HERALD INVESTMENT TRUST plc

REPORT & ACCOUNTS

31 December 2005

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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 advisor authorised under the Financial Services and Markets Act 2000 immediately.

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 2005	
Shareholders' funds	**Market capitalisation**
£358m	**£333m**

Policy and Objective	Herald's objective is to achieve capital appreciation through investments in smaller quoted companies, in the areas of communications and multi-media. Investments will be made throughout 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.
Benchmark	The portfolio benchmark against which performance is measured is ⅔ Hoare Govett Smaller Companies Index (extended capital gains ex. investment companies) and ⅓ Russell 2000 (small cap) Technology Index (in sterling terms). From 1 January 2006, the benchmark will be changed to ⅔ Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies) and ⅓ Russell 2000 (small cap) Technology Index (in sterling terms). This benchmark is considered more appropriate as an element of the portfolio is invested in AIM stocks.
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 87,556,010 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 no shares were bought back for cancellation.
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 2004 shareholders voted in favour of the Company continuing to operate as an investment trust. The next continuation vote is in 2007 and every third year thereafter.
AITC	The Company is a member of the Association of Investment Trust 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 2005	31 December 2004	% change
Total assets (before deduction of bank loans)	358.3m	£356.9m†	
Bank loans	–	£24.7m	
Equity shareholders' funds	358.3m	£332.2m†	7.9
Net asset value per ordinary share	409.2p	379.4p†	7.9
Share price*	379.8p	322.8p	17.7
FTSE 100	5,618.8	4,814.3	16.7
FTSE All-Share	2,847.0	2,410.8	18.1
FTSE Small Cap	3.305.5	2,758.2	19.8
Hoare Govett Smaller Companies Index (extended capital gains ex. investment companies)	3,423.2	2,752.2	24.4
Russell 2000 (small cap) Technology Index (in sterling terms)	71.0	65.1	9.1
Benchmark composite index			19.6
Dividend per ordinary share	0.60p	0.30p	100.0
Earnings per ordinary share	0.64p	0.34p	88.2
Expense ratio	1.16%	1.20%	
Discount	7.2%	14.9%†	

	Year to 31 December 2005		Year to 31 December 2004	
Year's high and low (on month end values)	**High**	**Low**	**High**	**Low**
Share price*	382.0p	310.0p	379.5p	291.0p
Net asset value‡	412.7	356.4	413.2p	348.6p
Discount‡	7.3%	15.1%	8.2%	19.0%

	31 December 2005	31 December 2004
Total return per ordinary share		
Revenue	0.64p	0.34p
Capital	29.45p	18.73p†
Total	30.09p	19.07p

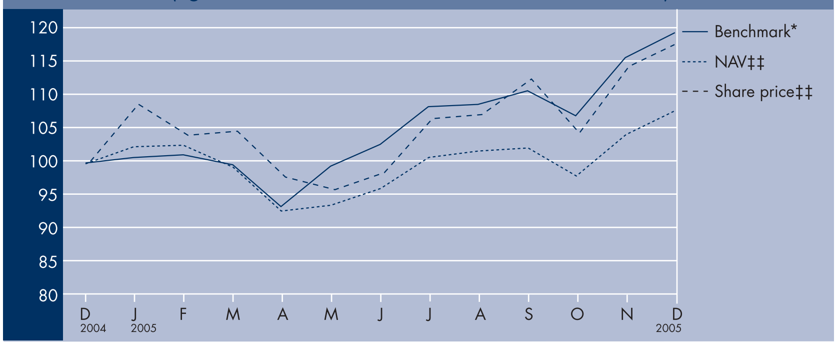
†Restated, see note 1 page 33.

*Mid market price.

‡Investments valued at mid market prices.

HERALD'S SHARE PRICE, NAV AND BENCHMARK

(figures have been rebased to 100 at 31 DECEMBER 2004)



Source: Baillie Gifford & Co

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

Dividends are not reinvested.

‡‡At bid

Past performance is no guarantee of future performance.

LONG TERM PERFORMANCE SUMMARY

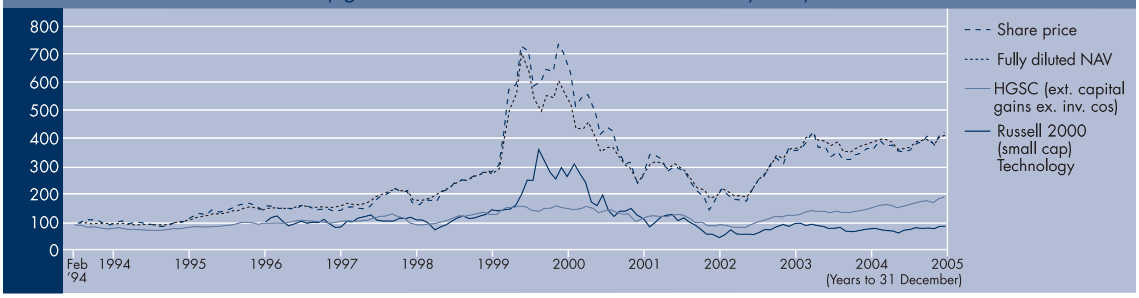
The following charts indicate how an investment in Herald has performed relative to its comparative indices (applied retrospectively) and its underlying fully diluted net asset value over the period since inception of the Company.

	31 December 2005	Inception 16 February 1994	% change
Net asset value per ordinary share	409.2p	98.7p	314.6
Share price	379.8p	90.9p	317.8
Hoare Govett Smaller Companies Index (extended capital gains ex. investment companies)	3,423.2	1,750.0	95.6
Russell 2000 (small cap) Technology Index (in sterling terms)	71.0	83.2*	(14.7)
FTSE 100	5,618.8	3,417.7	64.4
FTSE All-Share	2,847.0	1,717.8	65.7
FTSE Small Cap	3,305.5	2,076.1	59.2

