aligned

HARBERT
MANAGEMENT
CORPORATION

2009 ANNUAL REPORT

We are investors first. The same as you.

Our interests are aligned with yours. Given all the trauma that has shaken the investment community, it's important to understand that at Harbert® Management Corporation (HMC®), we invest our own money, on equal terms with other participants, in every fund we create. It's a fact that distinguishes HMC from the mass of alternative asset investment firms. Our investments mean that we value absolute returns every bit as much as you do. We align our interests with yours, so that our success is inseparable from your success.

Our business is aligned with transparency. It takes no insight to understand that investor confidence is shaken by events of the recent past. With each successive horror story played out in the headlines, we strengthen our belief in transparency. We've aligned our business philosophy to ensure that our investors have access to every important detail. We voluntarily sought registration with the SEC and FINRA, at our own expense, years before coming regulations will make it mandatory for everyone. And we did it to reassure our investors that our business is structured the right way.

Our approach is aligned with the times. There is great uncertainty in the market, but with uncertainty comes opportunity. More than ever, capital is king. The opportunities for absolute returns in the coming years are perhaps unprecedented—we're poised to capitalize on them.

When considering an alternative asset investment firm, be sure that the interests they hold dear are aligned with your own.

We align our interests with yours, so that our success is inseperable from your success.

IMPORTANT NOTICE: The information contained herein does not constitute the provision of investment advice, nor does it convey an offer of any type. It is not intended to be, and should not be construed as, an offer to sell or the solicitation of an offer to buy any securities or other financial products. Offers will only be made through a confidential offering memorandum to qualified investors and only in those jurisdictions where permitted by law. No assurances can be made that any expectations, strategies and/or goals expressed or implied will be realized or successful or that the activities or any described performance will continue in the same manner or at all. The information presented is confidential, is intended only for the designated recipient and may not be copied, reproduced or distributed in whole or in part to others. Past performance is not indicative of future results.

The 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's strategy, objectives or other plans will be realized or successful. 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.

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, L.P.*	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, L.P.**	In subscription
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
HPEF III	*Harbert Private Equity Fund III, LLC*	In subscription
HAV	*Harbinger/Aurora Venture Funds*	March 31, 2000
HVP	*Harbert Venture Partners, LLC*	December 31, 2004
HVP II	*Harbert Venture Partners II, L.P.*	October 29, 2009
HEREF	*Harbert European Real Estate Fund BV*	July 31, 2003
HEREF II	*Harbert European Real Estate Fund II, L.P.*	March 30, 2007
HMP	*Harbinger Mezzanine Partners, L.P.*	December 22, 2000
HMP II	*Harbert Mezzanine Partners II, L.P.*	January 10, 2006
HAPE I	*Harbert Australian Private Equity Fund I, L.P.**	In subscription
HEMF	*Harbert Emerging Markets Fund, L.P.**	Open
HEOF	*Harbert Event Opportunities Fund, L.P.**	Open
HVF	*Harbert Value Fund, L.P.**	Open

**Offshore feeder fund or parallel fund also available*

corporate profile

Harbert Management Corporation is an investment firm managing approximately $2.7 billion in assets and committed capital as of December 31, 2009, in 10 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 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

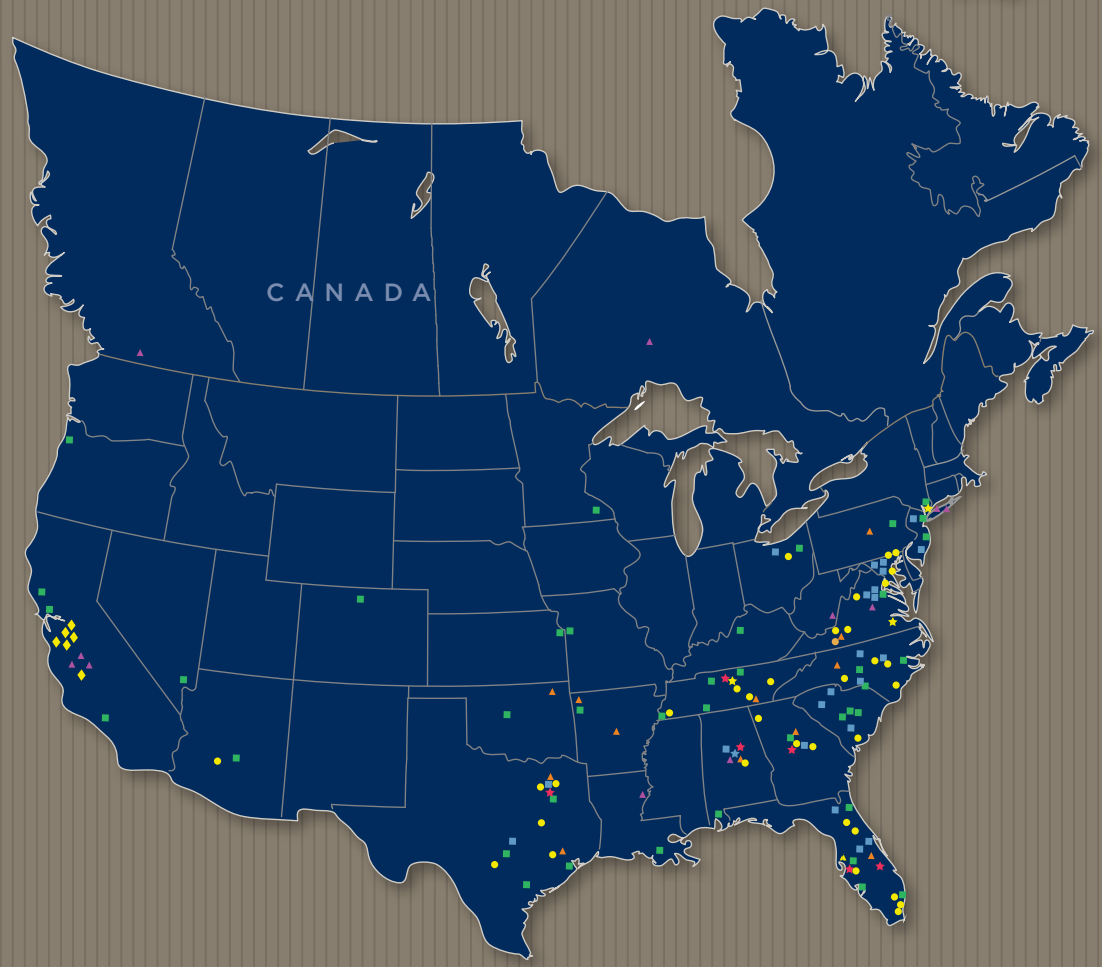
Private Capital
Private Equity
Venture Capital
Mezzanine Capital
Independent Power
Australian Private Equity

Absolute Return Strategies
Emerging Markets
Event Opportunities
Value

Harbert Management Corporation

LOCATIONS AND PRIVATE CAPITAL INVESTMENTS AS OF DECEMBER 31, 2009

- HMC Headquarters
- HMC Investment Offices
- Harbert Realty Services Offices
- United States Real Estate Investments
- European Real Estate Investments
- Independent Power Investments
- Independent Power Managed Assets
- Private Equity Investments
- Venture Capital Investments
- Mezzanine Capital Investments
- Australian Private Equity Investments



the year in review 2009

Letter to Partners, Associates and Friends

Everywhere we turn we hear the same questions being asked, from the "talking heads" of the electronic media, the financial pundits in the print media, the politicians, and most importantly, from you, our "partners, associates and friends."

