DISCIPLINE

2008 ANNUAL REPORT

HARBERT
MANAGEMENT
CORPORATION

TODAY, MORE THAN EVER, DISCIPLINE IS A VIRTUE.

The markets are punishing the emotional and the unfocused. As each new headline convulses the investment world, perhaps the only asset more valuable than available capital is discipline.

Discipline in the face of chaos is critical—because upheavals in the market inevitably are the source of opportunity. It takes discipline to preserve principal. And more than ever, we are executing our plan, growing organically in our existing strategies, accumulating capital and patiently waiting for the time when events in the markets open new opportunities for creating wealth.

HARBERT® MANAGEMENT CORPORATION

BIRMINGHAM / NEW YORK / RICHMOND / NASHVILLE / ATLANTA
SAN FRANCISCO / LONDON / MADRID / PARIS / MELBOURNE

HARBERT MANAGEMENT FUNDS

		FINAL CLOSE
HREP I	*Harbinger Real Estate Partners I, LP*	June 23, 1995
HREF II	*Harbert Real Estate Fund II, LLC*	September 30, 2002
HREF III	*Harbert Real Estate Fund III, LLC*	November 17, 2006
HUSREF IV	*Harbert United States Real Estate Fund IV, LP*	Second closing as of January 16, 2009
HIPF I	*Harbinger Independent Power Fund I, LLC*	June 16, 1997
HIPF II	*Harbinger Independent Power Fund II, LLC*	February 15, 2002
HPF III	*Harbert Power Fund III, LLC*	June 29, 2007
HPEF I	*Harbinger Private Equity Fund I, LLC*	December 15, 1999
HPEF II	*Harbert Private Equity Fund II, LLC*	December 23, 2004
HAV	*Harbinger/Aurora Venture Funds*	March 31, 2000
HVP	*Harbert Venture Partners, LLC*	December 31, 2004
HVP II	*Harbert Venture Partners II, LP*	Initial closing as of June 10, 2008
HEREF	*Harbert European Real Estate Fund BV*	July 31, 2003
HEREF II	*Harbert European Real Estate Fund II, LP*	March 30, 2007
HMP	*Harbinger Mezzanine Partners, LP*	December 22, 2000
HMP II	*Harbert Mezzanine Partners II, LP*	January 10, 2006
HAPE I	*Harbert Australian Private Equity Fund I, LP*	In formation
HEMF	*Harbert Emerging Markets Fund, LP*	Open ended
HEOF	*Harbert Event Opportunities Fund, LP*	Open ended
HVF	*Harbert Value Fund, LP*	Open ended
HSCF	*Harbert Strategic Commodities Fund, LP*	Open ended

CORPORATE PROFILE

Harbert Management Corporation (HMC℠) is an investment firm managing approximately $2.5 billion in assets and committed capital as of December 31, 2008, in 11 new and existing alternative asset classes in three areas of concentration: real estate, private capital and absolute return strategies.*

We (HMC℠ and our affiliates) make significant co-investments on a pari passu basis in each strategy offered to our investors. Our investors from around the world include endowments, foundations, fund of funds, family offices, pension plans, banks, insurance companies and high-net-worth individuals. We make each commitment of capital with a disciplined focus on risk, absolute return and diversification.

We have in place an extensive risk monitoring and compliance infrastructure that supports the growth of our diverse set of investment strategies. We demonstrate our commitment to risk management and compliance through the breadth and professionalism of the legal, accounting, compliance and risk management teams centrally located at our headquarters in Birmingham, Alabama.

In addition to our new headquarters in Birmingham, we have satellite offices in New York, London, Richmond, Nashville, Atlanta, San Francisco, Madrid, Melbourne and Paris. Our offices are close to the relevant markets for their respective strategies, while our centralized risk management and compliance programs enable these teams to concentrate on their goal of delivering superior risk-adjusted returns.

Real Estate
United States
European

Private Capital
Private Equity
Venture Capital
Mezzanine Capital
Independent Power
Australian Private Equity

Absolute Return Strategies
Emerging Markets
Event Opportunities
Value
Strategic Commodities

*Excludes Harbinger Capital Partners Funds, the management and control of which was transferred to their Senior Portfolio Manager, Philip A. Falcone, effective March 4, 2009. HMC and its affiliates will continue to provide administrative and operational support for the Harbinger funds, and will be available to provide investment advisory services upon request, pursuant to a transition services agreement.

Harbert Management Corporation Locations and Private Capital Investments as of December 31, 2008

2008 THE YEAR IN REVIEW

We live in interesting times. Emotions are high in the markets, and fear is a driving force. But fear also creates opportunity for those with the discipline, the patience and the will to find it and capitalize on it.

LETTER TO PARTNERS, ASSOCIATES AND FRIENDS

ON NOVEMBER 4, 2008, HARBERT MANAGEMENT CORPORATION CELEBRATED the 15th anniversary of its incorporation. For the sake of our curiosity, we pulled together some financial statistics for November 4, 1993, and compared them to those of that same date in 2008.

	Nov 1993	Nov 2008	High/Low	% Change Peak/Trough
Dow Jones Industrial	3,625	9,625	14,165 - 3,593	42%
10 Year U.S. Treasury	5.7%	3.8%	8.05 - 3.13%	61%
U.S. Dollar Spot Index	95.1	84.8	120.9 - 71.3	41%
NYMEX Crude Oil–Barrel	$17.40	$70.53	$145.29 - 10.72	57%

What is even more striking than the point to point changes in these measures is the extraordinary range of values exhibited during the fifteen years of our existence. As we, and our partners, evaluate HMC's long-term strategy and plans for the future, we believe it is worth reflecting on how our firm or any other investment manager, fund, bank, or other risk taker, could survive during this period–and we all know that many did not. Clearly an investor could not survive without the ability to make dynamic changes as events unfold. HMC has been able to adapt and prosper during the last fifteen years, not because we have adjusted our investment policies–to the contrary bottoms up asset-by-asset investing discipline has been crucial to our survival. Our flexibility has instead been provided through diversification on many levels. The investment risks we have chosen are individually underwritten and have been distributed across multiple asset classes in both the private and public markets. We have derived our returns not only by purchasing securities or hard assets where we saw values, but also by exiting investments or selling short where we saw opportunity. Within our portfolios, each one of which is a separate legal entity, we have avoided concentration and have used no, or modest amounts of leverage, usually with recourse only to individual assets.

These portfolio policies did not allow us to finish 2008 unscathed. Year-end audited results, marking all public and private market assets to market, resulted in modest losses in our funds dedicated to U.S. and European real estate, mezzanine lending, convertible arbitrage, long/short equities and commodities. We had more significant drawdowns in private equity, activist/distressed, and emerging markets. We were able to achieve attractive returns in venture capital, independent power, and risk arbitrage. Our overall absolute returns this year were disappointing, however in no way was the long-term future of our continuing strategies ever in question.

HMC has been able to adapt and prosper during the last fifteen years, not because we have adjusted our investment policies– to the contrary bottoms up asset-by-asset investing discipline has been crucial to our survival.

The task of defining HMC's longer-term performance is even more complex. As an investor across 11 different asset classes, each with its own dynamics, there is never a single answer to the question "how is your performance?" As we close 2008, that response is exponentially more difficult. There is no need to recount for you the worldwide turbulence in the financial markets this year when stocks, bonds, real estate, and all other asset prices experienced record or near record declines. For investment strategies which require access to the capital markets, there was a virtual shutdown in both the public and private markets for new issues of debt and equity. HMC was certainly not immune from these forces. In fact, for an investor like us to have been unaffected would have required anticipation of these conditions several years ago and a virtual shutdown of our private market investing activities and a liquidation of our private and public market investments by mid-year in 2008.

Raymond J. Harbert - *Chairman and CEO*

To the contrary, we were in the mix and suffered investment losses, some permanent, reflecting analyses that did not anticipate the economic downturn. We also have investments that are fundamentally sound but have suffered from the lack of liquidity in the financing markets. In our opinion, many of these losses are temporary "mark-to-market" losses and will be profitable but with delayed exits. The firm also suffered a material reduction in its assets under management as a result of both investment losses and redemptions, as many of our clients scrambled for liquidity where they could find it.

