

HERALD INVESTMENT TRUST plc

HALF-YEARLY FINANCIAL REPORT

For the six months ended 30 June 2016

SUMMARY OF PERFORMANCE

	At inception 16 February 1994	At 31 December 2015	At 30 June 2016	Performance since 31 December 2015	Performance since inception
NAV per share (including current year income)	98.7p	881.8p	889.6p	0.9%	801.3%
NAV per share (excluding current year income)	98.7p	881.8p	889.1p	0.8%	800.8%
Share price	90.9p	745.3p	680.0p	(8.8)%	648.1%
Numis Smaller Companies plus AIM (ex.investment companies) Capital Only	1,750.0	4,628.6	4,327.7	(6.5)%	147.3%
Russell 2000 (small cap) Technology Index Capital Only (in dollar terms)†	1,047.9*	2,269.4	2,289.9	0.9%	118.5%
Russell 2000 (small cap) Technology Index Capital Only (in sterling terms)†	688.7*	1,539.1	1,713.0	11.3%	148.7%

* 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 has been used from 31 December 2008 onwards.

CHAIRMAN'S REVIEW

The Trust's net asset value per share increased by 0.9% to 889.6p in the first half of 2016.

This small change might give the impression that the first six months of 2016 had been an uneventful period. In fact it disguises a very volatile period for our Manager to navigate. The new year had scarcely begun when a wave of fear about falling global growth prospects swept world markets, leading to major declines across all world equity markets. In this phase the Company's UK portfolio was a haven of stability while the North American portfolio fell nearly 20%. China's decision to stimulate credit allowed markets to regain their collective nerve. There was a rapid recovery after February, followed in the UK by a long hiatus ahead of the vote on continued EU membership.

The vote to leave, unexpected as it was by most pundits, caused momentary market panic and a sharp depreciation in sterling. The UK portfolio fell by 3.5% between the referendum result and the period end. But this reflected defensive mark-downs by market makers rather than real selling pressure. In the illiquid world of UK smaller companies, the Manager is generally very aware when there are sizeable sellers, because lines of stock are traded on a matched basis. There was no evident selling in the aftermath of the referendum, nor an opportunity to acquire cheap lines of stock.

The more immediate impact of the vote to leave was the precipitous decline of sterling. The Trust's assets benefited from foreign currency gains of £22.5m on overseas holdings and on cash held in overseas currencies, offsetting modest falls in the UK equity portfolio and interest rate swap losses. Whilst this is a one-off gain, the depreciation of sterling also has a longer-term impact on the portfolio. We own many UK companies that export products and services. Their increased competitiveness ought to lead to useful upgrades to profit forecasts. UK consumer demand is of modest relevance to the UK portfolio; in fact, European exports are also relatively unimportant. Longer term there may be meaningful benefits when trade agreements are signed in other overseas markets.

Over the first half of 2016, the UK portfolio returned -4.95% versus a setback of 5.2% (total return) in the Numis Small Companies Index (including AIM and excluding investment trusts). Portfolio performance was mixed. On the negative side, Alternative Networks issued a profits warning reflecting the decline in mobile roaming charges but continued to increase its dividend. Bango disappointed the market with continued margin pressure, in spite of 78% growth in end user spend. SQS, an AIM-listed company with a German headquarters, downgraded earnings and expectations because it lost a software testing contract with Morrisons the food retailer. However, profits continue to grow. None of these disappointments can be attributed to Brexit or to the macroeconomic environment. They are all very stock specific. In contrast Imagination Technologies bounced usefully (+£6m) and IDOX performed well.

KBC Advanced Technology was the only material takeover in the period. Its share price was 124p before the first bid at 185p from a NASDAQ listed company, and then a Japanese company counterbid 210p, valuing the Trust's holding at £8.3million. The scale of the takeover premium provides an interesting counterbalance to the market illiquidity.

The North American portfolio rose by 13.6% in sterling terms versus the Russell 2000 Technology Index which appreciated 11.5% (total return). In US dollar terms the index was only just in positive territory. Silicon Motion has been the outstanding performer, adding £8m to the Trust's NAV. Alliance Fibre Optic was acquired and delivered a 13.5x return since acquisition in 2008.

The European portfolio has been the star performer in the period, rising 23.3%. This reflects a strong performance from BE Semiconductor based in the Netherlands and the takeovers of two smaller holdings, Opera Software in Norway and Cegid in France. These bids signal the spread of acquisition activity from the UK to the Continent.

Asia has also delivered a positive return of 7.4%. Foreign exchange gains more than offset a slight reduction in the local currency return.