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

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

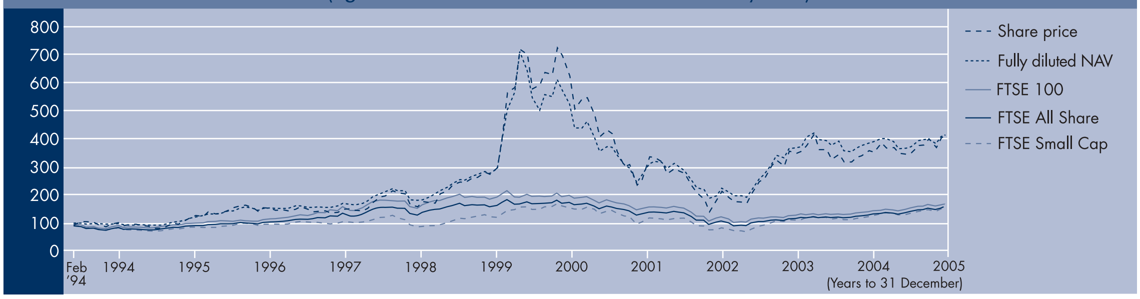
(figures have been rebased to 100 at 16 February 1994)



Source: Thomson Financial Datastream

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

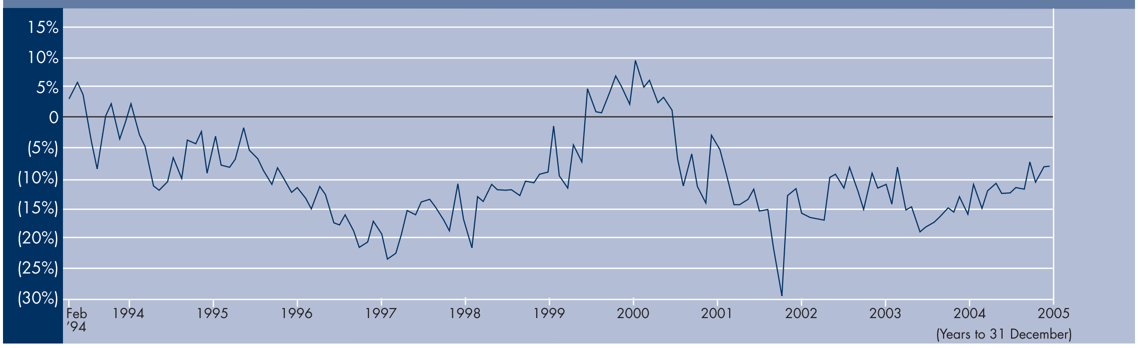
(figures have been rebased to 100 at 16 February 1994)



Source: Thomson Financial Datastream

PREMIUM/(DISCOUNT) TO FULLY DILUTED NET ASSET VALUE

(plotted on a monthly basis)



Source: Thomson Financial Datastream

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

DIRECTORS, MANAGER AND ADVISERS

Directors

Martin Boase, MA, FIPA (Chairman), aged 73, was appointed to the Board on 11 January 1994 and is Chairman of the Audit Committee and the Nomination Committee. He formed advertising agency Boase Massimi Pollitt plc in 1968 which was floated on the London Stock Exchange in 1983. He was chairman of the Advertising Association from 1987 to 1992 and is currently chairman of The Maiden Group plc and Jupiter Dividend and Growth Investment Trust PLC.

Clay Brendish, CBE, aged 58, was appointed to the Board on 23 July 2001. He has been Non-Executive Chairman of Beacon Investment Fund since 1995, Echo Research Limited since July 2003 and Anite plc since October 2005. He is a trustee of the Economist Newspapers Limited together with the Foundation for Liver Research. Clay's other Non-Executive Directorships are of British Telecommunications plc and Elexon 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, aged 63, was appointed to the Board on 22 July 2004. He was Chief Executive of Zetex plc (formerly Telemetrix PLC), is Non-Executive Chairman of RaceCourse Technical Services Ltd and of IBS OPENSystems plc. Former Non-Executive Directorships were with TVS Entertainment plc, Dobson Park Industries plc, Bournemouth & West Hampshire Water Co., and Pace Micro Technology plc. Tim was previously a Director of Unitech plc.

Douglas McDougall, OBE, aged 61, was appointed to the Board on 13 February 2002 and is 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, Foreign & Colonial Eurotrust 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 and Stramangate Assets plc. He is a former chairman of IMRO, of the Association of Investment Trust Companies and of the Fund Managers' Association.

All Directors are members of the Audit and Nomination Committees.

Secretary

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Calton Square
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Edinburgh EH1 3AN
Tel: 0131 275 2000

Registered Office

12 Charterhouse Square
London EC1M 6AX

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.

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CHAIRMAN'S STATEMENT

2005 has been another mixed year. Following a year of exceptional earnings growth in 2004 the share of earnings of the Trust's underlying investments, on consensus earnings estimates, grew a further 49% in 2005. This was not reflected in the rise in net assets, which was only 7.9%, so there has been another year of significant derating in the Trust's investee companies. This takes some explanation, and the Manager suggests that this may reflect a number of issues. First, expectations at the start of the year were even higher. Even so generally figures were outstandingly good. Second, a focus by brokers on new issues at the expense of promoting smaller existing companies. It is noticeable that larger small companies, which are more prominent on the radar screen, have higher valuations. Third, the psychology of investors following the bursting of the TMT bubble in 2004 is such that they are not inclined to ascribe a premium for anticipated growth, and prefer dividends. Fourth, there is a fear that earnings will not prove sustainable. Nevertheless, consensus earnings forecasts for 2006 suggest further growth of around 45%, which provides a confident background for the coming year.

There has been a noticeable divergence in performance geographically. The overseas portfolios overall rose 16.2%, and the UK, which accounts for 65% of the portfolio, lagged disappointingly, with a return of only 6.4%. The US growth was 7.5% and the Far East 23.9%, both enhanced by currency. The small European portfolio grew 26.3% in sterling and 30.2% in local currencies. The UK performance significantly lagged the Hoare Govett Smaller Companies index, which grew 27.8% in total return terms. However, the sectors in which the fund invests including AIM stocks also lagged the index with a weighted return of the Hoare Govett Index including AIM of 13.4%.

Although many investments do not pay dividends the income from equities has grown by 21.6%, which has been reflected in growth in the net income. Unusually for a technology oriented fund we can therefore again continue the Trust's custom of paying a modest dividend. The Board is proposing 0.60p in respect of 2005. Capital growth remains the prime focus.

The market for new issues has been almost overwhelming in the UK. Of the 519 AIM issues in 2005, 122 were in Herald's target sectors, which collectively raised in excess of £1bn. In addition there were 684 secondary issues raising a further £358m. Whilst it has been a boom year in London for investment bankers, there has been a conspicuously harsher climate in the US, and far fewer new issues. This was reflected in the Russell 2000 Index declining by 2.5% in $ terms. Sarbanes Oxley has proved a vicious cost for smaller quoted companies, and a deterrent for flotations. The drag on earnings associated with that has now worked through.

