth across HgT's top 20 holdings

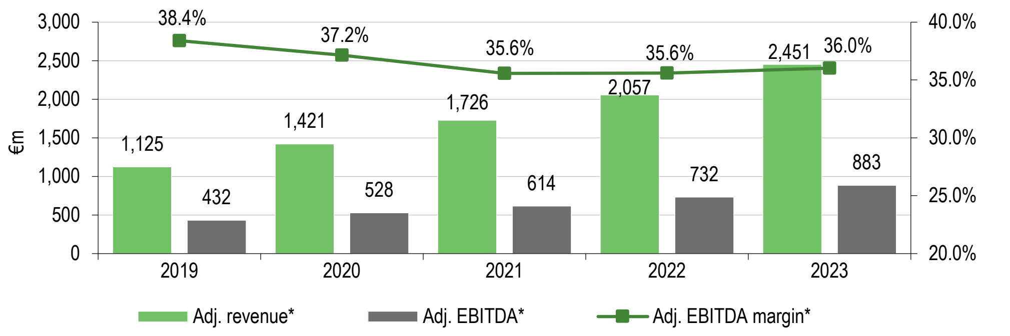


Source: HgT

Longtime portfolio holdings also delivering good results

HgT's top 20 holdings change over time, as it constantly refreshes its portfolio through realisations and new investments. That said, the recent superior earnings momentum across its portfolio also applies to companies that HgT has held for many years now (even beyond the usual private equity holding period of three to five years). One of the best examples here is Visma, which under Hg's 17-year ownership (mostly as lead sponsor or co-lead investor) has achieved organic revenue growth of 15% pa at an EBITDA margin of 28%+ (see Visma's five-year results in Exhibit 2). Despite being on a high-growth path for several years now, Visma posted increases in revenue and EBITDA of 17% and 24% y-o-y in Q423, respectively. Visma's management considers the growth in earnings above top-line momentum as confirmation of its good business scalability. Its LTM cash conversion to end-2023 was 99.7%, and Hg noted that the share of recurring revenue is now 90% (which is common among HgT's holdings), with 80% coming from software-as-a-service (SaaS) solutions. Visma will make up c 12.5% of HgT portfolio value after recent follow-on investment. HgT is well-positioned to run winners for longer thanks to the tiered suite of private funds managed by Hg (which HgT invests through), covering the small-cap Mercury funds, the mid-cap Genesis funds and the large-cap Saturn funds.

Exhibit 2: Visma's historical results

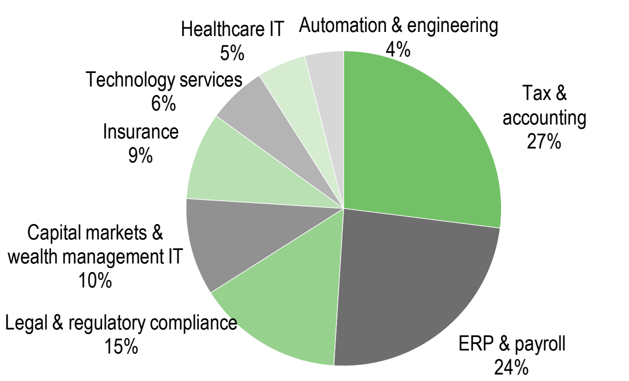


Source: Hg, Edison Investment Research. Note: *Adjusted for the divesture of Opic and TendSign in 2020, Consulting (2022) and Cloud Infrastructure Services (2022).

Well-positioned to further benefit from corporate digitalisation

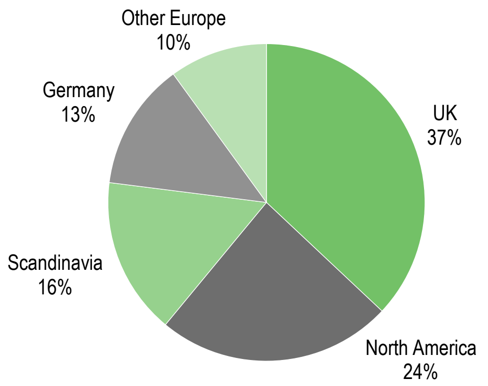
HgT's portfolio companies continue to be supported by the secular corporate digitalisation trend and the associated adoption of SaaS solutions by SMEs. According to Gartner's forecasts released in January 2024, global spending on software and IT services will grow by 12.7% and 8.7% in 2024, respectively (after increasing by 12.4% and 5.8% in 2023, respectively). Hg's focus on strong players within selected clusters has likely contributed to the good earnings momentum, with the largest clusters in HgT's portfolio currently being tax & accounting, ERP & payroll, as well as legal & regulatory compliance (see Exhibit 3).

