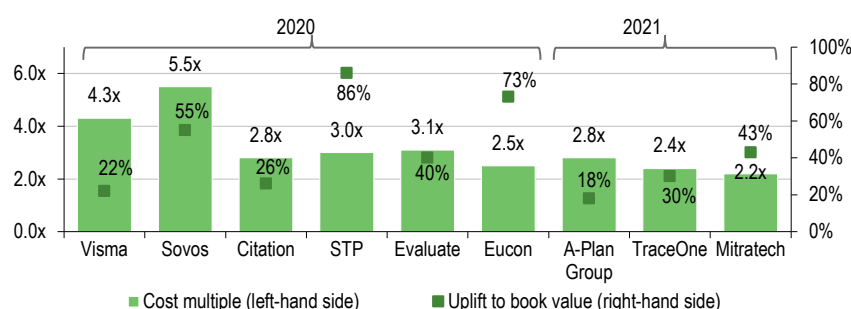


HgCapital Trust

Strong momentum continues

HgCapital Trust (HGT) posted a strong NAV TR of 8.4% in Q121, driven primarily by double-digit earnings growth across the portfolio (LTM EBITDA for top 20 holdings up 30% y-o-y). After record-high transaction volumes in FY20 (investments at £403m and realisations at £364m), HGT has maintained a high transaction activity to date in 2021 (£147m and £112m, respectively). Its coverage ratio was a healthy 69% at 12 May 2021, supported by tap equity issues, which totalled c £50m to 8 June 2021 (versus £25m in FY20), and a £200m credit facility agreed in Q420, which remains undrawn.

HGT's strong uplifts to book value on major exits in 2020 and 2021



Source: HgCapital. Note: Uplifts from 2020 and 2021 deals are versus book value at end-2019 and end-2020, respectively.

Why invest in HgCapital now?

HGT's portfolio companies continue to benefit from the ongoing digitalisation of the economy, accelerated recently by the pandemic. HGT's transaction activity has been high in 2021 to date and Hg (HGT's manager) expects further investment and liquidity events over the next 12 months. While valuations in the tech sector remain demanding, we believe that top sponsors such as Hg may still benefit from their strong financial positions, extensive deal origination networks, in-house value creation teams and the ability to pursue a 'buy-and-build' strategy.

The analyst's view

HGT focuses on the software and services sector, which has been one of the most sought-after industries (S&P 500 Software and Services index up 52% over the 12 months to end-March 2021). This has resulted in overall demanding public valuations. At the same time, HGT's shares are trading broadly in line with NAV (vs a c 20% average discount for PE peers, although in line with HGT's historical trading). However, we note that HGT's recent NAV TR has been mostly driven by earnings momentum across portfolio companies rather than public market multiples. Moreover, the company continues to report healthy uplifts to last carrying value on exits, suggesting a relatively conservative portfolio valuation policy. The broader software and services market remains supportive for HGT's portfolio, with the S&P 500 Software and Services Index (which historically has been a good valuation proxy for Hg's portfolio) up 7% since end-March 2021 to 8 June 2021.

Investment trusts Private equity funds

9 June 2021

Price 338.0p
Market cap £1,458m
NAV £1,438m

NAV* 336.3p

Premium to NAV 0.5%

*As at 31 March 2021.

Yield 1.5%

Ordinary shares in issue 431.4m

Code/ISIN HGT/GB00BJ0LT190

Primary exchange LSE

AIC sector Private Equity

52-week high/low 353.0p 230.0p

NAV* high/low 336.3p 236.3p

*Including income.

Gross gearing 13.9%

Net cash** £136m

*At 31 March 2021.

**Liquid resources at 12 May 2021

Fund objective

HgCapital Trust's investment objective is to achieve long-term capital appreciation by indirectly investing in unquoted companies. It does this through its investments in fund partnerships, mostly in the UK and Europe.

Bull points

- Focus on resilient software and services companies.
- Solid top- and bottom-line performance of portfolio companies.
- Experienced investment team with strong long-term track record.

Bear points

- High valuations in the software and services sector.
- Ample dry powder in the market translating into strong competition for quality assets.
- A significant increase in SME defaults may reduce net client additions across HGT's portfolio.