To quote an investor that we greatly respect, in his January 2009 letter to his partners: "superior investors are the ones that make more money in the good times than they give back in the bad." Taking the longer term view, as this standard suggests, we are succeeding. To measure our performance on this basis, we established and report each year the internal rate of return an investor would have earned by allocating to every investment platform we have created since the close of our first fund in 1995 in the same proportion and at the same time as the Harbert affiliated entities. This year's number, reflecting 13 years of cumulative investment performance, was an internal rate of return of approximately 15% and a realized cash on cash return of approximately 15%. This performance reflects a dilution in returns from the comparable numbers of approximately 19% and 18%, respectively, reported to you last year and are both net of all fees and expenses. These returns were generated by a diverse group of asset classes and underlying investments and include both the performance of successful funds and those with substandard performance which we have closed. They reflect the asset allocation decisions made by HMC partners and affiliates–not the relative sizes of individual funds.

We are absolute return investors and cannot help but be disappointed when the firm falls short of its goals, regardless of the extremity of the circumstances. With that said, we believe there are other measures we and our partners should consider in evaluating our performance. Perhaps the most important of which is to review how the firm and its investment funds are positioned after the tsunami of 2008 looking forward into '09 and beyond. In this respect, we are pleased.

For years, this letter has contained a long series of complaints about the investment environment. We have commented about high valuations, undisciplined capital, disregard for risk and other frustrations of a value-oriented investor. So now the question becomes: how are we positioned when absolute value standards are in our strike zone? Quality public companies can be purchased for single digit P/E's, attractive businesses can be acquired in the private markets for our target valuation standards of 4-6 times cash flow, capitalization rates in real estate transactions and valuation of venture capital opportunities are returning to historical averages, liquidity is no longer a drag on the market and credit and merger arbitrage spreads are wide. As we already noted, many managers are no longer investing, or are "wounded," lacking fresh capital or consumed with problem investments, reducing competition for new investments.

As we evaluate our opportunities for 2009 and beyond, we are excited. All of our continuing funds, without exception, are unleveraged or are geared below our long term targets.

As we evaluate our opportunities for 2009 and beyond, we are excited. All of our continuing funds, without exception, are unleveraged or are geared below our long term targets. We have capital available to invest and have been cautiously deploying funds in each and every one of our continuing strategies, yes, even during the fourth quarter of 2008 and as this letter is

written today in March. Some specific examples in the private markets include our Power Group acquiring power project debt at discounts from par; a new domestic real estate platform in self storage acquired partially through the purchase of discounted debt; new mezzanine loans and venture capital investments; and commitments to two new private equity platforms, both in healthcare-focused companies. Also during the last quarter our merger arbitrage team has allocated new capital to convertible arbitrage as many funds abandoned this space, and the emerging markets, and long short equity and commodities teams are adding new investments. All of our continuing hedge funds were profitable year to date 2009 through February.

This position is not a reflection of our clairvoyance, but of the absolute value, bottoms up investment and risk management discipline we have applied for the last 15 years. While we have certainly made our mistakes, HMC has not waivered from these standards. In the ebullient markets and excess liquidity that was available through the summer of 2008, we engaged in a constant struggle to deploy capital at the valuation and return standards we have established. The by-product of this discipline, as we enter 2009, is the availability of excess capital and borrowing power when we find the investment environment more attractive than it has been in recent memory.

Another way to evaluate our performance is to review HMC's business model juxtaposed against what we expect to be a changed landscape in 2009 and beyond. In response to several widely publicized frauds, we anticipate investors will have much higher standards as they evaluate new or existing relationships with their investment managers. HMC took many steps years ago to assure ourselves, as a large investor, as well as you, our outside clients, of the integrity of our capital. Specifically, HMC has: (1) always used top-flight international accounting firms to audit our investment funds and the firm itself; (2) employed independent administrators for our hedge funds from their inception in 2001; (3) provided our investors with total transparency and access to independently verify our holdings; (4) maintained accounting and internal audit functions for

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l-r: **Raymond J. Harbert,** *Chairman & CEO;* **Michael D. Luce,** *President & COO*

the valuation of investments and preparation of financial statements completely independent of our investment teams and finally, (5) many years ago, we chose to be regulated as a Broker Dealer by the NASD/FINRA and as a Registered Investment Advisor by the SEC in the U.S. and by the F.S.A. in the UK.

Another measure of performance is whether, after the turmoil of 2008, HMC is positioned to expand strategically, developing new investment platforms for ourselves and our partners. We are pleased to report that in this respect, the firm has not slowed down. In the fall of this year, after several years of effort and false starts, we opened the Harbert Strategic Commodities Fund managed by Hal Lehr. Hal joined us from one of the top macro hedge funds with more than 18 years of experience in the energy markets. The fund takes a diversified approach to the commodities markets, and Hal has assembled additional talent to target both agricultural commodities and metals as well as energy.

Also in the fourth quarter, we have finalized arrangements to launch an Australian private equity fund and open an office in Melbourne. Brendan Anderson who worked with HMC as an intern 12 years ago, has joined us from the Transaction Services Group of Deloitte and Touche in Melbourne. Brendan has partnered with Jeremy Steele, who led the middle-market buyout business for ANZ Bank, which was one of the largest participants in this segment of the Australian private equity market. HMC has targeted the mid-market buyout space in Australia because we believe conditions are similar to the U.S. environment 15 years or so ago, when the success of leading buyout firms caused them to "drift up" market and abandon smaller, more attractively valued LBO and recapitalization opportunities.

This letter must also serve as a farewell to two of our longtime partners. Effective March 4, 2009, Philip Falcone became the sole general partner and manager of the Harbinger Capital Partners® Funds, and he and his team will begin the transition to independence, probably in late '09 or early 2010. We continue to be significant investors in the Harbinger funds and HMC will provide accounting, operational, legal and compliance support to the Funds during an interim period. The Harbinger Capital Partners Funds were by far the largest of our investment platforms and one of the most profitable for our investors. Immediately upon joining us in 2001, Philip proved to be a magnificent investor that produced enormous value for all of his investors. From its early roots as a distressed investment fund, Philip evolved the strategy continuously. He was very early in applying a long/short approach to the high yield/distressed market and transitioned the Fund's strategy brilliantly into a highly successful player in the market for post reorganization equities as the distressed cycle played out. Philip and his team next developed an activist approach to their corporate investing, and were one of the earliest and largest short

HMC is positioned to expand strategically, developing new investment platforms for ourselves and our partners.

sellers of subprime mortgage credit and major U.S. and international banks and other financial intermediaries, correctly and profitably anticipating the credit cycle we are now in the midst of.

Harbert Management Corporation will find those investment opportunities in this difficult environment for our capital as well as our clients.

Philip has been a great partner; however, in the middle of 2008 we all agreed it made sense for Harbinger to begin to develop its own dedicated marketing and investor relations team. At the same time the group had outgrown their space at our Madison Avenue office, and we entered into a lease close by on Park Avenue. As the expanded team got into place, it became clear that management and control should be consolidated and we agreed it would make sense for Philip to buy us out and become the sole Fund manager. As we mentioned, HMC will continue to support Philip's team as it develops its own back office function and we retain our limited partnership interests. We wish Philip and his team the best and fully expect his success to continue for many years to come.

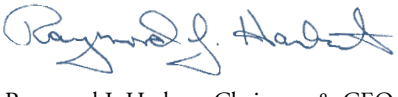
Finally, it is with great sadness that we say farewell to Bill Lucas, our General Counsel, who died tragically this past year. Bill was a good friend, a tireless worker and a lawyer who always saw the bigger picture and fought ferociously and tirelessly to defend HMC and its investors' interests. Bill was promoted to General Counsel in 2006 and proceeded to build a legal team with tremendous depth and breadth of experience and talent. That team, together with Joel Piassick, our previous General Counsel who stepped out of retirement to fill the breach, has performed flawlessly during this interim period. John McCullough, who joined HMC in 2006 was subsequently promoted to General Counsel effective March 2009. There could be no better legacy that Bill could have left to his partners than this seamless transition of leadership.

While 2008 certainly was a difficult period for all types of investments and for the global economy as well, we also believe 2009 will be difficult in most sectors.