There continue to be exceptional opportunities and risks in the defined remit. The risks relate to lack of pricing power for companies, in a world of efficient communications and global sourcing, unless they have either a technological differentiator or a strong market position. There are in particular structural problems in the traditional media. On the other hand new technologies are continuing to create new markets to which small companies can adapt readily. Stronger corporate capital expenditure has been a notable driver of profits in 2005, and economists are forecasting strength again in 2006 following a year of strong corporate cash flow in general. Whilst we are a little disappointed by the performance in 2005 the derating makes the prospects all the more encouraging for 2006.

Martin Boase

Chairman

13 February 2006

INVESTMENT MANAGER'S REPORT

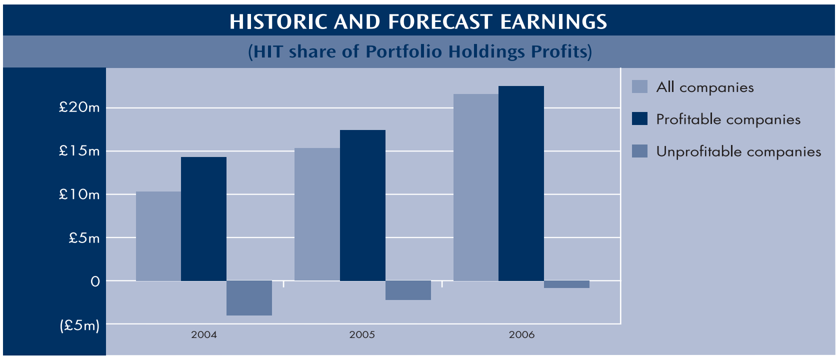
Last year we described how strong the earnings growth for companies in the portfolio seemed to have been in 2004. By the end of the earnings season it was apparent that expectations were broadly met and the Trust's share of earnings for the portfolio at the end of 2004 had indeed grown nearly 70%. It is a surprise that this year the message has to be repeated. Earnings growth for the current portfolio is estimated to have been close to 50% in 2005, and further strong growth is estimated again in 2006.

Market value as % of total equities	UK	US	Europe	Far East	Total
Companies profitable in 2004 and 2005 (as % of Total Market Value)	49.6%	10.1%	8.6%	11.0%	79.7%
Companies unprofitable in 2004 profitable in 2005 (as % of Total Market Value)	2.4%	0.8%	0.4%	0.3%	3.9%
Companies unprofitable in 2004 and 2005 (as % of Total Market Value)	8.1%	1.7%	0.3%	–	10.1%
Missing Data	4.8%	0.4%	0.3%	0.1%	5.1%
Total	65.4%	13.7%	9.6%	11.4%	100.0%
Earnings growth %					
2005: Companies always profitable (2004 and 2005)	16.3%	48.6%	12.0%	7.9%	16.3%
2006: Companies always profitable (2004 and 2005)	17.2%	10.7%	23.2%	24.7%	18.5%
2006: Companies unprofitable in 2004 and profitable in 2005	122.8%	77.9%	76.3%	76.4%	109.8%
Earnings growth %					
Total portfolio 2005*	68.2%	127.6%	29.9%	9.7%	48.9%
Total portfolio 2006*	52.5%	59.7%	29.7%	26.8%	45.1%
P/E profitable stocks with estimates only					
2004	19.2x	37.2x	27.0x	12.3x	19.6x
2005	16.8x	25.6x	24.5x	11.6x	17.1x
2006	14.5x	24.2x	19.6x	9.2x	14.6x
P/E of all stocks with estimates					
2004	49.5x	138.8x	127.5x	12.8x	41.4x
2005	23.3x	43.1x	27.9x	11.7x	22.4x
2006	15.7x	27.0x	20.4x	9.2x	15.5x

*The calculation for 2005 and 2006 earnings growth is based only on companies with data available in each of the respective years.

Source: JCF Group and brokers estimates

As last year the table above strips out the companies, which have made the transition from losses to profits which have in both years flattered the earnings growth. The numbers are not completely comparable with those last year because clearly the portfolio is dynamic. The statistics are sufficient to show the trend. The chart below shows the trend more simplistically. The earnings are defined as the share of earnings of the Herald shareholding in investee companies.



Portfolio as at respective year ends.

Source: JCF Group and brokers estimates

UK

The UK total return was only 6.4%. This was poor relative to the Hoare Govett Smaller Companies (Extended capital gains ex-investment companies) Index of 25.2%. However in 2004 the Trusts target sectors also underperformed as follows:–

	Total return %	Weight in index	Weighted return %
Electronic and Electrical Equipment	26.8	2.32	4.46
Media and Entertainment	(0.8)	4.18	(0.24)
Telecommunication Services	23.0	1.58	2.61
Information Technology	15.6	5.87	6.56
Total		13.95	13.39

However the UK growth in profits for 2005, according to consensus estimates, was 68.2% albeit the earnings growth for consistently profitable companies was only 16.3%. The growth is still much higher than the share price growth. The kicker to profits is the companies which were loss making in 2004 and became profitable in 2005. These companies are expected to grow earnings by 123% in 2006. There have been some noticeable disappointments such as Gresham, which remains way above our book cost but declined by £3.6m in 2005, and Plasmon which declined by £2.4m. On the positive side SDL, Northgate and Detica all contributed c£4m. CSR and Wolfson were particularly strong in percentage terms, but were insufficiently weighted to contribute quite as much. Anomalously the multiple on these companies is, we believe, now higher than they would be in the US at 29x and 35x respectively. CSR is expected to grow eps by 15% in 2006 and Wolfson considerably faster (c80%). The best performing IT stock which we overlooked was Autonomy, which has historically been one of the Trust's most profitable stocks. This is now on a prospective p/e greater than 30x, and is again a larger small company with a market capitalisation of c£750m. In other words the larger companies have been rerated and it is logical that it will feed through to the smaller sized companies which dominate the portfolio. The majority of the Herald holdings by value have a market capitalisation between £100–300m.