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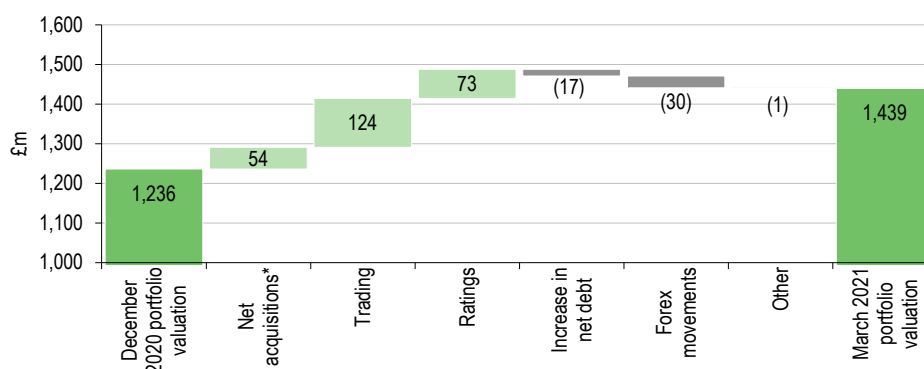
Performance driven by robust trading

HGT posted a strong 8.4% net asset value (NAV) total return (TR) in Q121, driven primarily by double-digit earnings growth across portfolio companies. HGT's top 20 investments (representing c 82% of HGT's portfolio) delivered last 12 months (LTM) EBITDA growth of 30% y-o-y at end-March 2021 (vs 31% at end-December 2020) and LTM sales growth of 20% y-o-y (22%), according to the manager. The average LTM EV/EBITDA for the top 20 investments increased slightly to 23.1x at end-March 2021 from 22.1x at end-2020, contributing to NAV TR in Q121, although to a lesser extent.

We believe that one of the value drivers in Q121 was MeinAuto (a German online car trader); its valuation increased significantly to c £89m at end-March 2021 (c 6.2% of HGT's NAV at this date) from c £39m at end-2020 (3.1%). MeinAuto announced in March 2021 its plans to list on the Frankfurt Stock Exchange. The IPO was initially scheduled for Q221, but the company decided to postpone it citing 'adverse market conditions for growth companies'. At the same time, we understand (based on MeinAuto's press releases) that it remains committed to listing on the Frankfurt Stock Exchange once market conditions stabilise.

Finally, the manager highlights that HGT's NAV TR in Q121 was supported by uplifts on exits, which included full realisations from A-Plan Group (£21.5m, with an uplift to last carrying value of 18%) and TeamSystem (£21.4m, uplift not available), as well as a refinancing at team.blue (£10.3m).

Exhibit 1: Changes in HGT's portfolio valuation between end-FY20 and end-Q121



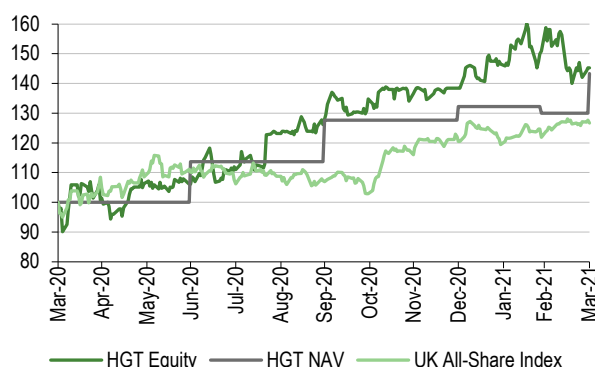
Source: Hg Capital. Note: *Net acquisitions is difference between acquisitions and disposals at last carrying value.

HGT's NAV TR was c 43% over 12 months to end-March 2021, which compares with a c 27% rise of the FTSE All-Share Index and a c 66% y-o-y increase of the LPX Europe Listed Private Equity Index (on a TR basis). We acknowledge that these growth rates were generated from a low base at end-March 2020 amid the COVID-19 outbreak. That said, HGT's NAV TR between end-December 2019 (pre-pandemic) and end-March 2021 was also healthy at c 27% versus a negative c 4% for the FTSE All-Share and a positive c 12% for LPX Europe Listed Private Equity Index over the same period.