Exhibit 3: HgT's portfolio by cluster



Source: HgT

Exhibit 4: HgT's portfolio by region

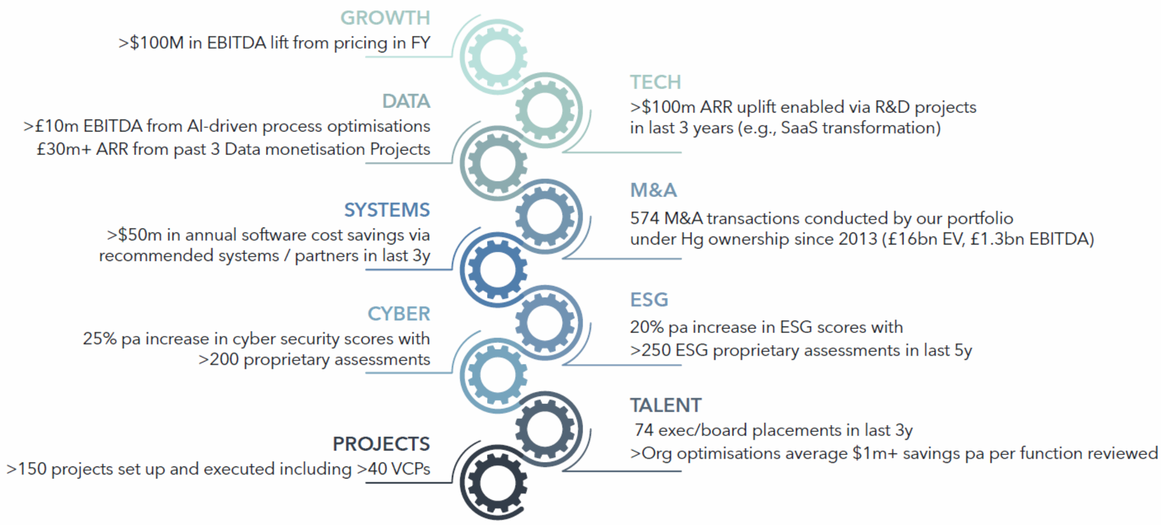


Source: HgT

Software sector expertise paying off

We believe that HgT's healthy long-term performance also comes from Hg's value creation capabilities. Hg significantly expanded its specialist portfolio team to more than 85 in 2023 from 47 in 2022. It consists of, among others, board advisors, serial chairs and operating partners, as well as specialists across areas such as data and analytics, HR and talent, technology, growth, value creation projects, legal, ESG, finance and financial planning and analysis. Hg highlighted multiple tangible effects of the activities undertaken by its team (see Exhibit 5).

Exhibit 5: Hg's value creation impact



Source: HgT

Running at more than twice the usual bolt-on pace

The above-mentioned EBITDA growth also comes from M&A activity (ie bolt-on acquisitions performed by HgT's portfolio holdings, ie its 'platform' investments). Hg has a healthy pipeline of acquisition targets and its portfolio is running at over twice the usual rate of more than 100 bolt-on acquisitions per year. The manager indicated that there is less competition for these smaller businesses from some types of acquirers (eg venture capital firms).HgT's portfolio companies have been recently executing bolt-on acquisitions at half the multiple at which the former are valued by Hg on average, providing significant benefits in terms of multiples arbitrage.