US

The US portfolio performed in line with its benchmark the Russell 2000 Technology Index, which declined 2.5% in $, but was 9% up in £. Again the smaller stocks underperformed the large capitalisation Russell 1000 index, which grew but only by 2%. This was against a background of profits growth in the US portfolio of 128%, and the consistently profitable companies grew by 48.6%, again on consensus forecasts for 2005. However, the p/e of the US portfolio is higher too, falling from 139x in 2004 to 43x in 2005 and 27.0x in 2006. The higher p/e seems rational because (i) growth rates are faster (ii) accounting is the most conservative and (iii) the SEC regulatory environment provides the greatest shareholder protection. US business and investors value both intellectual property and market position more highly than any other country on account of their potential to generate high gross margins and hence profit leverage to growth and volume. Morgan Stanley economists estimate that corporate capital expenditure in the US grew 11% last year and they expect a similar rate of growth in 2006. This lends credence to expectations for strong profits growth again in 2006. Furthermore there will not be the increment to costs in 2006 of the tough regulatory environment that businesses have had to bear in the last year.

Europe

The European portfolio benefited from exposure to some larger stocks which have mirrored the rerating seen in the larger UK stocks. Logitech in Switzerland, United Internet in Germany and ICOS Vision in Belgium have all been long standing investments, which performed particularly well. This led to a £ return of 26.3%. Ironically European profits growth is estimated to be only 29.9% in 2005 and a similar rate in 2006.

Far East

The Far East return overall was 24% in £, and 12.6% in local currencies. Further irony is that expectations for profits growth are the lowest for 2005 at 9.7%, albeit expected to accelerate in 2006 to 27%. Within the Far East there have been material divergences. Singapore has performed relatively poorly, declining 13.8% in local currency. This reflects profits pressure on subcontract manufacturers who suffered higher input prices and a profits squeeze from the strength of their own currency. In contrast the Korean and Taiwan investments made during the year performed particularly well, rising 75% and 37% respectively in £. These returns reflect currency gains and the fact that margins higher up the value chain are more defensible. Korea in particular is developing technical leadership in certain markets, such as LCD screens.

Market background

The main drivers to growth are (i) the widespread adoption of broadband, and the emergence of second generation DSL, which operates at full screen video quality speed. This is leading to a recovery in investment in the cable/telecommunications arena, after 3 barren years, significant growth in on-line commerce, and internet advertising is growing at c30% per annum. (ii) LCD TVs, and the move to digital and high definition, has led to growth in the average selling price of a TV. There were 9m LCD TVs sold in 2004, 25m in 2005 and there are projected to be 40m in 2006. (iii) the emergence of 3G mobile telephony at last, and the use of data, other than text messages, becoming statistically important. (iv) corporate capital expenditure has accelerated. This reflects the overhang of the millennium/internet investment bubble having worked through, the cheap cost of capital and the fierce appetite for cost control for companies to optimise profits growth in a low inflationary world. Specific areas of demand include security, storage, business intelligence, IP telephony, 300mm semiconductor plants (with finer size i.e. 90nm and lower) and network upgrades. There is an investment race between cable companies, telephone companies and satellite, all with the objective of winning the triple play fight, i.e. supplying voice, video and data.

In 2006 Microsoft will finally launch Windows Vista a replacement for Windows XP. Reviews are mixed, but clearly Microsoft aim to generate a replacement cycle, which is a driver to a big market. Apple has had an outstanding year with the i-Pod, and it has stimulated demand for their PCs. It is widely acknowledged to be a more stable system than Windows, and now it has migrated to an Intel processor it will be more compatible with Windows applications.

In the UK we view the AIM market with a certain amount of suspicion. At 31 December 2005 the Trust had invested £64m in AIM stocks. The attraction for investors is partly tax driven, and for companies the driver is lack of regulation, and for brokers the corporate fees. The tax attractions may well prove finite, the lack of regulation will prove to be two edged, and corporate fees do not pay for efficient secondary market coverage. We hope our fears are misplaced because it is extremely valuable to have a supply of capital to embryonic companies a few of which will emerge as substantial companies in due course.

There has been a discernible change in the stock market background. Regulation has forced a demarcation between analysts and corporate financiers. This has led to a radical reduction in coverage and availability of research. We regard this as a serious problem, an exciting challenge and probably a tremendous opportunity. Inefficiencies will emerge, and perhaps already have in a negative sense. On the other hand we welcome the prospect of an environment where informed diligence should be rewarded.

The oil price rises and terrorism have provided a worrying economic background. On the other hand the pension fund deficits should ensure the availability of cheap capital for some years. Asset values can inflate to reflect lower interest rates on a one-off basis, but longer term cheap capital can only be good for the IT sector. In the absence of unforeseen macro events, the scene seems set for a rewarding year.

PERFORMANCE ATTRIBUTION (in sterling terms)

Equity markets	Benchmark allocation 01.01.05 %	Benchmark allocation 31.12.05 %	Herald asset allocation 01.01.05 %	Herald asset allocation 31.12.05 %	Performance* Herald %	Performance* Benchmark %	Contribution to relative return %	Contribution attributable to: Stock selection %	Contribution attributable to: Asset allocation† %
UK	66.7	66.7	65.3	64.2	6.4	27.8	(11.6)	(11.4)	(0.2)
Europe ex. UK	–	–	7.1	6.9	26.3	–	0.4	–	0.4
Americas	33.3	33.3	15.9	15.6	7.5	9.1	1.5	(0.2)	1.7
Japan	–	–	0.8	–	(4.7)	–	–	–	–
Asia Pacific ex. Japan	–	–	7.5	10.8	23.9	–	0.2	–	0.2
Cash	–	–	10.7	2.5	4.8	–	(0.8)	–	(0.8)
Loans	–	–	(7.3)	–	13.1	–	–	–	–
Total	100.0	100.0	100.0	100.0	8.9	21.8	(10.5)	(11.6)	1.2

Past performance is no guarantee of 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 8.9% (against a benchmark of 21.8%) translates into a relative return of (10.5%), divide the portfolio return of 108.9 by the benchmark return of 121.8 and subtract one.

† Asset allocation includes the contribution attributable to currency movements.

13 February 2006

INVESTMENT CHANGES (£'000)

	Valuation at 31 December 2004†	Net acquisitions (disposals)	Appreciation (depreciation)	Valuation at 31 December 2005
Equities*:				
UK	215,284	1,818	11,817	228,919
Continental Europe	23,583	(4,094)	5,364	24,853
Americas	53,854	(2,112)	4,396	56,138
Japan	2,643	(2,649)	6	–
Asia Pacific	25,182	7,557	6,125	38,864
Total investments	320,546	520	27,708	348,774
Net liquid assets	36,328	(26,879)	70	9,519
Total assets	356,874	(26,359)	27,778	358,293

The figures above for total assets comprise assets less current liabilities before deduction of bank loans.