The Trust's net income has improved a little, though our main objective remains the generation of capital gains. Dividends have risen handsomely in investee companies. However, the dividends received by the Trust have in aggregate grown more slowly, reflecting portfolio changes and takeovers in particular.

During 2016, £9.3m has been spent buying back 1.36m shares at an average price of 684p. It is anomalous that the share price has declined 8.8% in the first half when the net assets/share has risen, and when the Company has been actively buying back shares. At the period end the discount was therefore 23.5%.

The proportion of gross assets invested in the UK has fallen from 60.6% at the end of December 2015 to 55.6% at the end of June 2016. This reflects market movements and a purposeful endeavour to be positioned defensively ahead of the referendum vote. Although there remain investment opportunities at very attractive valuations it remains the policy to limit the size of holdings while liquidity remains so uncertain.

The technology sector globally has had a challenging period reflecting declines in PC volumes and the maturity of the mobile phone market. However the Company's portfolio is largely unrelated to the large 'commodity' markets.

I suspect that the market has been cautious on Herald both ahead of and after the EU referendum because the majority of assets are UK-based. This ignores the fact that sales of the portfolio's companies are widely diversified internationally through exports and overseas subsidiaries and overall the Trust benefits enormously from sterling weakness. Margin expansion from UK exports can be much more significant than straight currency translation of overseas investments. Participants in the equity markets have reacted calmly to the referendum outcome. We continue to see attractive valuations and growing companies in a low-growth world. We now view the outlook with more optimism, and hope and expect that professional investors will return to the asset class in due course.

Julian Cazalet

Chairman
22 July 2016

TOP TWENTY EQUITY HOLDINGS AT 30 JUNE 2016

Company	Business	Value £'000	% of total assets *
Diploma	Distributor of components and systems	19,122	2.7
Imagination Technologies	Licensors of semiconductor intellectual property	19,056	2.7
GB Group	Intelligent identity software and services	18,297	2.6

IDOX	Supplier of software solutions primarily to the UK public sector	17,741	2.5
Silicon Motion Technology ADR	Develops controllers used in flash memory	17,442	2.5
Next Fifteen Communications	Supplier of marketing communications services	12,803	1.8
M&C Saatchi	Global marketing services business	11,242	1.6
Wilmington	Provides information and training to professional business markets	10,298	1.5
Telit Communications	Supplier of wireless machine to machine modems and services	9,001	1.3
Eckoh	Supplier of secure payment products and customer contact solutions	8,868	1.3
Telecom Plus	Supplier of telecommunications services and other utilities	8,498	1.2
BE Semiconductor Industries	Developer of semiconductor packaging and assembly equipment	8,226	1.2
Euromoney Institutional Investor	Business to business media group	7,901	1.1
Descartes Systems	Supplier of logistics management software	7,854	1.1
SQS Software Quality Systems	Specialist in software quality and software testing	7,542	1.1
Pegasystems	Develops applications for sales, marketing and operations	7,450	1.1
Maintel Holdings	Supplier of telecommunications and networking services	6,474	0.9
Ceva	Licenser of semiconductor signal processing intellectual property	6,469	0.9
Mellanox Technologies	Supplier of Ethernet and InfiniBand interconnect solutions	6,398	0.9
Statpro	Provider of portfolio analytics and risk management software	6,122	0.9
		216,804	30.9

* Total assets before deduction of bank loans and derivative financial instruments

INCOME STATEMENT (UNAUDITED)

	For the six months ended 30 June 2016			For the six months ended 30 June 2015		
	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
Gains on sales of investments	–	6,183	6,183	–	22,501	22,501
Movements in unrealised gains on investments	–	(1,989)	(1,989)	–	25,901	25,901
Fair value movement on interest rate swap	–	(5,230)	(5,230)	–	1,551	1,551
Currency gains/(losses)	–	3,844	3,844	–	(551)	(551)
Income from investments and interest receivable	4,945	–	4,945	4,727	–	4,727
Investment management fee (note 3)	(3,294)	–	(3,294)	(3,320)	–	(3,320)
Other administrative expenses	(273)	(1)	(274)	(200)	(1)	(201)
Profit before finance costs and taxation	1,378	2,807	4,185	1,207	49,401	50,608
Finance costs of borrowings	(822)	–	(822)	(951)	–	(951)
Profit before taxation	556	2,807	3,363	256	49,401	49,657
Taxation	(159)	–	(159)	(143)	–	(143)
Profit after taxation	397	2,807	3,204	113	49,401	49,514
Profit per ordinary share	0.53p	3.72p	4.25p	0.14p	63.91p	64.05p

(note 4)						
Weighted average number of ordinary shares in issue during each period	75,456,694			77,301,474		

The total column of this statement is the profit and loss account of the Company, prepared in accordance with UK Accounting Standards.