Is Modern Portfolio Theory an anachronism?
How should asset allocation be viewed going forward?
How should credit be utilized in active investment management?
Is active investment management worth the associated cost?
What have you learned since the summer of 2008?
What will you do different going forward?

These are valid questions that should be asked of us as well as others in investment management. The answers to these questions are critical to understanding whether your assets are being managed as they should. These questions led us to an in-depth review of the investment principles on which Harbert Management Corporation was founded and has been managed by over the last 15 years. Let us briefly recount them:

- First and foremost, we are investors, not asset gatherers, allocators, advisors or otherwise. Our interests will always be aligned with our partners through the commitment of our capital and reputation. As of the end of 2009, HMC shareholders and HMC affiliated entities had an aggregate of $687 million of investments and commitments to the funds we have formed.
- We are committed to provide total transparency in the exchange of information with our partners regarding their investments.
- We invest for absolute returns and are prepared to stay on the sidelines or sell when conditions dictate.

- We utilize fundamental, investment-by-investment analysis, underwriting to absolute return thresholds. We do not make investments based on momentum, mathematical models or other similar techniques.
- The best analysis will never be a substitute for the discipline of diversification, both across asset classes and within portfolios. Each portfolio is contained in a legally distinct entity in order to isolate risks. Leverage is used prudently, and whenever possible, individual assets are financed without recourse to other investments in that portfolio.

Our conclusion after conducting this institutional soul searching is that the basic concepts on which we have been managing capital for the last 15 years withstood the tests of 2008/2009 and are as valid going forward as they ever were. This is not to say that we did not learn anything from this period of unprecedented market volatility, unprecedented asset correlation and the worst global credit/liquidity freeze and general economic malaise since the great depression. We will come to that later in this letter.

The last 18 months provided an ideal, albeit unwelcome, test for our core principles. More broadly, this environment brought into question the rationale behind many investment strategies, including the diversified alternative asset investing that we employ. It has also become popular for the press to criticize hedge fund, private equity and other investment managers and to question the legitimacy of these investment vehicles. In some specific cases the criticism may be partially or wholly justified; however, a careful examination of longer term performance provides strong support for the investing strategies employed by HMC and other sophisticated investment managers like us.

The endowments of Harvard and Yale universities have been noted for their extensive commitment to alternative asset classes for many years, far greater in comparison to their peers in the endowment arena. During this past year, headlines criticized both institutions for their investment performance in 2008/2009 and questioned their portfolio strategies. A focus on longer-term performance, however, tells a decidedly different story. Harvard and Yale's ten year annualized returns of 8.9% and 11.8% respectively, trounced comparisons with unmanaged domestic stock portfolios -1.2%, domestic bonds 6.0% and comparisons with other University endowments 3.2% which employed more "traditional" portfolio management policies. Similarly the Hennessee Hedge Fund Index, a diversified blend of absolute return strategies, posted an annualized return of 6.5% for the ten years ending December 31, 2009 in contrast to the S&P 500's annualized loss of 2.6%.

Raymond J. Harbert
Chairman &
Chief Executive Officer

Our conclusion after conducting this institutional soul searching is that the basic concepts on which we have been managing capital for the last 15 years withstood the tests of 2008/2009 and are as valid going forward as they ever were.

By managing our individual assets and investments through a very trying macro environment, we learned that the case for active professional investment management and allocation to alternative investment strategies has greater validity than ever.

Taking this longer term view, HMC's performance during our 14 years of investing compares favorably with these benchmarks, and the performance of equity and bond market indices. To measure our performance on a long-term basis, we establish and report each year the internal rate of return an investor would have earned by allocating to every investment platform HMC has created since the close of our first fund in 1995, in the same proportion and at the same time as the HMC shareholders and HMC affiliated entities. This year's number, reflecting 14 years of cumulative investment performance, was an internal rate of return of approximately 12% and realized cash on cash return of approximately 13%. For reference, the S&P 500 and Barclays U.S. Aggregate Bond Indexes each had annualized returns of approximately 6% during this same period.

This performance reflects a dilution in returns from the comparable numbers reported in 2008 of approximately 15% IRR and 15% cash on cash. All this performance data is net of all fees and includes 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.

While this relative performance comparison may be favorable, we are absolute return investors and our 2008/2009 returns are a disappointment to us all. What we are proud of is how HMC, as an investor, responded to the extremely difficult economic and capital markets environment that generated these losses. By managing our individual assets and investments through a very trying macro environment, we learned that the case for active professional investment management and allocation to alternative investment strategies has greater validity than ever. (As an aside, HMC partners committed $185 million of new capital to our existing hedge funds and to new and follow-on private market funds that we formed during this period.) As wholesale panic set in during the fourth quarter of 2008 and the first quarter of 2009, total market irrationality became the norm. To limit losses and damage to investment portfolios, it was critically important to maintain discipline, emotional ambivalence and constant monitoring of your individual underwritings, which we did even though it was hard not to follow the herd. As you evaluate our performance and consider investing with us, we hope you will focus on four qualities that we feel an excellent investment management firm should exhibit, and we believe Harbert Management Corporation exemplifies.

First: There should be an irrefutable alignment of interest. An investment manger should not make money when his clients do not. The purest form of alignment we know is substantial co-investment by the manager alongside his clients on the same terms and conditions.

Second: The investment manager should have a disciplined objective investment process. If the manager cannot explain their investment process and how they derive their returns in a fashion you understand and believe, do not invest with them.

Third: The investment manager should provide 100% transparency–down to the level of each portfolio investment. You should know whether leverage is employed and in what form and to what degree. The use of short term borrowed funds and highly leveraged derivatives to increase returns have been a disaster for many investors, particularly in the past year. This data should be provided to you at least quarterly and you should receive audited financial statements annually from an accounting firm whose name you recognize.

Fourth: The investment manager should have a discernable track record that shows how they have performed through different investment cycles.