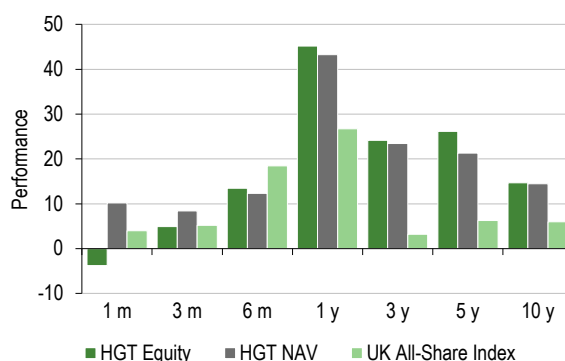
HGT's longer-term NAV TR, which is the best indication of private equity (PE) fund performance, has been visibly above the FTSE All-Share and LPX Europe Listed Private Equity Index, with the three-year NAV TR at c 23% (vs c 3% for FTSE All-Share and 11% for LPX Europe Listed Private Equity Index) and the five-year NAV TR to end-March 2021 at c 21% (c 6% and c 13%, respectively). HGT's NAV TR to end-March 2021 was above its peers over one, three, five and 10 years (Exhibit 2).

Exhibit 2: Investment trust performance to 31 March 2021

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



Price, NAV and benchmark total return performance (%)



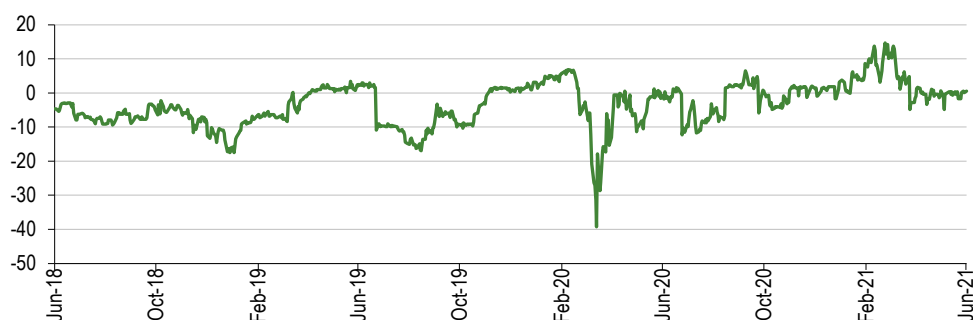
Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Exhibit 3: Selected peer group at 31 March 2021*

% 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	1,458.0	43.3	88.0	162.5	286.1	1.8	Yes	0.5	100	1.5
Altamir	753.5	20.1	56.8	132.8	257.4	2.7	No	(23.2)	100	4.5
ICG Enterprise Trust	733.1	22.5	53.1	109.3	210.8	1.5	Yes	(23.0)	100	2.3
Princess Private Equity	772.8	34.8	47.2	107.6	174.6	1.9	Yes	(11.9)	100	4.8
Standard Life Private Equity	685.7	26.1	47.2	96.5	189.2	1.1	No	(15.3)	100	3.0
NB Private Equity Partners	628.9	31.9	56.0	108.4	242.0	2.1	Yes	(24.8)	116	3.4
Oakley Capital Investments	617.7	18.2	71.6	116.2	157.4	2.5	Yes	(15.1)	100	1.3
BMO Private Equity Trust	303.2	22.7	52.6	98.2	192.2	1.3	Yes	(15.7)	115	4.0
Simple average (excl. HgCapital)	698.6	25.6	55.3	111.8	205.2	2.0	N/A	(18.9)	103	3.2
HGT rank in peer group	1	1	1	1	1	5	N/A	1	7	6

Source: Morningstar, Edison Investment Research. Note: TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared). *12-month performance based on latest available ex-par NAV: HGT, Princess Private Equity, NB Private Equity Partners, Standard Life Private Equity – end-March 2021; ICG Enterprise Trust – end-January 2021; Altamir, BMO Private Equity Trust, Oakley Capital Investments – end-December 2020.

HGT is currently trading broadly in line with its NAV compared to an average premium of c 6% in Q121. The narrowing premium to NAV since end-March 2021 followed a c 10% increase in NAV as at end-March 2021 compared with NAV at end-February 2021, coupled with a c 6% share price growth between end-March 2021 and 8 June 2021. Its current slight discount/premium to NAV is broadly consistent with HGT's historical trading (an average discount to NAV of c 3% over a period of three years to 8 June 2021). In the past the stock has only occasionally moved into double-digit discount territory, which is in general typical for PE investment companies. This has usually coincided with major UK stock market corrections, including the March 2020 market crash triggered by the COVID-19 pandemic, following which, however, the discount to NAV closed relatively quickly.