*Equities includes convertibles, preference stock and warrants.

†Restated, see note 1 page 33.

TOP TWENTY HOLDINGS
AT 31 DECEMBER 2005

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

Northgate Information Solutions

A major supplier of software applications and outsourcing solutions to the public services, human resources and corporate markets and is also the largest HR and payroll application supplier in the UK. The company works closely with many corporate organisations, in addition to all of the UK's regional police forces, 80% of UK local authorities and more than 50% of FTSE 100 companies. Headquartered in Hemel Hempstead, Northgate has over 3,300 staff operating throughout the UK and in California, USA.

Country	United Kingdom
Valuation	£14,921,000
% of total assets	4.2
% of issued share capital held	3.3

(Valuation at 31 December 2004† £12,368,000)

SDL

Provides multilingual website globalisation software in addition to support databases, training and translation services. Its 'Realtime' and 'Workflow' are leading solutions in this field. Its comprehensive and integrated offerings include multilingual content management solutions, real-time translation technologies, translation memory and a full range of internationalisation and localisation services.

Country	United Kingdom
Valuation	£10,700,000
% of total assets	3.0
% of issued share capital held	8.1

(Valuation at 31 December 2004† £6,600,000)

Detica Group

A specialty provider of business consulting, systems design and implementation services. The company focuses on helping organisations harness technology to identify, attract, develop and retain customers through effective integration with business processes. The company is also a provider of information and systems security services, notably in the UK National Security market. Detica aims to combine independent advice with the design and delivery of effective solutions.

Country	United Kingdom
Valuation	£10,500,000
% of total assets	2.9
% of issued share capital held	3.9

(Valuation at 31 December 2004† £6,694,000)

Amstrad

Designs and manufactures consumer electronic products, notably set-top satellite decoders for Sky including the new Sky Plus box. The Sky Plus box targets the growth area of Personal Video Recorders (PVD). Its products are sold primarily in the UK and Italy.

Country	United Kingdom
Valuation	£9,958,000
% of total assets	2.8
% of issued share capital held	8.0

(Valuation at 31 December 2004† £10,679,000)

Imagination Technologies Group

Develops 2D/3D graphics, digital signal processing, video and audio technologies and licenses this IP (Intellectual Property) to global semiconductor and system companies. These technologies are used in multimedia devices. 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).

Country	United Kingdom
Valuation	£9,813,000
% of total assets	2.7
% of issued share capital held	6.5

(Valuation at 31 December 2004† £7,726,000)

Diploma

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 divisions are life sciences, seals and components, and interconnect.

Country	United Kingdom
Valuation	£6,236,000
% of total assets	1.7
% of issued share capital held	3.5

(Valuation at 31 December 2004† £5,715,000)

Thomson Intermedia

Founded in 1997, as a response to a growing need by companies for a creative monitoring system that linked directly to expenditure. Driven by market requirements and their own desire to push forward the boundaries of media monitoring technology, the company grew at a phenomenal rate, floating on the stock exchange as an AIM listed company in 2000. To date, Thomson Intermedia Plc boasts over 500 of the UK's major advertisers as clients. Their media monitoring systems now cover Press, Television, Radio, Cinema, Direct Mail, Door Drops, Outdoor, and Internet – creative and expenditure – across all business sectors, making their systems the most comprehensive and technologically advanced in the world.

Country	United Kingdom
Valuation	£5,494,000
% of total assets	1.5
% of issued share capital held	9.5

(Valuation at 31 December 2004† £4,628,000)

Euromoney Institutional Investor

The group's principal activity is business publishing that focuses primarily on international finance. It publishes more than 100 magazines, newsletters and journals as well as surveys, directories, books and maps. It also runs conferences, seminars and training courses and provides electronic business information through its capital market databases and emerging markets information services.

Country	United Kingdom
Valuation	£5,424,000
% of total assets	1.5

(Valuation at 31 December 2004† £4,483,000)

SurfControl

Its principal activity is the development of web and e-mail filtering and content management software. Its main brands were SurfControl Superscout which was sold to the corporate market and CyberPatrol which was directed at the education and home markets. SurfControl is now the single brand for all server based web and e-mail filtering products sold into the corporate and education markets. CyberPatrol is the brand for client-based products sold into the home market.

Country	United Kingdom
Valuation	£5,024,000
% of total assets	1.4
% of issued share capital held	3.4

(Valuation at 31 December 2004† £5,265,000)

Logitech International

Designs, manufactures and markets personal peripherals that enable people to effectively work, play, and communicate in the digital world. The company's products combine essential core technologies, continuing innovation, award-winning industrial design and excellent price performance. Logitech International is a Swiss public company traded on the SWX Swiss Exchange (LOGN) and in the U.S. on the Nasdaq National Market System (LOGI). The company has manufacturing facilities in Asia and offices in major cities in North America, Europe and Asia Pacific.

Country	Switzerland
Valuation	£4,909,000
% of total assets	1.4

(Valuation at 31 December 2004† £2,803,000)

Alphameric

Engaged in the supply of solutions to retail, leisure and financial organisations worldwide. With skills in a wide range of areas including consultancy, software development, business intelligence, project management, installation, support services and help desks, the company provides solutions to organisations throughout Europe and the United States. Alphameric Retail offers products that can form part of a fully integrated system or operate independently in the areas of head office, in-store and business intelligence. Alphameric Leisure and Bookmaking supplies integrated systems and services covering the operational requirements of United Kingdom Licensed Betting Offices, including centrally controlled Display, Slip Capture and EPoS Systems. Alphameric Finance provides solutions covering the digital distribution of corporate information via satellite to the provision of private television networks for financial organisations.

Country	United Kingdom
Valuation	£4,885,000
% of total assets	1.4
% of issued share capital held	4.6

(Valuation at 31 December 2004† £4,385,000)

IBS OPENSystems

A dedicated supplier of software solutions to Local Authorities and Housing Organisations throughout the UK. They allow customers to provide improved service delivery and achieve enhanced, integrated and efficient business processes. They offer 4 software suites: OPENHousing – a single software solution for all social housing providers. IBS OPENFinancials offers a fully integrated, Windows solution for administering, managing, monitoring & analysing the financial functions of your organisation. IBS OPENRevenues is an easy to use, comprehensive integrated solution developed to support Local Authorities in the management and administration of revenues and payments. IBS OPENContractor offers a fully integrated solution covering all aspects of the typical Direct Labour operation, including building repairs, highways & grounds maintenance.