In our opinion, the next several years will prove to be one of the best periods to commit capital in our careers. HMC is well positioned to take advantage of this environment. We presently have 10 investment platforms and 190 employees solely dedicated to searching for and managing investments on a world-wide basis. Our current funds have capital available for new investments, and HMC partners are continuously seeking strategic opportunities to add investment teams and asset classes which meet the criteria for our platform.

We greatly appreciate the opportunity that so many of you have given us to manage a portion of your assets. We hope others who are evaluating Harbert Management Corporation will do so with a critical eye, because we believe that even under the harshest lens, you will like what you see.

Thank you for your continued confidence!

Raymond J. Harbert, Chairman & Chief Executive Officer

Michael D. Luce, President & Chief Operating Officer

Raymond J. Harbert
Chairman &
Chief Executive Officer

Michael D. Luce
President &
Chief Operating Officer

In our opinion, the next several years will prove to be one of the best periods to commit capital in our careers. HMC is well positioned to take advantage of this environment.

aligned

real estate

united states real estate





l-r: **Todd N. Jordan**, Director of Investments; **J. Travis Pritchett**, Director of Investments; **Alan C. Fuller**, Vice President & Senior Managing Director; **Jeffrey H. Seidman**, Vice President of Asset Management; **Michael P. White**, Vice President & Senior Managing Director; **Jon-Paul Momsen**, Managing Partner (San Francisco)

2009 IN REVIEW

In 2009, HMC continued to raise capital for HUSREF IV, the firm's fourth United States real estate fund. Capital raising efforts for the fund will continue until mid-year 2010. During the year, considerable attention was also placed on asset management, focusing on portfolio leasing, financing and capital needs. The investment team also continued to develop its deal flow network in anticipation of emerging distressed asset sales.

Other notable events during the year include:

- *Promoted Andrew Case to Asset Manager.*
- *Added an Associate for the San Francisco office, David Monte, formerly of Deutsche Bank/RREEF.*
- *Sold four office properties.*
- *Acquired a 13 asset self-storage portfolio and two multifamily properties; one in Phoenix, Arizona and the other in Ft. Myers, Florida.*

It's no secret that the real estate market is suffering through a contraction in value on a scale not seen since the early 90s. The contraction was led by a collapse of the capital markets. The capital markets showed the first signs of distress in August 2007; they fractured in full in late summer 2008, seizing up completely. Credit is near non-existent and what credit can be found comes with requirements for greater equity. Commercial Mortgage Backed Securities originations fell from a peak of $280 billion in 2007 to near zero by the end of 2008. The general economic recession and resulting unemployment then dealt the industry a second blow. Since December 2007, the U.S. economy has shed 7.6 million jobs and, of course, there is a direct correlation between jobs and real estate.

When we first perceived the rising risks in 2007, we curtailed deploying HREF III capital, cautiously moving to the sidelines. This un-deployed capital has been used to refinance existing projects in the portfolio and to fund tenant improvement and commission obligations required to attract and retain tenants in an effort to avoid the pain of becoming "motivated sellers." Our priorities are to protect and enhance the value of our existing assets, creating value through efficient operations and the management of our resources, while maintaining occupancies in a difficult economic climate.

Of course, the extreme downward pressure on valuations creates opportunities for outsized risk adjusted returns for investors with capital. We are currently investigating a number of attractive opportunities for HUSREF IV. In the later part of 2009, we've seen small pockets of thaw in certain sectors, particularly multifamily housing. Moving forward, it's important to note that we continue to invest our own capital on equal terms with our investors.

In the later part of 2009, we've seen small pockets of thaw in certain sectors, particularly multifamily housing.

2009 united states real estate transactions

HUSREF IV ACQUISITIONS

Santa Rosa Apartments – In June 2009, HUSREF IV acquired an 85% interest in Santa Rosa Apartments. This Class A 112-unit multifamily property located in Phoenix, Arizona was purchased at a cap rate of approximately 8.4% in an off-market recapitalization.

Beach Club and Viridian Lake Apartments – In December 2009, HUSREF IV acquired 9% interest in Beach Club and Viridian Lake Apartments. This distressed 640-unit multifamily property was purchased out of receivership in a joint venture with Greystar. The asset is located in Ft. Myers, Florida, and is scheduled to undergo an extensive renovation to correct deferred maintenance and upgrade unit interiors.

In 2010, HUSREF IV formed a joint venture with Greystar, the largest multifamily operator in the United States, to provide general partner investment capital. HUSREF IV will invest alongside institutional limited partner investors while participating in Greystar's incentive fee which could provide HUSREF IV enhanced returns.

W.P. Carey 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-feet 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 DISPOSITIONS

SunTrust Office Portfolio – During 2009, HREF III sold four properties from the SunTrust Office Portfolio totaling 215,774-square-feet or 21% of the portfolio. The attractive pricing of the dispositions allowed HREF III to reduce the outstanding mortgage debt of the portfolio by approximately 30%. An additional property is pending disposition in 2010.

HREF III PORTFOLIO

A summary of the assets in the HREF III portfolio as of year-end 2009 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-feet of office space acquired in a partial sale lease-back transaction.

Ellington Trade Center – 503,140-square-foot, three-building, newly developed industrial project in Houston, Texas.

NorthPointe Trade Center – 448,550-square-foot, three-building, newly developed industrial project in Austin, Texas.

MULTIFAMILY PROPERTIES

Chalk Rock Canyon – 264-unit, Class A multifamily development located in Austin, Texas.

Dry Creek Ranch – 288-unit, Class A multifamily development located near Fort Worth, Texas.

BellaTerra at Deerbrook – 360-unit, multifamily workforce housing property located in Houston, 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.

RETAIL PROPERTIES

Shadow Anchor Retail Portfolio – A four-property portfolio of shadow-anchor retail centers totaling 59,960-square-feet across multiple locations.

Chace Lake Center – 13,310-square-foot shopping center in Hoover, Alabama with Harbert Realty Services.

european real estate





l-r: **G. Huw Davies**, Vice President & Head of Asset Management; **Peter J.A. Land**, Principal; **Scott D. O'Donnell**, Vice President & Senior Managing Director; **James C. Flood**, Vice President; **Roque I. Rotaeche**, Principal; **Eric R. Desautel**, Principal; **Tor Tveitane**, Principal

2009 IN REVIEW

Although 2009 was challenging across all asset classes, it was a very productive year for the European Real Estate team. Taking advantage of the opportunistic investment environment, HEREFII invested approximately $120 million of its capital in three significant investments during the year. With these investments, HEREF II is approaching full investment and our investment team is preparing for the launch of HEREF III in 2010.

