HERALD INVESTMENT TRUST plc

ANNUAL REPORT & FINANCIAL STATEMENTS

31 December 2010

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THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to the action you should take you should consult your stockbroker, bank manager, solicitor, accountant or other independent financial adviser authorised under the Financial Services and Markets Act 2000 if you are in the United Kingdom or, if not, another appropriately authorised financial adviser.

If you have sold or otherwise transferred all of your ordinary shares in Herald Investment Trust plc, please forward this document and the accompanying form of proxy as soon as possible to the purchaser or transferee or to the stockbroker, bank or other agent through whom the sale or transfer was or is being effected for delivery to the purchaser or transferee.

COMPANY SUMMARY

COMPANY DATA AT 31 DECEMBER 2010		
Total assets†	**Shareholders' funds**	**Market capitalisation**
£533m	**£475m**	**£386m**

†Before deduction of bank loans and derivative financial instruments

Policy and Objective	Herald's objective is to achieve capital appreciation through investments in smaller quoted companies, in the areas of telecommunications, multimedia and technology (TMT). Investments may be made across the world. The business activities of investee companies will include information technology, broadcasting, printing and publishing and the supply of equipment and services to these companies. The Company's investment policy is contained within the Business Review on page 22.
Comparative Index	The portfolio comparative index against which performance is measured is $^2/_3$ Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies) and $^1/_3$ Russell 2000 (small cap) Technology Index (in sterling terms). Though we consider this comparative index to provide a reasonable base for measuring the Company's performance, the portfolio is not modelled on it and outcomes may diverge widely.
Management Details	Herald Investment Management Limited ('HIML') is the appointed investment manager to the Company. The management contract can be terminated at twelve months' notice. Administration of the Company and its investments is contracted by HIML to Baillie Gifford & Co, who also act as Company Secretary.
Capital Structure	The Company's share capital consists of 79,913,283 Ordinary shares of 25p each which are issued and fully paid. The Company has been granted authority to buy back a limited number of its own Ordinary shares for cancellation. During the year 1,140,000 Ordinary shares were bought back for cancellation. The Directors are seeking to renew this authority at the forthcoming Annual General Meeting.
Management Fee	Herald Investment Management Limited's annual remuneration is 1.0% of the Company's net asset value based on middle market prices, calculated on a monthly basis payable in arrears.
Wind-Up	At the Annual General Meeting of the Company held in April 2010 shareholders voted in favour of the Company continuing to operate as an investment trust. The next continuation vote is in 2013 and every third year thereafter.
AIC	The Company is a member of the Association of Investment Companies.

None of the views expressed in this document should be construed as advice to buy or sell a particular investment.

Investment trusts are UK public listed companies and as such comply with the requirements of the UK Listing Authority. They are not authorised or regulated by the Financial Services Authority.

YEAR'S SUMMARY

	31 December 2010	31 December 2009	% change
Total assets (before deduction of bank loans and derivative financial instruments)	£533.5m	£397.2m	
Bank loans	£50.0m	£50.0m	
Derivative financial instruments	£8.9m	£6.3m	
Shareholders' funds	£474.6m	£340.9m	
Net asset value per Ordinary share	593.8p	420.6p	41.2
Share price	483.0p	337.8p	43.0
FTSE 100	5,899.9	5,412.9	9.0
FTSE All-Share	3,062.9	2,760.8	10.9
FTSE Small Cap	3,228.6	2,776.9	16.3
Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies)	3,650.8	2,838.2	28.6
Russell 2000 (small cap) Technology Index (in sterling terms)††	957.3	678.5	41.1
Composite comparative index			33.1
Dividend per Ordinary share	–	0.30p	
Revenue earnings per Ordinary share	0.05p	0.39p	
Expense ratio	1.05%	1.12%	
Discount	18.7%	19.7%	

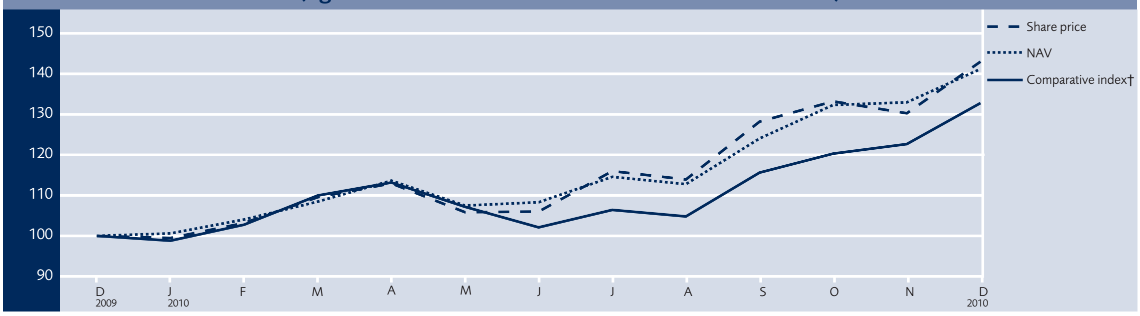
	Year to 31 December 2010		Year to 31 December 2009	
Year's high and low	**High**	**Low**	**High**	**Low**
Share price	490.0p	328.0p	342.0p	181.8p
Net asset value	599.4p	420.2p	422.7p	242.3p
Discount	23.6%	14.7%	30.3%	15.8%

	31 December 2010	31 December 2009
Net return per Ordinary share		
Revenue	0.05p	0.39p
Capital	171.87p	169.95p
Total	171.92p	170.34p

†† The Russell 2000 (small cap) Technology Index was rebased during 2009 following some minor adjustments to its constituents. The rebased index is used from 31 December 2008 onwards.

HERALD'S SHARE PRICE, NAV AND BENCHMARK

(figures have been rebased to 100 at 31 December 2009)



Source: Thomson Reuters Datastream/Baillie Gifford & Co

† 2/3 Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies) and 1/3 Russell 2000 (small cap) Technology Index (in sterling terms).

Dividends are not reinvested.

Past performance is not a guide to future performance.

LONG TERM PERFORMANCE SUMMARY

The following charts indicate how an investment in Herald has performed relative to its comparative indices (applied retrospectively) and its underlying fully diluted net asset value over the period since inception of the Company.

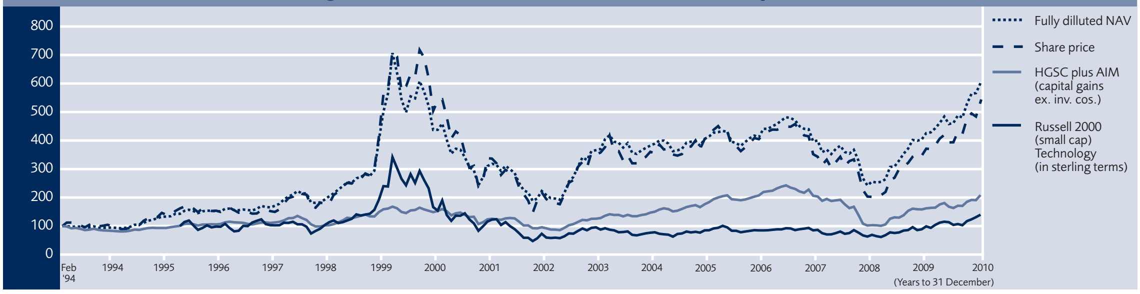
	31 December 2010	Inception 16 February 1994	% change
Net asset value per Ordinary share	593.8p	98.7p	501.6
Share price	483.0p	90.9p	431.4
Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies)	3,650.8	1,750.0	108.6
Russell 2000 (small cap) Technology Index (in sterling terms) ††	957.3	688.7*	39.0
FTSE 100	5,899.9	3,417.7	72.6
FTSE All-Share	3,062.9	1,717.8	78.3
FTSE Small Cap	3,228.6	2,076.1	55.5

* At 9 April 1996 being the date funds were first available for international investment.

†† The Russell 2000 (small cap) Technology Index was rebased during 2009 following some minor adjustments to its constituents. The rebased index is used from 31 December 2008 onwards.

RELATIVE PERFORMANCE OF HERALD'S FULLY DILUTED NAV AND SHARE PRICE TO THE COMPONENT INDICES OF THE COMPOSITE COMPARATIVE INDEX† SINCE INCEPTION

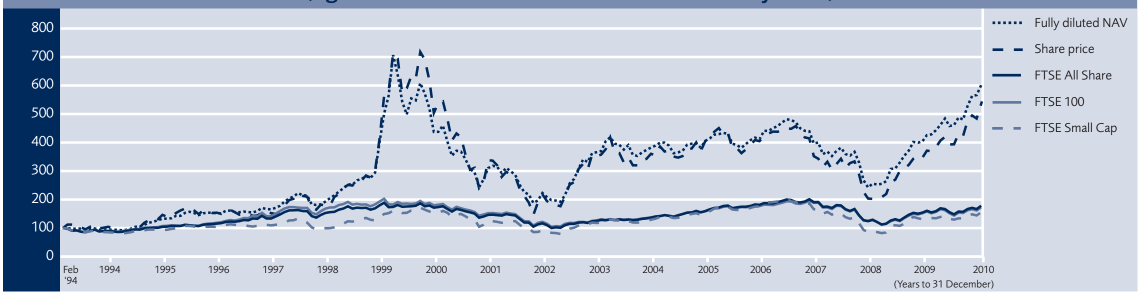
(figures have been rebased to 100 at 16 February 1994)



Source: Thomson Reuters Datastream/Baillie Gifford & Co

RELATIVE PERFORMANCE OF HERALD'S FULLY DILUTED NAV AND SHARE PRICE TO FTSE INDICES SINCE INCEPTION

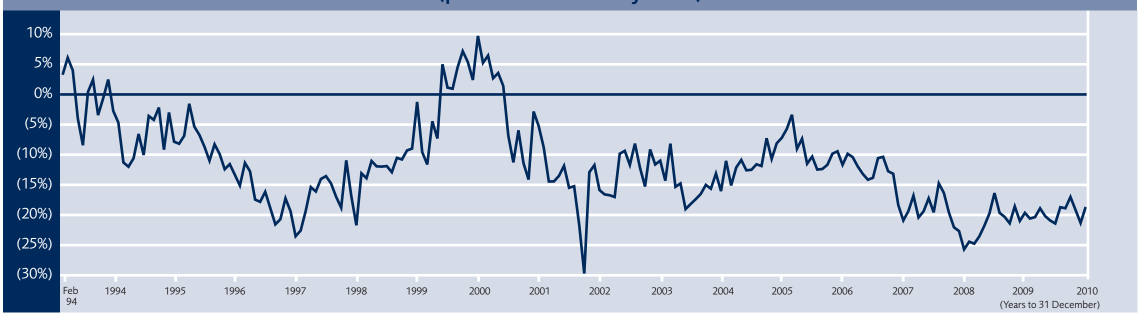
(figures have been rebased to 100 at 16 February 1994)



Source: Thomson Reuters Datastream

PREMIUM/(DISCOUNT) TO FULLY DILUTED NET ASSET VALUE

(plotted on a monthly basis)



Source: Thomson Reuters Datastream

The premium/(discount) is the difference between Herald's quoted share price and its underlying fully diluted net asset value.

† From 1 January 2006, the comparative index was changed to ²/₃ Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies) and ¹/₃ Russell 2000 (small cap) Technology Index (in sterling terms).

DIRECTORS, MANAGER AND ADVISERS

Directors

Julian Cazalet was appointed to the Board on 18 January 2008 and became Chairman on 1 September 2009. He was managing director – corporate finance at JPMorgan Cazenove until his retirement in December 2007. A Chartered Accountant he joined Cazenove in 1973 and was made a Partner in 1978. From 1989 he worked in Corporate Finance and advised investment trusts in addition to his work with industrial and commercial companies. He is a director of the White Ensign Association Limited, Deltex Medical Group plc, Charles Taylor Consulting plc and Cothill Educational Trust.

Clay Brendish, CBE was appointed to the Board on 23 July 2001. He has been non-executive chairman of Echo Research Limited since July 2003, Anite plc since October 2005 and SThree plc since May 2010. He is a trustee of the Economist Newspapers Limited. Clay's other non-executive directorships are with BT Group plc and The Test and Itchen Association Limited. He has been in the computer systems environment and high technology industry for over 30 years. He was formerly executive chairman of Admiral plc and, in turn, deputy chairman of CMG plc when the companies merged. He has also held a number of Government advisory posts.

Tim Curtis was appointed to the Board on 22 July 2004. He was chief executive of Zetex plc (formerly Telemetrix PLC), and is non-executive chairman of RaceCourse Technical Services Ltd. Former non-executive directorships were with IBS OPENSystems plc between 2005 and 2008, TVS Entertainment plc, Dobson Park Industries plc and Pace Micro Technology plc. Tim was previously a director of Unitech plc.

Douglas McDougall, OBE was appointed to the Board on 13 February 2002 and is Chairman of the Audit Committee and the senior independent director. He has extensive experience in the fund management industry and is a former senior partner of Baillie Gifford & Co. He is chairman of The Law Debenture Corporation plc, The European Investment Trust plc, The Independent Investment Trust PLC and The Scottish Investment Trust PLC and is a director of The Monks Investment Trust PLC, Pacific Horizon Investment Trust PLC, Stramongate Assets plc and is a member of Cambridge University Investment Board. He is a former chairman of IMRO, of the Association of Investment Companies and of the Fund Managers' Association.

All Directors are members of the Audit Committee and of the Nomination Committee.

Secretary

Baillie Gifford & Co
Calton Square
1 Greenside Row
Edinburgh EH1 3AN
Tel: 0131 275 2000

Registered Office

10-11 Charterhouse Square
London EC1M 6EE

Company Number

2879728 (England and Wales)

Manager

Herald Investment Trust plc is managed by Herald Investment Management Limited ('HIML'). The senior director of HIML with prime responsibility for the management of Herald Investment Trust is Katie Potts.

Katie Potts
Herald Investment Management Limited
10-11 Charterhouse Square
London EC1M 6EE
Tel: 020 7553 6300
Fax: 020 7490 8026
Website: www.heralduk.com
E-mail: info@heralduk.com

Advisers

Independent Auditors
Ernst & Young LLP
Ten George Street
Edinburgh EH2 2DZ

Stockbrokers
JP Morgan Cazenove Ltd
10 Aldermanbury
London EC2V 7RF

Singer Capital
Markets Limited
One Hanover Street
London W1S 1YZ

Solicitors
Macfarlanes
20 Cursitor Street
London EC4A 1LT

Bankers
The Bank of New
York Mellon
One Piccadilly Gardens
Manchester M1 1RN

Registrars
Capita Registrars
Northern House
Woodsome Park
Fenay Bridge
Huddersfield HD8 0LA
Tel: 0871 664 0300
(calls cost 10p per minute plus network extras, lines are open 8.30 am to 5.30 pm Monday–Friday)
E-mail: shareholder.services@capitaregistrars.com
Website: www.capitaregistrars.com

CHAIRMAN'S STATEMENT

The macroeconomic and stock market background was more benign in 2010. This was reflected in a continued recovery in the Company's market value and the net asset value (NAV) per share grew 41.2%, comfortably ahead of any relevant index.

The UK, which still accounts for the majority of the portfolio, had a total return of 42.4%. In comparison, the FTSE Small Cap index had a total return of 19.9%, and the FTSE 100 of 13.1%. The US portfolio performed even better with a $ return of 47.5%. This compares with the NASDAQ rising 18.2% and the Russell 2000 Technology Index rising 37.4%. The exchange rate enhanced these returns to 52.6% in £. The local currency return in Europe was a more modest 20.9%, 17.8% in sterling, but the Company's European exposure is now very modest. The Far East returned 15.6% in local currencies significantly enhanced by currency (27.5% in £). This lower return is consistent with the Manager's cautious weighting; the Taiwanese stock exchange Electronics index and the KOSDAQ IT index were relatively flat in local currencies.

In spite of the robust growth in NAV per share of 41.2%, the valuation of the portfolio is similar to last year in p/e terms illustrating the robust underlying growth in profits. This is somewhat higher than the long term growth rate and reflects a recovery in profits in certain companies that had been adversely impacted by the recession in 2009 and some of the funds raised through takeovers and profit taking giving the opportunity to reinvest on lower valuations. Nevertheless it provides an encouragingly solid base for further growth in 2011.

It is interesting to observe that smaller companies have continued to outperform larger ones in the technology sector in 2010, and the UK and the US have significantly outperformed the Far East and Europe, and the wider indices. The portfolio has been well positioned to exploit this. It might be worth illustrating some long term figures to highlight the long term performance divergences.

Compound annual rate of return from inception and from full globalisation at the end of 1998

	21/02/1994	31/12/1998
HIT NAV (fully diluted)	11.2%	9.4%
HIT share price	10.4%	9.6%
HIT UK capital	15.7%	15.1%
HGSC capital	5.5%	7.4%
Russell 2000 Technology £	–	3.4%
Taiwan Electronics £ (total return)	–	5.0%
KOSDAQ IT £ (total return)	–	(0.2%)

Source: HIML

There are a number of interesting points to make. Firstly the Company's NAV has compounded in capital terms since inception at 11.2% per annum. The UK (+15.7% per annum) and European portfolios (+13.9% per annum) which were the Company's original focus, have compounded somewhat faster than this. This is significantly ahead of the returns on the UK market as a whole and the various smaller companies indices and demonstrates that the UK has been, and the Manager believes will remain, a fertile area for investing in TMT stocks. The satisfactory UK return has also been enabled by the opportunity to exploit the market's volatility. In particular the Manager raised cash in 2000 but was a net investor in 2002, 2008 and 2009. Whilst the fund has benefited from its specialist focus on the sector, which is now unique in the UK, the US portfolio has performed satisfactorily relative to US indices but lagged the UK. The focus on the US, where trends emerge first, has also enabled greater returns in the UK. The long term returns have been weaker elsewhere, which in part reflects a greater focus on the UK and US, but the asset allocation has correctly perceived the easier returns in the UK. The Taiwanese electronics index has performed marginally better than the Russell 2000 Technology Index, but the KOSDAQ IT index in Korea much worse.