The revenue and capital columns are presented for information purposes in accordance with the Statement of Recommended Practice issued by the Association of Investment Companies. All items in the above statement derive from continuing operations and the Company has no other gains or losses, therefore no statement of comprehensive income is presented. No operations were acquired or discontinued in the period.

BALANCE SHEET
(UNAUDITED)

	As at 30 June 2016 £'000	As at 31 December 2015 £'000
Fixed assets		
Investments held at fair value through profit or loss	636,356	642,151
Current assets		
Cash and cash equivalents	72,581	69,360
Other receivables	2,676	1,411
	75,257	70,771
Current liabilities		
Derivative financial instruments	(18,232)	(13,002)
Other payables	(28,385)	(28,783)
	(46,617)	(41,785)
Net current assets	28,640	28,986
Total net assets	664,996	671,137
Capital and reserves		
Called up share capital	18,688	19,028
Share premium	73,738	73,738
Capital redemption reserve	3,264	2,924
Capital reserve	568,664	575,202
Revenue reserve	642	245
Shareholders' funds	664,996	671,137
Net asset value per ordinary share (including current year income)	889.60p	881.78p
Net asset value per ordinary share (excluding current year income)	889.06p	881.83p
Ordinary shares in issue (note 8)	74,752,605	76,111,546

STATEMENT OF CHANGES IN EQUITY
(UNAUDITED)

For the six months ended 30 June 2016

	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 2016	19,028	73,738	2,924	575,202	245	671,137
Profit after taxation	–	–	–	2,807	397	3,204
Shares bought back (note 8)	(340)	–	340	(9,345)	–	(9,345)
Shareholders' funds at 30 June 2016	18,688	73,738	3,264	568,664	642	664,996

For the six months ended 30 June 2015

	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 2015	19,335	73,738	2,617	532,946	281	628,917
Profit after taxation	–	–	–	49,401	113	49,514
Shares bought back (note 8)	(38)	–	38	(1,096)	–	(1,096)
Shareholders' funds at 30 June 2015	19,297	73,738	2,655	581,251	394	677,335

* The capital reserves as at 30 June 2016 include investment holdings gains of £177,123,000 (30 June 2015 - £179,112,000).

NOTES TO THE CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

1 Financial Statements

The condensed financial statements for the six months to 30 June 2016 within the Half Yearly Report comprise the statements set out above together with the related notes that follow below. The condensed financial statements do not constitute statutory accounts as defined in sections 434 to 436 of the Companies Act 2006 and have been neither audited or reviewed by the Company's auditors. Financial information in relation to the year ended 31 December 2015 has been extracted from the statutory accounts which have been filed with the Registrar of Companies. The Auditors' report on those accounts was unqualified and did not contain a statement under Section 498 (2) or (3) of the Companies Act 2006.

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 covenants are reviewed by the Board on a regular basis. 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 2019. Accordingly, 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.

2 Accounting policies

The condensed financial statements for the six months to 30 June 2016 have been prepared in accordance with FRS 102, 'Interim Financial Reporting' (FRS 104) issued by the FRC in March 2015 and the revised Statement of Recommended Practice - 'Financial Statements of Investment Trust Companies and Venture Capital Trusts' (SORP) issued by the Association of Investment Companies (AIC) in November 2014.

The accounting policies applied for the condensed financial statements are as set out in the Company's annual report for the year ended 31 December 2015.

3 Investment management fee

Herald Investment Management Limited is appointed investment manager under a management agreement which is terminable on twelve months' notice. Its 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. The management fee is levied on all assets except the holding in Herald Ventures II Limited Partnership managed by Herald Investment Management Limited.

4 Net return per ordinary share

	Six months ended 30 June 2016 £'000	Six months ended 30 June 2015 £'000
Revenue profit after taxation	397	113
Capital profit after taxation	2,807	49,401
Total net return	3,204	49,514
Weighted average number of ordinary shares	75,456,694	77,301,474

Net return per ordinary share is based on the above totals of revenue and capital and the weighted average number of ordinary shares in issue during each period.

There are no dilutive or potentially dilutive shares in issue.

5 Dividends

In accordance with FRS 102 Section 32 'Events After the End of the Reporting Period', the final dividend payable on ordinary shares is recognised as a liability when approved by shareholders. Interim dividends are recognised only when paid.