Asset management also continued to be a core focus of the team, with the following significant events:

- *Two dispositions from HEREF I were completed, generating returns significantly above original underwriting despite the challenging real estate investment environment in 2009.*
- *Completed the construction and handover of all three phases of our development in Esslingen, Germany.*
- *Completed the extension of our Dublin warehouse for the existing tenant who occupies 100% of the facility under a triple net lease with 21 years remaining.*

Clearly, we have been in a time of unprecedented turmoil in commercial real estate. After 2008, when investment in commercial real estate fell 53% in Europe (73% in the U.S.), the markets have existed in a state of sustained anxiety. Lenders drove a wave of deleveraging, valuations fell sharply and credit nearly vanished from the market. Debt has gone from an abundant, relatively cheap commodity to a scarce resource.

For well-capitalized investors with discipline and experience, however, these circumstances present reason for optimism in a near unprecedented investment environment. The repricing of risk, along with restricted capital flows and limited financing options, has created a window of opportunity to acquire fundamentally sound assets at substantial discounts to historic prices.

As a result, this year was perhaps the most productive year in the history of our fund. In 2008, we were largely sidelined due to lack of value in the market. Our discipline paid off in 2009, as we acquired three off-market portfolios, putting to work more than $120 million of equity. Each purchased asset is of institutional quality, has an attractive remaining lease term and is priced both markedly below historic cost and with upside potential.

In our existing portfolio, the greatest risk we face today is the prevalence of falling rental levels driven by the weak economic environment and rising vacancy rates. We're pragmatic in our approach to leasing, and we continue to monitor each asset to help lessen the risk of any income voids and tenant insolvencies.

In the coming year, given the continued economic uncertainty across the continent, we remain focused on the more transparent markets of Western Europe, with an emphasis on the U.K. and France. We expect that poorly capitalized and overleveraged properties will present significant investment opportunities, as financially stressed owners may be forced to sell in order to repair or improve their balance sheets. Distressed sellers have already started to emerge, and with approximately $1 trillion of loan maturities over the next ten years, there is likely to be an increasing requirement for fresh equity as property owners delever.

For well-capitalized investors with discipline and experience, however, these circumstances present reason for optimism in a near unprecedented investment environment.

2009 european real estate transactions

ADDITIONS TO HEREF II

Parc Mail – The fund acquired Parc Mail in Lyon, France from Goodman European Business Park Fund on May 18, 2009. Located within the Parc Technologique Business Park, Parc Mail comprises a self-contained mini-park of eleven modern office buildings providing 236,655-square-feet of modern local grade A office accommodation. The transaction was brought on by the seller's need to raise capital for another project under development for which they were unable to secure adequate debt financing.

ProLogis Portfolio – On June 29, 2009, the fund acquired five prime warehouse facilities containing 857,819- square-feet from ProLogis European Property Fund I in an off-market transaction. The sale was necessitated by the seller's need to deleverage their portfolio. The buildings are all located in the Southeast of England, the main logistics hub for the country, and are all fully occupied by single-tenant users with a weighted average remaining lease term at closing of 12.2 years.

SEGRO Multi-Let Industrial Portfolio – Through a joint venture with an experienced U.K. industrial developer and asset manager, on August 20, 2009, the fund purchased four multi-let industrial estates from SEGRO Plc, the U.K.-listed real estate investment trust. The transaction was an off-market deal and was originated by the seller's need to raise capital for their acquisition of Brixton Plc, also a U.K.-listed real estate investment trust. In total, the four estates comprise 2.1-million-square-feet of built space with a weighted average remaining lease term at closing of 7.1 years.

aligned

private capital

private equity

l-r: **Bradford D. Garvey,** Associate; **Donald R. Beard**, Vice President & Senior Managing Director; **Winston H. Gillum**, **Jr.**, Vice President & Managing Director; **C. Baxter Lee**, Associate; **R. Lee Bryan**, Director of Investments; **J. David Harper**, Director of Investments

2009 IN REVIEW

HPEF II currently holds positions in ten separate platform companies in various industries and sectors.

During 2009, HPEF II invested in two new platform companies: Onward Behavioral Health, Inc. and STX Healthcare Management Services, Inc.

Two of our existing platform companies in HPEF II completed add-on acquisitions. CF Holding Company, Inc. acquired a small competitor in its furniture logistics niche, and Child Health Holdings, Inc. acquired an autism services provider to expand its breadth of pediatric services.

Several of HPEF II's existing platform companies successfully completed debt restructurings or negotiated amendments to existing debt facilities.

The investment team formed HPEF III and completed a first close with HMC partner capital. HPEF III consummated its first investment during 2009, co-investing alongside HPEF II in STX Healthcare Management Services, Inc.

Our strategy is inherently long term, designed to straddle the inevitable troughs in the economy. What we might have expected to be a five-year wave, however, turned out to be a tsunami. Virtually every business model and investment has been stress-tested over the past 18 months.

Our approach to investing is, by nature, conservative. We have a well-defined set of parameters that guide our decision making. We avoid commodity-focused business models, choosing instead companies that have a defendable niche, and are recognized leaders within their own industries. Today, about one-fourth to one-third of our portfolio is healthcare companies, and that industry has endured better than most. We also generally stick to operational, distribution and manufacturing companies, being careful to avoid products and services that could be impacted by foreign competition.

Events in the economy have placed even greater emphasis on operations. Our investment team has a great blend of operational and financial experience to ensure that our portfolio companies run as efficiently as possible. The key, however, is to ensure that each company stays healthy enough to react quickly when the markets, again, inevitably turn. It is pointless to starve a company now so that it is too weak to capitalize later. In fact, our philosophy is quite the opposite: we work now to take advantage of weakening competition, so that we may gain market share in the coming years.

Within the private equity universe, there have been very few transactions over the past year, and almost none outside of healthcare. With credit tight and fear pervasive, many of the investors who might normally be active are instead on the sidelines. But history has proven that investing on the backside of a recession is a profitable strategy. We are bullish about this strategy. Time will tell.

Our investment team has a great blend of operational and financial experience to ensure that our portfolio companies run as efficiently as possible.

2009 private equity portfolio

HPEFII PORTFOLIO AS OF DECEMBER 31, 2009

ECA Holding, LLC – A consumer finance company that operates payday-advance and title loan lending branches in seven states. Based in Chattanooga, Tennessee.

PFC Acquisition Company, Inc. – A commercial finance company that provides asset-based working capital financing to small businesses. 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. – One of the nation's largest less-than-truckload carriers and logistics managers, serving furniture manufacturers, importers and retailers. Based in Lenoir, North Carolina.

Child Health Holdings, Inc. – Operator of the nation's largest chain of daycare and respite care facilities for children with acute medical conditions. Based in Tampa, Florida.

Dent-a-Med, Inc. – Consumer finance company that provides private-label credit cards to consumers purchasing healthcare services and healthcare-related products. 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.