Winston Churchill stated back in the middle of the last century:

–*"The pessimist sees difficulty in every opportunity. The optimist sees opportunity in every difficulty."*

Harbert Management Corporation will find those investment opportunities in this difficult environment for our capital as well as our clients. We thank you for giving us the opportunity to serve you.



Raymond J. Harbert, Chairman & CEO

Michael D. Luce, President & COO

REAL ESTATE

UNITED STATES REAL ESTATE

l-r: **Jeffrey H. Seidman,** *Vice President of Asset Management;* **Alan C. Fuller,** *VP & Senior Managing Director,* **Michael P. White,** *VP & Senior Managing Director*

2008 IN REVIEW

In 2008, HMC launched HUSREF IV, the firm's fourth commingled domestic US real estate fund. The investment team expects to raise approximately $500 million with a final closing planned in 2009.Consistent with its 14-year track record, the team members plan to acquire a portfolio diversified by property type and geography .

Added Vice President of Asset Management, Jeffrey H. Seidman, a 30-year veteran of the real estate industry.

Added Managing Director for the San Francisco office, Jon-Paul Momsen, formerly of Deutsche Bank/RREEF.

Added Analyst, Walker P. Badham; a recent graduate of Davidson College.

Closed eight new transactions.

THE UNITED STATES REAL ESTATE TEAM TARGETS MID-SIZED, COMMERCIAL office, industrial, multifamily, retail and hospitality opportunities ranging in value from $20 million to $50 million.

Leveraging its deep operational experience, the team pursues "value enhancement" strategies, carefully selecting investments that will benefit from active operational and financial management. As part of the acquisition process, the investment team develops a rigorous asset-specific management plan to improve the competitive position of each portfolio asset. The team mitigates risk through acquisition underwriting and structuring, emphasizing downside protection, and through diversification of portfolio investments by property type, geography and investment profile.

In the face of a slowing economy and limited liquidity, the US Real Estate team is managing its portfolio and considering new investments with the understanding that property market fundamentals are deteriorating and debt capital is scarce. The team expects further deterioration throughout 2009. In the near term, the investment team expects the commercial real estate market to experience a pricing correction creating difficulties, particularly for properties that have debt maturing over the next 24 months that have failed to achieve aggressive income growth projections. On a positive note, in most cases, new supply has been constrained by the rising cost of construction and a lack of financing, which should temper the deterioration of property market fundamentals.

The US Real Estate team pursues "value enhancement" strategies that exhibit the potential for strong current cash returns and capital appreciation.

The US Real Estate team remains confident that its disciplined initial underwriting will benefit the portfolio as we move through this difficult period. Due to the current lack of liquidity, the investment team anticipates holding portfolio investments longer than originally projected and aggressively managing capital to ensure that the portfolio is adequately capitalized to weather this environment. It will be extremely cautious in considering new investments, but will be alert to take advantage of investment opportunities that may become available in this real estate retrenchment.

2008 UNITED STATES REAL ESTATE TRANSACTIONS

ADDITIONS TO HARBERT REAL ESTATE FUND III, LLC ("HREF III")

BELLATERRA AT DEERBROOK - In June 2008, HREF III acquired a 90% interest in BellaTerra at Deerbrook. This newly constructed 360-unit multifamily workforce housing property was purchased in an off-market transaction and is located in Houston, Texas.

ELLINGTON TRADE CENTER - In February 2008, HREF III acquired land and commenced development on this 503,140-square-foot industrial project in Houston, Texas as part of the Fund's industrial development platform with Koll Development Company.

NORTHPOINTE TRADE CENTER - In May 2008, HREF III acquired property and commenced construction on this 448,550-square-foot industrial project in Austin, Texas also as part of the Fund's industrial development platform with Koll Development Company. The warehouses are centered in the confluence of Austin's highway infrastructure and I-35 also known as the NAFTA Freeway.

SHADOW ANCHORED RETAIL DEVELOPMENT PLATFORM - Throughout 2008, HREF III acquired four sites in conjunction with the Fund's joint venture with Giltz & Associates, Inc., and began developing a series of shadow-anchor retail centers across multiple locations in growth markets.

CHACE LAKE CENTER - In October 2008, HREF III acquired property to develop a 13,400-square-foot shopping center in Hoover, Alabama with Harbert Realty Services.

ADDITIONS TO HARBERT UNITED STATES REAL ESTATE FUND IV, LP ("HUSREF IV")

SELF STORAGE PLATFORM - HUSREF IV committed $30 million to form a joint venture with W. P. Carey to pursue self-storage properties. In January 2009, the Fund invested roughly $18 million to acquire a 60% interest in 13 assets across seven states for $54 million. The original 13 properties make up approximately 927,000-square-foot and were 74% occupied at the time of purchase. The remaining $12 million will be used to acquire additional self-storage properties. New acquisitions will target one-off, financially or operationally distressed assets with a goal of stabilizing to create an institutional quality portfolio.

HREF III PORTFOLIO

A summary of the other assets in the HREF III portfolio as of year-end 2008 follows:

OFFICE & INDUSTRIAL PROPERTIES

BANK OF AMERICA PLAZA - 366,842-square-foot, Class A office building in Raleigh, North Carolina.

INTERSTATE BUSINESS PARK - 118,031-square-foot office/flex park in Tampa, Florida.

NORTH DALLAS OFFICE PORTFOLIO - 455,889-square-foot, Class B, three-building office portfolio located in Dallas, Texas.

EAST POINTE BUSINESS CENTER - 287,482-square-foot, Class B office/flex park located in Memphis, Tennessee.

THREE NORTHBOROUGH - 157,304-square-foot Class B office building located in Houston, Texas.

GWINNETT CORPORATE CENTER -1,181,022-square-foot shallow-bay distribution and single-story office park located in Atlanta, Georgia.

SUNTRUST OFFICE PORTFOLIO - A portfolio of 25 properties totaling 1,016,161-square-foot of office space acquired in a partial sale lease-back transaction.

MULTIFAMILY PROPERTIES

CHALK ROCK CANYON - 264 units, Class A multifamily development located in Austin, Texas.

DRY CREEK RANCH - 288 units, Class A multifamily development located near Fort Worth, Texas.

MIXED-USE PROPERTIES

CHARLESTON CIGAR FACTORY - A mixed-use redevelopment located in the peninsula historic district of Charleston, South Carolina that will be comprised of residential lofts, office condominiums and boutique retail shops upon completion.

EUROPEAN REAL ESTATE

l-r: **Scott D. O'Donnell,** *VP & Senior Managing Director;* **Tor Tveitane,** *Principal;* **Peter J. A. Land,** *Principal;* **Roque L. Rotaache,** *Principal;* **Eric R. Desautel,** *Principal*

2008 IN REVIEW

The European Real Estate Fund continued to build its investment team, hiring Tor Tveitane, a highly seasoned real estate professional with more than ten years investment experience in Europe.

Formed a joint venture with a highly experienced warehouse/logistics specialist to target investment opportunities in and around Madrid, Spain. One site with approximate building rights of 120,000 square meters is under contract.

Entered into an option to acquire a site in Malaga, Spain, for the development of an approximate 17,000-square-meter retail warehouse project.

Formed a joint venture with a UK-based industrial/warehouse specialist to acquire well-located assets throughout the Midlands and southeast of the UK.

Completed construction and handover of the Fund's Ostfildern warehouse development, which is fully leased.

Commenced construction of the Fund's Esslingen development and signed leases for approximately 70% of space.

Executed leases for the Clemenceau asset, taking occupancy to 91%.

THE EUROPEAN REAL ESTATE TEAM TARGETS ACQUISITION AND DEVELOPMENT opportunities in which it can add value through proactive management. The investment team targets opportunities in the office, retail, warehouse/distribution, hospitality and residential sectors and looks for transactions ranging from approximately $15 million to $150 million. In many cases, opportunities of this size are too small for the larger funds to pursue effectively, yet too large and/or complex for some of the local and smaller regional investors.

Other key elements of the Fund's investment philosophy include a disciplined focus on underlying real estate fundamentals, diversification, exit strategies and local knowledge. The European Real Estate team includes real estate investors with operational expertise; they evaluate each transaction based on the projected returns they expect the respective property to generate. Although the Fund will capitalize its transactions in a manner designed to enhance returns, the investment team will not rely on leverage to justify its investment decisions. In an attempt to reduce the overall risk within its portfolio, the investment team has diversified its investments across property types, geography and investment risk.