Despite the expanding multiples of listed peers last year (with median EV/sales and EV/EBITDA for US SaaS businesses up from c 5x to 6x and from c 25x to 26x, respectively), the contribution from multiples expansion to HgT's FY23 returns was negligible (£9.3m of unrealised gains). This is partly because HgT values its portfolio holdings based on blended public and private M&A multiples, with the latter being less volatile that public multiples both to the upside and to the downside.

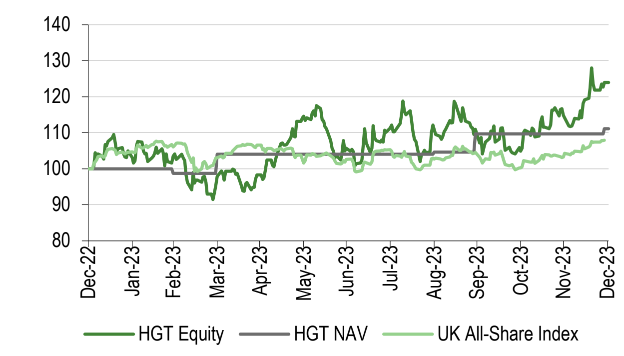
The positive contribution from earnings growth was partly offset by an increase in net debt (£103m unrealised valuation loss in FY23), mostly to fuel the 'buy-and-build' strategy. During the FY23 earnings call, Hg highlighted that most of its portfolio companies can maintain the strong bolt-on activity this year based on their balance sheet headroom and potential follow-on investments from Hg-managed funds (including HgT).

Considerable outperformance of listed small caps

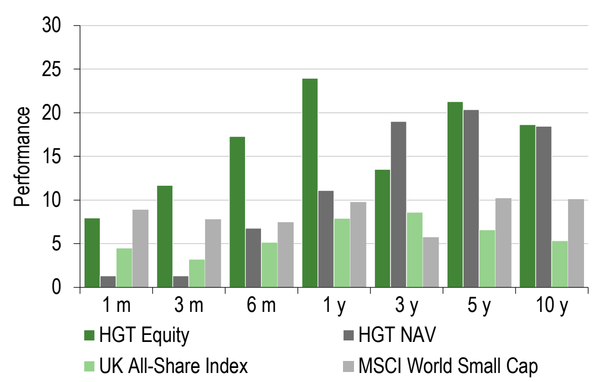
HgT's solid FY23 results allowed the trust to maintain its strong mid- and long-term track record, with five- and 10-year NAV TRs of 20.4% and 18.4% pa, respectively (which was broadly matched by its share price total return of 21.7% and 18.8% pa, respectively). This is significantly ahead of the five-year and 10-year total returns posted by the MSCI World Small Cap Index of 10.2% and 10.1% pa, respectively, and represents an even greater outperformance of the UK All-Share Index, which posted returns of 6.6% and 5.3% pa, respectively (see Exhibit 6). Importantly, this was achieved at a loss ratio (ie percentage of invested capital realised below initial cost) of a mere c 1%, with 98% of HgT's current portfolio being held above cost. Around 90% of investments realised by Hg over its more than 20-year track record to end-September 2023 (adjusted for events post period end) yielded a multiple on invested capital (MOIC) above 2x and an internal rate of return (IRR) above 20%. Overall, Hg achieved a historical MOIC and IRR on full and partial exits of more than 3x and 32%, respectively. HgT has also been the top performer across the listed private equity (PE) space over one and 10 years, and achieved the second-best result over five years (see Exhibit 8). We believe that this demonstrates the consistency of HgT's returns over time.

Exhibit 6: HgT's performance to 31 December 2023 in sterling terms

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



Price, NAV and benchmark total return performance (%)



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

Exhibit 7: HgT's discrete performance versus selected indices in total return, sterling terms (%)

12 months ending	HgT's NAV	HgT's share price	MSCI Europe Small Cap Index	UK All-Share Index
31/12/19	20.8	47.5	21.9	19.2
31/12/20	24.0	21.6	12.9	(9.8)
31/12/21	43.9	39.8	17.3	18.3
31/12/22	5.4	(15.6)	(8.1)	0.3
31/12/23	11.1	24.0	9.8	7.9