It is pleasing to see that, as a consequence of the strength of the performance in the UK, over the long term the Company has outperformed all but one of the 87 surviving technology or TMT specialist funds managed in the US, UK and Europe since 31 December 1998, even in share price terms in spite of a wider discount. This seems a fair starting point because it includes the period over which the Company's mandate has been fully global and includes the boom and ensuing bust of 1999-2000, as well as the more recent financial turbulence. Undoubtedly the Company has benefited from its closed end nature as an investment trust, which has avoided cash inflows at times of excess enthusiasm and avoided cash outflows in the market troughs, which would have led to assets being sold on a distressed basis. The other closed end technology funds have also performed relatively well over the cycles.

Net income has been affected by the interest payable on the loan stock. As a consequence, no dividend is proposed in respect of the year.

Whilst the structural imbalances in the world economy cast a continuing cloud, the sector should fare relatively well in a background of inflation or deflation. Whilst investee company valuations are not as compelling as two years ago, they are attractive against the valuation of bonds and very modest versus the last time your Company had a NAV per share at this level in 2000. The launch of the iPad in 2010, from which the portfolio has benefited, epitomises how innovation can drive new markets.

Julian Cazalet

Julian Cazalet
Chairman

22 February 2011

INVESTMENT MANAGER'S REPORT

At the start of the year I thought the portfolio was good value, with expectations of solid earnings. Candidly, I did not expect a return of over 40%. These seem to be the main reasons why my expectations were exceeded:

1) Global growth exceeded expectations. The structural trade imbalances remain severe and excessive levels of debt proliferate. While there is an evident credit squeeze on private sector debt, global fiscal deficits have ballooned, stimulating demand growth and providing a sympathetic background for growth in corporate profitability for those with sufficient capital. I have experienced several recessions in my career, but 1980, 1984, 1991 and 2002 all seemed to have a greater adverse effect on profitability. I suspect this reflects more prudent business models in TMT companies since the ferocious 2002 downturn, low interest rates and also the continued buoyant levels of demand reflecting the pervasive adoption of technology in the enterprise and the home. Relative to bonds, property values and the wider equity markets, the portfolio's earnings yield continues to seem good value. However, I cannot fathom out how the excessive Government fiscal deficits in US, Japan, Europe and the Chinese local Government, combined with the continued deleveraging of the banks, will play out. The appetite and need for pensions in the developed world and the dramatic increase in life expectancy imply a higher savings ratio and subdued consumer demand. This in turn implies that returns on capital will be low - i.e. capital will be cheap and equities seem likely to become more expensive. This will be a change from the current environment of capital scarcity and where pension funds have been migrating into bonds, out of equities. Asset allocation seems to be driven by actuaries and accounting standards rather than fund managers. The trick will be to find companies that can continue to grow profits in this environment.

2) Continuing takeovers in the portfolio, with the ability to reinvest on substantially lower valuations means that in spite of further net outflows from the UK and US markets, redeployment of some of the proceeds has provided much needed liquidity. This year there have been 13 takeovers in the portfolio for cash realising £32.3m. In contrast the market for IPOs has again been minimal in the UK (only Digital Barriers appealed), and although it tried to get going in the US, many issues were withdrawn. There is a curious dichotomy between some of the larger technology companies in the US holding huge cash balances which generate an inadequate return on capital, while there is a shortage of capital for earlier stage companies. This mirrors the divergence in remuneration between the skilled workers and the unemployed. The knowledge based economy presents challenges for investors as it does for those starting their careers. The unwillingness by investors to participate in primary fund raisings has in the short term been helpful to the Company, both in providing reasonably priced investment opportunities and enabling the focus of available resources to support the secondary market as described. However, if the UK and the US are going to maintain their lead in developing leading edge technologies and growing companies with pricing power, then this capital drought in the venture market as well as the quoted market has to end. It is a source of frustration that more people do not share my enthusiasm for the sector in which I believe and invest, with an idealism that it is the sector which can enable the developed world to sustain and grow its living standards.

3) Innovation continues to open new markets and in 2010 the iPad arrived, stimulating demand for component suppliers, internet traffic and paid content. This product was more disruptive than anticipated, has clearly stimulated the portfolio and contributed to upgrades in profit expectations. The drivers that have led to this eruption include 3G mobile telephones, 802.11n wifi, touchscreens, multi-threading technology, multi-core processing, increased integration, all of which have led to market share shifts and spectacular growth for certain companies other than just Apple.

UK

The UK portfolio has delivered a total return of 42.4%. Within this the biggest monetary returns came from the two biggest holdings, Imagination (+£10.0m) and SDL (+£8.3m), but 12 holdings yielded a return in excess of 100% and an increase in excess of £1m. These include CML Microsystems +536%, Avesco +378%, Telit +232%, Bango +189%, Andor +177%, Xaar +158%, Zoo Digital +153%, IQE +138%, Sandvine +139%, K3 +124%, Wolfson +117% and OMG +106%. Of these CML, Avesco, Telit, K3 and Wolfson were new holdings in 2008 or 2009. In addition we participated in secondary placings providing expansion capital for Bango, Xaar and IQE materially increasing the stake in each and a rescue financing at 15p for Zoo Digital. The Andor, IQE and OMG stakes were all materially increased in the secondary market. Imagination had been the worst loss in the portfolio in 2008, but we materially added to the holding and then reduced it over time in 2010 until they too had a secondary placing towards the end of the year in which we also participated. It is extremely fulfilling to have been able usefully to provide capital to these businesses, while also achieving exceptional returns for investors. Unfortunately we bought back c9% of Herald's equity in the downturn. As I suspected at the time this has clearly adversely affected the net assets per share for continuing shareholders, because although the repurchases were on discounts up to 25%, the scale of outperformance of new or increased positions has almost invariably outperformed the portfolio as a whole by more than 25% and there simply was not the liquidity in other holdings to switch. Anyway, even the more resilient holdings were under pressure and we were determined to be supportive in fear of losing positions too cheaply to opportunistic acquisitions. Bear in mind that the portfolio had already risen 66.5% in 2009. Mercifully the Directors and a number of substantial wiser shareholders were supportive in resisting pressure from a small aggressive minority who were pushing for buy-backs, which either reflected their own distress or a failure to comprehend the market in which we invest and the outstanding opportunities that were available. With hindsight I regret not trusting my instincts more, resisting totally and utilising borrowing facilities more fully, but realistically it has probably only adversely impacted the NAV per share by 3-8%. Even more so, I regret my inability to convey my enthusiasm to the wider market. The sceptics and the pension funds and insurance companies seem to have significantly left the register, so I hope that 2011 might see an improvement in the share price relative to the assets.

It is interesting that in spite of two recovery years the market for IPOs ended the year firmly closed. In part this reflects a couple of overpriced issues getting away and disappointing, in part the continued shift of capital away from equities by insurance companies and pension funds and in part a fear of the illiquidity of smaller companies. This caused unfortunate volatility in Herald's NAV when there were distressed sellers in the market, but it has enhanced assets. Pension funds and insurance companies really are the investors that ought to be able to take long term stakes and I cannot help but believe that this dramatic switch into fixed interest will prove expensive.

Takeovers in the UK portfolio include Portrait Software, Innovision, Intec and Datacash, which was nearly a ten bagger.

US

The US portfolio rose 47.5% (52.6% in sterling) which is an even greater increase than the UK. This has been driven significantly by takeovers including Sonicwall, Virage Logic, Actel, Art Technology and ADC Telecom. Two of these rose over 100% in the year – ADC Telecom and Virage Logic and seven other holdings did too. In US$ terms, the percentage rises were as follows: MIPS +259%, Finisar +211%, Silicon Image +186%, MRV +151%, Support.com +147%, Radware +145% and Alliance Fiber +172%. MIPS has a similar business model to Arm, Imagination, Ceva and Virage Logic. They all receive royalties when their IP is designed in. Finisar and MRV are fibre component makers. The excess network build out in 2000 was accompanied by a bubble in fibre optics. The growth in internet traffic is leading to network capacity constraints and the fibre optic component market has consolidated, so sensible margins are now in sight. Finisar and MRV have benefited from this. Radware and F5 have both been outstanding contributors to the portfolio over the last two years supplying application delivery controllers. The latter was acquired in April 2008 when it dipped into the Herald size remit at a price of $18.7 per share at $2/£, and was sold in March at c $70 and c $1.50/£, when the market capitalisation was $6bn. By the year-end it had risen further to $130.16! There are signs of the momentum players re-emerging, and some of the larger smaller companies are now quite expensive, while others are still in the shade. To a degree this applies in the UK. Rarely have I seen such a two tier market, but it provides switching opportunities. The game is to spot the companies before they hit the radar screen and sell into the rush. Overall the US portfolio is now on its historic valuation premium making further relative returns more challenging than 2010.

Far East

After the 136.8% increase in the Asia Pacific portfolio in 2009, as growth returned to the global economy, the Asian portfolio had a muted 2010 with the Korean IT index down 2.1% and the Taiwan Taiex index up 3.6% in local currency terms. Sterling adjusted returns are more respectable in both markets with the Herald portfolio returning 27.5% (KOSDAQ IT 5.3%, Taiex Electron 17.7%). Herald has continued with the policy of avoiding investment in the Japanese market, believing the limited opportunities within the smaller companies arena do not justify the specialist resources required. JASDAQ sits at less than half the peak value of 2006.

Following the market movements in 2010, the key Asian technology stock markets are trading at p/e's of around 10x-12x – a more normal level of discount to the rest of the portfolio and broadly appropriate given the low margin, cyclical and capital intensive nature of companies in the region.

Europe

The European portfolio is small at £12m, but has risen 20.9% (17.8% in sterling). Highlights include the final sale of Logitech and United Internet, which have been trusty stalwarts over the years. Logitech was acquired in 1995 and returned over 10x (SFr14m), and United Internet I luckily managed to pick out of a great deal of Neuer Markt dross in October 1999. This has returned 5x yielding Euro8m profit. The best return for 2010 has been Nordic Semiconductor at +133%.

Sector Background

The internet is clearly the killer application, but if 2009 was the year of the mobile internet, 2010 has seen another kicker with Android and the iPad to the fore. Behind the end products the drivers have included multi-threading graphics, processors, capacitive touchscreens, mifi, flash memory (CML the best % rise in the portfolio supplies flash controllers to Cisco and Juniper), baseband IP, infiniband, 3D TV, virtualisation in the data centre, applications and online content-internet TV, eReaders, iNewspapers, and many more. SAAS software models have demonstrated durability.

P/E of stocks profitable in 2009	UK	US	EMEA	Asia Pac	Total
2009	16.3x	30.4x	19.5x	16.3x	18.3x
2010	15.0x	25.5x	19.2x	12.2x	16.4x
2011	13.1x	20.4x	14.6x	10.1x	14.0x
P/E of all stocks with estimates					
2009	32.0x	67.8x	23.6x	27.0x	35.9x
2010	16.7x	27.2x	19.7x	11.8x	18.1x
2011	13.3x	20.3x	14.4x	9.5x	14.3x

It is difficult to be as positive as previously when the assets have risen strongly two years running and the economic flaws remain. Nevertheless, it is extremely encouraging that the valuation of the portfolio in p/e terms at the end of 2010 is similar to that at the end of 2009. Further profits growth is expected in 2011 albeit at a more modest rate than a year which included some holdings where profits recovered from a dip in 2009. When I compare our sector with alternative sector choices, I remain enthused. Cash generation is key. I cannot think of another sector outside TMT where companies can repeatedly generate such high margins and cash. We constantly seek investments with pricing power that enables premium margins, either through technical leadership, or a defensible market position and the technology sector has a plethora of such companies. The Far East is in general conspicuously different and generally has the low margin subcontract manufacturing. I continue to feel safer in technology stocks in US and UK at this juncture!

PERFORMANCE ATTRIBUTION (in sterling terms)

Equity markets	Comparative index allocation 01.01.10 %	Comparative index allocation 31.12.10 %	Herald asset allocation 01.01.10 %	Herald asset allocation 31.12.10 %	Performance* Herald %	Performance* Comparative index %	Contribution to relative return %	Contribution attributable to: Stock selection %	Contribution attributable to: Asset allocation† %
UK	66.7	66.7	66.2	65.4	42.4	31.5	5.3	5.4	(0.1)
Europe ex. UK	–	–	3.4	2.6	17.8	–	(0.3)	–	(0.3)
Americas	33.3	33.3	25.7	25.5	52.6	41.1	1.5	1.9	(0.4)
Asia Pacific ex. Japan	–	–	8.5	6.3	27.5	–	(0.5)	–	(0.5)
Emerging Markets	–	–	0.4	0.4	45.4	–	–	–	–
Bonds	–	–	7.7	4.2	5.8	–	(1.4)	–	(1.4)
Cash	–	–	4.7	8.0	2.8	–	(2.0)	–	(2.0)
Swap	–	–	(1.9)	(1.9)	n/a	–	(0.7)	–	(0.7)
Loans	–	–	(14.7)	(10.5)	1.4	–	3.5	–	3.5
Total	100.0	100.0	100.0	100.0	42.6	35.1	5.5	7.4	(1.8)

Past performance is not a guide to future performance.
Source: HSBC.

* The above returns are calculated on a total return basis with net income reinvested. Dividends and interest are reinvested on a cash basis, unlike the NAV calculation where income is recognised on an accruals basis. Relative performance may differ as a result.
Contributions cannot be added together, as they are geometric; for example, to calculate how a return of 42.6% against a comparative index return of 35.1% translates into a relative return of 5.5%, divide the portfolio return of 142.6 by the comparative index return of 135.1 and subtract one.

† Asset allocation includes the contribution attributable to currency movements.

Katie Potts

22 February 2011

INVESTMENT CHANGES (£'000)

	Valuation at 31 December 2009	Net acquisitions/ (disposals)	Appreciation/ (depreciation)	Valuation at 31 December 2010
Equities*				
UK	225,100	(2,104)	87,338	310,334
Continental Europe	11,632	(1,871)	2,535	12,296
Americas	87,402	(10,099)	43,664	120,967
Asia Pacific	28,908	(5,354)	6,137	29,691
Emerging Markets	1,388	(48)	622	1,962
Total equities	354,430	(19,476)	140,296	475,250
Bonds:				
UK bonds	19,620	–	531	20,151
US$ bonds	6,407	(6,191)	(216)	–
Total bonds	26,027	(6,191)	315	20,151
Total investments	380,457	(25,667)	140,611	495,401
Net liquid assets	16,737	21,014	347	38,098
Total assets	397,194	(4,653)	140,958	533,499

The total assets figure above comprises assets less current liabilities before deduction of bank loans and derivative financial instruments.
* Equities includes convertibles and warrants.

TOP TWENTY EQUITY HOLDINGS

AT 31 DECEMBER 2010

A brief description of the twenty largest equity holdings in companies is as follows:

SDL

SDL is the leader in Global Information Management (GIM) solutions that help organisations to accelerate the delivery of high-quality multilingual content to global markets alongside their products and services. SDL's best-of-breed Web Content Management, eCommerce, Structured Content and Language Technologies, combined with its Language Services drive down the cost of content creation, management, translation and publishing. SDL solutions increase conversion ratios and customer satisfaction through targeted information across all customer touch points. Global industry leaders who rely on SDL include ABN-Amro, Bosch, Canon, CNH, FICO, GlaxoSmithKline, Hewlett-Packard, KLM, Microsoft, NetApp, Philips, SAP and Sony. SDL has over 1,500 enterprise customers, has deployed over 170,000 software licenses and provides access to on-demand portals for 10 million customers per month. It has a global infrastructure of more than 60 offices in 35 countries. SDL is in Gartner's leader quadrant for web content management.

Country		United Kingdom
% of total assets		4.0
% of issued share capital held		4.3
	31/12/10	31/12/09
Valuation (£m)	21.55	15.23
Shares (m)	3.36	3.71

Imagination Technologies Group

Imagination Technologies is an international leader in the creation and licensing of semiconductor System-on-Chip Intellectual Property (SoC IP). Imagination creates market-leading embedded graphics, video and display acceleration, multi-threaded processing and multi-standard receiver technologies and licenses this IP (Intellectual Property) to global semiconductor and system companies. These technologies are used in the following markets: digital radio and audio, mobile phone multimedia, personal media player, car navigation and driver information, personal navigation, mobile computing, digital TV and set-top box, and mobile TV. Imagination has been particularly successful in selling graphics technology to the mobile phone and LCD TV sectors and is a pioneer in developing Digital Audio Broadcasting Technology (DAB). Imagination Technology incorporates this technology in its "Pure Digital" radio brand, which is the number one supplier of radios in the UK. The adoption of digital radio in other countries, France and Germany in particular, is opening up a bigger international market and they have launched an internet radio range for the US market. The group has a highly skilled workforce of over 600 people, of which over 80% are R&D engineers. Apple and Intel are both investors in Imagination Technologies.

Country		United Kingdom
% of total assets		3.9
	31/12/10	31/12/09
Valuation (£m)	21.00	22.25
Shares (m)	5.86	9.23

Phoenix IT Group

Phoenix IT was established in 1980, the Group provides a growing range of complementary IT infrastructure support services including systems management, communications, remote telephone support, high-touch field services, project and consultancy services as well as business continuity and disaster recovery services. Often these services are sold and delivered as a managed service where Phoenix manages complex IT infrastructures to agreed levels of service under long-term contracts. In May 2007 Phoenix acquired ICM for £130m in cash and shares, ICM had been a portfolio holding since 2002.

Country		United Kingdom
% of total assets		2.6
% of issued share capital held		7.1
	31/12/10	31/12/09
Valuation (£m)	14.09	8.21
Shares (m)	5.35	3.10

Telecom Plus

Telecom Plus, which owns and operates the Utility Warehouse brand, is the UK's only fully integrated provider of a wide range of competitively priced utility services, spanning both the communications and energy markets. Telecom Plus supplies fixed wire and mobile telecommunications services, gas and electricity to over 350,000 residential and small business customers in the United Kingdom with a unified bill and good value utilities. Telecom Plus was incorporated in 1996 and began operations in 1997 providing a unique range of low-cost telephony services to the residential and SOHO markets. They use the collective buying power of individual users to negotiate bulk buying deals with major suppliers, passing the benefit back to their customers. Telecom Plus does not advertise and has no shops. Instead, they rely on word of mouth recommendations from satisfied customers and from a network of Independent Distributors.