Exhibit 4: Share price discount to NAV over three years (%)


Source: Refinitiv, Edison Investment Research

Investments and realisations continue in 2021

After a record investment and realisation volume in 2020 (£403m and £364m in the period, respectively), HGT has invested a further £147m and generated £112m from exits so far in 2021. The latter figure includes a £21.4m realisation on TeamSystem, which should be considered a partial roll-over as the exit from the company by the Hg Genesis 6 Fund was coupled with a £14.3m investment in the company by the Hg Genesis 8 Fund. Since [our last review note](#) published on 31 March 2021, HGT announced a £12.6m investment in Dext (a provider of pre-accounting software), a £7.4m investment in AUVESY (a provider of version control software for smart production machinery and other industrial internet of things devices) and a minor £0.6m realisation from EidosMedia (a provider of enterprise content management software).

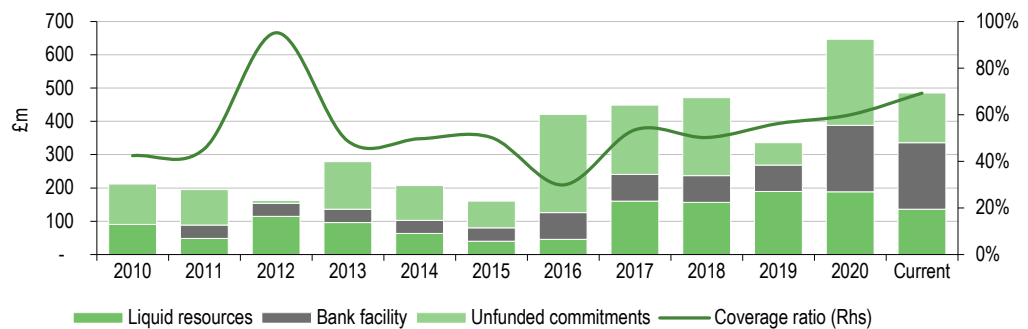
HGT continues posting significant uplifts on realisations (after 50% on average in 2020), with Mitrates's uplift at 43%, TraceOne's at 30% (both announced in March 2021) and A-Plan Group's at 18% (completed in Q121). Mitrates and TraceOne were disposed to other investment companies (Ontario Teachers' Pension Plan Board and Symphony Technology Group, respectively), while A-Plan Group was a trade sale to Hyperion (formerly Howden), an international insurance broking group. The latter is also a portfolio holding of HGT, which it invested in after the disposal of A-Plan Group. Over the past 10 years, the manager realised 54 investments, with an average uplift to last carrying value of 27%.

Exhibit 5: HGT's investments and realisations, 2006–21 to date*



Source: HgCapital Trust, Edison Investment Research. Note: *Last column with transactions and realisations announced to 8 June 2021 and cash as % of NAV at end-March 2021.

HGT's coverage ratio stood at a healthy 69% on 12 May 2021, compared with 60% at end-FY20 and c 50% on average between FY16 and FY20. Outstanding commitments were £485m and are likely to be invested over the next three to four years at a rate of c £150 pa. HGT's liquid resources at end-March 2021 (adjusted for all announced transactions and the dividend payable in May) reached £136m, with the company's £200m revolving credit facility remaining undrawn. HGT's liquidity position has been supported with a series of tap equity issues recently, with the total volume of c £50m in 2021 to 8 June 2021 (vs £25m in total in 2020).

Exhibit 6: HGT's historical coverage ratio


Source: HgCapital Trust, Edison Investment Research. Note: Last column at 12 May 2021, including all transactions announced to this date, the proposed final dividend of 3.0p per share and equity raised via tap issuance.

The manager expects further investment and liquidity events over the next 12 months. In a typical 12-month period, it makes between eight and 16 new platform investments and seeks to deliver similar numbers of liquidity events each year, including sales or partial sales of portfolio companies and refinancings (HGT completed or announced seven investments and five realisations in 2021 to date). Hg will maintain its cautious and selective approach and focus on 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 founders and management teams. Bolt-ons and strategic M&A within the portfolio remain a key focus.

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