Source: LSEG, Edison Investment Research

Exhibit 8: HgT versus listed private equity peers at 21 March 2024*

% 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 (%)
HgCapital Trust	**2,144**	**11.1**	**68.6**	**152.6**	**438.7**	**1.7**	**Yes**	**(6.4)**	**100.0**	**1.4**
HarbourVest Global Priv Equity	1,801	(1.6)	70.3	117.7	368.5	1.2	No***	(40.6)	100.0	0.0
Pantheon International	1,507	2.3	54.4	81.7	266.1	1.3	Yes	(33.9)	100.0	0.0
ICG Enterprise Trust	806	3.8	65.4	104.5	250.8	1.5	Yes	(38.3)	108.4	2.7
abrdn Private Equity Opportunities	816	5.1	66.7	103.3	301.4	1.1	No	(30.4)	106.9	2.3
CT Private Equity Trust	316	1.6	98.4	125.9	284.7	1.2	Yes	(37.7)	111.9	6.4
Apax Global Alpha	713	2.0	19.9	70.5	N/A	1.8	Yes	(36.0)	100.0	7.8
NB Private Equity Partners	747	(1.9)	47.0	84.2	291.8	1.9	Yes	(30.8)	105.2	5.0
Princess Private Equity	635	(0.5)	14.6	53.8	194.9	1.7	Yes	(24.7)	104.1	6.8
Altamir	764	(0.1)	21.5	83.1	233.7	3.3	No	(31.2)	100.0	4.4
Oakley Capital Investments	791	4.0	73.7	155.6	275.6	2.8	Yes	(34.4)	100.0	0.5
Simple average (excl HgCapital)	**890**	**1.5**	**53.2**	**98.0**	**274.2**	**1.8**	**-**	**(33.8)**	**103.6**	**3.6**
HgT rank in peer group	1	1	4	2	1	5	-	1	6	8

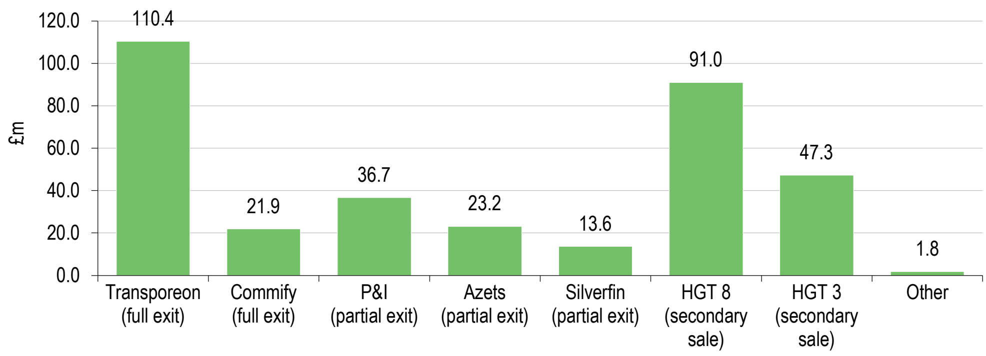
Source: LSEG, Edison Investment Research. Note: Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared). *12-month performance based on ex-par NAV as at end-December 2023, except for ICG Enterprise Trust (end-October 2023). **Based on last published annual report, excludes look-through expenses at the underlying funds level.*** No performance fee is charged at the HVPE level, but it is charged on the HarbourVest secondary and direct funds.

Healthy realisations despite tough PE exit markets

In a difficult market environment, characterised by low PE exit activity, Hg put an emphasis on cash returns, generating strong total realisations of £345.9m in FY23 or c 17% of opening NAV (£323.8m net of carried interest) , despite the significant decline in global PE exit activity in 2023 (down 27% y-o-y and 66% from the 2021 peak, according to PitchBook data). Importantly, HgT continues to realise its investments at prices above previous portfolio valuations, which for full and partial exits in 2023 stood at a strong 25% on average (even if somewhat lower than the average 38% in 2017–22).