The European Real Estate team has been cautious on the acquisition front over the past few years; consequently, it still has a significant amount of capital available to invest. The investment team believes that this capital puts the Fund in a good position to capitalize on opportunities that may arise throughout 2009. Europe is comprised of many different countries, each with its own underlying economy and drivers and each at a different point in the overall downturn affecting the world's economies. With the significant displacement of capital and pressure on investors in all asset classes to de-leverage during the course of 2009, the European Real Estate team plans to focus on well-located cash-flowing assets with value enhancement opportunities that can be acquired at yields in excess of their historic norms.

The European Real Estate team plans to focus on well-located cash-flowing assets with value enhancement opportunities.

The investment team recognizes that while capital is global, real estate is a local business. They seek to join with local partners in each investment, partners who have an established track record in both the relevant market and product type and whose investment interests are aligned with the Fund.

EUROPEAN REAL ESTATE TRANSACTIONS

Acquisitions as of December 31, 2008

ACQUISITIONS

PROMOCIONA INDUSTRIAL - The Fund committed €20 million to a joint venture with an established local industrial warehouse developer in Madrid for the development of a number of warehouse projects in and around Madrid. On closing the joint venture, the investment team purchased an option over a development site in the Madrid region for up to 120,000-square-meters of warehouse space. This transaction is contingent on the seller completing the urbanization and re-allotment of the site. Based upon the current status of the project, the investment team anticipates that the seller's obligations will be complete around the middle of 2009.

DORIC RETAIL DEVELOPMENT - Through a joint venture with an experienced European retail developer, the Fund has committed to purchase three parcels of land in Malaga, Spain, for the development of a 17,000-square-meter retail warehouse. The land purchase is subject to receiving all necessary planning consents, urbanization of the site and the required operating license. The site is extremely well-located adjacent to a newly constructed Ikea retail facility and an existing retail center, with direct access to two major highways and close to Malaga International Airport. Construction on the first parcel is expected to commence in the first quarter of 2009.

UK MULTI-LET INDUSTRIAL - The Fund committed £30 million to a joint venture formed with a UK industrial/warehouse specialist. The joint venture will seek to acquire a number of well-located industrial/warehouse estates throughout the Midlands and southeast of the UK. The key criteria will focus on multi-let estates that can be acquired at yields in excess of historic norms and that offer value creation opportunities through active asset management (e.g. leasing vacant space, refurbishment, expansion, etc.).

PRIVATE CAPITAL

PRIVATE EQUITY

l-r: **Kevin P. Grebe,** *Director of Investments;* **R. Lee Bryan,** *Director of Investments;* **Winston H. Gillum, Jr.,** *Vice President & Managing Director;* **Donald R. Beard,** *VP & Senior Managing Director;* **J. David Harper,** *Director of Investments*

2008 IN REVIEW

HPEF II currently holds positions in eight separate platform companies in various industries and sectors, including: healthcare, specialty finance, logistics, insurance and manufacturing.

HPEF II's investment period for new investments ended in October 2008, and at that time, the Fund had two new platform companies in the healthcare services sector under letter of intent to purchase, as well as three add-on investments to existing portfolio companies under letter of intent.

HPEF II exited two platforms (Winnercom Holdings and TSF Holdings), both at a loss.

Two of the Fund's senior analysts left to pursue graduate degrees in business school. The investment team filled those ranks with two new additions: Baxter Lee and William Plumer.

Mike Rowland resigned and Don Beard was appointed Senior Managing Director, with additional assistance from Winston Gillum.

THE PRIVATE EQUITY TEAM SEEKS TO IDENTIFY AND ULTIMATELY INVEST IN businesses that are positioned for growth and have experienced management teams already in place. The investment team typically looks for opportunities in less competitive sectors of the market, pursuing what it considers to be attractive investments at a discount to valuations in the broader private equity markets. Investment opportunities are often developed by directly contacting companies in targeted industries, bypassing intermediaries.

The Private Equity team finds investment opportunities in leveraged buyouts, recapitalizations and expansion projects, as well as select distressed opportunities. They target middle-market companies with valuations of approximately $10 million to $100 million, with an emphasis on $20 million to $50 million transactions. The investment team attempts to invest in companies with not only quality management but also superior competitive positions, which is consistent with the Fund's goal of acquiring investments with the potential for long-term capital appreciation. With each investment, the Private Equity team seeks to take an active role, using its experience to help increase value and, when needed, by providing portfolio companies access to more than just capital, including managerial experience, legal, accounting, treasury and other support services.

The investment team attempts to invest in companies with not only quality management but also superior competitive positions.

The Private Equity team has a disciplined and conservative approach for evaluating potential acquisitions and investments. The investment team's goal in due diligence is to avoid surprises and identify ways in which it can contribute to the long-term success of an investment after the acquisition closes. The Private Equity team believes strongly that there is no single road to success, and it is willing to work with the management team of each company in which they invest to develop and support a strategy that fits the company and its current situation.

PRIVATE EQUITY INVESTMENTS

Portfolio as of December 31, 2008

ECA HOLDING, LLC - A consumer finance company that operates payday-advance lending branches in seven states. Based in Chattanooga, Tennessee.

PFC ACQUISITION COMPANY, INC. - A commercial finance company that provides working capital financing to small businesses in the form of asset-based loans. Based in Atlanta, Georgia.

PWI HOLDINGS, INC. - Underwriter and administrator of vehicle extended-service agreements. Also offers sales finance contracts to subprime credit consumers through select independent automotive dealers. Based in Orwigsburg, Pennsylvania.

CF HOLDING COMPANY, INC. - The nation's largest less-than-truckload carrier and logistics manager, serving furniture manufacturers, importers and retailers exclusively. Based in Lenoir, North Carolina.

CHILD HEALTH HOLDINGS, INC. - Operator of daycare and respite care facilities for children with acute medical conditions. Based in Tampa, Florida.

DENT-A-MED, INC. - Consumer finance company that funds retail purchases for consumers with less-than-perfect credit. Based in Springdale, Arkansas.

PRECISION ALLOYS CORPORATION - Value-added specialty stainless steel processor and distributor that specializes in the production of flat-rolled stainless strips and coils. Based in Dallas, Texas.

TBT HOLDING COMPANY, INC. - Manufacturer of aluminum end-dump, bottom-dump and tipper trailers; dump truck bodies; and other customized aluminum trailers. Based in Houston, Texas.

VENTURE CAPITAL

l-r: **William W. Brooke,** *EVP & Managing Partner;* **Thomas D. Roberts III,** *Partner;* **Wayne L. Hunter,** *Managing Partner*

2008 IN REVIEW

Agility Healthcare Solutions, Inc., a HVP and HVP II portfolio company, was sold to GE Healthcare, a unit of General Electric Corporation, in September of 2008.

During 2008, HVP II made initial investments in ClaraBridge, Inc., Intelliject, Inc., NovaMin Technology, Inc. and Yap, Inc. The team led or co-led three of these transactions.

HVP made follow-on investments in Aldagen, Inc., BroadSource, Inc., Innovative Biosensors, Inc., Ion Healthcare, Inc., JackBe Corporation, MaxCyte Inc., Optimal Reading Services Group, Inc., Privaris, Inc., TapRoot Systems Inc., Unitrends Software Corporation and WindChannel Communications.

Robert L. Crutchfield joined the team as a Venture Partner after 20 years in the medical device and services industries.

Molly E. Escalante also joined the team as an Associate. Molly was formerly a Senior Analyst with Harris Williams & Company.

THE VENTURE CAPITAL TEAM INVESTS PRIMARILY IN EARLY-STAGE information technology and healthcare companies. The investment team seeks to invest in the first or second institutional round of financing for companies with experienced management, a defensible strategy and unique technologies that address large and growing markets. A member of the Venture Capital team usually takes a seat on the board of each portfolio company in which it invests at the time of initial investment providing strategic value and perspective to the company's management.

The Venture Capital team's target region, stretching from Maryland to Florida, encompasses the fifth-largest economy in the world and the fastest-growing economic region of the nation. This dynamic area is home to numerous research universities, government and corporate research facilities, public companies and an active entrepreneurial community; nevertheless, this area has historically suffered from a lack of local venture capital. The Venture Capital team believes this disparity produces significant opportunities for high-quality investments at reasonable valuations.