Dividends paid on ordinary shares in respect of earnings for each period are as follows:

	Six months ended 30 June 2016 £'000	Six months ended 30 June 2015 £'000
Amounts recognised as distributions in the period:		
Final dividend for the year ended 31 December 2015 - nil (2014 - nil)	–	–

No interim dividend will be declared.

- 6 The Company has a sterling loan facility of £25 million and a £25 million multi-currency revolving advance loan maturing 31 December 2017.

At 30 June 2016, the sterling loan facility was fully drawdown. Interest on the loan is payable in quarterly instalments in January, April, July and October. The estimated repayment value of the loan at 30 June 2016 was £25 million. The indicative costs of repaying the loan as at 30 June 2016 were not materially different in the context of the above figures.

The interest on the facilities 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 30 June 2016 was an estimated liability of £18.2 million (31 December 2015 – £13.0 million) which was based on an external valuation model.

7 Financial Instruments

The Company's investments and derivative financial instruments, as disclosed in the Company's balance sheet, are valued at fair value.

Nearly all of the Company's portfolio of investments are in the Level 1 category as defined in FRS 102 as amended for fair value hierarchy disclosures (March 16).

The three levels set out in FRS 102 are as follows:

Level 1: The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

Level 2: Inputs other than quoted prices included within Level 1 that are observable (ie developed using market data) for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable (ie for which market data is unavailable) for the asset or liability.

The analysis of the valuation basis for the financial instruments based on the hierarchy is as follows:

	30 June 2016		31 December 2015	
	Assets £'000	Liabilities £'000	Assets £'000	Liabilities £'000
Level 1	699,443	(28,385)	700,484	(28,783)
Level 2	–	(18,232)	–	(13,002)
Level 3	12,170	–	12,438	–
Total net assets	711,613	(46,617)	712,922	(41,785)

The fair value of listed security investments is bid value. 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. The value of the swap is estimated by RBS, the provider of the swap, and is compared to an external model and external prices. The valuation used in the report and accounts is the external model.

- 8 At the Annual General Meeting held on 19 April 2016 the Company's authority to buy back shares was renewed in respect of 11,257,880 ordinary shares (equivalent to 14.99% of its issued share capital at that date). In the six months to 30 June 2016 a total of 1,358,941 (30 June 2015 – 153,000) ordinary shares of 25p each were bought back at a total cost of £9,344,635 (30 June 2015 - £1,096,000). At 30 June, the Company had authority to buy back a further 9,898,939 ordinary shares.

- 9 During the period, cost of purchases amounted to £33,258,000 (30 June 2015 - £46,417,000) and proceeds of sales amounted to £43,247,000 (30 June 2015 - £53,119,000). Transaction costs of £100,000 (30 June 2015 - £229,000) were incurred on the purchase of investments and £168,000 (30 June 2015 - £123,000) on sales of investments.

INVESTMENT POLICY

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.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks facing the Company relate to the Company's investment activities. These risks are market risk (comprising other price risk, interest rate risk and foreign currency risk), credit risk and liquidity risk. An explanation of these risks and how they are managed is contained in note 18 of the Company's Annual Report and Financial Statements for the year to 31 December 2015. The principal risks and uncertainties have not changed since the publication of the Annual Report which can be obtained free of charge from Herald Investment Management Limited and is available on the Manager's website: www.heralduk.com. Other risks facing the Company include the following: regulatory risk (that the loss of investment trust status or a breach of applicable legal and regulatory requirements could have adverse financial consequences and cause reputational damage), operational/financial/custody risk (failure of service providers' accounting and/or settlements systems could lead to inaccurate reporting or financial loss), the risk that the discount can widen and gearing risk (the use of borrowings can magnify the impact of falling markets). Further information can be found on page 23 of the latest Annual Report and Financial Statements.

RESPONSIBILITY STATEMENT

We confirm that to the best of our knowledge:

We confirm that to the best of our knowledge:

- a) the condensed set of financial statements has been prepared in accordance with FRS102 "Interim Financial Reporting" (FRS104) published by the FRC and gives a true and fair view of the assets, liabilities, financial position and profit of the Company;
- b) the Half Yearly Report and interim management report (Chairman's Review) includes a fair review of the information required by Disclosure and Transparency Rules 4.2.7R (indication of important events during the first six months, and their impact on the financial statements and a description of principal risks and uncertainties for the remaining six months of the year); and
- c) the Half-Yearly Financial Report includes a fair review of the information required by Disclosure and Transparency Rules 4.2.8R (disclosure of related party transactions and changes therein – see note 3 above).

By order of the Board

Julian Cazalet

Chairman

22 July 2016

The Half Yearly Financial report will be posted to shareholders on or around 4 August 2016 and published on the Manager's website: www.heralduk.com

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