HgCapital Trust plc

THE TRUST'S RATIONALE AND BUSINESS MODEL

AS AT 30 JUNE 2011

RATIONALE AND BUSINESS MODEL

The Board has a clear view of the rationale for investing in private equity through an investment trust and this informs its decisions on the operation of the Trust and the evolution of the Board's Business Model.

RATIONALE

The Board believes that there is a convincing rationale for investing in well-researched private businesses with potential for growth, especially where the Investment Manager and the management of the business can work together to implement strategic change or operational efficiency. These can result in higher rates of growth in sales and enhanced profits, offering investors capital gains on realisation. Many large institutional investors allocate a proportion of their assets to this asset class, but it is difficult for private investors and small institutions to invest in private equity due to the large commitments required over long periods of time. The Trust provides an opportunity for investors to hold shares listed on the London Stock Exchange through which they can invest in private equity transactions not otherwise accessible.

BUSINESS MODEL

Working within the constraints of the Trust's Investment Policy, the Board and the Manager have together developed a Business Model, which is kept under regular review. The Business Model evolves as market conditions change and new opportunities appear.

Asset class

The Trust invests directly into unquoted businesses in the UK and Continental Europe alongside other institutional clients of HgCapital, an experienced private equity manager whose principal business is to invest in, and manage, leveraged buyouts.

Private equity investments are normally held through partnerships that provide legal and taxation advantages. Most of the Trust's investments are held through partnerships of which it is the sole limited partner and which invest alongside pooled funds managed by HgCapital (currently its Hg6 fund) on the same terms as institutional investors. The Trust normally acquires a 15% interest in each business in which Hg6 invests. The Manager is organised in investment teams that focus on well researched business sectors, but it does not make top-down allocations to these sectors or to particular countries; the balance may change as investment opportunities appear and portfolio companies are sold. The Trust is not a fund of funds and does not invest in other managers' funds. The Trust's strategy of making direct investments into businesses provides greater transparency for the Board and shareholders in the Trust and avoids the double fees inherent in a fund of funds.

The Board of the Trust decides, after consultation with the Manager, on the timing, amount and terms of each commitment it makes to invest in or alongside any of the Manager's funds. Such commitments are normally drawn down over five years as investment opportunities arise. The Board agrees each commitment at a level it believes the Trust will be able to fund from its own resources or from temporary borrowing. However, to protect the Trust from the risk of being unable to fund any drawdown under its commitment the Board has negotiated a right to 'opt-out', without penalty, of any HGT 6 LP investment where certain conditions exist (see note 12 to the financial statements).

In addition, the Trust has invested in renewable power generating projects, an area where the Manager has developed its skills and built a specialist team. This sector provides the Trust with an element of diversification, as it has fundamentally different drivers of risk and return, but is expected to deliver comparable risk-adjusted returns. In this sector, it is advantageous to the Trust to participate with other institutional clients of HgCapital as limited partners in HgCapital's two renewable energy funds.

Cash and borrowing

The Board and the Manager agree that prudent use of borrowing to fund acquisitions can increase diversification within the portfolio and yield rates of return superior to the market in listed shares. Businesses in the underlying portfolio are acquired with the benefit of bank borrowing at levels that can be serviced from the cash flows generated within that business. The Board does not currently see any advantage in using a further level of structural borrowing by the Trust, as this would add risk without any certainty of enhancing returns. From time to time, the Board arranges a bank facility on which it can draw to meet short-term needs, between making an investment and receiving the proceeds from a realisation.

At certain points in the investment cycle the Trust may hold substantial cash awaiting investment, which it holds in bank deposits or invests in short-dated government bonds. If there appears to be surplus capital and conditions for new investment appear to be unfavourable, the Board will consider returning capital to shareholders, probably through the market purchase of shares.

Hedging

The Trust offers exposure to a range of businesses operating in the UK, the eurozone and the Nordic region. The Trust does not strategically hedge investments back into sterling. From time to time, the Manager may use derivatives approved by the Board to hedge tactically with the object of protecting the anticipated sterling value of proceeds from realising investments in other currencies.

Benchmark

For most shareholders, their investment in the Trust represents a small allocation of funds that would otherwise be invested in UK equities. The Trust's benchmark is therefore the FTSE All-Share Index.

To assess the Manager's performance relative to other private equity managers, the Board regularly compares the NAV and share price performance against a basket of peers listed on the London Stock Exchange and against the UK and pan- European indices of listed private equity companies published by LPX.

Priorities as a listed investment company

As the rationale for the Trust is to provide investors with a way to invest in an illiquid asset class, through a liquid listed vehicle, the Board has a number of priorities including: retaining the status of an investment trust; maintaining a liquid market in its shares; providing shareholders with transparent reports on the underlying portfolio; adopting prudent valuations; and avoiding adding risk at the Trust level.

Valuation

The Board values each investment in the portfolio after considering analytical data and draft valuations prepared by its Manager. Valuations are carried out in accordance with the International Private Equity and Venture Capital ('IPEV') Valuation Guidelines, September 2009 edition. Further information can be found at www.privateequityvaluation.com.

Net asset value and trading in the Trust's shares

The Board values the portfolio and publishes the Trust's NAV as at 30 June and 31 December. Each month, following these valuations, the NAV figure is published after adjustment for realisations and movements in foreign exchange and the market prices of any listed securities. The Trust's shares trade on the London Stock Exchange at prices that are independent of the Trust's NAV but reflect the NAV and expectations of future changes in it. The shares have traded at a discount to the NAV and at times at a premium to it. The Board has not attempted to manage any discount through repurchase of shares, which it believes usually has only temporary effect. The Board believes that discounts to NAV are minimised through consistent long-term returns, transparent reporting, rigorous valuation and avoidance of risk at Trust level.

Dividends

The Board does not structure the Trust's balance sheet or underlying investments in order to deliver any target level of dividend. To maintain the Trust's status as an investment trust, annual net revenue return retained, after dividend distributions in respect of that financial year, may not exceed 15% of the annual total income earned from investments. The level of the net revenue return varies from year to year according to the level of the Trust's liquid funds and the structure of the buy-outs held at the time. Accordingly, dividends may vary from year to year. The Trust has elected to 'stream' its income from interest-bearing investments as dividends that will be taxed in the hands of shareholders as interest income; this minimises the tax charge payable by the Trust.