Onward Behavioral Health, Inc. – Operator of a residential treatment facility for adult women suffering from eating disorders. Based in Columbiana, Alabama.

STX Healthcare Management Services, Inc. – Operator of 21 pediatric dental clinics in major markets in Texas. Based in Houston, Texas.

venture capital





l-r: **Thomas D. Roberts, III**, Partner; **Robert L. Crutchfield**, Venture Partner; **Wayne L. Hunter**, Vice President & Managing Partner; **John R. Uhrin**, Venture Partner; **William W. Brooke**, Executive Vice President & Managing Partner; **Brian C. Carney**, Principal; **Molly E. Escalante**, Associate

2009 IN REVIEW

HVP II held its final closing in October 2009 with $57.8 million in total commitments.

Since our last report, we have made investments in nContact Surgical, Inc. and PMW Technologies, Inc. (PeopleMatter). The team led or co-led each of these investments.

Also during 2009, we made follow-on investments in each of Aldagen, Inc., Innovative Biosensors, Inc., Ion Healthcare, Inc., MaxCyte Inc., nContact Surgical, Inc., Optimal IMX, Inc., Privaris, Inc., TapRoot Systems Inc. and WindChannel Communications, Inc.

In November 2009, Intellijet, Inc. entered into a product development and distribution agreement with Sanofi Aventis for its EpiCard epinephrine auto-injector device for the treatment of anaphylaxis associated with acute allergic reactions. This agreement provides a potential for $230 million in revenue to Intellijet, Inc., as well as royalty revenues upon commercialization.

*In December 2009, NovaMin Technology, Inc. was sold in an all-cash transaction which has yielded an 8.6x return on invested capital to date, not including a 10% escrow bucket.**

In 2009, the broader economy significantly impacted the venture capital industry. For many, the year required twice as much work to stay in the same place. Fundraising for most venture funds ground to a halt, while both the M&A and IPO exit markets were reduced to a fraction of healthy levels. An industry built on risk suddenly avoided risk at every turn. Certainly, there were bigger issues afoot.

As investors moved to the sidelines, so too did the venture capital funds. Harbert Venture Partners made only one new investment in 2009, reflecting three principle realities. First, disruption of the market created gaps in value expectations, making transactions harder to complete. Second, broader economic issues made modeling and forecasting with confidence difficult, eroding risk tolerance. Third, the lack of funds willing to invest reduced competition and reinforced the core practice of patience—waiting for ripe opportunities.

We spent much of 2009 focusing on our existing portfolio; we made a few follow-on investments, but spent most of our energy helping our management teams do more with less, while coping with the new realities. Along the way we looked for exit opportunities.

While most of our portfolio withstood the pressure of 2009, stress did expose weak managers and poor business practices. Of our 17 portfolio companies, five experienced significant difficulties during the year. We stopped funding one, restructured or headed toward restructuring two others; two additional companies appear headed toward recovery. The remaining companies performed surprisingly well.

We announced two significant transactions at the end of the year. The first was a single-product strategic partnership between Intelliject, Inc. and a global pharmaceuticals company, with a potential value of $230 million. The second transaction was the all cash sale of NovaMin Technology, Inc. The NovaMin sale returned approximately 9x our invested capital.*

We spent much of 2009 focusing on our existing portfolio; we made a few follow-on investments, but spent most of our energy helping our management teams do more with less.

*IMPORTANT NOTICE: Past performance is not indicative of future results.

active hvp I & II portfolio companies

PORTFOLIO AS OF DECEMBER 31, 2009

Aldagen, Inc. – Develops clinical-stage therapies related to the transplant of adult human stem cells used for tissue regeneration, 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. – Provides 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.

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.

Intellijject, 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.

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. – Offers 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. – Developing a minimally invasive surgical platform for treating atrial fibrillation using a closed-chest, minimally invasive procedure. Existing devices approved for tissue ablation in the United States, and for atrial fibrillation in Europe. Based in Morrisville, North Carolina.

Optimal IMX, Inc. – Provides radiology and teleradiology services to hospitals and clinics, utilizing staff and independent radiologists for reading and diagnosis in order to optimize and improve the quality of radiology services for patient care. Based in Birmingham, Alabama.

+PMW Technologies, Inc. (PeopleMatter) – Offers strategic human resources and workforce productivity software that enables organizations to manage employees from initial on-boarding through full career development. Based in Charleston, South Carolina.

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. Based in Research Triangle Park, North Carolina.

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

WindChannel Communications, Inc. – 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 voicemail applications and applications on mobile devices. Based in Charlotte, North Carolina.

Exited HVP I & II Portfolio Companies:

Agility Healthcare Solutions – 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.

NovaMin Technology, Inc. – Created a proprietary oral healthcare active-ingredient that addresses unmet oral care needs by amplifying the mouth's natural defense and repair mechanisms. Based in Alachua, Florida. Sold to a public company in December 2009.

+Investment made on January 20, 2010.

mezzanine capital





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

2009 IN REVIEW

In 2009, HMP I and HMP II closed four new transactions and seven add-on investments for a total of slightly over $38 million.

The team exited three portfolio companies either through a sale of the business or a refinancing transaction. In all cases, the loans were repaid and warrants were sold. Two other companies refinanced or repaid from internally generated cash flow all or a majority of our loans while the equity components remain outstanding. The funds ended the year with a portfolio of $225 million in investments.

The financial crisis that started in 2008 continued into 2009 with the result of reduced availability in the once-liquid credit markets. The demand for junior capital increased, but with the underlying economic weakness, the supply of financing opportunities decreased. As 2009 progressed, the markets moved back toward normalcy, but remain very fragile and selective. This is especially true in the small business market that our fund serves. The capital markets returned in the second half of the year giving larger companies access to credit. However, the nation's small businesses that rely on commercial banks and finance companies still have trouble obtaining credit for the purposes we most often finance: change of ownership, recapitalizations and future growth projects.

At the end of 2009, and as we move into 2010, we have seen these lending markets begin to thaw slightly, as well as a general improvement in the U.S. economy. As a result, we feel there will be increased deal flow in the coming year, but those transactions will typically be approached with extreme caution and skepticism. We are optimistic 2010 will present interesting opportunities in our markets that will embrace our "friendlier-than-senior" approach.

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2009 mezzanine transactions

NEW INVESTMENTS

RedVector.com, Inc. – Provider of online continuing education for design, construction and healthcare professionals. Based in Tampa, Florida.

Landscape Services Holdings, LLC – Provider of infrastructure outsourcing and landscape management services. Based in Denver, Colorado.

EnduraCare Acute Care Services, LLC – Provider of therapy program management services for hospitals, outpatient clinics and physician practices. Based in Mobile, Alabama.