Realisations last year included £132.3m generated on the full exits of the cloud-based transportation management software platform Transporeon (at an uplift of 18% to carrying value, agreed in December 2022, sold to a trade buyer) and the business messaging solutions provider to local enterprises Commify (at a 32% uplift, sold to ECI Partners). Moreover, HgT completed the partial exits of P&I (with proceeds of £36.7m at a 25% uplift to end-2022 carrying value), Azets (£23.2m, at a 16% uplift to end-March 2023 carrying value) and Silverfin (£13.6m, sold to Visma). Finally, HgT completed a secondary sale of 25% of its limited partner position in Hg Genesis 8 (a 2017 vintage mid-market fund) for £91m at 100% end-December 2022 NAV (representing a healthy MOIC of 3.2x), with proceeds paid in two instalments on 31 March 2024 and 31 March 2025. It also agreed with Hg to reduce its commitment to Hg Saturn 3, which led to a £47.3m rebate of invested capital.

Exhibit 9: HgT's 2023 realisations



Source: HgT

HgT reported further realisations post the reporting date, which Hg expects to generate £191m of proceeds. This includes £48m from the full exit from Argus Media (at uplifts of 7% and 15% to end-September 2023 and end-2022 carrying values, respectively), £82m from GGW Group (at a 40% uplift to end-September 2023 carrying value, though £44.2m will be reinvested in the same business), as well as £42.1m net proceeds from the partial realisation of IRIS (valued in line with end-September 2023 carrying value, but c 14% above the end-2022 value). Moreover, in January 2024, Hg completed the sale of the 'MeinAuto' and 'Mobility Concept' divisions of the MeinAuto Group to Mobilize Lease & Co, a subsidiary of Mobilize Financial Services, part of the Renault Group, for £11m. Following the transaction, Hg continues to hold an investment in Athletic Sport Sponsoring, a German flat-rate car subscription provider. Finally, HgT will receive £8m from the partial sale of TeamSystem (agreed in August 2023), with the transaction valuing the holding at £33.3m (a c 68% uplift to end-March 2023 carrying value). We believe that overall, the FY23 realisations and recently announced deals are a testament to the quality of the trust's portfolio and its conservative valuation approach, particularly in light of the materially lower realisation activity reported across the private equity sector as a whole.

Cautious investment activity but picking up recently

HgT was quite cautious in terms of new investments, with a modest £73.5m (3% of opening NAV) spent in FY23. This includes three new investments totalling £28.6m in GTreasury (a US-based treasury, payments and risk management software provider), JTL (a German ERP software provider specialising in e-commerce enablement solutions) and Nomadia (a SaaS provider of smart mobility solutions). HgT also made follow-on investments in its existing portfolio companies: Septeo, P&I, GGW Group, Howden, Citation and Waystone.

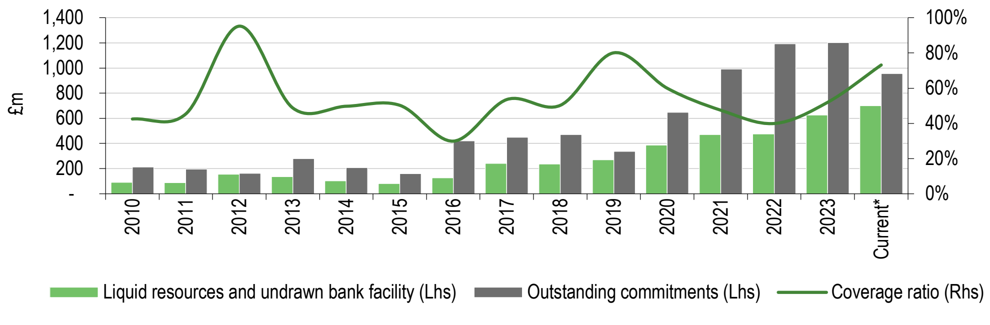
That said, Hg highlighted that an improving deal environment lately is supportive of increased investment activity in 2024. HgT announced several further transactions in late 2023 and 2024 to date, which Hg expects will represent over £200m investments in FY24. This includes a £13.6m new investment in CINC Systems (a cloud-based software business serving the community association management sector), as well as a £6.7m investment in Induver and Clover (two independent corporate insurance brokers in Belgium, which will be merged). Moreover, HgT announced in December 2023 a c £83.5m follow-on investment in Visma (which will bring the company's share in HgT's portfolio value to 12.5% vs 8.7% at end-2023), as well as the above-mentioned £44.2m reinvestment into GGW Group (a European insurance brokerage platform) to power its next phase of growth. We note that Hg normally targets eight to 16 new platform investments per year, with a similar number of liquidity events (ie full or partial exits, and refinancings).