Country		United Kingdom
% of total assets		2.3
% of issued share capital held		3.9
	31/12/10	31/12/09
Valuation (£m)	12.07	8.06
Shares (m)	2.69	2.74

Group NBT

Group NBT is a leading provider of domain names, managed hosting solutions and other internet-related services. With five market-leading brands, Group NBT is now made up of the following companies: NetBenefit, providing high quality managed hosting services in both the UK and Continental Europe; NetNames, providing registration services for every top level domain available and providing corporate domain name management to large organisations through its industry leading NetNames Platinum Service, which is now used by over 30% of the FTSE 100; Easily.co.uk, a top UK provider of cost effective web hosting and domain name services to UK businesses and consumers; Speednames, the dominant provider of domain name services in Denmark; Ascio, which is responsible for the provision of domain name services indirectly through more than 300 partnerships including telecom operators, web hosting companies, internet access providers and IP law firms; and Envisional, whose services monitor the internet for brand abuse, fraud, counterfeiting and piracy. Group NBT currently has over 280 employees world-wide, with offices in London, Copenhagen, New York, Nice, Munich, Zurich and Oslo.

Country		United Kingdom
% of total assets		2.0
% of issued share capital held		9.7
	31/12/10	31/12/09
Valuation (£m)	10.45	7.98
Shares (m)	2.52	2.53

TOP TWENTY EQUITY HOLDINGS *continued*

AT 31 DECEMBER 2010

IQE

IQE is a leading global supplier of advanced compound semiconductor wafers with products that cover a diverse range of applications, supported by an innovative outsourced foundry services portfolio. IQE uses advanced crystal growth technology (epitaxy) to manufacture and supply bespoke semiconductor wafers ('epi-wafers') to the major chip manufacturing companies, who then use these wafers to make the chips which form the key components of virtually all high technology systems. IQE is unique in being able to supply wafers using all of the leading crystal growth technology platforms. IQE's products are found in many leading-edge consumer, communication, computing and industrial applications, including a complete range of wafer products for the wireless industry, such as mobile handsets and wireless infrastructure, Wi-Fi, WiMAX, base stations, GPS and satellite communications; optical communications, optical storage (CD, DVD), laser optical mouse, laser printers and photocopiers, thermal imagers, leading-edge medical products, barcode, high efficiency LEDs and a variety of advanced silicon based systems. The manufacturers of these chips are increasingly seeking to outsource wafer production to specialist foundries such as IQE in order to reduce overall wafer costs and accelerate time to market.

Country		United Kingdom
% of total assets		1.7
% of issued share capital held		4.0
	31/12/10	31/12/09
Valuation (£m)	9.14	3.34
Shares (m)	20.64	19.95

Advent Software

Advent supplies investment management companies with integrated software products and services in portfolio administration, including workflows within the managers and external portfolio reporting. Each solution focuses on specific mission-critical functions of the front, middle and back offices and is designed to meet the needs of the particular client, as determined by size, assets under management and complexity of the investment environment. With more than 4,500 client firms, Advent has established itself as a leading provider of mission-critical applications to meet the demands of investment management operations around the world. It has adopted a rental model.

Country		USA
% of total assets		1.7
	31/12/10	31/12/09
Valuation (£m)	8.88	6.30
Shares (m)	0.24	0.25

Euromoney Institutional Investor

Euromoney is a leading international business-to-business media group focused primarily on the international finance, metals and commodities sectors. It publishes more than 100 magazines, newsletters and journals, including Euromoney Institutional Investor and Metal Bulletin. It also runs an extensive portfolio of conferences, seminars and training courses and is a leading provider of electronic information and data covering international finance, metals and emerging markets. Its main offices are in London, New York and Hong Kong and nearly half its revenues are derived from the United States.

Country		United Kingdom
% of total assets		1.6
	31/12/10	31/12/09
Valuation (£m)	8.65	5.88
Shares (m)	1.25	1.35

Alterian

Alterian features in Gartner's Enterprise Marketing Management (EMM) Quadrant. It focuses on campaign management, marketing resource management and online marketing with the use of proprietary databases. Alterian's integration of analytics, content and execution through industry leading tools, such as the Dynamic Messenger email platform, SM2 Social Media Monitoring platform and the award winning Content Management solutions, enables companies to build integrated communication strategies. Alterian distributes through a number of marketing service providers including Acxiom, Experian, Epsilon, Harte-Hanks, Merkle, Allant, Donnelley Marketing and KnowledgeBase Marketing. It generally licences the products on a one year term. Alterian also has a number of direct customers.

Country		United Kingdom
% of total assets		1.5
% of issued share capital held		6.6
	31/12/10	31/12/09
Valuation (£m)	8.08	7.66
Shares (m)	4.04	4.14

StatPro Group

StatPro is a leading provider of portfolio analysis and asset valuation software and services for the global asset management industry. The company's focus is on delivering a SaaS-based analytics and data platform on a rental basis to investment management companies, allowing them to analyse portfolio performance, attribution, risk and GIPS® compliance. StatPro also provides market data and valuation feeds including a Complex Asset Pricing service. StatPro has over 250 clients and generally experiences in excess of a 90% annual renewal rate.

Country		United Kingdom
% of total assets		1.4
% of issued share capital held		11.3
	31/12/10	31/12/09
Valuation (£m)	7.71	6.98
Shares (m)	6.88	6.98

M&C Saatchi

M&C Saatchi is a global marketing services business working for clients across a wide variety of industry sectors. The Company was founded in 1995. Starting with a strong base in the UK and Australia, Saatchi have added new agencies and disciplines in Asia, USA and Europe, employing over 1,100 staff in 18 countries.

Country		United Kingdom
% of total assets		1.3
% of issued share capital held		8.7
	31/12/10	31/12/09
Valuation (£m)	6.86	3.52
Shares (m)	5.40	4.40

Electrocomponents

Electrocomponents is the world's largest distributor of electronics and maintenance products serving 1.5 million customers with 500,000 products worldwide. Starting in 1937 in London selling spare parts for radios, the Group now has operations in 27 countries. Revenue is close to £1bn, with 52% of sales now coming via e-commerce. Electrocomponents trades as RS in the UK, most of Europe and Asia, Radiospares in France, Radionics in Republic of Ireland and Allied Electronics in North America.

Country		United Kingdom
% of total assets		1.3
	31/12/10	31/12/09
Valuation (£m)	6.80	4.30
Shares (m)	2.56	2.66

NCC Group

As a trusted adviser, NCC Group provides business critical IT assurance and protection to over 15,000 organisations worldwide, including 94 out of the FTSE 100. The Group operates two main complementary divisions, Escrow and Assurance: Escrow, includes ensuring source code, data or other business critical material is protected and accessible should anything happen to a key supplier. Furthermore NCC confirm the material held is properly protected by verifying that it can be rebuilt from its source code components. NCC trades under the NCC Group Escrow and Escrow Europe brands. Assurance, incorporates expert led security testing, covering forensics, vulnerability research and the development of expert software to aid organisations in their on-going battle with information security breaches. NCC trades under the NGS Secure, iSEC Partners, SDLC Solutions, Meridian and Site Confidence brands.

Country		United Kingdom
% of total assets		1.2
% of issued share capital held		3.6
	31/12/10	31/12/09
Valuation (£m)	6.66	1.16
Shares (m)	1.21	0.3

Diploma

Diploma is a group of specialised distribution businesses serving industries with long term growth potential and with the opportunity for sustainable superior margins through the quality of customer service, depth of technical support and value-adding activities. The three sectors the company focuses on are life sciences, seals and controls.

Country		United Kingdom
% of total assets		1.2
	31/12/10	31/12/09
Valuation (£m)	6.46	5.64
Shares (m)	2.35	3.20

Fidessa Group

Fidessa supplies trading systems to the world's financial markets. It is the leading supplier of multi-asset trading, portfolio analysis, decision support, compliance, market data and connectivity solutions. Fidessa's products and services make it easier to buy, sell and own financial assets of all types on a global basis and uniquely, serves both the buy-side and sell-side communities globally. Fidessa has developed its products over 28 years, investing heavily in their continual evolution. Fidessa's products are used by over 85% of tier-one, global financial institutions. Headquartered in London and with regional operations across Europe, North America, Asia and the Middle East, Fidessa supports over 26,000 users across 900 clients, serving a broad spectrum of customers from major investment banks and asset managers through to specialist niche brokers and hedge funds. The product is supplied on a rental basis.

Country		United Kingdom
% of total assets		1.1
	31/12/10	31/12/09
Valuation (£m)	6.00	4.57
Shares (m)	0.39	0.39

Bango

Bango provides technology that powers commerce for businesses targeting the growing market of internet enabled mobile phone users. Bango's payments products collect payment from mobile users for on-line content and services. There are over 30 million users worldwide transacting with content providers across mobile networks using Bango. Bango also provides in-app billing for the BlackBerry AppWorld and is in discussions with other application store owners. Bango Analytics provides data about mobile visitors, reporting precise customer insights in real-time giving website owners and application developers information about customers visiting their site. Customers include RIMM (Blackberry), Fox Mobile Group, EA Mobile and Turner Broadcasting System Inc.

Country		United Kingdom
% of total assets		1.1
% of issued share capital held		10.1
	31/12/10	31/12/09
Valuation (£m)	5.93	2.34
Shares (m)	3.83	4.33

Radware

Radware is a global leader in integrated application delivery solutions and a member of the RAD Group. Radware products have been sold to over 10,000 enterprises and carriers worldwide. The key target markets Radware serves are: Application Delivery and Network Security. The Application Delivery product portfolio consists of advanced application delivery platforms, which offer, in addition to Layer 4-7 switching, benefits in terms of business continuity and resiliency, agility and efficiency by optimising the delivery of applications across IP and web-based networks. Radware is identified as a leader in Gartner's magic quadrant for Application Delivery Controllers (ADC's). Network Security solutions consist of firewall/Virtual Private Networks (VPN), Unified Threat Management (UTM), intrusion detection systems, intrusion prevention systems, network behavioral analysis (NBA) systems and Secure Sockets Layer/Internet Protocol Security (SSL/IPSec) VPN appliances. Radware's security offering focuses on network intrusion prevention and attack mitigation systems, which can react, in real-time, to block or prevent malicious activities. Radware is a visionary in Gartner's magic quadrant for Network Intrusion Prevention Systems.

Country		USA
% of total assets		1.1
	31/12/10	31/12/09
Valuation (£m)	5.81	2.90
Shares (m)	0.24	0.31

Websense

Websense is a global leader in integrated web, data and e-mail security solutions. Distributed through its global network of channel partners, Websense software, appliance and Software as a Service (SaaS) security solutions help organisations block malicious code, prevent the loss of confidential information and enforce internet use and security policies. In March 2007 Websense acquired its main competitor SurfControl for $400m in cash, SurfControl had been a portfolio holding since 1998.

Country		USA
% of total assets		1.1
	31/12/10	31/12/09
Valuation (£m)	5.75	5.03
Shares (m)	0.45	0.47

Digital Barriers

Digital Barriers provides consulting, integration services and technology to the international homeland security and defence sectors. The focus is on counter-terrorism, cyber-security and specialist areas of defence, helping clients select, architect and deploy effective and proportionate solutions to enhance the physical and electronic security of high-profile, high-value potential targets. Digital Barriers deployments protect airports, public transportation systems, secure government locations, border crossings, critical national infrastructure facilities and computer systems and networks in a significant number of locations around the world. Digital Barriers also provide advanced technology to support military operations, particularly in the areas of counter-insurgency and force protection. Digital Barriers was founded by the team behind Detica Group plc, a UK-based FTSE 250 specialist consultancy acquired by BAE Systems in 2008. Detica was a portfolio holding within the Trust from just after the Detica IPO in 2002 until its takeover by BAE Systems.

Country		United Kingdom
% of total assets		1.1
% of issued share capital held		6.8
	31/12/10	31/12/09
Valuation (£m)	5.66	–
Shares (m)	2.98	–

Kofax

Kofax is the leading provider of document driven business process automation solutions. For more than 20 years, Kofax has provided solutions that streamline the flow of information throughout an organisation by managing the capture, transformation and exchange of business critical information arising in paper, fax and electronic formats in a more accurate, timely and cost effective manner. These solutions provide a return on investment to thousands of customers in financial services, government, business process outsourcing, healthcare, supply chain and other markets. Kofax delivers these solutions through its own sales and service organisations and a global network of more than 700 authorised partners in more than 60 countries throughout the Americas, EMEA and Asia Pacific.

Country		United Kingdom
% of total assets		1.0
	31/12/10	31/12/09
Valuation (£m)	5.13	3.19
Shares (m)	1.72	1.82

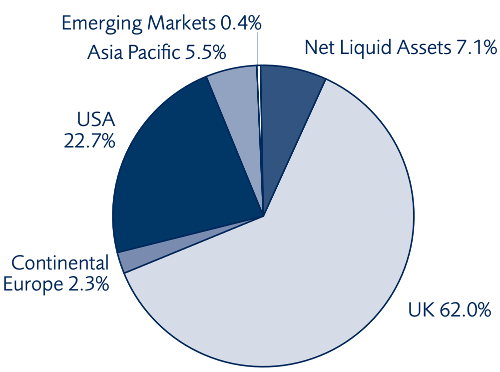
Note: A figure is presented for % issued share capital held only if greater than 3%.

CLASSIFICATION OF INVESTMENTS

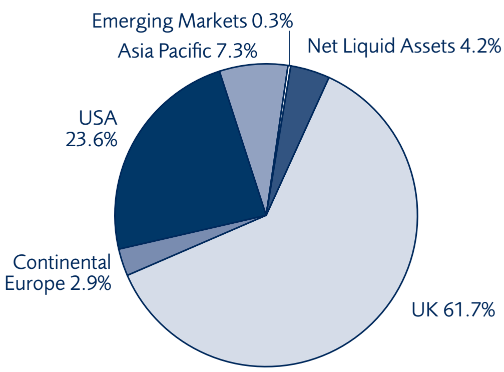
Classification	UK %	Continental Europe %	USA %	Asia Pacific %	Emerging Markets %	2010 Total %	2009 Total %
EQUITIES: (including convertibles and warrants)							
OIL & GAS	**0.1**	**–**	**–**	**–**	**–**	**0.1**	**–**
Oil equipment services and distribution	0.1	–	–	–	–	0.1	–
BASIC MATERIALS	**–**	**–**	**–**	**0.6**	**–**	**0.6**	**0.5**
Chemicals	–	–	–	0.6	–	0.6	0.5
INDUSTRIALS	**7.2**	**0.2**	**–**	**1.8**	**–**	**9.2**	**9.3**
Aerospace and defence	0.2	–	–	–	–	0.2	0.4
Electronic and electrical equipment	1.3	–	–	1.8	–	3.1	4.2
Industrial engineering	–	–	–	–	–	–	0.1
Support services	5.7	0.2	–	–	–	5.9	4.6
CONSUMER GOODS	**0.2**	**–**	**–**	**–**	**–**	**0.2**	**0.2**
Leisure goods	0.2	–	–	–	–	0.2	0.2
HEALTH CARE	**0.3**	**–**	**0.2**	**–**	**–**	**0.5**	**0.5**
Health care equipment and services	0.3	–	0.2	–	–	0.5	0.5
CONSUMER SERVICES	**9.0**	**0.2**	**–**	**–**	**–**	**9.2**	**10.3**
Media	9.0	0.2	–	–	–	9.2	9.1
Travel and leisure	–	–	–	–	–	–	1.2
TELECOMMUNICATIONS	**3.2**	**–**	**0.6**	**0.1**	**–**	**3.9**	**3.6**
Fixed line telecommunications	3.0	–	0.6	–	–	3.6	2.9
Mobile telecommunications	0.2	–	–	0.1	–	0.3	0.7
FINANCIALS	**0.4**	**–**	**–**	**–**	**–**	**0.4**	**0.5**
Financial services	0.1	–	–	–	–	0.1	–
Equity investment instruments	0.3	–	–	–	–	0.3	0.5
TECHNOLOGY	**37.8**	**1.9**	**21.9**	**3.0**	**0.4**	**65.0**	**64.3**
Software and computer services	27.6	1.5	10.2	0.6	0.4	40.3	38.7
Technology hardware and equipment	10.2	0.4	11.7	2.4	–	24.7	25.6
TOTAL EQUITIES (including convertibles and warrants)	**58.2**	**2.3**	**22.7**	**5.5**	**0.4**	**89.1**	
Total equities – 2009 (including convertibles and warrants)	56.7	2.9	22.0	7.3	0.3		**89.2**
BONDS	**3.8**	**–**	**–**	**–**	**–**	**3.8**	**6.6**
NET LIQUID ASSETS	**6.7**	**–**	**–**	**0.4**	**–**	**7.1**	**4.2**
TOTAL ASSETS (before deduction of bank loans and derivative financial instruments)	**68.7**	**2.3**	**22.7**	**5.9**	**0.4**	**100.0**	
Total assets – 2009	65.6	2.9	23.6	7.6	0.3		**100.0**
BANK LOANS	**(9.4)**	**–**	**–**	**–**	**–**	**(9.4)**	**(12.6)**
DERIVATIVE FINANCIAL INSTRUMENTS	**(1.7)**	**–**	**–**	**–**	**–**	**(1.7)**	**(1.6)**
SHAREHOLDERS' FUNDS	**57.6**	**2.3**	**22.7**	**5.9**	**0.4**	**88.9**	
Shareholders' funds – 2009	51.4	2.9	23.6	7.6	0.3		**85.8**
Number of equity investments (including convertibles and warrants)	123	14	51	31	1	220	234