Candescent Healing, LLC – Developer and operator of comprehensive wound care and hyperbaric oxygen therapy facilities within hospitals. Based in Woodbury, New York.

independent power

l-r: **Patrick E. Molony**, Executive Vice President & Chief Operating Officer; **G. Tatum Lassiter, Jr.,** Director of Investments; **J. Russell Martin**, Director of Investments; **Wayne B. Nelson III**, President & Chief Executive Officer; **Kenneth W. Kilgore**, Vice President & Controller; **J. Clayton Hamblen, III**, Associate; **Jeffrey W. Moore**, Vice President

2009 IN REVIEW

HPF I and HPF II continued to meet or exceed their financial goals.

HPF II's GWF Energy entered into a new long-term power sales agreement with Pacific Gas & Electric to expand GWF Energy's Tracy facility.

HPF III acquired additional senior notes of Longview Power, acquired ownership interests in Sydney A. Murray hydroelectric plant, GWF Energy and York Energy Centre. Dixie Pellets suspended operations, filed for bankruptcy protection and is being marketed.

This past year may well be remembered as the year reason returned to the Independent Power investment space. As more and more investors discovered the attractive risk-reward profile associated with power generation over the past few years, the price of assets increased and investment returns declined. The convulsion of the financial markets in 2008 and early 2009 drove many investors away from the power market, particularly those investors who used significant leverage to fund their transactions.

Within our strategy, we seek equity or debt interests in power generation or power related assets that meet our risk-reward criteria. Investments will typically be in power generation plants, especially with the recent return to better pricing for these assets; we will consider, however, power related assets such as fuel supply and transportation assets. Overall, our transactions have grown in size; in the past 18 months, we have committed more capital than in our first two funds combined. Looking ahead, we anticipate funding two investments in early 2010, which will nearly complete our investments in Fund III.

At the close of 2009, we continued to see a stream of viable opportunities. With the fairly recent turmoil in the financial markets, well-structured power assets can now be acquired at more attractive pricing. We don't know how long this window of opportunity will remain open, but while it does we expect to continue to find attractive investments.

Overall, our transactions have grown in size; in the past 18 months, we have committed more capital than in our first two funds combined.

harbert power investments

PORTFOLIO AS OF DECEMBER 31, 2009

INVESTMENTS

Kalaeloa (50% ownership)

209 MW oil-fired plant

Oahu, Hawaii

Lockport (24% ownership)

200 MW gas-fired plant

Lockport, New York

GWF Energy (50% ownership)

- Phase 1

  94 MW gas-fired plant

  Hanford, California

- Phase 2

  96 MW gas-fired plant

  Henrietta, California

- Phase 3

  170 MW gas-fired plant

  Tracy, California

Mackenzie Green Energy (50% ownership)

55 MW wood-fired plant

British Columbia *(on hold)*

Dixie Pellets (86% ownership)

520,000 tons per year wood pellet plant

Selma, Alabama *(in bankruptcy)*

Longview Power (investment in debt securities)

695 MW supercritical coal-fired plant

Maidsville, West Virginia *(under construction)*

Sidney A. Murray (9.93% ownership)

192 MW hydroelectric plant

Vidalia, Louisiana

York Energy Centre (50% ownership)

400 MW gas-fired plant

King Township, Ontario *(in development)*

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 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

Kalaeloa Plant, Oahu, Hawaii

australian private equity




l-r: **Brendan J. Anderson**, Vice President & Senior Managing Director; **Michael R.J. DaGama Pinto**, Senior Associate; **Jeremy E. Steele**, Vice President & Senior Managing Director; **Robert P.A. Whitaker,** Senior Associate,

2009 IN REVIEW

We launched HAPE I in January 2009.

We organized an Australian dollar-denominated parallel fund in November 2009.

We made our first investment in May, in a solar panel company that is an industry leader in a rapidly growing market.

We made our second investment in December when we acquired a significant minority stake in a Melbourne-based premium skin care business that retails across the world.

This has been a year of interesting contradictions in Australia. The country's economy missed much of the global meltdown, though the effects of the financial system collapse certainly reached the continent. In the years leading up to 2009, Australia's government ran large budget surpluses; this lack of public debt allowed the government to fund the world's second largest stimulus package, as a percentage of GDP, and meant Australia was one of only two developed countries to avoid slipping into a technical recession. Australia did not, however, avoid negative economic consequences altogether. Capital in general left the market. Banks that weren't lending in the U.S., Europe and Asia weren't lending here either; even Australia's well-capitalized banks, which get significant wholesale funding offshore, reduced lending. Private equity activity was limited, and a number of funds left the market. For those with capital, Australia increasingly became an attractive opportunity.

Today, there exists a backlog of well-managed companies starved for capital. For private equity, there are fewer funds competing, and combined with the lower levels of debt, valuations have subsided. Australia's original private equity pioneers have grown in scale, scope and fund size, leaving a significant gap in the middle and lower tiers of the market. We launched the U.S. dollar-denominated HAPE I in January to fill this void—targeting companies with an overall valuation in the A$10 million to A$75 million range. We organized an Australian dollar-denominated parallel fund in November to offer our offshore investors access to this strategy without exposure to U.S. currency fluctuations.

Private equity activity was limited, and a number of funds left the market. For those with capital, Australia increasingly became an attractive opportunity.

2009 HAPE I transactions/holdings

Solar Shop Australia Pty Ltd – A renewable energy solutions provider that designs and installs photovoltaic grid connected and remote solar power systems. Based in Adelaide, South Australia.

Emeis Holdings Pty Ltd – Owner of Aesop, a body, skin and hair care beauty products company established in 1987 and based in Melbourne, Victoria. Available in over 21 countries throughout Australia, Asia, Europe and the U.S.

aligned

absolute return strategies

emerging markets



l-r: **Greg P. Ebeyer**, Director of Investments; **Robin Y. Yang**, Director of Investments; **Heather N. Leonard**, Senior Managing Director

2009 IN REVIEW

The U.S. banking sector debacle, which continued into 2009, stressed all of the Emerging Markets countries and broke none. The year's first half was marked by continued fear and near collapse, countered by aggressive and unprecedented global public sector intervention. The size of these government stimulus packages has served to delay, perhaps for years, much needed consolidation and reform. For the second half, risk taking returned.

In 2009, the Harbert Emerging Markets Fund performed well while adapting to an altered and, at times, fragmented array of opportunities posed by the new brokerage business entrants and a highly sensitized regulatory atmosphere. Looking forward to 2010, we see an excellent opportunity for idiosyncratic investment ideas in emerging markets, and we are excited about pursuing those that prove most promising.