Maintaining a safe level of balance sheet headroom

HgT made new investment commitments of £183m to Hg funds in FY23. Its pro-forma commitments currently stand at £957m, which is 73% covered by cash and equivalents (£325m) and the undrawn credit facility (£375m, recently upsized from £350m), see Exhibit 10. We also note that the maturity of HgT's credit facility was extended to three years (ie until March 2027). We consider this commitment coverage ratio a safe level given that these outstanding commitments should be drawn gradually over the next three to four years, and they will at least partly be financed by further realisations in the coming years.

We believe that this provides HgT with good headroom for further co-investments, as it aims to increase the share of co-investments in its portfolio from the current c 5% to 10–15% over the medium term. Co-investments offer greater flexibility in terms of capital deployment (as they are done on a case-by-case basis and capital is deployed faster), leading to higher capital efficiency and easier balance sheet management. Moreover, Hg does not charge any fees on HgT's co-investments alongside Hg's funds, translating into a lower ongoing charges ratio.

Exhibit 10: HgT's commitment coverage ratio



Source: HgT, Edison Investment Research. Note: *Pro-forma figures adjusted for all announced transactions, currency movements, post-period increase of credit facility and the dividend to be paid in May 2024.

General disclaimer and copyright

This report has been commissioned by HgCapital Trust and prepared and issued by Edison, in consideration of a fee payable by HgCapital Trust. Edison Investment Research standard fees are £60,000 pa for the production and broad dissemination of a detailed note (Outlook) following by regular (typically quarterly) update notes. Fees are paid upfront in cash without recourse. Edison may seek additional fees for the provision of roadshows and related IR services for the client but does not get remunerated for any investment banking services. We never take payment in stock, options or warrants for any of our services.

Accuracy of content: All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of the research department of Edison at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

Exclusion of Liability: To the fullest extent allowed by law, Edison shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out or in connection with the access to, use of or reliance on any information contained on this note.

No personalised advice: The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.

Investment in securities mentioned: Edison has a restrictive policy relating to personal dealing and conflicts of interest. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report, subject to Edison's policies on personal dealing and conflicts of interest.

Australia

Edison Investment Research Pty Ltd (Edison AU) is the Australian subsidiary of Edison. Edison AU is a Corporate Authorised Representative (1252501) of Crown Wealth Group Pty Ltd who holds an Australian Financial Services Licence (Number: 494274). This research is issued in Australia by Edison AU and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. Any advice given by Edison AU is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

New Zealand

The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (i.e. without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision.

United Kingdom

This document is prepared and provided by Edison for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This Communication is being distributed in the United Kingdom and is directed only at (i) persons having professional experience in matters relating to investments, i.e. investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "FPO") (ii) high net-worth companies, unincorporated associations or other bodies within the meaning of Article 49 of the FPO and (iii) persons to whom it is otherwise lawful to distribute it. The investment or investment activity to which this document relates is available only to such persons. It is not intended that this document be distributed or passed on, directly or indirectly, to any other class of persons and in any event and under no circumstances should persons of any other description rely on or act upon the contents of this document.

This Communication is being supplied to you solely for your information and may not be reproduced by, further distributed to or published in whole or in part by, any other person.

United States

Edison relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. This report is a bona fide publication of general and regular circulation offering impersonal investment-related advice, not tailored to a specific investment portfolio or the needs of current and/or prospective subscribers. As such, Edison does not offer or provide personal advice and the research provided is for informational purposes only. No mention of a particular security in this report constitutes a recommendation to buy, sell or hold that or any security, or that any particular security, portfolio of securities, transaction or investment strategy is suitable for any specific person.