The Venture Capital team's target region, stretching from Maryland to Florida, encompasses the fifth-largest economy in the world and the fastest-growing economic region of the nation.

The senior members of the management team have more than 100 years of combined experience working with entrepreneurs in the Southeast region of the US. They bring together backgrounds in finance, law, business operations, information technology and life sciences to produce a valuable and coherent perspective on venture investing. Since 1999, members of the Venture Capital team have participated in nearly 40 venture capital investments which have, to date, produced four initial public offerings and several M&A transactions.

HARBERT VENTURE PARTNERS I & II INVESTMENTS

Portfolio as of December 31, 2008

AGILITY HEALTHCARE SOLUTIONS, INC. - Provides business process optimization solutions for hospitals and other acute care facilities, using its domain expertise, proprietary software platform, RFID and other location awareness technologies to improve resource use and patient throughput. Based in Richmond, Virginia. Sold to GE Healthcare in September 2008.

ALDAGEN, INC. - Develops clinical-stage regenerative therapies related to the transplant of adult human stem cells for tissue regeneration and for treating blood diseases, cancer and genetic diseases. Based in Durham, North Carolina.

BROADSOURCE, INC. - Offers enterprise software solutions targeted at telecommunications cost management, enabling businesses to automate service order processing, track assets and inventory, consolidate and reconcile invoices and manage information flow, from network planning and engineering to operations. Based in Atlanta, Georgia.

CLARABRIDGE, INC. - Sells to Fortune 1000 businesses with customer experience analytics software as a service enabling them to develop stronger relationships with their end customers. Based in Reston, Virginia.

INNOVATIVE BIOSENSORS, INC. - Involved in commercializing novel technology for the rapid detection of pathogens for military and homeland defense markets, food-safety testing and human diagnostics. Based in College Park, Maryland.

INTELLIJECT, INC. - Creates medical device drug delivery technologies utilizing its proprietary, state-of-the-art technology platforms. The company's first product, EpiCard, is an innovative auto-injector device designed to deliver epinephrine during allergic emergencies known as anaphylaxis. Based in Richmond, Virginia.

ION HEALTHCARE, INC. - Offers sleep apnea management solutions to hospitals, large physician practice groups and sleep labs through the application of screening tools, diagnostic testing, treatment solutions, and long-term compliance management. Based in Richmond, Virginia.

JACKBE CORPORATION - Provides enterprise mashup software that enables corporations to improve the functionality and performance of Web applications, delivering data from any application to any user, while meeting enterprise-grade security and governance requirements. Based in Chevy Chase, Maryland.

MAXCYTE INC. - Develops both proprietary and partnered therapeutics, taking advantage of advanced capabilities for development and manufacturing of cell-based therapies through its proprietary ex-vivo cell-loading platform technology. Based in Rockville, Maryland.

NCONTACT SURGICAL, INC. - Provides a minimally invasive surgical platform for treating atrial fibrillation without requiring an open-chest, stopped-heart procedure. Based in Morrisville, North Carolina.

NOVAMIN TECHNOLOGY, INC. - Created a proprietary oral healthcare active-ingredient which addresses rapidly growing and unmet oral care needs by amplifying the mouth's natural defense and repair mechanisms. Based in Alachua, Florida.

OPTIMAL READING SERVICES GROUP, INC. - Coordinates gathering and management of diagnostic images from hospitals and clinics in a digital format and delivers them to independent radiologists for reading and diagnosis in order to optimize and improve the quality of radiology services for patient care in hospitals and radiology groups. Based in Birmingham, Alabama

PRIVARIS, INC. - Develops wireless biometric authentication devices using fingerprint recognition technology that can overlay onto existing security systems. Based in Charlottesville, Virginia.

TAPROOT SYSTEMS INC. - Provides software and services for mobile phone manufacturers and wireless operators worldwide specializing in developing off-the-shelf software subsystems that support a suite of communications protocols for smartphone operating systems. Based in Research Triangle Park, North Carolina.

UNITRENDS SOFTWARE CORPORATION - Offers business system continuity solutions to small- and medium-sized businesses, enabling them to promptly get back in business when their systems and servers fail. Provides disk-to-disk, high-speed data backup and recovery capabilities in a neatly packaged and cost-effective appliance-based solution. Based in Columbia, South Carolina.

WINDCHANNEL COMMUNICATIONS - Supplies wireless broadband services, offering public safety communications infrastructure and wireless Internet connectivity to municipalities and targeted multifamily communities. Based in Atlanta, Georgia.

YAP, INC. - Creates and markets voice-enabled software which converts speech to text for multiple applications on mobile devices. Based in Charlotte, North Carolina.

MEZZANINE CAPITAL

l-r: **John S. Scott,** *Managing Director;* **Robert A. Bourquin,** *Managing Director;* **Brent G. Ray,** *Managing Director;* **J. Pryor Smartt,** *Director of Investments,* **John C. Harrison,** *VP & Senior Managing Director*

2008 IN REVIEW

The 2008 financial crisis reduced liquidity and increased costs within the senior debt market. As a result, demand has increased in the junior debt market, especially for the service sector in which many companies have "asset-lite" balance sheets. This, combined with the movement of many large mezzanine funds toward larger transactions and HMC's "friendlier-than-senior" structure has created opportunities for the Mezzanine Capital team.

HMP and HMP II closed six new investments and six add-on investments for a total of approximately $37 million invested.

The investment team exited four portfolio companies through sales to strategic and financial buyers or recapitalizations. All of these loans were repaid with warrant gains and/or paid-in-kind interest realized. Two additional loans were repaid while the equity/warrant remains outstanding.

The Funds ended the year with a portfolio of $219 million in outstanding loans and equity investments and 41 portfolio companies.

THE MEZZANINE CAPITAL TEAM TYPICALLY INVESTS IN SMALL- TO MEDIUM-SIZED businesses that have reached the lending limits of their commercial banks, or that have limited ability to borrow from traditional senior lenders. The Fund normally provides between $3 million and $15 million in subordinated debt to companies with revenues between $10 million and $100 million, and whose management has a demonstrated track record and significant ownership interest. The investment team also looks for operating profitability, sufficient cash flow to service debt, growth potential and a viable exit strategy. While the Mezzanine Capital team focuses on the service sector in compelling markets, it considers opportunities in any market.

The Mezzanine Funds' investments are, as a rule, structured as five-year interest-only loans that provide a layer of long-term capital to growing businesses. The investment team concentrates on opportunities where it believes the risk to principal is limited and the prospect for equity appreciation is high. The Funds typically deal in the unsponsored market, where the investment team believes it can obtain higher returns in lower levered transactions. The Funds also pursue long-term returns that are competitive with those of venture capital and private equity transactions. Usually, the Funds' returns are driven by a combination of leverage, current coupon interest, paid-in-kind interest, warrants with a nominal strike price and equity positions in portfolio companies.

The investment team concentrates on opportunities where it believes the risk to principal is limited and the prospect for equity appreciation is high.

HARBERT MEZZANINE PARTNERS INVESTMENTS

New Investments in 2008

HOPE AT THE HOME HOLDINGS, INC. - Provider of home health services. Based in Denver, Colorado.

PLASMA SYSTEMS HOLDINGS, INC. - Provider of engineered ruggedized solutions for the electronics manufacturing industry. Based in San Jose, California.

NRI CONSTRUCTION, INC. - Provider of apartment renovation and restoration services. Based in Atlanta, Georgia.

GLOBAL CONNECTION HOLDINGS CORPORATION - Direct marketing company focused on selling prepaid wireline home phone service. Based in Atlanta, Georgia.

ISS HOLDINGS, INC. - Supplier of aftermarket parts and services to the vehicle and heavy duty equipment markets. Based in Portland, Oregon.

CQ HOME HEALTH ACQUISITION HOLDINGS, LP - Provider of home health services to geriatric and pediatric patients. Based in Dallas, Texas.