The meltdown of the global financial system over the past two years revealed a number of telling facts about the emerging markets. Brazil, Russia, India, China and Korea continue to mature, offering a number of viable opportunities. In many ways, the emerging markets withstood the stresses of the meltdown better than the developed economies.

In many of the emerging markets, we are seeing consolidation of the industrial base. In some cases, high-priced, inefficient producers have been forced out, pushed into bankruptcy or moved to merge with more stable competitors. A number of these same countries invested stimulus money directly into the market, as well as creating attractive opportunities for private investment.

Our task is to find those opportunities—companies that have done the heavy lifting and are ready to emerge from this global recession in a position of strength. Today, political risks are a less dominant theme; difficult economic times tend to lead countries into more pragmatic governance. The greater challenge for us is finding companies with good internal governance that are also positioned to grow over the coming years.

Within our fund, perhaps the most significant development was the commencement of trading operations in HMC's London office. The move allows us greater time zone coverage, giving us access to the last half of the Asian trading day. Our fund has always found a competitive advantage in size, being small enough to move quickly yet large enough to attract attention. Greater time zone coverage accentuates that advantage.

In many ways, the emerging markets withstood the stresses of the meltdown better than the developed economies.

event opportunities





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

2009 IN REVIEW

2009 marked the beginning of a gradual return to normalcy in the global equity and credit markets.

M&A activity picked up in both large and small capitalization stocks across a wide swath of industries.

The merger arbitrage environment became healthier with a greater focus on high-quality strategic transactions and diminished financing risks.

The fund's experienced investment professionals were able to generate alpha and positive returns across their merger arbitrage, event-driven and convertible strategies, while still maintaining an overall market hedge.

Uncertainty creates opportunity. This past year, and events leading into 2010, confirm this truism. 2009 came in like a lion and went out like a lamb. Volatility spiked in the early part of the year and historically high credit spreads helped to depress the volume of M&A. Though some companies bucked this trend by announcing megamergers, most companies were focused on survival rather than growth. Among those that did pursue deals, we saw a return of hostile activity that we do not expect will abate. In our universe, merger arbitrage spreads widened as a number of bank prop trading desks shut down and hedge funds exited the strategy. All of these issues conspired to create tremendous uncertainty. By late 2009, though, that uncertainty had begun to turn to opportunity.

Strategically, our fund seeks to take advantage of the discrepancy between a security's current price and the value implied by an announced merger transaction or other transformational corporate event. As we enter 2010, about half of our portfolio is invested in announced transactions. The other half is allocated to mandatory convertibles and catalyst-driven events, such as spin offs, restructurings and liquidity situations. We're also evaluating the legislative and regulatory environment in Washington, D.C. (e.g. healthcare, climate change, financial services reform) to source new opportunities.

Mergers & Acquisitions are now a part of the DNA of many companies. In the later stages of 2009, we saw a noticeable upsurge in M&A activity, particularly hostile takeovers—often our most lucrative opportunities. For mergers and acquisitions, the coming year could be among the most eventful we've seen in our lifetime; our pipeline of potential investments is the most robust it's been in years. Despite the increase in activity, low interest rates and the exit of capital should keep spreads very attractive—again creating opportunity.

Though most companies, notably in healthcare, bucked this trend by announcing megamergers, most companies were focused on survival rather than growth.

value




l-r: **A. Daniel Thomasson**, Director of Investments; **Todd D. Nunnelley**, Vice President & Senior Managing Director; **T. Partlow Willings**, Analyst, **Zachary P. Turnage**, Director of Investments,

2009 IN REVIEW

We generated strong returns throughout the year, even during the extreme equity market weakness early in the year. The returns resulted from our disciplined focus on identifying compelling absolute value opportunities on both the long and short sides.

The long portfolio drove the full-year gains, but the short portfolio made important and substantial contributions during the early months.

Consistent with our objectives of making disciplined investment decisions during any market environment, many of the top contributors for the year were positions that we adjusted or initiated during the tumultuous fourth quarter of 2008 and early months of 2009.

We entered 2010 with a compelling portfolio featuring strong future return potential on both sides and excess cash available to deploy in attractive new opportunities.

This past year can be divided into two distinct extremes. The first two months of the year were dominated by fear, which helped continue a major sell-off that began during the financial crisis of 2008.

In March, investor perceptions started to change and financial markets began to rebound. Since then, the equity markets have been characterized by a feeling of relief and growing optimism. A significant rebound in equities has ensued as investors have once again become more risk tolerant. Perhaps the greatest surprise of this year was the speed at which investor attitudes changed.

For the Value Fund, the year simply confirmed why we employ our unabashedly straight-forward strategy. We have a disciplined focus on absolute value, which for us is a determination of what a company is worth on its own merits. We analyze the risks that we perceive exist if our assessment is incorrect. We then invest, long or short, when there is a compelling gap between a company's market value and our assessed value of that company. Helped by our use of both long and short strategies, we were able to earn positive returns through the market's extreme ups and downs.

In evaluating our strategy moving forward, it's clear that turmoil creates opportunity for disciplined investors. But maintaining discipline in extreme markets, both up and down, when emotions are running high, is not easy. We will continue to do what we have done in the past—be opportunistic, move fast when the situation calls for it, but most importantly, stick to our fundamental principles and resist the pull to be irrationally swayed by the market's emotions.

A significant rebound in equities has ensued as investors have once again become more risk tolerant.

aligned

support

investor services and risk management





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

Our back office team of more than 50 professionals (including almost 20 CPAs and five IT specialists) exists to safeguard our clients' assets, and to report with integrity on the performance of our various funds. Events of the past two years have created increased scrutiny of the operations of all investment firms. But we've historically taken steps far beyond those required by law to ensure transparency and clear communication, like voluntarily registering with the SEC as a registered investment adviser before any requirement to do so.

As for safeguarding our assets, we use independent unaffiliated custodians for custody of client funds and securities. As an additional control, our funds are annually audited by Big 4 international auditing firms, which verify the existence of all of our funds' assets directly with the independent custodians. Given that we are investors in our own funds, as well as managers, we have a vested interest in ensuring transparency into, and safekeeping of, fund assets.

Private Market Strategies. Our accounting, tax and investor reporting groups manage both the 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, as well as annual 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 performance returns in the audited financial statements.

Absolute Return Strategies. HMC's hedge fund administration department provides administrative and operational support functions for HMC's public market, or 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 that we comply with all policies and procedures adopted by HMC in various areas. This team also monitors and assists the due diligence efforts of the company's private market funds' transactions. The team's responsibilities include an annual review of performance returns, custody of assets, the conduct of periodic compliance audits and site visits to portfolio assets.

Risk Management. The independent risk management team monitors the 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 in both private market and absolute return strategies.