GEOGRAPHICAL SPREAD OF INVESTMENTS

31 December 2010



31 December 2009



DETAILED LIST OF INVESTMENTS

AT 31 DECEMBER 2010

Classification	Name	Value £'000	%
UNITED KINGDOM			
Oil equipment, services and distribution	† KBC Advanced Technologies	682	0.1
Aerospace and defence	† Cohort	960	0.2
Electronic and electrical equipment	† Andor Technology	3,876	
	e2v Technologies	1,987	
	† PhotonStar LED Group	650	
	† RCG Holdings	206	
		6,719	1.3
Support services	Acal	3,453	
	AEA Technology	1,725	
	† Avisen	445	
	† Digital Barriers	5,661	
	Diploma	6,456	
	† Eckoh Technologies	1,212	
	Electrocomponents	6,804	
	† Maintel	1,824	
	† Opsec Security	1,535	
	† Planet Payment	866	
	† Tangent Communications	263	
		30,244	5.7
Leisure goods	Hiwave Technology	933	0.2
Health care equipment and services	† Deltex Medical	1,737	0.3
Media	† Avesco	2,665	
	Bloomsbury Publishing	1,854	
	† Brainjuicer	1,000	
	† Burst Media	133	
	Centaur Media	1,015	
	Chime Communications	2,971	
	† Coolabi	172	
	† Digital Marketing Group	237	
	† Directex Realisations	83	
	† Ebiquity	2,745	
	Euromoney Institutional Investor	8,650	
	† First Artist	358	
	* Freshwater UK	–	
	† Independent Media Distribution	2,357	
	* Independent Media Support Group	–	
	† M&C Saatchi	6,858	
	† Media Corporation	702	
	† Next Fifteen Communications	3,558	
	† Parallel Media Group	420	
	† Phorm	33	
	† Progressive Digital Media Group	509	
	Quarto Group	2,259	
	† Ten Alps	2,038	
	† The Mission Marketing Group	331	
	† Touch Group	278	
	Trinity Mirror	1,489	
	† UBC Media Group	222	
	† WFCA	238	
	Wilmington Group	3,791	
	† Yougov	852	
		47,818	9.0
Fixed line telecommunications	† Alternative Networks	4,075	
	Telecom Plus	12,071	
		16,146	3.0

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2010

Classification	Name	Value £'000	%
UNITED KINGDOM (continued)			
Mobile telecommunications	† 2 Ergo Group	350	
	† Monitise	723	
		1,073	0.2
Non-life insurance	* ‡ Culver Holdings	29	–
Financial services	IP Group	381	0.1
Equity investment instruments	* Herald Ventures II	1,608	
	* HIML Holdings Limited	207	
	* HIML Jersey Ltd	–	
		1,815	0.3
Software and computer services	† @UK	40	
	† Allocate Software	4,562	
	Alterian	8,083	
	Anite	53	
	† Atlantic Global	101	
	† Bango	5,930	
	† Brady	1,889	
	* Business Control Solutions	–	
	† Clarity Commerce Solutions	787	
	† Corero	760	
	† Craneware	3,776	
	† Dealogic	1,568	
	† Dillistone	906	
	Electronic Data Processing	900	
	† Ffastfill	3,646	
	Fidessa Group	6,003	
	† First Derivatives	445	
	† GB Group	2,150	
	Gresham Computing	1,005	
	† Group NBT	10,451	
	† IDOX	4,169	
	* Intechnology	220	
	† Intercede	1,368	
	*†‡ Invu	286	
	† Iomart	1,817	
	† K3 Business Technology	2,232	
	Kewill Systems	1,931	
	Kofax	5,131	
	† Maxima Holdings	2,199	
	Microgen	2,651	
	NCC Group	6,655	
	† OMG	2,655	
	† Parseq	2,450	
	† Patsystems	3,250	
	Phoenix IT Group	14,091	
	† Scisys	840	
	SDL	21,545	
	*†‡ Servicepower Technologies	660	
	† Silanis International	207	
	† Smart Focus	553	
	†¶ SocialGO	717	
	† SQS Software Quality Systems	4,417	
	† StatPro Group	7,708	
	† Strategic Thought Group	1,033	
	† Timeweave	3,690	
	*†‡ Zoo Digital Group	1,996	
		147,526	27.6

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2010

Classification	Name		Value £'000	%
UNITED KINGDOM (continued)				
Technology hardware and equipment	† Amino Technologies		1,132	
	BATM Advanced Communications		1,411	
	* Celoxica Holdings		–	
	CML Microsystems		1,706	
	† Concurrent Technology		289	
	CSR		1,592	
	Filtronic		230	
	Imagination Technologies Group		21,006	
	† IQE		9,135	
	* Itis		–	
	† MTI Wireless Edge		281	
	Northamber		1,741	
	Pace		3,322	
	† Sandvine		885	
	* Spectrum Interactive		–	
	† Telit Communications		2,738	
	† Toumaz		4,834	
	Wolfson Microelectronics		1,214	
	Xaar		2,755	
			54,271	10.2
	TOTAL UNITED KINGDOM EQUITIES		310,334	58.2
CONTINENTAL EUROPE				
Support services	Hologram Industries	France	970	0.2
Media	High Co	France	465	
	Roularta Media Group	Belgium	564	
			1,029	0.2
Software and computer services	* Atex	Norway	–	
	Devoteam	France	747	
	InfoVista	France	1,239	
	Isra Vision Systems	Germany	807	
	Lbi International	Netherlands	673	
	Norkom	Ireland	1,450	
	Opera Software	Norway	1,275	
	Ordina	Netherlands	786	
	Sword Group	France	947	
			7,924	1.5
Technology hardware and equipment	Nordic Semiconductor	Norway	2,027	
	Soitec	France	346	
			2,373	0.4
	TOTAL CONTINENTAL EUROPEAN EQUITIES		12,296	2.3
USA				
Electronic and electrical equipment	RF Monolithics		157	–
Leisure goods	THQ		174	–
Health care equipment and services	SonoSite		807	0.2
Fixed line telecommunications	AboveNet		3,360	0.6

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2010

Classification	Name		Value £'000	%
USA (continued)				
Software and computer services	Actuate		5,088	
	Advent Software		8,878	
	Art Technology		3,819	
	Descartes Systems Group		2,455	
	Epiq Systems		2,631	
	Falconstor Software		642	
	Fundtech		2,283	
	Ilinc Communications		125	
	Keynote Systems		2,521	
	KEYW		937	
	Mentor Graphics		1,918	
	NetScout Systems		4,409	
	Pegasystems		4,325	
	Retalix Ltd		991	
	SPS Commerce		506	
	Support.com		4,139	
	Telvent		337	
	Vasco Data Security		1,038	
	Web.com Group		1,351	
	Websense		5,750	
			54,143	10.2
Technology hardware and equipment	Alliance Fiber Optic Product		1,883	
	Anadigics		3,806	
	ATMI		5,094	
	Aviat Networks		826	
	Cavium Networks		1,203	
	Ceva		4,963	
	Extreme Networks		2,420	
	Finisar		1,838	
	* Green Plug		1,022	
	Lantronix		389	
	Mellanox		4,620	
	Micros Systems		2,801	
	Mindspeed Technologies		3,175	
	MIPS Technologies		3,873	
	MRV Communications		2,533	
	OCZ Technology		3,078	
	PLX Technology		1,153	
	Power Integrations		897	
	Radisys		600	
	Radware		5,810	
	Sandvine	Canada	903	
	Silicon Image		329	
	Silicon Motion Technology		2,683	
	STEC		1,127	
	Supertex		2,008	
	Trident Microsystems		455	
	Viasat		2,837	
			62,326	11.7
	TOTAL USA EQUITIES		120,967	22.7

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2010

Classification	Name		Value £'000	%
ASIA PACIFIC				
Chemicals	OCI Materials	Korea	387	
	Techno Semichem	Korea	2,635	
			3,022	0.6
Electronic and electrical equipment	BSE Holdings	Korea	497	
	Dae Duck Electronics	Korea	566	
	Fine DNC	Korea	235	
	Huan Hsin	Singapore	375	
	Innotek	Singapore	723	
	KH Vatec	Korea	1,074	
	Simm Tech	Korea	796	
	Surface Mount Technology	Singapore	138	
	Tripod Technology	Taiwan	1,546	
	UJU Electronics	Korea	1,866	
	Unimicron Technology	Taiwan	1,602	
			9,418	1.8
Industrial engineering	Fine Technix	Korea	284	–
Media	Hong Kong Economic Times	Hong Kong	340	–
Mobile telecommunications	CITIC Telecom International	Hong Kong	428	0.1
Software and computer services	Melbourne IT	Australia	492	
	Reckon	Australia	1,656	
	Springsoft	Taiwan	926	
			3,074	0.6
Technology hardware and equipment	Advantech	Taiwan	485	
	Ardentec	Taiwan	870	
	D-Link	Taiwan	1,372	
	Gemtek Technology	Taiwan	291	
	Global Testing	Singapore	374	
	Jadason Enterprises	Singapore	778	
	King Yuan Electronics	Taiwan	472	
	Kinsus Interconnect Technology	Taiwan	958	
	Min Aik Technology	Taiwan	2,774	
	Nepes	Korea	1,612	
	Powertech Technology	Taiwan	2,380	
	Unizyx Holdings	Taiwan	759	
			13,125	2.4
	TOTAL ASIA PACIFIC EQUITIES		29,691	5.5
EMERGING MARKETS				
Software and computer services	Datatec	South Africa	1,962	0.4
	TOTAL EMERGING MARKETS EQUITIES		1,962	0.4

					At 31 December 2009 £'000	%
	Value of equity stocks	474,360			353,660	
	Convertible loan stocks having an element of equity	843			769	
	Warrants having an element of equity	47			1	
TOTAL EQUITY INVESTMENTS			475,250	89.1	354,430	89.2
FIXED INTEREST	Daily Mail 5.75% 2018	1,658				
	Daily Mail 7.5% 2013	1,683				
	UK Treasury 4% 2016	8,629				
	UK Treasury 4.25% 2011	6,040				
	WPP Group 6% 2017	2,141				
TOTAL FIXED INTEREST			20,151	3.8	26,027	6.6
TOTAL INVESTMENTS			495,401	92.9	380,457	95.8
NET LIQUID ASSETS			38,098	7.1	16,737	4.2
TOTAL ASSETS AT MARKET VALUE (before deduction of bank loans and derivative financial instruments)			533,499	100.0	397,194	100.0

(† denotes holding listed on AIM)
(* denotes unlisted security)
(‡ denotes holding wholly or partly in convertible loan stock)
(¶ denotes holding wholly or partly in warrants)

TEN YEAR RECORD

CAPITAL

At 31 December	Total assets £'000	Bank loans £'000	Shareholders' funds £'000	Net asset value per share p	Diluted net asset value per share* p	Share price p	Warrant price p	(Discount)/ premium† %
2000	378,607	(3,233)	375,374	447.55	431.43	491.00	382.50	13.8
2001	275,624	(2,892)	272,732	322.94	314.53	306.00	212.50	(2.7)
2002	199,900	(22,310)	177,590	210.23	206.68	177.00	79.00	(14.4)
2003	350,209	(29,325)	320,884	365.44	365.44	325.25	–	(11.0)
§2004	356,874	(24,663)	332,211	379.43	379.43	322.75	–	(14.9)
2005	358,293	–	358,293	409.22	409.22	379.75	–	(7.2)
2006	401,228	(20,000)	381,228	435.41	435.41	383.50	–	(11.9)
2007	343,497	–	343,497	394.96	394.96	312.00	–	(21.0)
2008	275,789	(65,079)#	210,710	252.63	252.63	184.00	–	(27.2)
2009	397,194	(56,298)#	340,896	420.58	420.58	337.75	–	(19.7)
2010	**533,499**	**(58,937)#**	**474,562**	**593.85**	**593.85**	**483.00**	**–**	**(18.7)**

* The diluted net asset value per ordinary share figures have been calculated in accordance with FRS22.
† (Discount)/premium is the difference between Herald's quoted share price and its underlying diluted net asset value.
§ The figures prior to 2004 have not been restated for the changes in accounting policies implemented in 2005.
\# Includes derivative financial instruments.

REVENUE / GEARING RATIOS

Year to 31 December	Gross revenue £'000	Available for ordinary shareholders £'000	Earnings per ordinary share net** p	Dividend per ordinary share net p	Expense ratio†† %	Actual gearing‡‡	Potential gearing§§
2000	6,508	778	0.93	0.85	1.40	86	101
2001	4,728	1,145	1.36	0.85	1.07	84	101
2002	3,539	627	0.74	0.85	1.21	108	113
2003	3,882	276	0.32	0.30	1.20	103	109
2004	4,776	301	0.34	0.30	1.20	97	107
2005	5,368	556	0.64	0.60	1.16	97	100
2006	6,492	1,922	2.19	1.20	1.13	102	105
2007	5,167	(1,370)	(1.57)	0.50	1.25	93	100
2008	7,629	4,742	5.59	1.55‡	1.13	101	131
2009	6,077	324	0.39	0.30	1.12	105	117
2010	**7,277**	**42**	**0.05**	**–**	**1.05**	**101**	**112**

** The calculation of earnings per ordinary share is based on the revenue from ordinary activities after taxation and the weighted average number of ordinary shares in issue (see note 9, page 43).
†† Ratio of total operating costs against average shareholders' funds.
‡‡ Total assets (including all debt used for investment purposes) less all cash and fixed interest securities (excluding convertibles and corporate bonds) divided by shareholders' funds.
§§ Total assets (including all debt used for investment purposes) divided by shareholders' funds.
‡ The 2008 dividend excludes the special dividend of 3.45p.

CUMULATIVE PERFORMANCE (taking 2000 as 100)

At 31 December	Diluted net asset value per share*	Share price p	Comparative index¶¶	Hoare Govett Smaller Cos & AIM Index	Russell 2000 Technology IndexΔ	Earnings per ordinary share	Dividend per ordinary share net	Retail price index
2000	100	100	100	100	100	100	100	100
2001	73	62	84	82	80	146	100	101
2002	48	36	56	60	39	80	100	104
2003	85	66	79	84	57	34	35	107
§2004	88	66	85	99	51	37	35	110
2005	95	77	101	121	55	69	71	113
2006	101	78	114	144	55	235	141	118
2007	92	64	109	133	56	(169)	59	122
2008	59	37	65	68	45	601	182	124
2009	97	69	100	106	64	42	35	127
2010	**138**	**98**	**133**	**137**	**91**	**6**	**–**	**133**
Compound Annual Returns								
5 year	7.7%	4.9%	5.5%	2.6%	10.4%	(41.1%)	n/a	8.2%
10 year	3.2%	(0.2%)	2.9%	3.2%	(1.0%)	(24.7%)	n/a	5.3%

Past performance is not a guide to future performance.

§ The figures prior to 2004 have not been restated for the changes in accounting policies implemented in 2005.
¶¶ From 1 January 2006 the comparative index was charged to 2/3 Hoare Govett Smaller Companies Index plus AIM (capital gains ex investment companies) and 1/3 Russell 2000 (small cap) Technology Index (in sterling terms).
Δ The Russell 2000 (small cap) Technology Index was rebased during 2009 following some minor adjustments to its constituents. The rebased index is used from 31 December 2008 onwards.

DIRECTORS' REPORT

The Directors present their Report together with the financial statements of the Company for the year to 31 December 2010.

Business Review

Business and Status

The Company is an investment company within the meaning of Section 833 of the Companies Act 2006.

The Company carries on business as an investment trust. It was approved by HM Revenue & Customs as an investment trust under Section 842 of the Income and Corporation Taxes Act 1988 for the year ended 31 December 2009, subject to matters that may arise from any subsequent enquiry by HM Revenue & Customs into the Company's tax return. In the opinion of the Directors the Company has conducted its affairs so as to enable it to continue to obtain such approval and it will continue to seek approval under Section 1158 of the Corporation Tax Act 2010 (formerly Section 842 ICTA 1988) each year.

Objective

Herald's objective is to achieve capital appreciation through investments in smaller quoted companies, in the areas of telecommunications, multi-media and technology (TMT). Investments may be made across the world. The business activities of investee companies will include information technology, broadcasting, printing and publishing and the supply of equipment and services to these companies.

Investment Policy

While the policy is global investment in the above target areas the approach is to construct a diversified portfolio through the identification of individual companies which offer long term growth potential, typically over a five year horizon or more. The portfolio is actively managed and does not seek to track any comparative index. With a remit to invest in smaller companies with market capitalisation generally below £1bn, there tends to be a correlation with the performance of smaller companies, as well as those of the technology sector. A degree of volatility relative to the overall market should be expected.

The risk associated with the illiquidity of smaller companies is reduced by generally restricting the stake in any one company to less than 10% of the shares in issue. A number of investments are in early stage companies, which have a higher stock specific risk but the potential for above average growth. Stock specific risk is reduced by having a diversified portfolio of over 200 holdings. In addition, to contain the risk of any one holding, the Manager generally takes profits when a holding reaches more than 5% of the portfolio. The Manager actively manages the exposure within the constraint that illiquid positions cannot be traded for short term movements.

The Company has a policy not to invest more than 15% of gross assets in other UK listed investment companies.

From time to time, fixed interest holdings, non equity or unlisted investments may be held on an opportunistic basis.

The Company recognises the long term advantages of gearing and has a maximum gearing limit of 50% of net assets. Borrowings are invested primarily in equity markets but the Manager is entitled to invest in other securities in the companies in the target areas when it is considered that the investment grounds merit the Company taking a geared position. The Board's intention is to gear the portfolio when appropriate with borrowings to around 30% of net assets. Gearing levels are monitored closely by the Manager and reviewed by Directors at each Board Meeting.

The Company may use derivatives which will be principally, but not exclusively, for the purpose of efficient portfolio management (i.e. for the purpose of reducing, transferring or eliminating investment risk in its investments, including protection against currency risk).

A detailed analysis of the Company's investment portfolio is set out on pages 16 to 20 and in the Investment Manager's Report.

Performance

At each Board meeting, the Directors consider a number of performance measures to assess the Company's success in achieving its objectives.

The key performance indicators (KPIs) used to measure the progress and performance of the Company over time are established industry measures and are as follows:

- the movement in net asset value per ordinary share compared to the comparative index;
- the movement in the share price;
- the discount; and
- the total expense ratio.

A historical record of these measures is shown on pages 2, 3 and 21.

In addition to the above, the Board considers peer group comparative performance.

Results and Dividend

The net asset value (NAV) of the Company at 31 December 2010 was 593.85p per Ordinary share (2009 – 420.58p). This represented an increase of 41.2% during the year, compared to an increase in the comparative index of 33.1%. The discount narrowed from 19.7% to 18.7%.

The Directors do not recommend a dividend (2009 – 0.30p) per Ordinary share for the year ended 31 December 2010.

Review of the Year and Future Trends

A review of the year and the investment outlook is contained in the Chairman's Statement and the Investment Manager's Report on pages 5 to 11.

Principal Risks and Uncertainties

The Company's assets consist mainly of listed securities and its principal risks are therefore market related and include market risk (comprising currency risk, interest rate risk and other price risk), liquidity risk and credit risk. An explanation of those risks and how they are managed is contained in note 21 to the accounts on pages 47 to 53.