HAPE I WILL SEEK TO GENERATE LONG-TERM CAPITAL APPRECIATION through private equity and mezzanine debt investments, directly or indirectly, in Australian resident companies (with substantial assets and operations) in Australia. The Fund will target transactions involving companies with a total enterprise value in the A$10 million to A$100 million range, with a particular emphasis on companies with a total enterprise value in the A$20 million to A$50 million range. The Australian Private Equity team believes that this segment is largely underserviced by the Australian Private Equity community, particularly in light of the recent decision by a major financial institution to cease new private equity investments and abandon plans to create subsequent funds.

The team intends to employ a conservative valuation strategy targeting companies with low absolute valuation multiples that they believe represent discount to their potential long-term value. To achieve the lower valuation multiples, the Fund will often invest in companies with certain operational and execution risks (e.g., customer concentration, inefficient operations, senior management needs, etc.) and assist these companies in attempting to mitigate or alleviate those risks. The team believes the industries and companies to be targeted by the Fund have frequently been overlooked or "undiscovered" by institutional and other private equity investors due to the size of the companies involved. HAPE I will target investments in companies that the investment team believes have a definable "niche," defensible market share, good growth prospects, and positive cash flow in small, fragmented or emerging industries sectors in 2009-2010 than in recent years.

l-r: **Jeremy E. Steele,** *VP & Senior Managing Director;* **Brendan J. Anderson,** *VP & Senior Managing Director*

l-r: **Patrick E. Molony,** *EVP & COO;* **Wayne B. Nelson III,** *President and CEO;* **Jeffrey W. Moore,** *Vice President;* **Kenneth W. Kilgroe,** *Vice President & Controller*

2008 IN REVIEW

Fund I and Fund II continue to meet or exceed their financial goals.

Fund I sold its interest in the Soda Lake project.

Fund II sold its interests in the Fluvanna, Freeport, and Pinelawn projects.

Fund III made an investment in the senior secured notes of Longview Power.

Fund III was selected with a partner to develop, construct, and operate a 400 MW gas-fired project in Ontario, Canada.

THE INDEPENDENT POWER TEAM INVESTS IN POWER GENERATION AND other power-related assets. The Power Fund investment team members began investing in power in the mid-1980s when power investing was a relatively new, fragmented and less efficient market. Initial focus was on small, early stage development projects, and by the early 1990s the investment team had assembled a portfolio of ownership interests in mostly solid fuel projects. As the independent power industry grew, a secondary market for assets developed, which made it possible to invest in a diversified portfolio of existing projects with attractive risk-adjusted returns. Harbinger Independent Power Fund I was formed to take advantage of this opportunity and acquired interests in five operating projects. As the industry continued to mature, it attracted more financial investors and equity returns came down. Partly because of this trend, Harbinger Independent Power Fund II returned to investing in earlier-stage projects in order to deliver better investment returns. In Harbert Power Fund III, the investment team anticipates building a portfolio by acquiring existing assets, as well as by developing power assets. The investment team believes that their experience and capability to develop projects distinguish them from many power industry investors, and that this competitive advantage can provide investors additional opportunity to achieve attractive returns on their investment. Recent problems in the financial markets are affecting the availability and the cost of credit for some power assets and for financing power asset acquisitions. The Independent Power team believes this development should result in better opportunities for equity investors in 2009-2010 than in recent years.

The team's experience and capability to develop projects distinguish it from many power industry investors.

HARBERT POWER INVESTMENTS

Portfolio as of December 31, 2008

INVESTMENTS

KALAELOA (50% OWNERSHIP)

209 MW oil-fired plant

Oahu, Hawaii

LOCKPORT (24% OWNERSHIP)

200 MW gas-fired plant

Lockport, New York

GWF ENERGY (40% OWNERSHIP)

- Phase I

  94 MW gas-fired plant

  Hanford, California
- Phase II

  96 MW gas-fired plant

  Henrietta, California
- Phase III

  170 MW gas-fired plant

  Tracy, California

MACKENZIE GREEN ENERGY (50% OWNERSHIP)

55 MW wood-fired plant

British Columbia (in development)

DIXIE PELLETS (86% OWNERSHIP)

520,000 tons per year wood pellet plant

Selma, Alabama

LONGVIEW POWER (INVESTMENT IN DEBT SECURITIES)

695 MW supercritical coal-fired plant

Maidsville, West Virginia (under construction)

MANAGED ASSETS

BRIDGEWATER (40% OWNERSHIP)

17 MW wood-fired plant

Bridgewater, New Hampshire

GWF POWER SYSTEMS (50% OWNERSHIP)

- Site I - Site II - Site V

  18.5 MW petroleum coke plants

  Pittsburg, California
- Site III - Site IV

  18.5 MW petroleum coke plants

  Antioch, California
- Hanford (50% ownership)

  23 MW petroleum coke plant

  Hanford, California

SOLD ASSETS

SODA LAKE

14 MW geothermal plant

Fallon, Nevada

FLUVANNA

885 MW gas-fired plant

Fluvanna County, Virginia

FREEPORT

47 MW gas-fired plant

Long Island, New York

PINELAWN

80 MW gas-fired plant

Long Island, New York

GWF Energy's, Tracy Peaker Plant, Tracy, California

ABSOLUTE RETURN STRATEGIES

EMERGING MARKETS

Heather N. Leonard, *Senior Managing Director;* not pictured: **Greg P. Ebeyer,** *Trader;* **Robin Y. Yang,** *Director of Investments;* **Tom A. Chyla,** *Director of Investments*

2008 IN REVIEW

The financial crisis that began in 2007 intensified in the second half of 2008. The magnitude of the losses sustained in G-7 markets represented a brutal expression of structural stress and forced a rationalization of a financial system running in excess. Financial markets of emerging markets countries sustained collateral damage and buckled under their own idiosyncratic systemic stresses. Such periods of stress can be catalysts to radical political change and often result in broad-based structural reforms.

Although conditions in 2009 will continue to be volatile, the investment team believes the opportunities to generate attractive returns in the emerging financial markets are in many ways better than those found during a similar collapse in 1997 and 1998.

In December, Peter Lannigan resigned from the Emerging Markets Investment team. Heather Leonard, who has been a senior member of the team since its inception, assumed the Senior Portfolio Manager position.

HMC'S EMERGING MARKETS STRATEGY SEEKS TO IDENTIFY ATTRACTIVE absolute return opportunities in the financial markets of Latin America, Eastern and Central Europe, Africa and Asia, excluding Japan. The investment team uses an approach that typically focuses on government and corporate issuers. The Fund's strategy is expressed primarily through unlevered cash investments in equity and fixed-income securities. Additionally, the team seeks to capitalize on opportunities in derivative markets for both corporate and sovereign issuers and foreign currencies to provide both a hedging mechanism and a liquid means for short trades.

The Fund attempts to acquire investments that factor both short-term and long-term trends, while observing an absolute pricing discipline. As a result, the strategy does not represent an index of emerging markets investments. Firm-level examinations are conducted to determine competitiveness and comparability. Risks inherent to a particular investment in an emerging markets country may be greater or less than that of an investment in a developed market country. Therefore, the investment team examines market pricing and gives consideration to the macro-economic framework established by the respective sovereign administrator. Additionally, an assessment of the global condition is vital to identifying risks beyond a particular firm's control.

The Fund attempts to acquire investments that factor both short-term and long-term trends, while observing an absolute pricing discipline.

EVENT OPPORTUNITIES

l-r: **Niraj Gupta,** *Director of Investments;* **Charles E. Perilman,** *Managing Director;* **Michael P. Reinking,** *Trader;* **Neil B. Kennedy,** *VP & Senior Managing Director;* **John H. Frank,** *Director of Investments*

2008 IN REVIEW

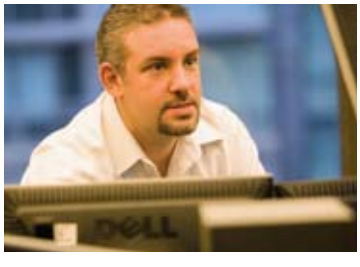
The credit crisis that stretched into 2008 placed considerable stress on this strategy, causing a significant amount of capital to exit the marketplace. Despite these challenges, the Fund managed to maintain its footing through effective stock selection and dynamic hedging. In this environment, the Fund's experienced investment professionals have been cognizant that preservation of capital is of primary importance. They are optimistic that the landscape in 2009 will include less competition and decreased leverage, offering potential returns that compare favorably to assumed risk.