Country	United Kingdom
Valuation	£4,582,000
% of total assets	1.3
% of issued share capital held	7.3

Plasmon

Provides the industry's most comprehensive line of automated storage libraries, optical drives, disks, library storage management software and associated support services. Technologies include 5.25″ Magneto Optical, 12-inch TrueWORM, LTO-Ultrium/AIT Tape and 120mm DVD/CD technology. Plasmon has developed Ultra Density Optical (UDO) the next generation 5.25″ professional optical storage technology, released in 2003. It is a convergent technology that delivers the performance of 5.25″ MO, the longevity of 12-inch WORM, and the cost effectiveness of DVD.

Country	United Kingdom
Valuation	£4,403,000
% of total assets	1.2
% of issued share capital held	5.1

(Valuation at 31 December 2004† £6,390,000)

Wilmington Group

Specialises in high quality information products to business and professional markets. The principal sectors are: Legal and Regulatory; Healthcare; Media and Entertainment; and Design and Construction. The information is delivered through magazines, directories, databases, special reports and face to face training. Increasingly products are delivered electronically through the Internet and CD-ROM.

Country	United Kingdom
Valuation	£4,339,000
% of total assets	1.2

(Valuation at 31 December 2004† £3,336,000)

Alterian

A global provider of Database Marketing and Customer Insight solutions which help blue-chip organisations to improve the effectiveness of their marketing activity. Alterian provides innovative software and a unique business relationship to Marketing Service Providers which enables them to deliver closed loop Database Marketing solutions to their clients. With 80 employees and international headquarters in Bristol, UK, and North American headquarters in Chicago, Alterian has a further 4 satellite offices in Boston, New York, Salt Lake City and Toronto. Alterian also has a Master Reseller based in Barcelona. Alterian's network of over 50 partners include: infoUSA, Carlson Marketing, Omnicom Group, CFM Direct, CC3, Experian, GB Group, DataForce Group and Euro RSCG Worldwide, which all deliver industry leading database marketing solutions based on Alterian technology.

Country	United Kingdom
Valuation	£4,224,000
% of total assets	1.2
% of issued share capital held	7.9

(Valuation at 31 December 2004† £3,519,000)

ICM Computer Group

Offers a combination of IT solutions, IT support and Business Continuity services. It achieved public listing on the London Stock Exchange in May 1998. The company has since grown from strength to strength, both organically and through acquisition. Operating from a network of support centres, strategically located throughout the UK, ICM has an impressive resource of skills and expertise and an excellent reputation for quality of service.

Country	United Kingdom
Valuation	£4,198,000
% of total assets	1.2
% of issued share capital held	6.0

(Valuation at 31 December 2004† £5,184,000)

Taylor Nelson Sofres

The company is the world's second largest market research conglomerate (behind Dutch giant VNU), with operations serving customers in 70 countries. They offer market data on the automotive business, consumer products and retail sales, the financial services industry, healthcare, and information technology. TNS also produces television audience ratings in 25 countries in addition to other media measurement services, and it provides a variety of polling and survey data.

Country	United Kingdom
Valuation	£3,735,000
% of total asset	1.0

(Valuation at 31 December 2004† £3,739,000)

United Internet

A premium Internet Service Provider (ISP). Their Internet applications and value-added technical services are tailored to the needs of communication-oriented home users and small to mid-size companies. All their applications and technical value-added services are based on their own products and in-house developed software. In their end-user-oriented 'Product' segment, with its GMX, WEB.DE, 1&1 and Schlund+Partner brands, they target both private and commercial customers. In the B2B 'Outsourcing' segment, InterNetX markets technical value-added services (e.g. domains or shared and dedicated hosting products) as white-label products to other ISPs while twenty4help provides customer relationship services. In the 'Online Marketing' segment, they offer various marketing solutions for advertisers: a European online advertising network via AdLINK, domain marketing via Sedo and affiliate marketing via affilinet.

Country	Germany
Valuation	£3,567,000
% of total assets	1.0

(Valuation at 31 December 2004† £2,265,000)

NRJ Group

Owns four networks, including Cherie FM (music from the '70s to the '90s), Rire & Chansons (music and comedy), NRJ (hit music), and Nostalgie (oldies). NRJ is one of the top radio groups in France and also owns stations in Austria, Belgium, Denmark, Finland, Germany, Norway, Sweden and Switzerland. Its NRJ channel is broadcast on 252 frequencies in France and 80 frequencies in other countries. NRJ also has a stake in FranceMP3.com. Founder Jean-Paul Baudecroux controls the company through NRJ Group (formerly Groupe Sonopar).

Country	France
Valuation	£3,493,000
% of total assets	1.0

(Valuation at 31 December 2004† £2,836,000)

M-Systems Flash Disk Pioneers

Engages in the development, manufacture, and marketing of flash-based data storage solutions for markets, such as mobile phones, personal digital assistants, set-top boxes, embedded systems, military/rugged applications, personal computers (PCs), and laptops. It primarily offers DiskOnKey product in the universal serial bus (USB) flash drive market and the Mobile DiskOnChip product in the multimedia mobile handset market.

Country	United States
Valuation	£3,472,000
% of total assets	1.0

(Valuation at 31 December 2004† £1,539,000)

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

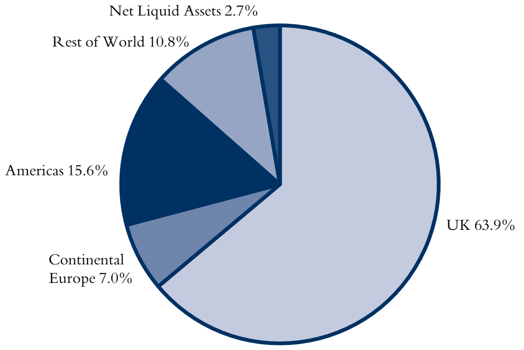
†Restated, see note 1 page 33.