Other risks faced by the Company include the following:

Regulatory Risk – failure to comply with applicable legal and regulatory requirements could lead to suspension of the Company's Stock Exchange Listing, financial penalties or a qualified audit report. Breach of Section 1159 of the Corporation Tax Act 2010 (formerly Section 842 ICTA 1988) could lead to the Company being subject to tax on capital gains. The Manager's Compliance Officer and Baillie Gifford's Heads of Business Risk & Internal Audit and Regulatory Risk provide regular reports to the Audit Committee on their monitoring programmes. The Manager monitors investment movements and the Secretary monitors the level of forecast income and expenditure to ensure the provisions of Section 1159 are not breached.

Operational/Financial Risk – failure of the Secretary's accounting systems or those of other third party service providers could lead to an inability to provide accurate reporting and monitoring or a misappropriation of assets. The Audit Committee reviews the Secretary's Report on Internal Controls and the reports by other key third party providers are reviewed by the Secretary on behalf of the Audit Committee.

Discount Volatility – the discount at which the Company's shares trade can widen. The Board monitors the level of discount and the Company has authority to buy back its own shares.

Gearing Risk – the Company may borrow money for investment purposes (sometimes known as 'gearing'). If the investments fall in value, any borrowings will magnify the extent of this loss. If borrowing facilities are not renewed, the Company may have to sell investments to repay borrowings.

All borrowings require the prior approval of the Board and gearing levels are discussed by the Board and Managers at every meeting. The majority of the Company's investments are in quoted securities.

Employees

The Company has no employees.

Social and Community Issues

As an investment trust, the Company has no direct social or community responsibilities. However, the Company believes that it is in the shareholders' interests to consider environmental, social and governance factors when selecting and retaining investments. Details of the Company's policy on socially responsible investment are set out on page 27.

Corporate Governance

The Board is committed to achieving and demonstrating high standards of Corporate Governance. This statement outlines how the principles of The Combined Code on Corporate Governance, published in 2008 (the 'Combined Code') and the AIC Code of Corporate Governance were applied throughout the financial year.

Compliance

The Board believes that the Company has complied throughout the year with the provisions set out in Section 1 of the Combined Code.

The Association of Investment Companies (AIC) has published its own Code of Corporate Governance which provides a framework of best practice for investment companies. The Board is of the opinion that the Company has complied with the recommendations of the AIC Code.

The Board

The Board has overall responsibility for the Company's affairs. It has a number of matters reserved for its approval including strategy, approval of the financial statements, investment policy, borrowings, gearing, treasury matters, dividend and corporate governance policy. The Board also reviews the financial statements, investment transactions, revenue budgets and performance. Full and timely information is provided to the Board to enable the Board to function effectively and to allow Directors to discharge their responsibilities.

The Board currently comprises four Directors all of whom are non-executive. The executive responsibilities for investment management and administration have been delegated to Herald Investment Management Limited ('HIML') and Baillie Gifford & Co respectively, and in the context of a Board comprising entirely non-executive Directors, there is no chief executive officer. Mr DCP McDougall is the senior independent director.

The Directors believe that the Board has a balance of skills and experience which enable it to provide effective leadership and proper governance of the Company. Information about the Directors, including their relevant experience, can be found on page 4.

There is an agreed procedure for Directors to seek independent professional advice if necessary at the Company's expense.

Terms of Appointment

Letters which specify the terms of appointment are issued to new Directors. The letters of appointment are available for inspection on request.

Under the provisions of the Company's Articles of Association, a Director appointed during the year is required to retire and seek election by shareholders at the next Annual General Meeting. Directors are required to submit themselves for re-election at least once every three years, Directors who have served for more than nine years offer themselves for re-election annually.

Independence of Directors

All the Directors are considered by the Board to be independent of the Manager and free of any business or other relationship which could interfere with the exercise of their independent judgement.

Mr CM Brendish and Mr DCP McDougall have served on the Board for more than nine years. The Directors recognise the importance of succession planning for company boards and review the Board composition annually. However, the Board is of the view that length of service will not necessarily compromise the independence or contribution of Directors of an investment trust company, where continuity and experience can be a benefit to the Board. The Board subscribes to the view expressed in the AIC Code that long-serving directors should not be prevented from being considered as independent.

The Board considers Mr CJ Cazalet to be independent notwithstanding that he was a managing director – corporate finance at JPMorgan Cazenove, the Company's broker, until his retirement in 2007. In the view of the Board, Mr Cazalet is independent of the Manager in character and judgement and his independence is not compromised by any previous relationship with the Company.

Meetings

There is an annual cycle of Board meetings which is designed to address in a systematic way overall strategy, review of investment policy, investment performance, revenue budgets, dividend policy and communication with shareholders. The Board considers that it meets sufficiently regularly to discharge its duties effectively. The table below shows the attendance record for the Board and Committee meetings held during the year. All the Directors attended the Annual General Meeting.

	Board	Audit Committee	Nomination Committee
Number of meetings	**6**	**2**	**1**
Julian Cazalet	6	2	1
Clay Brendish	5	2	1
Timothy Curtis	6	2	1
Douglas McDougall	3	1	1

Nomination Committee

The Nomination Committee consists of all the Directors and the Chairman of the Board is Chairman of the Committee. The Committee meets on an annual basis and at such other times as may be required. The Committee has written terms of reference which include reviewing the Board, identifying and nominating new candidates for appointment to the Board, Board appraisal, succession planning and training. The Committee also considers whether Directors should be recommended for re-election by shareholders. The Committee is responsible for considering Directors' potential conflicts of interest and for making recommendations to the Board on whether or not the potential conflicts should be authorised. The terms of reference are available on request and on the Manager's website: **www.heralduk.com**.

Performance Evaluation

The Nomination Committee met to assess the performance of the Chairman, each Director, the Board as a whole and its Committees, after inviting each Director and the Chairman to consider and respond to a set of questions. The appraisal of the Chairman was led by Mr DCP McDougall. The appraisals and evaluations considered, amongst other criteria, the balance of skills of the Board, the contribution of individual Directors and the overall effectiveness of the Board and its Committees. Following this process it was concluded that the performance of each Director, the Chairman, the Board and its Committees continues to be effective and each Director and the Chairman remain committed to the Company.

Induction and Training

Training for new Directors is tailored to the particular circumstances of the individual appointee. Regular briefings are provided on changes in regulatory requirements that could affect the Company and the Directors. Directors receive other relevant training as necessary.

Remuneration

As all the Directors are non-executive, the provisions of the Combined Code in respect of Directors' remuneration are not relevant to the Company except to the extent that they relate specifically to non-executive directors. Consequently there is no requirement for a separate remuneration committee. Directors' fees are considered by the Board as a whole within the limits approved by shareholders. The Company's policy on remuneration is set out in the Directors' Remuneration Report on pages 31 and 32.

Internal Controls and Risk Management

The Directors acknowledge their responsibility for the Company's system of internal controls and for reviewing its effectiveness. The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Company, in accordance with the guidance 'Internal Controls: Revised Guidance for Directors on the Combined Code.'

The Directors confirm that they have reviewed the effectiveness of the system and they have procedures in place to review its effectiveness on a regular basis. No significant weaknesses were identified in the year under review.

The practical measures to ensure compliance with regulation and company law, and to provide effective and efficient operations and investment management, have been delegated to HIML and Baillie Gifford & Co. The Board acknowledges its responsibilities to supervise and control the discharge by the Manager and Secretary of their obligations.

The Manager has been delegated responsibility for the design, implementation and maintenance of control policies and procedures to safeguard the assets of the Company and to manage its affairs properly. This responsibility also extends to maintaining effective operational and compliance controls and risk management.

The Manager has a compliance function in accordance with the Financial Services Authority regulations. The Manager's compliance function provides the Board with a report on monitoring procedures on a regular basis. In addition, Baillie Gifford & Co conducts an annual review of its own system of internal controls which is documented within an internal controls report which has been designed to comply with Technical Release AAF 01/06 – Assurance Reports on Internal Controls of Service Organisations made available to Third Parties. This report is independently reviewed by Baillie Gifford & Co's auditors. A copy of the internal controls report is submitted to the Board. The Baillie Gifford & Co Heads of Business Risk & Internal Audit and Regulatory Risk provide the Board with regular reports on Baillie Gifford & Co's monitoring programmes as they relate to the secretarial and administrative function.

The Company's investments are segregated from the investment and administration functions through the appointment of The Bank of New York Mellon as independent custodian of the Company's investments.

A detailed risk map is prepared which identifies the significant risks faced by the Company and the key controls to manage these risks.

These procedures ensure that consideration is given regularly to the nature and extent of the risks facing the Company and that they are being actively monitored. Where changes in risk have been identified during the year they also provide a mechanism to assess whether further action is required to manage the risks identified. The Board confirms that these procedures have been in place throughout the Company's financial year and continue to be in place up to the date of approval of this Report.

Internal Audit

The Audit Committee carries out an annual review of the need for an internal audit function. The Committee continues to believe that the compliance and internal control systems and the internal audit function in place within the Investment Manager and Company Secretary provide sufficient assurance that a sound system of internal control, which safeguards shareholders' investment and the Company's assets, is maintained. An internal audit function, specific to the Company, is therefore considered unnecessary.

Accountability and Audit

The respective responsibilities of the Directors and the auditors in connection with the Financial Statements are set out on pages 33 to 35.

Going Concern

In accordance with The Financial Reporting Council's guidance on going concern and liquidity risk issued in 2009, the Directors have undertaken a rigorous review of the Company's ability to continue as a going concern. The Company's assets, the majority of which are investments in quoted securities, exceed its liabilities significantly. All borrowings require the prior approval of the Board. Gearing levels and compliance with loan convenants are reviewed by the Board on a regular basis. The loan facilities currently drawn down expire in May 2011 and May 2013. A new loan facility is being considered by the Board to replace the facility expiring in May 2011. In accordance with the Company's Articles of Association, shareholders have the right to vote on the continuation of the Company every three years with the next vote being in April 2013.

After making enquiries and notwithstanding the above, the financial statements have been prepared on the going concern basis as it is the Directors' opinion that the Company will continue in operational existence for the foreseeable future.

Audit Committee

An Audit Committee has been established consisting of all the independent non-executive Directors. Its authority and duties are clearly defined within its written terms of reference which are available on request from the Company and on the Manager's website: **www.heralduk.com**. Mr DCP McDougall is Chairman of the Audit Committee. The Committee's responsibilities, which were discharged during the year, include:

- monitoring and reviewing the integrity of the half-yearly and annual financial statements and any formal announcements relating to the Company's financial performance;
- reviewing standards of internal control and risk management;
- making recommendations to the Board in relation to the appointment of the external auditors and approving the remuneration and terms of their engagement;
- developing and implementing policy on the engagement of the external auditors to supply non-audit services (there were no non-audit services during the year);
- reviewing and monitoring the independence, objectivity and effectiveness of the external auditors;
- reviewing the arrangements in place within HIML whereby their staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters insofar as they may affect the Company;
- reviewing the terms of the Investment Management Agreement; and
- considering annually whether there is a need for the Company to have its own internal audit function.

Ernst & Young LLP have been the Company's auditors since 1994. Having considered the experience and tenure of the audit partner and staff and level of service provided, the Committee remains satisfied with the auditors' effectiveness. The audit partners responsible for the audit are rotated every 5 years and the current lead audit partner has been in place for 5 years. Accordingly, a new lead audit partner has been appointed for next year. There are no contractual obligations restricting the Company's choice of external auditor. The Committee receives confirmation from the auditors that they have complied with the relevant UK professional and regulatory requirements on independence. The Committee does not believe that there has been any impairment to the auditors' independence.

Relations with Shareholders

The Board places great importance on communication with shareholders. The Company's Manager meets regularly with institutional shareholders and reports to the Board. The Chairman is available to meet with shareholders as appropriate. Shareholders wishing to communicate with the Chairman or any other Director may do so by writing to him at the registered office of the Company which is shown on page 4.

The Company's Annual General Meeting provides a forum for communication with all shareholders. The level of proxies lodged for each resolution is announced at the meeting and is published on the Manager's website, **www.heralduk.com**, subsequent to the meeting. The notice period for the Annual General Meeting is at least twenty working days. Shareholders and potential investors may obtain up-to-date information on the Company from the Manager's website.

Corporate Governance and Stewardship

The Company has given discretionary voting powers to the investment manager, HIML. The Manager votes against resolutions it considers may damage shareholders' rights or economic interests. The Company believes that it is in the shareholders' interests to consider environmental, social and governance (ESG) factors when selecting and retaining investments and has asked the Manager to take these issues into account as long as the investment objectives are not compromised. The Manager does not exclude companies from its investment universe purely on the grounds of ESG issues but adopts a positive engagement approach whereby matters are discussed with management with the aim of improving the relevant policies and management systems and enabling the Manager to consider how ESG factors could impact long term investment returns. The Manager's Statement of Compliance with the UK Stewardship Code can be found on the Manager's website at **www.heralduk.com**. The Manager's policy has been reviewed and endorsed by the Board.

Conflicts of Interest

Each Director submits a list of potential conflicts of interest to the Nomination Committee on an annual basis. The Committee considers these carefully, taking into account the circumstances surrounding them, and makes a recommendation to the Board on whether or not the potential conflicts should be authorised. Board authorisation is given for a period of one year. Having considered the lists of potential conflicts there were no situations which gave rise to a direct or indirect interest of a Director which conflicted with the interests of the Company.

Directors

The Directors at the year end and their interests in the Company were:

Name	Nature of Interest	Number of Ordinary Shares 31 December 2010	1 January 2010
Julian Cazalet	Beneficial	100,000	75,000
	Non-beneficial	50,000	–
Clay Brendish	Beneficial	14,700	14,700
Timothy Curtis	Beneficial	10,000	10,000
Douglas McDougall	Beneficial	233,500	233,500

There have been no changes intimated in the above Directors' interests up to 21 February 2011.

Mr CJ Cazalet, Mr CM Brendish and Mr DCP McDougall will offer themselves for re-election at the Annual General Meeting. Mr Brendish and Mr McDougall have served for more than nine years and are subject to annual re-election.

The Board has reviewed the performance of Mr CJ Cazalet, Mr CM Brendish and Mr DCP McDougall. Their performance continues to be effective and they remain committed to the Company. Their contribution to the Board is valued highly and the Board recommends their re-election to shareholders.

Director Indemnification and Insurance

The Company has entered into deeds of indemnity in favour of each of the Directors. The deeds cover any liabilities that may arise to a third party, other than the Company, for negligence, default or breach of trust or duty. The Directors are not indemnified in respect of liabilities to the Company, any regulatory or criminal fines, any costs incurred in connection with criminal proceedings in which the Director is convicted or civil proceedings brought by the Company in which judgement is given against him. In addition, the indemnity does not apply to any liability to the extent that it is recovered from another person.

The Company maintains Directors' and Officers' Liability insurance.

Management and Administration

For the entire year under review the management of the Company was contracted to Herald Investment Management Limited ('HIML'). HIML is authorised and regulated by the Financial Services Authority.

The management contract is subject to 12 months' notice by either party. The senior director of HIML with prime responsibility for the management of Herald Investment Trust plc is Katie Potts, who is also a substantial shareholder of HIML. HIML is remunerated at a monthly rate of 0.08333% of the Company's net asset value calculated using middle market prices. Compensation fees would only be payable in respect of this 12 month period if termination were to occur sooner. Careful consideration has been given by the Board as to the basis on which the management fee is charged. The Board considers that maintaining a relatively low total expense ratio is in the best interest of all shareholders. The Board is also of the view that calculating the fee with reference to performance would be unlikely to exert a positive influence over the long term performance. At 31 December 2010, Katie Potts held 321,559 ordinary shares of Herald Investment Trust plc.

At 31 December 2010, the Company was the beneficial owner of 14.29% of the Ordinary share capital of HIML Holdings Limited. HIML Holdings Limited is the parent company of HIML.

Administration of the Company and its investments is contracted by HIML to Baillie Gifford & Co, who also act as Company Secretary.

Custody of investments is contracted to The Bank of New York Mellon.

The Board considers the investment management and secretarial arrangements for the Company on an ongoing basis and a formal review is conducted annually. The Board considers, amongst others, the following topics in its review: investment performance in relation to the investment policy and strategy; the continuity of personnel managing the assets and reporting to the Board; the level of service provided in terms of the accuracy and timeliness of reports to the Board and the frequency and quality of both verbal and written communications with shareholders. Following the most recent review the Board is of the opinion that the continued appointment of HIML as investment manager, on the terms agreed, is in the interests of shareholders due to the experience of the Manager and the quality of information provided to the Board.

Major Interests in the Company's Shares

At 21 February 2011 the Directors have been notified of the following:

Name	Ordinary Shares	% of issue†
1607 Capital Partners (Direct)	4,243,147	5.3
Rathbone Brothers Plc (Indirect)	4,103,909	5.1
Legal & General Group Plc (Direct)	3,162,493	4.0
Rensburg Sheppards Investment Management Limited (Indirect)	2,423,163	3.0

† Based on issued share capital at 31 December 2010 of 79,913,283 Ordinary shares.

Share Capital

Capital Structure

At 31 December 2010 the Company's capital structure consisted of 79,913,283 Ordinary shares of 25p each (2009 – 81,053,283 Ordinary shares). During the year 1,140,000 (2009 – 2,354,840) shares were bought back and cancelled. There are no restrictions concerning the holding or transfer of the Company's Ordinary shares and there are no special rights attached to any of the shares.

Dividends

The Ordinary shares carry a right to receive dividends. Interim dividends are determined by the Directors and final dividends are subject to shareholder approval.

Capital Entitlement

On a winding up, after meeting the liabilities of the Company, the surplus assets will be paid to Ordinary shareholders in proportion to their shareholdings.

Voting

Each Ordinary shareholder present in person or by proxy is entitled to one vote on a show of hands and, on a poll, to one vote for every share held.

Information on the deadlines for proxy appointments can be found on page 55.

Annual General Meeting

At the Annual General Meeting of the Company to be held on 19 April 2011 the following resolution will be proposed as special business.