THE EVENT OPPORTUNITIES TEAM SEEKS TO GENERATE SUPERIOR, risk-adjusted returns by taking advantage of the discrepancy between an equity's current price and the value implied by an announced transaction.

The Event Opportunities team is selective in the opportunities it pursues, believing that every transaction must stand on its own merits. The team's research process combines a rigorous analysis of the fundamental and strategic benefits of a transaction with an intensive review of the regulatory landscape. The investment team further seeks to enhance returns and manage risk by optimizing position size at critical points throughout the merger process and, when appropriate, through the creative use of derivatives.

The Fund also invests in companies experiencing significant internal or external changes that the investment team believes could lead to materially different valuations. These event-driven situations can include legislative catalysts, restructurings, management changes, regulatory changes, corporate auctions, spin-offs and the involvement of corporate activists.

As a natural extension of the Fund's strategy and core competencies, the investment team invests in the convertible arbitrage space. With the addition of Chuck Perilman to the investment team, the team is confident that the Fund has the necessary expertise and experience to take advantage of the compelling opportunities currently being offered in this strategy.



The Event Opportunities team is selective in the opportunities it pursues, believing that every transaction must stand on its own merits.

l-r: **Zachary P. Turnage,** *Director of Investments;* **A. Daniel Thomasson,** *Director of Investments;* **Todd D. Nunnelley,** *VP & Senior Managing Director;* not pictured: **P. Partlow Willings,** *Analyst*

2008 IN REVIEW

Navigated the extremely volatile investment environment with strong short profitability and an ongoing disciplined focus on new opportunities emerging from the turmoil.

Added Part Willings to the investment team as an Analyst at the end of the year.

Entered the new year with a compelling portfolio with strong future return potential on both sides and excess cash available to deploy in increasingly compelling new investments.

THE VALUE FUND OPERATES UNDER FIVE CORE PRINCIPLES: A DISCIPLINED emphasis on absolute value; fundamentally-based analysis of investment opportunities; a tightly focused portfolio; selective use of short selling; and maintaining a long-term analytical view.

The Value Fund investment team uses fundamental analysis to uncover opportunities where the price of an investment appears materially different from its worth. The investment team measures value by comparing the price of a security against a series of fundamental analyses, including financial statements, industry, free cash flow or asset value. The team members place particular emphasis on free cash-flow potential over the long term.

Opportunities often exist in special situations, such as spin-offs, holding company discounts and stub discounts, where the team attempts to capitalize on valuation dislocations that result from corporate actions or structural complexity. The Fund's portfolio is relatively concentrated because its strategy demands that each opportunity stand on its own merits; the Fund invests in an individual opportunity, not in a particular trend or sector.

The Value Fund's strategy generally has a bias toward the long side, but employs selective short selling. The investment team's short selling is not only used as a portfolio hedge but also to provide concentrated positions that are expected to contribute positively to performance on a stand-alone basis. The Fund's investment professionals are generalists as it relates to sectors, market cap and geography, though most of their investments to date are in the US. However, the team will look at any opportunity with the potential for exceptional value.

The Value Fund investment team uses fundamental analysis to uncover opportunities where the price of an investment appears materially different from its worth.

STRATEGIC COMMODITIES

l-r: **Ari P. Dach,** *Associate;* **Kevin O'Shaughnessy,** *Trader;* **Fiona P. Boal,** *Vice President;* **Harold A. Lehr,** *VP & Senior Managing Director;* **Maziar Brumand,** *Associate;* not pictured: **Adam Q. H. Clarke,** *Strategist*

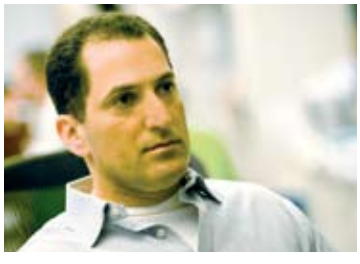
2008 IN REVIEW

We carefully built the Fund's infrastructure to optimize the effectiveness of our investment strategy for the upcoming year and remained focused on the development and formalization of our risk parameters and analytical process.

We are excited by the opportunities which are in front of us and believe we have created an optimal platform for success within the energy, metals and agriculture sectors in 2009.

HMC LAUNCHED THE STRATEGIC COMMODITIES FUND IN OCTOBER OF 2008 with six investment professionals in New York. The investment team seeks to capture fundamental value opportunities by employing both directional and relative value trading strategies within and across commodities and commodity-related asset classes. The primary investment focus is on the energy, metals and agricultural sectors. The Fund seeks to trade products whose values are based on tangible fundamental factors within some of the most active, liquid and transparent markets.

The investment team typically initiates its process by developing investment themes from a strategic macro perspective based on evaluation of international commodities and commodity-related markets, global and regional economic conditions, and current and future supply and demand imbalances. Subsequently, information is examined from multiple sources and analyzed using detailed fundamental methodologies. Both the depth and breadth of the investment team's experience enable the Fund to cover a variety of sectors globally, with accuracy and detail.



HSCF seeks to trade products whose values are based on tangible fundamental factors within some of the most active, liquid and transparent markets.

Risk assessment is one of the cornerstones of the Fund. The background and experience of the investment team reflects a culture of due diligence, discipline and independent thought. Investment team members use a variety of risk monitoring resources, including third-party administrators, and implement proprietary asset mix and risk optimization techniques to implement trades and structure the Fund's portfolio with a view to maximizing risk appropriate returns.

SUPPORT

INVESTOR SERVICES AND RISK MANAGEMENT

l-r: **Christopher N. Jones,** *Director of Information Technology;* **Susan M. Shalhoop,** *Director of Hedge Fund Administration;* **Darlene A. Hartmann,** *Director of Investor Reporting;* **Thomas M. Hicks,** *Director of Risk Management;* **Sonja J. Keeton,** *Controller & Director of Corporate Tax;* **David A. Boutwell,** *EVP & CAO;* **Elizabeth A. Deuel,** *Director of Internal Audit*

HMC'S BACK OFFICE TEAM OF MORE THAN 50 PROFESSIONALS INCLUDES approximately 25 CPAs and 10 IT specialists that support infrastructure and business continuity plans.

PRIVATE CAPITAL AND REAL ESTATE FUNDS. The accounting, tax and investor reporting groups handle reporting functions and communications for each investor's capital account in the private market funds, as well as capital calls and distributions. The groups provide quarterly and annual investment reports and tax information to HMC's private market fund investors; they independently calculate fund-level performance for all of the private market funds. HMC's auditors annually review all performance returns in the annual report.

ABSOLUTE RETURN STRATEGIES. Hedge fund administration provides administrative and operational support functions for HMC's absolute return strategies. The group's responsibilities include monitoring trade capture and settlement; preparing daily performance and risk reports for management; acting as liaison to each hedge fund's respective prime brokers, custodians and administrators; and coordinating investor servicing functions with the funds' administrators.

INTERNAL AUDIT. The internal audit team ensures compliance with policies and procedures adopted by HMC in various areas. It also monitors and assists the company's private capital fund's due diligence efforts. The team's responsibilities also include an annual review of performance returns and the conduct of periodic compliance audits.

RISK MANAGEMENT. The independent risk management team monitors daily trading for HMC's absolute return strategies through the use of concentration, leverage and other portfolio guidelines specific to each fund. The team also reviews the fair value determination for private investments.

INVESTMENT COMMITTEES. A separate investment committee monitors each of HMC's private capital and real estate investment strategies. The committees include principals of the respective investment team and at least one member of HMC's Board of Directors who is not engaged in the day-to-day execution of the respective strategy. These investment committees must unanimously approve each commitment of capital and asset dispositions.

REGULATORY OVERSIGHT. The following HMC subsidiaries are registered with regulatory authorities: Harbert Fund Advisors, Inc. is an investment adviser registered with the SEC. HMC Investments, Inc. serves as a placement agent and is a registered broker-dealer and member of FINRA/SIPC. Harbert European Fund Advisors, Ltd. carries on certain activities that are regulated within the United Kingdom by the Financial Services Authority.