CLASSIFICATION OF INVESTMENTS

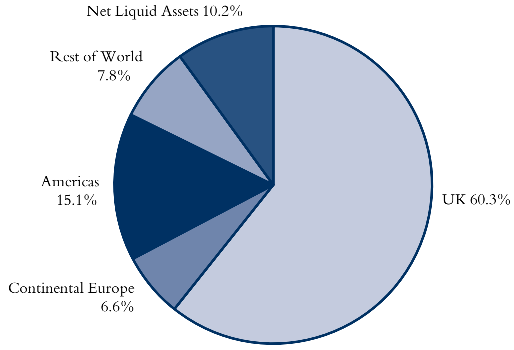
Classification	UK %	Continental Europe %	Americas %	Japan %	Asia Pacific %	2005 Total %	2004 Total† %
EQUITIES: (including convertibles, preference stock and warrants)							
INDUSTRIALS	**5.9**	**1.4**	**1.9**	**–**	**6.7**	**15.9**	**13.7**
Chemicals	–	–	–	–	–	–	0.1
Electronic and electrical equipment	5.9	1.4	1.9	–	5.4	14.6	12.4
Engineering and machinery	–	–	–	–	1.3	1.3	1.2
CONSUMER GOODS	**0.9**	**–**	**0.2**	**–**	**–**	**1.1**	**1.0**
Healthcare and pharmaceuticals	0.9	–	0.2	–	–	1.1	1.0
SERVICES AND UTILITIES	**24.4**	**3.0**	**2.1**	**–**	**1.3**	**30.8**	**31.0**
Distributors	3.7	–	0.2	–	0.2	4.1	4.8
Leisure and hotels	0.8	–	0.1	–	–	0.9	0.6
Media and entertainment	13.3	2.8	1.6	–	1.1	18.8	20.1
Support services	4.2	0.2	0.2	–	–	4.6	4.5
Telecommunication services	2.4	–	–	–	–	2.4	1.0
FINANCIALS	**0.4**	**0.1**	**–**	**–**	**–**	**0.5**	**0.2**
Speciality and other finance	0.4	–	–	–	–	0.4	0.1
Investment companies	–	0.1	–	–	–	0.1	0.1
INFORMATION TECHNOLOGY	**32.3**	**2.5**	**11.4**	**–**	**2.8**	**49.0**	**43.9**
Information technology hardware	6.6	1.6	5.0	–	2.0	15.2	15.6
Software and computer services	25.7	0.9	6.4	–	0.8	33.8	28.3
TOTAL EQUITIES (including convertibles, preference stock and warrants)	**63.9**	**7.0**	**15.6**	**–**	**10.8**	**97.3**	
Total equities – 2004† (including convertibles, preference stock and warrants)	60.3	6.6	15.1	0.7	7.1	–	**89.8**
NET LIQUID ASSETS	**2.0**	**–**	**–**	**–**	**0.7**	**2.7**	**10.2**
TOTAL ASSETS (before deduction of bank loans)	**65.9**	**7.0**	**15.6**	**–**	**11.5**	**100.0**	
Total assets – 2004†	70.3	6.6	15.3	0.7	7.1		**100.0**
BANK LOANS	**–**	**–**	**–**	**–**	**–**	**–**	**(6.9)**
EQUITY SHAREHOLDERS' FUNDS	**65.9**	**7.0**	**15.6**	**–**	**11.5**	**100.0**	
Equity shareholders' funds – 2004†	70.3	6.6	8.4	0.7	7.1		**93.1**
Number of equity investments (including convertibles, preference stock and warrants)	128	20	73	–	41	262	253

GEOGRAPHICAL SPREAD OF INVESTMENTS

31 December 2005



31 December 2004†



†Restated, see note 1 page 33.

DETAILED LIST OF INVESTMENTS

AT 31 DECEMBER 2005

Classification	Name	Market value £'000	%
UNITED KINGDOM			
Electronic and electrical equipment	Alba	1,960	
	Amstrad	9,958	
	†Andor Technology	229	
	†Bright Things	330	
	†Innovision Research & Technology	2,058	
	†Nanoscience	1,323	
	†OMG	1,076	
	†SPI Lasers	1,160	
	†TRL Electronics	2,542	
	†Vigilant Technology	535	
		21,171	5.9
Healthcare and pharmaceuticals	Biotrace International	2,555	
	†Osmetech	757	
		3,312	0.9
Distributors	Abacus Group	429	
	Acal	2,799	
	Deltron Electronics	1,067	
	Diploma	6,236	
	†Netcentric Systems	5	
	Northamber	2,785	
		13,321	3.7
Leisure and hotels	†First Artist	192	
	†ukbetting	2,585	
		2,777	0.8
Media and entertainment	Aegis Group	2,430	
	†Apace Media Group	667	
	Applied Optical Technologies	1,928	
	Bloomsbury Publishing	3,330	
	Capital Radio now GCAP Media	437	
	Chime Communications	2,184	
	†Coolabi	163	
	Euromoney Institutional Investor	5,424	
	†Expomedia Group	852	
	Incisive Media	3,003	
	Independent Media Distribution	293	
	†Independent Media Support Group	110	
	Informa	2,163	
	†Local Radio Company	1,142	
	†M & C Saatchi	325	
	¶†Mama Group	612	
	Metal Bulletin	2,672	
	Pinewood Shepperton	731	
	Quarto Group	3,180	
	†Screen Fx	592	
	†Screen Technology	762	
	†SPG Media	407	
	Taylor Nelson Sofres	3,735	
	†Ten Alps Communications	1,839	
	†Touch Group	454	
	†UBC Media Group	1,432	
	†WILink	1,521	
	Wilmington Group	4,339	
	¶†Yoomedia	868	
	†Zyzygy	14	
		47,609	13.3
Support services	†Cardpoint	397	
	Creston	2,058	
	†Group NBT	1,816	
	Harvey Nash Group	372	
	Lorien	685	
	†Maintel Holdings	683	
	Mice Group	944	
	‡†Mondas	27	
	OPD Group	992	
	SThree	647	
	†Thomson Intermedia	5,494	
	†United Clearing	825	
	†Xpertise Group	175	
		15,115	4.2