Authority to Repurchase the Company's Ordinary Shares

At the Company's Annual General Meeting held on 21 April 2010 it was resolved that the Company be authorised to purchase in the market up to 12,115,409 Ordinary shares (14.99% of its Ordinary share capital in issue at that time). During the year to 31 December 2010 the Company bought back 1,140,000 Ordinary shares (nominal value £285,000 which comprised 1.4% of the issued share capital at 1 January 2010) on the London Stock Exchange for cancellation. Between 1 January 2011 and the date of this report, no further shares have been bought back. The Board continues to believe that the ability of the Company to purchase its own Ordinary shares in the market will potentially benefit all shareholders of the Company. The repurchase of Ordinary shares at a discount to the underlying net asset value ('NAV') should enhance the NAV per Ordinary share of the remaining shares and may also enable the Company to address more effectively any imbalance between supply and demand for the Company's Ordinary shares.

Accordingly, the Directors are now recommending in Resolution 8 that this authority to purchase the Company's own Ordinary shares should be renewed and should now expire at the Company's Annual General Meeting to be held in 2012. Authority will be sought to purchase up to 14.99% of the Company's Ordinary shares in issue at the date of the passing of the resolution (the maximum permitted under the Listing Rules of the UK Listing Authority) at a price that is not less than 25p per share (the nominal value of each share) and must not exceed the higher of (a) 5% above the average closing price (as derived from the Daily Official List of the London Stock Exchange) for the five business days immediately preceding the day of purchase and (b) the higher of the last independent trade and the highest current independent bid on the London Stock Exchange. The authority being sought, the full text of which can be found in Resolution 8 in the Notice of Annual General Meeting, will last until the date of the Annual General Meeting in 2012. The decision as to whether the Company repurchases any shares will be at the absolute discretion of the Board and will only be considered when it is in the interests of the Company and its shareholders as a whole. It is the intention that purchases will only be made at a discount to net asset value.

Recommendation

The Directors unanimously recommend all holders to vote in favour of all the Resolutions to be proposed at the Annual General Meeting by completing and returning the enclosed form of proxy. The proxy form should be returned to the Company's Registrar as soon as possible but in any event so as to arrive no later than 48 hours (excluding non-working days) before the time of the Annual General Meeting.

Payment of Suppliers

It is the Company's payment policy to obtain the best possible terms for all business. The Company negotiates with its suppliers the terms on which business will take place and abides by such terms.

The Company did not have any trade creditors at 31 December 2009 or 2010.

Disclosure of Information to Auditors

The Directors confirm that so far as each of the Directors is aware there is no relevant audit information of which the Company's auditors are unaware and the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Independent Auditors

The Auditors, Ernst & Young LLP, are willing to continue in office and in accordance with sections 489 and 491(1) of the Companies Act 2006 resolutions concerning their reappointment and remuneration will be submitted to the Annual General Meeting.

By order of the Board

Julian Cazalet

Chairman

22 February 2011

DIRECTORS' REMUNERATION REPORT

The Board has prepared this report in accordance with the requirements of Section 420 to 421 of the Companies Act 2006. An ordinary resolution for the approval of this report will be put to the members at the forthcoming Annual General Meeting.

The law requires the Company's auditors to audit certain of the disclosures provided. Where disclosures have been audited, they are indicated as such. The Auditors' opinion is included in their report on pages 34 and 35.

Remuneration Committee

The Company has four Directors all of whom are non-executive (see page 4). There is no separate Remuneration Committee and the Board as a whole considers changes to Directors' fees from time to time. The Company Secretary, Baillie Gifford & Co, provides advice and comparative information when the Board considers the level of Directors' fees.

Policy on Directors' Fees

The Board's policy is that the remuneration of Directors should be set at a reasonable level that is commensurate with the duties and responsibilities of the role and consistent with the requirement to attract and retain Directors of the appropriate quality and experience. It should also reflect the experience of the Board as a whole, be fair and comparable to that of other investment trusts that are similar in size. It is intended that this policy will continue for the year ending 31 December 2011 and subsequent years.

The fees for the non-executive Directors are determined within an aggregate limit set out in the Company's Articles of Association which currently stands at £100,000. Non-executive Directors are not eligible for bonuses, pension benefits, share options, long term incentive schemes or other benefits.

The Board reviewed Directors' fees during the year and concluded that the fees should remain unchanged at £25,500 for the Chairman and £17,000 for each Director.

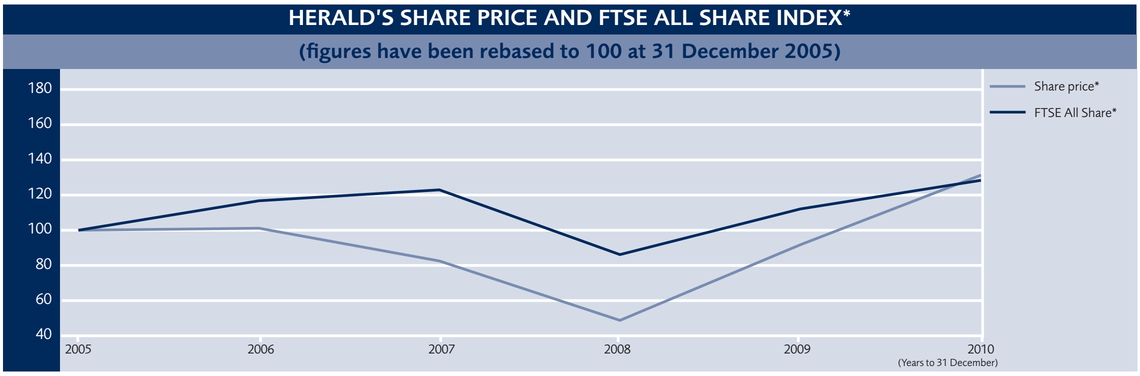
Directors' Service Contracts

It is the Board's policy that none of the Directors has a service contract. All of the Directors have been provided with appointment letters. The terms of their appointment provide that a Director shall retire and be subject to election at the first Annual General Meeting after their appointment. Directors are thereafter obliged to retire every three years, and may, if they wish, offer themselves for re-election. Any Director who has served on the Board for more than nine years will submit themselves for re-election annually. There is no notice period and no provision for compensation upon early termination of appointment.

Name	Date of appointment	Due date for re-election
Julian Cazalet	18 January 2008	AGM 2011
Clay Brendish	23 July 2001	AGM 2011
Timothy Curtis	22 July 2004	AGM 2012
Douglas McDougall	13 February 2002	AGM 2011

Company Performance

The graph below compares, for the five financial years ended 31 December 2010, the total return (assuming all dividends are reinvested) to Ordinary shareholders compared to the total shareholder return on a notional investment made up of shares in the component parts of the FTSE All-Share Index. This index was chosen for comparison purposes, as it is the best measure of performance for UK listed companies.



Source: Thomson Reuters Datastream

* Total return (assuming all dividends are reinvested)

Past performance is not a guide to future performance.

Directors' Remuneration for the Year (audited)

The Directors who served in the year received the following emoluments in the form of fees:

	Fees 2010 £	Fees 2009 £
Directors who served during the year:		
Julian Cazalet	25,500	18,833
Clay Brendish	17,000	16,000
Timothy Curtis	17,000	16,000
Douglas McDougall	17,000	16,000
Martin Boase (retired 1 September 2009)	–	15,582
	76,500	82,415

Approval

The Directors' Remuneration Report on pages 31 and 32 was approved by the Board of Directors on 22 February 2011 and signed on its behalf by

Julian Cazalet

Chairman

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent; and
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for the keeping of adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors have delegated responsibility to the Manager for the maintenance and integrity of the Company's page of the Manager's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names and functions are listed within the Directors, Manager and Advisers section confirm that, to the best of their knowledge:

- the financial statements, which have been prepared in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), give a true and fair view of the assets, liabilities, financial position and net return of the Company; and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

By order of the Board

Julian Cazalet

22 February 2011

Notes

The following notes relate to financial statements published on a website and are not included in the printed version of the Annual Report and Financial Statements:

- *The maintenance and integrity of the Herald Investment Management Limited website is the responsibility of Herald Investment Management Limited; the work carried out by the auditors does not involve consideration of these matters and accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.*
- *Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.*

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF HERALD INVESTMENT TRUST plc

We have audited the financial statements of Herald Investment Trust plc for the year ended 31 December 2010 which comprise the Income Statement, the Balance Sheet, the Reconciliation of Movements in Shareholders' Funds, the Cash Flow Statement and the related notes 1 to 21. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of Directors and Auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 33, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the Audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on Financial Statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' Statement, set out on page 26, in relation to going concern;
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to the shareholders by the Board on Directors' remuneration.

Susan Dawe, Senior Statutory Auditor
for and on behalf of Ernst & Young LLP
Statutory Auditor
Edinburgh

22 February 2011

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	2010 Revenue £'000	2010 Capital £'000	2010 Total £'000	2009 Revenue £'000	2009 Capital £'000	2009 Total £'000
Gains on investments	15	–	137,953	137,953	–	139,718	139,718
Currency gains	15	–	347	347	–	311	311
Income	2	7,277	–	7,277	6,077	–	6,077
Investment management fee	3	(3,966)	–	(3,966)	(2,773)	–	(2,773)
VAT recovered	4	–	–	–	292	–	292
Other administrative expenses	5	(299)	–	(299)	(313)	–	(313)
Net return before finance costs and taxation		3,012	138,300	141,312	3,283	140,029	143,312
Finance costs of borrowings	6	(2,816)	–	(2,816)	(2,875)	–	(2,875)
Net return on ordinary activities before taxation		196	138,300	138,496	408	140,029	140,437
Tax on ordinary activities	7	(154)	–	(154)	(84)	–	(84)
Net return on ordinary activities after taxation		42	138,300	138,342	324	140,029	140,353
Net return per Ordinary share	9	0.05p	171.87p	171.92p	0.39p	169.95p	170.34p

The total column of this statement is the profit and loss account of the Company.

All revenue and capital items in the above statement derive from continuing operations. No operations were acquired or discontinued during the year.

A Statement of Total Recognised Gains and Losses is not required as all gains and losses of the Company have been reflected in the above statement.

The accompanying notes on pages 40 to 53 are an integral part of the financial statements.

BALANCE SHEET

AT 31 DECEMBER 2010

	Notes	2010 £'000	2010 £'000	2009 £'000	2009 £'000
Fixed assets					
Investments held at fair value through profit or loss	10		495,401		380,457
Current assets					
Debtors	11	1,316		1,593	
Cash and short term deposits	18	39,497		18,551	
		40,813		20,144	
Creditors:					
Amounts falling due within one year	12	(52,715)		(53,407)	
Derivative financial instruments	13	(8,937)		(6,298)	
		(61,652)		(59,705)	
Net current liabilities			(20,839)		(39,561)
TOTAL NET ASSETS			474,562		340,896
Capital and reserves					
Called-up share capital	14		19,978		20,263
Share premium	15		73,738		73,738
Capital redemption reserve	15		1,974		1,689
Capital reserve	15		376,931		243,064
Revenue reserve	15		1,941		2,142
SHAREHOLDERS' FUNDS			474,562		340,896
NET ASSET VALUE PER ORDINARY SHARE (including income)	16		593.85p		420.58p
NET ASSET VALUE PER ORDINARY SHARE (excluding income)			593.80p		420.19p

The financial statements of Herald Investment Trust plc (Company Registration No. 2879728) were approved by the Board of Directors and authorised for issue on 22 February 2011 and signed on their behalf by

Julian Cazalet

Chairman

The accompanying notes on pages 40 to 53 are an integral part of the financial statements.

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	Called-up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Share-holders' funds £'000
Shareholders' funds at 1 January 2010		20,263	73,738	1,689	243,064	2,142	340,896
Net return on ordinary activities after taxation		–	–	–	138,300	42	138,342
Shares bought back	14	(285)	–	285	(4,433)	–	(4,433)
Dividends paid during the year	8	–	–	–	–	(243)	(243)
Shareholders' funds at 31 December 2010		19,978	73,738	1,974	376,931	1,941	474,562

FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	Called-up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Share-holders' funds £'000
Shareholders' funds at 1 January 2009		20,852	73,738	1,100	109,072	5,948	210,710
Net return on ordinary activities after taxation		–	–	–	140,029	324	140,353
Shares bought back	14	(589)	–	589	(6,037)	–	(6,037)
Dividends paid during the year	8	–	–	–	–	(4,130)	(4,130)
Shareholders' funds at 31 December 2009		20,263	73,738	1,689	243,064	2,142	340,896

The accompanying notes on pages 40 to 53 are an integral part of the financial statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	2010 £'000	2010 £'000	2009 £'000	2009 £'000
Net cash inflow from operating activities	17		3,580		3,729
Servicing of finance					
Loan and derivative interest		(2,823)		(2,871)	
Net cash outflow from servicing of finance			(2,823)		(2,871)
Financial investment					
Purchase of investments		(77,590)		(59,037)	
Sale of investments		102,455		55,350	
Net cash inflow/(outflow) from financial investment			24,865		(3,687)
Equity dividend paid	8		(243)		(4,130)
Net cash inflow/(outflow) before financing			25,379		(6,959)
Financing					
Shares repurchased	14	(4,433)		(6,037)	
Net cash outflow from financing			(4,433)		(6,037)
Increase/(decrease) in cash	18		20,946		(12,996)
Reconciliation of net cash flow to movement in net debt	18				
Increase/(decrease) in cash for period			20,946		(12,996)
Movement in net funds/(debt) in period			20,946		(12,996)
Net debt at 1 January			(31,449)		(18,453)
Net debt at 31 December			(10,503)		(31,449)

The accompanying notes on pages 40 to 53 are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting policies

The financial statements for the year to 31 December 2010 have been prepared on the basis of the accounting policies set out below, which are consistent with those in the Company's Annual Report and Financial Statements at 31 December 2009.

(a) Accounting convention

The financial statements are prepared on the assumption that approval as an investment trust will continue to be granted by HM Revenue & Customs.

The Directors consider the Company's functional currency to be sterling as the Company's shareholders are predominantly based in the UK and the Company is subject to the UK's regulatory environment.

The financial statements have been prepared in accordance with The Companies Act 2006, applicable UK accounting standards and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies and Venture Capital Trusts' (issued January 2009).

In order to better reflect the activities of the Company and in accordance with guidance issued by the AIC, supplementary information which analyses the profit and loss account between items of a revenue and capital nature has been presented in the Income Statement.

Financial assets and financial liabilities are recognised in the Company's balance sheet when it becomes a party to the contractual provisions of the instrument.

(b) Investments

Purchases and sales of investments are accounted for on a trade date basis.

All investments are designated as valued at fair value through profit or loss upon initial recognition and are measured at subsequent reporting dates at fair value. The fair value of listed security investments is bid value, or in the case of FTSE 100 constituents, at last traded prices issued by the London Stock Exchange. Investments on the Alternative Investment Market are included at their bid value. The fair value of unlisted investments uses valuation techniques determined by the Directors on the basis of latest information in line with the relevant principles of the International Private Equity and Venture Capital Valuation Guidelines.

Gains and losses arising from changes in the fair value of investments are taken to capital reserve.

(c) Income

Dividend income is accounted for when the entitlement to the income is established (normally on the ex-dividend date). Franked income is stated net of tax credits. Unfranked investment income includes the taxes deducted at source. Interest from fixed interest securities is recognised on an effective yield basis. Underwriting commission and interest receivable on deposits are recognised on an accruals basis.

(d) Expenses

All expenses are accounted for on an accruals basis and are charged through the revenue column of the Income Statement except where they relate directly to the acquisition or disposal of an investment (transaction costs) and are taken to the Income Statement as a capital item.

(e) Finance costs

Finance costs are accounted for on an accruals basis and are charged through the revenue column of the Income Statement.

(f) Financial instruments

The Company uses interest rate swaps to hedge the cash flow risk arising from interest rate fluctuations. The swap is marked to the value at which the position can be closed out daily. The fair value calculation is based on an external model and external prices which are regularly checked to the swap provider's valuation. The current intention is to hold the swap for the long term. Gains or losses arising on the fair value of the interest rate swap during the year are taken to the income statement as a capital item.

In accordance with FRS 26: 'Financial Instruments: Measurement', derivative instruments are valued at fair value and are included in current assets or current liabilities in the balance sheet.

(g) Deferred taxation

Deferred taxation is provided on all timing differences which have originated but not reversed at the balance sheet date, calculated on an undiscounted basis, and based on enacted tax rates relevant to the benefit or liability. Deferred tax assets are recognised only to the extent that it is more likely than not that there will be taxable profits from which underlying timing differences can be deducted.

(h) Foreign currency

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and loans denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. Exchange differences of a revenue nature are taken to the revenue account. Those of a capital nature are taken to capital reserve.

1. Accounting policies (continued)

(i) Capital reserve

The Company is precluded by its Articles from making any distribution of capital profits by way of dividend.

Gains and losses on disposal of investments, changes in investment holding gains/(losses), realised exchange differences of a capital nature and purchases of the Company's own shares for cancellation are dealt with in this reserve.

2. Income

	2010 £'000	2009 £'000
Income from investments		
Franked dividends from listed investments	2,919	2,465
Franked dividends from unlisted investments (inc AIM)	1,574	1,022
Unfranked income from unlisted (inc AIM) UK convertible bonds	43	22
UK unfranked investment income	217	248
Overseas dividend income	1,135	584
UK interest	1,036	939
Overseas interest	177	398
	7,101	5,678
Other income		
Deposit interest	142	373
Underwriting commission	34	26
	176	399
Total income	7,277	6,077
Total income comprises:		
Dividends from equity securities designated at fair value through profit or loss	5,845	4,319
Interest from financial assets designated at fair value through profit or loss	1,256	1,359
Deposit interest	142	373
Underwriting commission	34	26
	7,277	6,077

3. Investment management fee

	2010 £'000	2009 £'000
Investment management fee	3,966	2,773

Herald Investment Management Limited is appointed investment manager under a management agreement which is terminable on twelve months' notice. Their fee is calculated on a monthly rate of 0.08333% of the Company's net asset value based on middle market prices. The management fee is levied on all assets except the holding in Herald Ventures II Limited Partnership managed by Herald Investment Management Limited.

4. VAT recovered

In 2007 the European Court of Justice ruled that investment trust management fees should be exempt from VAT.

In the year to 31 December 2009, £292,000 of VAT together with £171,000 of interest was received by the Company in respect of the repayment claims for the period from 1994 to 1996.

Herald Investment Trust plc has joined a case which has recently been brought against HMRC to seek to recover the amounts relating to the period 1997 to 2000 together with interest on a compound basis. No VAT or related interest recovery has been accrued or recognised as a contingent asset as the outcome of the case is expected to remain uncertain for several years.