LEGAL AND COMPLIANCE

l-r: **Michael C. Bauder,** *VP & Chief Compliance Officer;* **Trey Ferguson, III,** *VP & Assistant General Counsel;* **Joel B. Piassick,** *EVP & Former General Counsel;* **John W. McCullough,** *Senior VP & General Counsel;* **S. Perry Given, Jr.,** *VP & Associate General Counsel;* **Kevin A. McGovern,** *Assistant General Counsel*

THE 16 PROFESSIONALS AND SUPPORT STAFF, INCLUDING NINE ATTORNEYS, comprising HMC's legal and compliance department, are focused on providing legal support and supervision to HMC's investment funds, ensuring adherence to prescribed policies and applicable laws and regulations affecting the funds, and acting as counsel to HMC's management and internal departments.

HMC's public market funds trade equity and debt securities in multiple international markets, potentially implicating a variety of US and foreign regulatory issues. HMC's legal staff has significant experience identifying these issues in the US and abroad (such as beneficial ownership and "short selling" reporting requirements) and assuring compliance. HMC's legal staff also provides support and advice with respect to significant corporate transactions and provides general corporate counsel concerning administrative and operational matters for the funds.

HMC's private market funds typically invest in controlling interests in privately-owned businesses and assets through the purchase of illiquid equity and debt securities. HMC's legal staff is well-versed in the legal issues unique to private market investing, including private placement of securities, tax structuring, indemnification remedies, corporate governance and equity holder rights. In addition to advising the private market investment teams, the legal team supervises and interfaces with outside counsel on all portfolio investment acquisitions and dispositions and provides legal support through participation in investment committee meetings.

The legal staff leads the legal structuring and formation of all new public and private market funds and their subsidiaries.

Our compliance group has implemented and monitors policies and procedures designed to ensure that HMC, its subsidiaries and employees, and the HMC-sponsored funds comply with applicable securities regulations, as well as HMC's internal policies and controls. HMC's compliance programs include regular internal audits, licensing and training of employees, supervision of employee and fund trading, and identification and management of risk and conflicts of interest.

INVESTOR RELATIONS

l-r: **Charles D. Miller,** *EVP & CFO;* **Melissa M. Babb,** *Managing Director;* **Rest B. Heppenstall,** *Managing Director;* **Michael J. Larsen,** *Managing Director,* **Lynette P. Horton,** *Managing Director,* **Neal J. Howe,** *Managing Director*

THE HMC INVESTOR RELATIONS TEAM IS RESPONSIBLE FOR INFORMATION flow between our worldwide investor base and the entire firm. Each investor benefits from a relationship with an experienced HMC professional who understands the investor's needs and can deliver information on all aspects of the firm or their respective investments as and when needed. Clients cite this model as client service at its best.

Many investment firms struggled in 2008 and have been forced to downsize or scale back their investor relations activities. HMC understands the importance of having a strong investor relations presence in place, especially during these challenging times, and made the decision that now is the time to expand. A new investor relations branch office was opened in Atlanta during the second half of 2008, and a senior investor relations professional was hired in the London office to cover the German markets. New investor relations operations are also being considered for the San Francisco office and a new office yet to be opened in Tokyo.

HMC understands the importance of having a strong investor relations presence in place, especially during these challenging times and made the decision that now is the time to expand.

As an investment management firm with 11 distinct strategies, managing information flow is a substantial responsibility. HMC centralizes the production and distribution of marketing materials, performance reporting and this annual report through the HMC Communications group. The Communications group administers the HMC Web site (www.harbert.net) and is responsible for its user interface and current content. HMC has begun implementing a password-protected, Web-based environment for secure access to and distribution of fund performance and account information.

HARBERT REALTY SERVICES, INC.

l-r: **Mary C. Echols,** *EVP of Financial Services;* **Eric B. Massey,** *Senior Vice President/Development;* **Harry M. Lynch,** *President & CEO;* **W. Dean Nix,** *Senior Vice President;* **David R. Williams,** *EVP & COO;* **C. Michael Murray,** *Senior Vice President;* **George B. Elliott, Jr.,** *Senior Vice President*

2008 IN REVIEW

Added Synthes (USA), a maker of surgical steel pins used in joint replacements, as a new client.

Managed the bank real estate needs for Regions Financial Corporation across their entire 16-state footprint.

Completed 170 transactions in 34 states during the contract year on behalf of Amedisys, a rapidly growing home healthcare client.

Established a restaurant specialty team to serve a growing list of national restaurant concepts, including The Wine Loft Wine Bar, Indigo Joe's Sports Pub & Restaurant and Five Guys® Famous Burgers & Fries.

Completed construction on The Solary I, an office/retail development in Orlando, Florida; HRS leases and markets this two-phase 10-acre development.

HARBERT REALTY SERVICES (HRS), A SUBSIDIARY OF HMC, IS A FULL-SERVICE commercial real estate company, offering a range of commercial real estate services from leasing and property management to construction and development services. HRS also offers lease administration and corporate real estate services supported by a team of highly experienced professionals with backgrounds in accounting, real estate and law.

HRS provides support to HMC's broader real-estate-related activities, including due-diligence services, local market expertise and consulting support for strategic real estate needs and financial consolidation. Their team also provides real estate management and leasing services for select HMC properties and for the properties of other major corporate clients.

Within HRS are three specialized groups. The Corporate Services Group (CSG) is a commercial real estate service provider for multi-location companies offering transactional, administrative and advisory services. CSG's various offices provide assistance nationwide to maximize the total portfolio of its partners, rather than focusing on the singular transaction approach of traditional brokerages. The Transaction Services Group (TSG) primarily focuses on representing landlords and tenants in leasing and sale transactions. The Development Group advances the interests of investors/developers in new projects throughout the Southeast, as well as performing Construction Management Services for third-party clients.

HRS provides support to HMC's broader real-estate-related activities, including due-diligence services, local market expertise and consulting support for strategic real estate needs and financial consolidation.

HARBERT EMPLOYEES REACHING OUT

(HERO) FOUNDATION

She was a single mother with four children; her youngest born with severe cerebral palsy. Her life, hard enough under the best of times, was devastated in December of 2007 when fire consumed their apartment and everything in it. What possessions she had that weren't burned were so damaged by smoke and water that only a few clothes were salvaged. It was for people like this that we created the HERO Foundation. Our employees stepped in and provided Christmas gifts and food in the days after the fire. When this mother found a new apartment, HERO provided furniture to help her reestablish her life.

These are challenging times for all of us. But for some, the challenges are insurmountable without immediate help. That's precisely why we created the HERO Foundation, to give our employees a vehicle for assisting people in the communities where we live. Through the HERO Foundation, we provide direct financial assistance to people affected by natural disasters, medical conditions or temporary financial hardships. We help people regain their independence and self-sufficiency. Since 1998, our employees have helped many people when no other safety net was available.

During 2008, HERO granted 24 awards totaling $170,000. The average grant size was approximately $5,000. However, the largest grants, which were used to buy vans for families with special needs, totaled more than $15,000 each.

A group of employees from across the company manage the Foundation. HERO's resources come from our employees, our affiliates and from fund-raisers we hold throughout the year. We learn of people in need from employee referrals and from several partners in the community, including Children's Hospital, Alabama Children's Rehabilitation Services and the Alabama Head Injury Foundation to name a few.

For some, the challenges are insurmountable without immediate help. That's precisely why we created the HERO Foundation.

Ask anyone involved in HMC and they will tell you that the entire company takes great pride in the successes of the HERO Foundation.

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This annual report contains certain "forward-looking statements" that are based on our assumptions and judgments with respect to, among other things, future economic, competitive and market conditions, subjective evaluations of current investments and their prospects and future business decisions, all of which are difficult or impossible to predict or evaluate accurately and many of which are beyond our control. Because of the significant uncertainties inherent in these assumptions and evaluations, you should not place undue reliance on these forward-looking statements, nor should you regard the inclusion of these statements as our representation that any fund will achieve any strategy, objectives or other plans. All forward-looking statements are made as of the date of this report. There is no obligation to update these forward-looking statements to reflect events or circumstances after the date hereof, nor is there any assurance that the policies, strategies or approaches discussed herein will not change. Any referenced performance information has not been prepared to meet the reporting standards of the CFA Institute (AIMR-PPS and GIPS) or any other regulatory agency or trade organization. All performance information included in this report is unaudited and should not be viewed as predictions or representations as to actual future performance.

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