Investment Committees. A separate investment committee monitors each of HMC's private market strategies. Each investment committee includes 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. is authorized by the U.K. Financial Services Authority to carry on certain regulated activities, and Harbert Fund Advisors (Australia) Pty Ltd holds the Australian Financial Services license.

legal and compliance





l-r: **Joel B. Piassick**, Executive Vice President & Former General Counsel; **Bufkin K. Frazier**, Assistant General Counsel; **Kevin A. McGovern**, Assistant General Counsel; **John W. McCullough**, Senior Vice President & General Counsel; **Michael C. Bauder**, Vice President & Chief Compliance Officer; **S. Perry Given, Jr.**, Vice President & Associate General Counsel; **R. A. (Trey) Ferguson III**, Vice President & Assistant General Counsel

Our commitment to compliance and transparency is evident in the 12 professionals and support staff, including seven attorneys, who make up our legal and compliance department. These professionals 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. The legal staff leads the legal structuring and formation of all new public and private market funds and their subsidiaries.

HMC's public market funds trade equity and debt securities in multiple international markets where they constantly face a variety of regulatory issues. HMC's legal staff has significant experience identifying these issues in the U.S. and abroad and ensuring our 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. Our 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 of our portfolio investment acquisitions and dispositions and provides legal support through participation in investment committee meetings.

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. Our 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.

Our commitment to compliance and transparency is evident in the 12 professionals and support staff, including seven attorneys, who make up our legal and compliance department.

investor relations

l-r: **Melissa M. Babb**, Managing Director; **Charles D. Miller**, Executive Vice President & Chief Financial Officer; **Lynette P. Horton**, Managing Director; **Brad A. Middleton,** Managing Director; **Michael J. Larsen**, Senior Managing Director; **Neal J. Howe**, Managing Director; **Rest B. Heppenstall**, Managing Director

HMC's Investor Relations team is responsible for information flow, including access to fund managers and fund transparency. The Investor Relations team is the portal by which investors enter and coordinate with all aspects of the HMC organization. Each investor benefits from a relationship with an experienced HMC professional who understands the investor's needs and can deliver any element of the firm —on demand, as anticipated or as- and-when needed. Clients cite this model as client service at its best.

HMC has expanded the Investor Relations team. We now have professionals in Birmingham, New York, London, Atlanta and our most recent office in Melbourne. Each of the firm's Investor Relations professionals is a registered representative with FINRA and, where appropriate, the FSA.

As an alternative asset management firm with ten investment 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 is also moving toward a password-protected, Web-based environment for secure access to and distribution of fund performance and account information.

The Investors Relations team is the portal by which investors enter and coordinate with all aspects of the HMC organization.

harbert realty services, inc.





l-r: **David R. Williams**, Executive Vice President & Chief Operating Officer; **C. Michael Murray**, Senior Vice President; **Harry M. Lynch**, President & Chief Executive Officer; **W. Dean Nix**, Senior Vice President; **Mary C. Echols**, Executive Vice President of Financial Services; **George B. Elliott, Jr.**, Senior Vice President

2009 IN REVIEW

The financial meltdown of the past few years has severely impacted the real estate industry in the U.S. We've not been immune to the pressures that followed. In 2009, most new construction stopped; equity has been difficult and credit nearly non-existent as the entire industry deleverages.

Diversification pays dividends. Our strategically diverse range of services has helped stabilize our business, even in the face of unprecedented pressures. While construction projects have almost completely stopped (but for projects for our own account in Central Florida), our asset management and leasing services have provided sustainable returns. We've expanded our client information services—lease administration, real estate accounting and back-end portfolio management.

As part of our diversification plan, we recently expanded our services into digital outdoor advertising. Outdoor advertising is, in many respects, an extension of the real estate business, because location is everything in terms of value. We've developed the expertise to source and acquire highly relevant billboard locations that has helped us build competitive advantage in the South over much larger and more heavily funded competitors.

As the major players in the outdoor advertising market have been severely impacted over the past year or two, they've been unable to expand in a time when opportunities have become more attractive. Because we are focused solely on digital outdoor advertising, we have far less legacy cost inherent in our product than traditional outdoor. These factors have combined to give us a strong competitive position when the advertising business begins to rebound.

We've expanded our client information services—lease administration, real estate accounting and back-end portfolio management.

harbert employees reaching out (HERO) foundation

At three, she is a "miracle baby." Born prematurely, she suffered severe complications during childbirth when a lack of oxygen damaged her internal organs. She spent months in the hospital and recovery, enduring multiple surgeries. Her mother, a single parent, can't work when her daughter is in the hospital. Our employees created the HERO (Harbert Employees Reaching Out) Fund precisely to help families like this stay on their feet.

Times are hard, even for the most fortunate among us. But for some in our community, a helping hand is all that prevents catastrophe. And that's why we created the HERO Foundation, to give our employees the means to help 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 get back on their feet; we help families stay together. Since 1998, our people, through HERO, have stepped in when no other help was available.

"HMC, as a company, employs a number of remarkable people," Raymond Harbert, Chairman and CEO said. "But the HERO Foundation shows that they possess more than extraordinary skill in their work. They also possess heart; they care about the lives of the people in their communities. You see it in the pride with which they manage the Foundation. You see it in the effort they put into fundraising. Of all the things we do in this company, I believe our employees take the most pride in the accomplishments of the HERO Foundation."

During 2009, HERO awarded 43 grants totaling $144,000. The average grant was approximately $3,400. The Foundation is managed by HMC employees from throughout the company. The Foundation's resources come from contributions from employees, our affiliates and from fund-raisers we hold throughout the year. Most of our referrals for help come from partners in the community, including Children's Hospital, Alabama Children's Rehabilitation Services and the Alabama Head Injury Foundation to name a few.

And that's why we created the HERO Foundation, to give our employees the means to help in the communities where we live.

management

EXECUTIVE OFFICERS

Raymond J. Harbert**
Chairman & Chief Executive Officer

Michael D. Luce**
President & Chief Operating Officer

David A. Boutwell**
Executive Vice President & Chief Administrative Officer

William W. Brooke*
Executive Vice President & Managing Partner Venture Capital

Charles D. Miller*
Executive Vice President & Chief Financial Officer

John W. McCullough
Senior Vice President, General Counsel & Secretary

Joel B. Piassick
Executive Vice President

INVESTMENT PROFESSIONALS

ABSOLUTE RETURN STRATEGIES

Emerging Markets
Heather N. Leonard
Vice President & Senior Managing Director

Event Opportunities
Neil B. Kennedy
Vice President & Senior Managing Director

Value
Todd D. Nunnelley
Vice President & Senior Managing Director

REAL ESTATE

United States Real Estate
Michael P. White
Vice President & Senior Managing Director

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