5. Other administrative expenses

	2010 £'000	2009 £'000
Custodian's fees	33	29
Registrars' fees	27	21
Directors' fees	77	82
Auditors' fees – statutory audit	17	17
Miscellaneous expenses	145	164
	299	313

6. Finance costs of borrowings

	2010 £'000	2009 £'000
Bank loans repayable within one year	707	1,261
Interest on swap	2,109	1,614
	2,816	2,875

7. Tax on ordinary activities

	2010 £'000	2009 £'000
Analysis of charge in year		
Overseas taxation	154	84

Factors affecting tax charge for year

The tax charge for the year is lower than the standard rate of corporation tax in the UK of 28% (2009 – 28%).

The differences are explained below:

	2010 £'000	2009 £'000
Net return on ordinary activities before taxation	138,496	140,437
Net return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 28% (2009 – 28%)	38,779	39,322
Capital returns not taxable	(38,724)	(39,208)
Dividends not subject to UK tax	(1,637)	(1,088)
Overseas withholding tax claimed as a deduction	–	(24)
Overseas withholding tax	154	84
Movement in excess management expenses	1,582	995
Overseas income taxable on receipt	–	3
Current tax charge for the year	154	84

As an Investment Trust, the Company's capital gains are not taxable.

There is no UK corporation tax charge at 31 December 2010 or 31 December 2009 as the Company has unrelieved management expenses which are available to be carried forward. The tax charge for 31 December 2010 and 2009 comprises overseas withholding taxes written off.

At 31 December 2010 the Company had surplus management expenses of £28 million (2009 – £22 million) which have not been recognised as a deferred tax asset. This is because the Company is not expected to generate taxable income in a future period in excess of the deductible expenses of that future period and, accordingly, it is unlikely that the Company will be able to reduce future tax liabilities through the use of existing surplus expenses.

8. Ordinary dividends

	2010	2009	2010 £'000	2009 £'000
Amounts recognised as distributions in the period:				
Previous year's final (paid 29 April 2010)	0.30p	5.00p	243	4,130

Set out below are the total dividends payable in respect of the financial year, which is the basis on which the requirements of Section 1158 of the Corporation Tax Act 2010 are considered. The revenue available for distribution by way of dividend for the year ended 31 December 2010 is £42,000 (2009 – £324,000). The Directors do not propose a dividend for the year ended 31 December 2010 (2009 – 0.30p).

	2010	2009	2010 £'000	2009 £'000
Amounts paid and proposed in respect of the period:				
Proposed final dividend per Ordinary share	–	0.30p	–	243

9. Net return per Ordinary share

2010 Revenue	2010 Capital	2010 Total	2009 Revenue	2009 Capital	2009 Total
0.05p	171.87p	171.92p	0.39p	169.95p	170.34p

Revenue return per Ordinary share is based on the net revenue return on ordinary activities after taxation of £42,000 (2009 – £324,000) and on 80,465,858 Ordinary shares (2009 – 82,397,262) being the weighted average number of Ordinary shares in issue during the year.

Capital return per Ordinary share is based on the net capital return for the financial year of £138,300,000 (2009 – £140,029,000) and on 80,465,858 Ordinary shares (2009 – 82,397,262) being the weighted average number of Ordinary shares in issue during the year.

There are no dilutive or potentially dilutive shares in issue.

10. Fixed assets – investments

			2010 £'000	2009 £'000
Financial assets designated at fair value through profit or loss on initial recognition				
Listed UK	– equity investments	– London Stock Exchange	158,864	123,001
		– AIM	148,592	98,988
	– debt investments		20,151	19,620
Listed Overseas	– equity investments		163,894	129,330
	– debt investments		–	6,407
Unquoted*			3,900	3,111
Total investments in financial assets at fair value through profit or loss			495,401	380,457

10. Fixed assets – investments (continued)

	Listed in UK £'000	Listed overseas £'000	AIM £'000	Unquoted* £'000	Total £'000
Cost of investments at 1 January 2010	100,643	130,212	125,093	9,702	365,650
Investment holding gains/(losses) at 1 January 2010	41,978	5,525	(26,105)	(6,591)	14,807
Fair value of investments at 1 January 2010	142,621	135,737	98,988	3,111	380,457
Movements in the year:					
Purchases at cost	22,478	30,113	22,558	1,639	76,788
Sales – proceeds	(26,460)	(54,915)	(21,080)	–	(102,455)
– gains on sales	18,012	15,161	2,797	–	35,970
Amortisation of fixed income book cost	100	(81)	–	–	19
Changes in investment holding gains/(losses)	29,669	37,879	39,502	(2,428)	104,622
Change in listing	(7,405)	–	5,827	1,578	–
Fair value of investments at 31 December 2010	179,015	163,894	148,592	3,900	495,401
Cost of investments at 31 December 2010	107,368	120,490	135,195	12,919	375,972
Investment holding gains/(losses) at 31 December 2010	71,647	43,404	13,397	(9,019)	119,429
Fair value of investments at 31 December 2010	179,015	163,894	148,592	3,900	495,401

	2010 £'000	2009 £'000
Gains/(losses) on investments designated at fair value through profit or loss on initial recognition		
Realised gains/(losses) on sales	35,970	(7,581)
Changes in investment holding gains	104,622	138,518
	140,592	130,937

*The unquoted balance comprises Business Control Solutions at Nil, Celoxica at Nil, Culver Holdings at £29,000, Freshwater UK at Nil, HIML Holdings Limited and HIML Jersey Ltd at their aggregated cost of £207,000, Herald Ventures II at £1,608,000, Independent Media Support Group at Nil, Intechnology at £220,000, Invu Convertible loan notes at £240,000, Itis at Nil, Servicepower Technology Convertible loan stock at £205,000, Spectrum Interactive at Nil, Zoo Digital at £369,000, Atex at Nil and Green Plug at £1,022,000.

At 31 December 2010 the Company was the beneficial owner of 14.29% (2009 – 14.13%) of the Ordinary share capital of both HIML Holdings Limited and HIML Jersey Ltd. HIML Holdings Limited is incorporated in the United Kingdom whereas HIML Jersey Ltd is incorporated in Jersey.

	2010 £'000	2009 £'000
Transaction costs		
The following transaction costs were incurred during the period:		
Purchases	422	339
Sales	368	141
	790	480

11. Debtors

	2010 £'000	2009 £'000
Due within one year:		
Income accrued	1,270	1,541
Taxation recoverable	9	17
Other debtors and prepayments	37	35
	1,316	1,593

None of the above debtors are financial assets designated at fair value through profit or loss. The carrying amount of debtors is a reasonable approximation of fair value.

12. Creditors

	2010 £'000	2009 £'000
Amounts falling due within one year:		
Purchases for subsequent settlement	1,750	2,552
Bank loans	50,000	50,000
Swap interest	382	389
Other creditors and accruals	583	466
	52,715	53,407

None of the above creditors are financial liabilities designated at fair value through profit or loss. Included in other creditors and accruals is £399,000 (2009 – £286,000) in respect of the investment management fee.

The Company has a £50 million multi-currency variable rate loan facility with The Royal Bank of Scotland plc, which comprises two £25 million tranches expiring on 31 May 2011 and 2013.

At 31 December 2010, there were outstanding drawings of £50 million (2009 – £50 million). Interest on the loans is payable in quarterly instalments in January, April, July and October. The estimated repayment value of the loan at 31 December 2010 was £50 million. The indicative costs of repaying the loan as at 31 December 2010 were not material in the context of the above figures.

The interest on the £50 million facility has been fixed for the long term through a 30 year interest rate swap but may vary on periodic renewals of the debt facility to the extent that the mark up over LIBOR charged by a lending bank varies. The fair value of the interest rate swap contract at 31 December 2010 was an estimated liability of £9 million (2009 – £6 million) which was based on the marked to market value.

The main covenant relating to the loan is:

Total borrowings shall not exceed 25% of the Company's Gross Assets adjusted by deducting:

(i) the market value of any unlisted investments (excluding AIM);

(ii) the amount by which the market value of any single investment represents more than 7.5% of the Company's gross assets; and

(iii) the amount by which the aggregate market value of the ten largest investments exceeds 45% of gross assets.

13. Derivative financial instruments

	2010				2009			
	Notional contract amount £'000	Fair value assets £'000	Fair value liabilities £'000	Fair value balance £'000	Notional contract amount £'000	Fair value assets £'000	Fair value liabilities £'000	Fair value balance £'000
Total derivative assets/(liabilities) held for trading	50,000	49,370	(58,307)	(8,937)	50,000	34,211	(40,509)	(6,298)

14. Called-up share capital

		2010	2009
Allotted, called-up and fully paid:			
Ordinary shares of 25p:	Number	79,913,283	81,053,283
	£'000	19,978	20,263

At the Annual General Meeting in April 2010, Shareholders granted the Company authority to purchase shares in the market up to 12,115,409 Ordinary shares (equivalent to 14.99% of its issued share capital at that date). In the year to 31 December 2010, a total of 1,140,000 (2009 – 2,354,840) Ordinary shares with a nominal value of £285,000 (2009 – £588,710) were bought back at a total cost of £4,433,000 (2009 – £6,037,000). At 31 December 2010 the Company had authority to buy back a further 11,205,409 Ordinary shares. Under the provisions of the Company's Articles share buy-backs are funded from the capital reserve.

15. Capital and reserves

	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000
At 1 January 2010	73,738	1,689	243,064	2,142
Shares purchased for cancellation	–	285	(4,433)	–
Gains on sales	–	–	35,970	–
Changes in investment holding gains	–	–	104,622	–
Movement in fair value of interest rate swap	–	–	(2,639)	–
Other exchange differences	–	–	347	–
Dividends appropriated during the year	–	–	–	(243)
Revenue return on ordinary activities after taxation	–	–	–	42
Balance at 31 December 2010	73,738	1,974	376,931	1,941

The capital reserve includes investment holding gains of £119,429,000 (2009 – £14,807,000) as disclosed in note 10.

The revenue reserve represents the only reserve from which dividends can be funded.

16. Net asset value per Ordinary share

The net asset value per Ordinary share and the net assets attributable to the Ordinary shareholders at the year end calculated in accordance with the Articles of Association were as follows :

	2010	2009	2010 £'000	2009 £'000
Ordinary shares	593.85p	420.58p	474,562	340,896

Net asset value per Ordinary share is based on net assets as shown above and on 79,913,283 (2009 – 81,053,283) Ordinary shares, being the number of Ordinary shares in issue at each date.

17. Reconciliation of net return before finance costs and taxation to net cash inflow from operating activities

	2010 £'000	2009 £'000
Net return on ordinary activities before finance costs and taxation	141,312	143,312
Gains on investments	(137,953)	(139,718)
Currency gains	(347)	(311)
Decrease in accrued income	279	102
(Increase)/decrease in other debtors	(2)	14
Increase in creditors	117	109
Amortisation of fixed income book cost	(19)	(5)
Income tax suffered	–	(1)
Overseas tax suffered	(154)	(84)
Realised currency profit	347	311
Net cash inflow from operating activities	3,580	3,729

18. Analysis of changes in net debt

	At 1 January 2010 £'000	Cash flows £'000	At 31 December 2010 £'000
Cash at bank and in hand	18,551	20,946	39,497
Loans due within one year	(50,000)	–	(50,000)
	(31,449)	20,946	(10,503)

19. Contingent liabilities, guarantees and financial commitments

At 31 December 2010 and 31 December 2009 the Company had a commitment to participate in Herald Ventures II Limited Partnership. The Company's commitment is limited to £3 million, drawn down in tranches. The first tranche was drawn down in October 2004, with a total of £2,400,000 being drawn down at 31 December 2009 with a further £300,000 in the year to 31 December 2010. The commitment will be fully drawn down in June 2011.

20. Capital management

The Company does not have any externally imposed capital requirements. The capital of the Company is the Ordinary share capital and reserves as detailed in notes 14 and 15. It is managed in accordance with its investment policy in pursuit of its investment objective, both of which are detailed on page 22, and shares may be repurchased as explained on page 29.

21. Financial instruments

In accordance with the corporate objective of maximising capital appreciation the Company invests in securities on a worldwide basis. The Company makes use of gearing to achieve improved performance in rising markets and has an interest rate swap, the purpose of which is to hedge the variability in cash flows arising from interest rate fluctuations on bank loans. The Company's other financial instruments consist of cash, short term debtors and creditors.

The main risks arising from the Company's financial instruments are:

A. Market Risk

(i) Other price risk, being the risk that the value of investment holdings will fluctuate as a result of changes in market prices caused by factors other than interest rate or currency rate movement.

(ii) Interest rate risk, being the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates; and

(iii) Foreign currency risk, being the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

B. Credit Risk, being the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

C. Liquidity Risk, being the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

These risks and the policy for managing them have been applied throughout the year and are summarised below. Further detail is contained in the Business Review – Investment Policy section on page 22.

A. Market Risk

(i) Other Price Risk

The Company's investment portfolio is exposed to market price fluctuations which are monitored by the Manager in pursuance of the corporate objective. Securities held by the Company are valued at bid prices, whereas material unlisted investments are valued by the Directors on the basis of the latest information in line with the relevant principles of the International Private Equity and Venture Capital Valuation Guidelines (Accounting Policy (b)). These valuations also represent the fair value of the investments, see note 10 on pages 43 and 44.

A full list of the Company's investments is given on pages 16 to 20. In addition, a geographical analysis of the portfolio, an analysis of the investment portfolio by broad industrial or commercial sector and a review of the 20 largest equity investments by their aggregate market value, are shown on pages 12 to 15.

Other Price Risk Sensitivity

33.4% of the Company's equity investments at 31 December 2010 (2009 – 34.7%) were listed on the main list of the London Stock Exchange and a further 31.2% (2009 – 27.9%) on AIM. The NASDAQ Stock Exchange accounts for 25.3% (2009 – 23.9%) and other stock exchanges 9.4% (2009 – 12.6%). A 10% increase in stock prices at 31 December 2010 would have increased total net assets and net return on ordinary activities after taxation by £47,500,000 (2009 – £35,000,000). A decrease of 10% would have had an equal but opposite effect. The portfolio does not target any exchange as a comparative index, and the performance of the portfolio has a low correlation to generally used indices.

The shares of Herald Investment Trust plc have an underlying NAV per share. The NAV per share of Herald Investment Trust plc fluctuates on a daily basis. In addition, there is volatility in the discount/premium the share price has to NAV.

21. Financial instruments (continued)

(ii) Interest Rate Risk

The majority of the Company's assets are equity shares and other investments which neither pay interest nor have a maturity date. However, the Company does hold Convertible Bonds and Government Securities, the interest rate and maturity dates of which are detailed below. Interest is accrued on sterling cash balances at a rate linked to the UK base rate.

The Company has borrowings, from time to time. The aim of the use of gearing is to enhance long term returns to shareholders by investing borrowed funds in equities and other assets. Gearing is actively managed. How and where borrowings are invested is reviewed by the Board in consultation with the Manager at every Board meeting. In light of the decisions made, appropriate adjustments to the gearing position are then made by the Manager.

At the year end the Company had borrowings of £50 million (2009 – £50 million). Under the terms of an interest rate swap, the interest payable on the bank loans has been fixed.

The interest rate risk profile of the financial assets and financial liabilities at 31 December was:

Financial Assets

	2010			2009		
	Fair value £'000	Weighted average interest rate/ interest rate	Weighted average period until maturity/ maturity date	Fair value £'000	Weighted average interest rate/ interest rate	Weighted average period until maturity/ maturity date
Fixed rate:						
UK bonds	20,151	4.7%	4 years	19,620	4.7%	5 years
US bonds	–	–	–	6,407	4.5%	11 months
UK convertible bonds	843	6.9%	3 years	769	6.9%	4 years
Cash:						
Other overseas currencies	2,278			1,041		
Sterling	37,219	0.2%		17,510	0.3%	
	39,497			18,551		

The cash deposits generally comprise call or short term money market deposits with original maturities of less than 3 months which are repayable on demand. The benchmark rate which determines the interest payments received on cash balances is the bank base rate.

Financial Liabilities

	2010			2009		
	£'000	Net interest rate paid	Loan facility expires	£'000	Net interest rate paid	Loan facility expires
Bank Loan	25,000	1.3%	May 2011	25,000	2.3%	May 2011
	25,000	1.4%	May 2013	25,000	2.4%	May 2013
	50,000	1.4%		50,000	2.4%	
Swap	50,000	4.2%		50,000	3.2%	
Total		5.6%			5.6%	

The effective fixed rate of interest on the loans of 5.6% (2009 – 5.6%) reflects a weighted average variable interest rate paid of 1.4% (2009 – 2.4%), with a further weighted average of 4.2% paid on the swap (2009 – 3.2%). The Company's facilities are rolling on a quarterly basis with the facility on a £25 million tranche expiring in May 2011 and a £25 million tranche expiring in May 2013. While the 30 year swap remains in place, the net interest payable will effectively be fixed for the duration of the term of the facility.

21. Financial instruments (continued)

(ii) Interest Rate Risk (continued)

	2010				2009			
	Notional contract amount £'000	Fair value assets £'000	Fair value liabilities £'000	Fair value balance £'000	Notional contract amount £'000	Fair value assets £'000	Fair value liabilities £'000	Fair value balance £'000
Total derivative assets/(liabilities) held for trading	50,000	49,370	(58,307)	(8,937)	50,000	34,211	(40,509)	(6,298)

Interest rate risk sensitivity

(a) Cash

An increase of 100 basis points in interest rates as at 31 December 2010 would have a direct effect on net assets. Based on the position at 31 December 2010, over a full year, an increase of 100 basis points would have increased the net return on ordinary activities after taxation by £395,000 (2009 – £186,000) and would have increased the net asset value per share by 0.49p (2009 – 0.23p). The calculations are based on the cash balances as at the respective balance sheet dates and are not representative of the year as a whole.

(b) Fixed rate bonds

An increase of 100 basis points in bond yields as at 31 December 2010 would have decreased total net assets and total return on ordinary activities by £678,000 (2009 – £803,000) and would have decreased the net asset value per share by 0.85p (2009 – 0.99p). A decrease in bond yields would have had an equal and opposite effect. The Convertible loan stocks having an element of equity are not included in this analysis as given the nature of the businesses and the risk profile of the balance sheets they are considered to have more equity like characteristics.

(c) Bank loans

The effect of an increase or decrease of 100 basis points in 3 month LIBOR interest rates as at 31 December 2010 on the interest cost of the bank loans and the net income return has been eliminated through a 30 year floating interest rate to fixed interest rate swap. The swap generates payments or charges that offset changes in the 3 month LIBOR interest rate, so that the interest payable on the bank loans is effectively converted to a fixed rate loan at 4.8975% (2009 – 4.8975%) plus margin cost. The initial term of the swap on commencement at 30 years did not match the term of the loans, therefore, hedge accounting is not used and mark to market gains or losses on the swap are captured in the net return on ordinary activities as set out in (d) below.

(d) Floating interest rate to fixed interest rate swap

A decrease of 100 basis points on 30 year interest rates as at 31 December 2010 would have a direct mark to market effect on the value of the swap and net assets. Based on the position as at 31 December 2010, over a full year, a decrease of 100 basis points would have decreased the gains on investments and net return on ordinary activities after taxation by £9,617,000 (2009 – £9,059,000) and would have decreased the net asset value per share by 12.03p (2009 – 11.18p). An increase of 100 basis points would have had an equal but opposite effect.

(iii) Foreign Currency Risk

The Company's reporting currency is sterling, but investments are made in overseas markets as well as the United Kingdom and the asset value can be affected by movements in foreign currency exchange rates.

Furthermore many companies trade internationally both through foreign subsidiaries, and through exports. The greatest foreign currency risk occurs when companies have a divergence in currencies for costs and revenues. A much less risky exposure to currency is straight translation of sales and profits. The List of Investments on pages 16 to 20 breaks down the portfolio by geographic listing. However the location of the stock market quote only has a limited correlation to the costs, revenues and even activities of those companies, and so this note should not be regarded as a reliable guide to the sensitivity of the portfolio to currency movements. For example, the holdings in the portfolio that have suffered most from US$ weakness are UK companies with dollar revenues and sterling costs.

The Company does not hedge the sterling value of investments that are priced in other currencies. Overseas income is subject to currency fluctuations. The Company does not hedge these currency fluctuations because it is impossible to quantify the effect for the reasons stated above. However, from time to time the Manager takes a view by holding financial assets or liabilities in overseas currencies.

21. Financial instruments (continued)

(iii) Foreign Currency Risk (continued)

Exposure to currency risk through asset allocation by currency of listing is indicated below:

At 31 December 2010

	Investments £'000	Cash and deposits £'000	Loans £'000	Other debtors and creditors* £'000	Net exposure £'000
US dollar	120,967	–	–	3	120,970
Taiwan dollar	14,435	2,245	–	–	16,680
Korean won	9,952	33	–	–	9,985
Euro	8,994	–	–	(14)	8,980
Other overseas currencies	10,568	–	–	–	10,568
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	164,916	2,278	–	(11)	167,183
Sterling	330,485	37,219	(50,000)	(10,325)	307,379
	495,401	39,497	(50,000)	(10,336)	474,562

*Includes net non-monetary assets of £49,000.

At 31 December 2009

	Investments £'000	Cash and deposits £'000	Loans £'000	Other debtors and creditors* £'000	Net exposure £'000
US dollar	94,068	–	–	47	94,115
Taiwan dollar	12,583	1,010	–	–	13,593
Korean won	12,451	31	–	36	12,518
Euro	8,420	–	–	7	8,427
Other overseas currencies	8,215	–	–	–	8,215
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	135,737	1,041	–	90	136,868
Sterling	244,720	17,510	(50,000)	(8,202)	204,028
	380,457	18,551	(50,000)	(8,112)	340,896

*Includes net non-monetary assets of £28,000.

Foreign currency risk sensitivity

At 31 December 2010, had sterling strengthened by 10% (2009: 10%) in relation to all currencies, with all other variables held constant, total net assets and net return on ordinary activities after taxation would have decreased by the amounts shown on page 51 based solely on translation of securities quoted in currencies overseas. A 10% (2009: 10%) weakening of sterling against all currencies, with all other variables held constant, would have had an equal but opposite effect on the financial statement amounts. However companies whose cost base diverges in currency terms from its sales will in the longer term have a significantly greater effect on valuation than simple translation. In the short term investee companies generally cover their currency exposure to varying degrees. There is insufficient publicly disclosed information to quantify this, but in the long term this effect is expected to dwarf simple translation of foreign listings in terms of both risk and reward, because many investee companies trade globally. Furthermore the country of listing is not necessarily an indication of the geography of some or even any operational activities for investee companies. The Manager does not use financial instruments to protect against currency movements. From time to time financial leverage has been made using debt in overseas currencies.

21. Financial instruments (continued)

(iii) Foreign Currency Risk (continued)

	2010 £'000	2009 £'000
US dollar	12,097	9,411
Taiwan dollar	1,668	1,359
Korean won	998	1,252
Euro	898	843
Other overseas currencies	1,057	822
	16,718	13,687

B. Credit Risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment which it has entered into with the Company. The Manager monitors counterparty risk on an ongoing basis.

The Company has investments in convertible loan stocks that have an element of equity. These securities are viewed as having a risk profile similar to the equity holdings. This is because the convertibles held are in nascent technology companies that may be loss making and may have weak balance sheets. For this reason these stocks are categorised as equity holdings.

The fixed interest securities held are UK Government securities and UK corporate bonds.

Credit Risk Exposure

The exposure to credit risk at 31 December was:

	2010 £'000	2009 £'000
Fixed interest investments	20,151	26,027
Cash and short term deposits	39,497	18,551
Debtors and prepayments	1,316	1,593
	60,964	46,171

The maximum exposure in fixed interest investments was £27,331,000 (2009 – £28,417,000) and the minimum £20,041,000 (2009 – £15,948,000). The maximum exposure in cash was £45,239,000 (2009 – £32,900,000) and the minimum £ 13,213,000 (2009 – £13,008,000).

None of the Company's financial assets are past due or impaired.

C. Liquidity Risk

The Company's policy with regard to liquidity is to provide a degree of flexibility so that the portfolio can be repositioned when appropriate and that most of the assets can be realised without an excessive discount to the market price. The Company's unlisted investments are not readily realisable, but these only amount to 0.7% of the Company's total assets at 31 December 2010 (2009: 0.9%).

In practice, liquidity in investee companies is imperfect, particularly those with a market value of less than £100 million. To reduce this liquidity risk it is the policy to diversify the holdings and generally to restrict the holding in any one company to less than 10% of the share capital of that company. Furthermore the guideline is for no single investment to account for more than 5% of the assets of the Company.

The market valuation of each underlying security gives an indication of value, but the price at which an investment can be made or realised can diverge materially from the bid or offer price depending on market conditions generally and particularly to each investment. 32% (£160 million) (2009: 36% (£135 million)) of the portfolio is invested in stocks with a market capitalisation below £100 million, where liquidity is expected to be more limited. If these stocks had on average a realisable value 20% below the bid price the value of the total fund would be adversely affected by 6.4% (2009: 7.1%).

21. Financial instruments (continued)

C. Liquidity Risk (continued)

Liquidity Risk Exposure

Contractual maturities of the financial liabilities at the year end, based on the earliest date on which payment can be required are as follows:

	2010					2009				
	One year or less £'000	In more than one year but not more than two years £'000	In more than two years but not more than five years £'000	Five years or more £'000	Total £'000	One year or less £'000	In more than one year but not more than two years £'000	In more than two years but not more than five years £'000	Five years or more £'000	Total £'000
Bank loans	25,594	544	25,453	–	51,591	737	26,184	26,853	–	53,774
Derivative financial instruments	2,037	1,719	2,643	6,536	12,935	2,042	1,243	1,017	6,335	10,637
Other creditors	2,201	–	–	–	2,201	2,888	–	–	–	2,888
	29,832	2,263	28,096	6,536	66,727	5,667	27,427	27,870	6,335	67,299

Fair Value of Financial Instruments

Fair values are measured using the following fair value hierarchy:

Level 1: reflects financial instruments quoted in an active market.

Level 2: reflects financial instruments whose fair value is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables includes only data from observable markets.

Level 3: reflects financial instruments whose fair value is determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable market transactions in the same instrument and not based on available observable market data.

The valuation techniques used by the Company are explained in the accounting policies on page 40.

The tables below set out the fair value measurements using the fair value hierarchy.

At 31 December 2010

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets				
Equity investments	471,350	–	3,900	475,250
Government debt securities	14,669	–	–	14,669
Other debt securities	5,482	–	–	5,482
Current assets	40,813	–	–	40,813
Total assets	532,314	–	3,900	536,214
Financial liabilities				
Bank loans	50,000	–	–	50,000
Derivatives	–	8,937	–	8,937
Current liabilities (excluding bank loans)	2,715	–	–	2,715
Total liabilities	52,715	8,937	–	61,652
Total net assets	**479,599**	**(8,937)**	**3,900**	**474,562**

21. Financial instruments (continued)

A reconciliation of fair value measurements in Level 3 is set out below:

At 31 December 2010

	Equity Investments £'000
Opening balance at 1 January 2010	2,949
Purchases	1,639
Sales	–
Transfers into Level 3	1,578
Total gains or losses:	
– on assets sold during the year	–
– on assets held at 31 December 2010	(2,266)
Closing balance at 31 December 2010	3,900

Transfers into Level 3 relate to investments for which listing has been suspended during the year.

At 31 December 2009

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets				
Equity investments	351,319	162	2,949	354,430
Government debt securities	20,916	–	–	20,916
Other debt securities	5,111	–	–	5,111
Current assets	20,144	–	–	20,144
Total assets	397,490	162	2,949	400,601
Financial liabilities				
Bank loans	50,000	–	–	50,000
Derivatives	–	6,298	–	6,298
Current liabilities (excluding bank loans)	3,407	–	–	3,407
Total liabilities	53,407	6,298	–	59,705
Total net assets	**344,083**	**(6,136)**	**2,949**	**340,896**

A reconciliation of fair value measurements in Level 3 is set out below:

At 31 December 2009

	Equity Investments £'000
Opening balance at 1 January 2009	2,898
Purchases	815
Sales	(1,738)
Transfers into Level 3	1,607
Total gains or losses:	
– on assets sold during the year	(1,639)
– on assets held at 31 December 2009	1,006
Closing balance at 31 December 2009	2,949

Transfers into Level 3 relate to investments for which listing has been suspended during the year.

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Herald Investment Trust plc will be held at 10-11 Charterhouse Square, London EC1M 6EE on 19 April 2011 at 11.30 am for the following purposes:

To consider and, if thought fit, approve resolutions 1 to 7 as ordinary resolutions and resolution 8 as a special resolution.

Ordinary Business

1. To receive and adopt the Directors' Report, the Financial Statements and the Auditor's Report in respect of the year ended 31 December 2010.
2. To approve the Directors' Remuneration Report for the year ended 31 December 2010.
3. To re-elect Mr CJ Cazalet as a Director of the Company.
4. To re-elect Mr CM Brendish as a Director of the Company.
5. To re-elect Mr DCP McDougall as a Director of the Company.
6. To reappoint Ernst & Young LLP as Independent Auditors of the Company to hold office until the conclusion of the next Annual General Meeting at which financial statements are laid before the Company.
7. To authorise the Directors to determine the remuneration of the Independent Auditors.

Special Business

8. That, the Company be generally and subject as hereinafter appears unconditionally authorised in accordance with Section 701 of the Companies Act 2006 (the 'Act') to make market purchases (within the meaning of Section 693(4) of the Act) of its issued shares of 25p each in the capital of the Company in substitution for any existing authority under section 701 of the Act but without prejudice to any exercise of any such authority prior to the date hereof.

   PROVIDED ALWAYS THAT

   (i) the maximum number of shares hereby authorised to be purchased shall be 14.99% of the issued share capital on the date on which this resolution is passed;

   (ii) the minimum price which may be paid for a share shall be 25p;

   (iii) the maximum price (exclusive of expenses) which may be paid for a share shall not be more than the higher of (a) 5% above the average closing price (as derived from the Daily Official List of the London Stock Exchange) for the shares for the five business days immediately preceding the date of purchase and (b) the higher of the last independent trade and the highest current independent bid on the London Stock Exchange;

   (iv) any purchase of shares will be made in the market for cash at prices below the prevailing net asset value per share (as determined by the Directors);

   (v) unless previously varied, revoked or renewed, the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2012; and

   (vi) the Company may make a contract to purchase shares under the authority hereby conferred prior to the expiry of such authority and may make a purchase of shares pursuant to any such contract notwithstanding such expiry.

By order of the Board

Baillie Gifford & Co
Secretary

Registered Office:
10-11 Charterhouse Square
London EC1M 6EE

10 March 2011

NOTES

1. As a member you are entitled to appoint a proxy or proxies to exercise all or any of your rights to attend, speak and vote at the AGM. A proxy need not be a member of the Company but must attend the AGM to represent you. You may appoint more than one proxy provided each proxy is appointed to exercise rights attached to different shares. You can only appoint a proxy using the procedure set out in these notes and the notes to the proxy form. You may not use any electronic address provided either in this notice or any related documents (including the circular and proxy form) to communicate with the Company for any purpose other than those expressly stated.
2. To be valid any proxy form or other instrument appointing a proxy, together with any power of attorney or other authority under which it is signed or a certified copy thereof, must be received by post or (during normal business hours only) by hand at the Registrars of the Company at Capita Registrars, PXS, 34 Beckenham Road, Beckenham, BR3 4TU no later than 48 hours (excluding non-working days) before the time of the meeting or any adjourned meeting.
3. Shareholders may also use the online proxy voting service offered by Capita Registrars at www.capitashareportal.com to vote or appoint a proxy online. Votes must be received no later than 48 hours (excluding non-working days) before the time of the meeting or any adjourned meeting. To vote online, the unique personal identification Investor code printed on the proxy form will be required.
4. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual and/or by logging on to the website www.euroclear.com/CREST. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.
5. In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with Euroclear UK & Ireland Limited's specifications, and must contain the information required for such instruction, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the Company's registrar (ID RA10) no later than 48 hours (excluding non-working days) before the time of the meeting or any adjournment. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Application Host) from which the Company's registrar is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.
6. CREST members and, where applicable, their CREST sponsors, or voting service providers should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member, or sponsored member, or has appointed a voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.
7. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.
8. The return of a completed proxy form or other instrument of proxy will not prevent you attending the AGM and voting in person if you wish.
9. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001 and Section 311 of the Companies Act 2006 the Company specifies that to be entitled to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast), shareholders must be registered in the Register of Members of the Company no later than 48 hours (excluding non-working days) prior to the commencement of the AGM or any adjourned meeting. Changes to the Register of Members after the relevant deadline shall be disregarded in determining the rights of any person to attend and vote at the meeting.
10. Any person to whom this notice is sent who is a person nominated under Section 146 of the Companies Act 2006 to enjoy information rights (a 'Nominated Person') may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights.
11. The statement of the rights of shareholders in relation to the appointment of proxies in Notes 1 and 2 above does not apply to Nominated Persons. The rights described in those Notes can only be exercised by shareholders of the Company.
12. The members of the Company may require the Company to publish, on its website, (without payment) a statement (which is also passed to the auditors) setting out any matter relating to the audit of the Company's accounts, including the auditors' report and the conduct of the audit. The Company will be required to do so once it has received such requests from either members representing at least 5% of the total voting rights of the Company or at least 100 members who have a relevant right to vote and hold shares in the Company on which there has been paid up an average sum per member of at least £100. Such requests must be made in writing and must state your full name and address and be sent to the Company at 10-11 Charterhouse Square, London, ECIM 6EE.
13. Information regarding the Annual General Meeting, including information required by Section 311A of the Companies Act 2006, is available from the Company's page of the Manager's website at www.heralduk.com.
14. Members have the right to ask questions at the meeting in accordance with Section 319A of the Companies Act 2006.
15. As at 21 February 2011 (being the last practicable date prior to the publication of this notice) the Company's issued share capital consisted of 79,913,283 ordinary shares, carrying one vote each. Therefore, the total voting rights in the Company as at 21 February 2011 were 79,913,283 votes.
16. Any person holding 3% or more of the total voting rights of the Company who appoints a person other than the Chairman of the meeting as his proxy will need to ensure that both he and his proxy complies with their respective disclosure obligations under the UK Disclosure and Transparency Rules.
17. No Director has a contract of service with the Company.

FURTHER SHAREHOLDER INFORMATION

- **How to Invest** The Company's shares are traded on the London Stock Exchange. They can be bought by placing an order with a stockbroker or by asking a professional adviser to do so.
- **Sources of Further Information on the Trust** The price of shares is quoted daily in the *Financial Times*, *The Daily Telegraph* and *The Times*. The NAV per share is calculated and released daily to the London Stock Exchange and monthly to the Association of Investment Companies.
- **Key Dates** Ordinary shareholders normally receive a dividend in respect of each financial year which is normally paid late April/early May. The AGM is normally held in April.
- **Taxation** The price of the Ordinary shares (adjusted for the price of attributable warrants) on 21 February 1994, which was the first day of trading, was 90.9p. The amount attributable to the warrants for the purpose of capital gains tax is 9.1p per share issued (1994 Annual Report). Up to 5 April 1998 the basis for calculating non-trading gains or losses was the difference between that price, or any subsequent purchase price, and the sale price, using the indexation allowance for inflation. However, this indexation allowance was frozen at 5 April 1998, and replaced by a taper relief. Taper relief, however, cannot create or increase a loss. Any shareholder uncertain of his or her position is recommended to seek expert advice.
- **ISAs** The Ordinary shares of the Company are qualifying investments for individual saving accounts.
- **Electronic Proxy Voting** If you hold stock in your own name you can choose to vote by returning proxies electronically at **www.capitashareportal.com**. If you have any questions about this service please contact Capita Registrars on 0871 664 0300 (calls cost 10p per minute plus network extras, lines are open 8.30 am to 5.30 pm Monday-Friday).

Herald is an investment trust. Investment trusts offer investors the following:

- Participation in a diversified portfolio of shares.
- Constant supervision by experienced professional managers.
- The Company is free from capital gains tax on capital profits realised within the portfolio.
- The opportunity to achieve improved performance for shareholders' funds in rising markets by the borrowing of additional money.