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2005

Classification	Name	Market value £'000	%
Telecommunication services	†Eckoh Technologies	1,836	
	THUS Group	2,212	
	†Spectrum Interactive	892	
	†Symphony Telecom	496	
	Telecom Plus	3,308	
		8,744	2.4
Speciality and other finance	*Herald Investment Management Ltd	207	
	*Herald Venture 2	343	
	*HIML Jersey Ltd	–	
	†T2 Income Fund	758	
		1,308	0.4
Information technology hardware	CML Microsystems	549	
	CSR	2,805	
	Dialight	845	
	E2V Technologies	1,103	
	†ID Data	878	
	Imagination Technologies Group	9,813	
	Plasmon	4,403	
	*UbiNetics	–	
	Wolfson Microelectronics	2,535	
	Zetex	710	
		23,641	6.6
Software and computer services	Alphameric	4,885	
	Alterian	4,224	
	†At Comms. Group	385	
	†Atlantic Global	126	
	†@UK	533	
	†Bango	490	
	†Celoxica Holdings	1,104	
	†Clarity Commerce Solutions	863	
	Clinical Computing	37	
	†Corpora	141	
	‡*Culver Holdings	36	
	†DataCash Group	1,260	
	†Dealogic	896	
	Detica Group	10,500	
	Electronic Data Processing	1,125	
	†Empire Interactive	216	
	Gresham Computing	1,480	
	†Harrier Group	307	
	†IBS OPENSystems	4,582	
	ICM Computer Group	4,198	
	†IDOX	1,980	
	†IMS Maxims	50	
	Intec Telecom Systems	856	
	†InTechnology	203	
	†Intelligent Environments Group	300	
	†Interactive Digital Solutions	96	
	†IQ-Ludorum	326	
	†Manpower Software	681	
	†Matrix Communications Group	1,551	
	†Maxima Holdings	818	
	Northgate Information Solutions	14,921	
	†OneClickHR	287	
	†Patsystems	848	
	Phoenix IT Group	3,407	
	Retail Decisions	1,386	
	RM	1,560	
	SDL	10,700	
	ServicePower Technologies	1,080	
	†SQS Software Quality Solutions	1,435	
	†Statpro Group	1,297	
	†Strategic Thought Group	1,800	
	SurfControl	5,024	
	Trace Group	937	
	†Visual Defence	227	
	†Z Group	817	
	†Zoo Digital Group	1,946	
		91,921	25.7
	TOTAL UNITED KINGDOM EQUITIES	228,919	63.9

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2005

Classification	Name		Market value £'000	%
CONTINENTAL EUROPE				
Electronic and electrical equipment	Logitech International	Switzerland	4,909	1.4
Media and entertainment	Impresa SGPS	Portugal	1,020	
	NRJ Group	France	3,493	
	PubliGroupe	Switzerland	1,101	
	Roularta Media Group	Belgium	918	
	United Internet	Germany	3,567	
			10,099	2.8
Support services	Teleplan International	Netherlands	593	0.2
Investment companies	Inspire Investments	Israel	307	0.1
Information technology hardware	ICOS Vision Systems	Belgium	3,439	
	Nera	Norway	1,040	
	Nordic Semiconductor	Norway	852	
	Sez Reg	Switzerland	335	
			5,666	1.6
Software and computer services	*Atex	Norway	–	
	Ementor ASA	Norway	254	
	Horizon Technology Group	Ireland	385	
	Infovista	France	406	
	Iona Technologies	Ireland	510	
	Isra Vision System	Germany	760	
	SkillSoft	Ireland	129	
	Unit 4 Agresso	Netherlands	835	
			3,279	0.9
	TOTAL EUROPEAN EQUITIES		24,853	7.0
AMERICAS				
Electronic and electrical equipment	M-Systems Flash Disk Pioneers		3,472	
	MIPS Technologies		827	
	Netgear		559	
	Pemstar		264	
	Power Integrations		277	
	Remec		108	
	‡Reptron Electronics		25	
	Silicon Image		369	
	Sipex		149	
	Varian		579	
			6,629	1.9
Healthcare and pharmaceuticals	SonoSite		814	0.2
Distributors	Agilysys		636	
	Jaco Electronics		179	
			815	0.2
Leisure and hotels	Pegasus Solutions		311	0.1
Media and entertainment	C Trip		1,008	
	Emmis Communications		463	
	Harris Interactive		750	
	Jupitermedia		1,933	
	Multivision Communications	Canada	1	
	Netease		816	
	Scholastic		830	
			5,801	1.6
Support services	Computer Horizons		326	
	Wireless Facilities		445	
			771	0.2

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2005

Classification	Name	Market value £'000	%
Information technology hardware	Actel	910	
	Adaptec	846	
	Advanced Digital Information	1,133	
	Anadigics	1,061	
	Asyst Technologies	633	
	ATMI	325	
	Brooks Automation	292	
	Credence Systems	404	
	McData	218	
	Micros Systems	1,406	
	MRV Communications	1,112	
	Nova Measuring Instruments	199	
	On Track Innovations	820	
	Powerwave Technologies	1,688	
	Redback Networks	1,633	
	Rimage	506	
	RIT Technologies	467	
	Simpletech	764	
	Skyworks Solutions	592	
	Spectralink	553	
	Stratex Networks	456	
	Supertex	2,056	
		18,074	5.0
Software and computer services	Advent Software	1,684	
	Aladdin Knowledge Systems	501	
	At Road	426	
	Borland Software	380	
	Carreker	366	
	Datastream Systems	453	
	EPIQ Systems	1,507	
	Fundtech	1,186	
	I-many	109	
	INVU	1,337	
	Keynote	636	
	Kronos	1,279	
	Macrovision	1,948	
	Manhattan Associates	382	
	Mentor Graphics	299	
	Netscout Systems	627	
	PDF Solutions	896	
	Pegasystems	423	
	Retalix	1,875	
	RSA Security	1,301	
	Seachange International	252	
	Serena Software	682	
	Sonicwall	689	
	Sourcecorp	558	
	THQ	625	
	Virage Logic	573	
	Vitria Technology	212	
	Websense	1,717	
		22,923	6.4
	TOTAL AMERICAN EQUITIES	56,138	15.6

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2005

Classification	Name			Market value £'000	%
ASIA PACIFIC					
Electronic and electrical equipment	Action Asia	Singapore		98	
	Advantech	Taiwan		1,122	
	BSE Holdings	Korea		1,001	
	Display Manufacturing	Korea		185	
	Enter Tech	Korea		1,746	
	Global Testing	Singapore		455	
	Jusung Engineering	Korea		414	
	¶Kingboard Chemicals Holdings	Hong Kong		1,240	
	Lite-onit	Taiwan		761	
	Merry Electronic	Taiwan		674	
	MFS Technology	Singapore		800	
	Mtek Vision	Korea		1,026	
	Norelco UMS Holdings	Singapore		168	
	Optimax Technology	Taiwan		1,365	
	Phicom	Korea		1,446	
	Powertech Technology	Taiwan		1,388	
	Seoul Semiconductor	Korea		1,362	
	Solomon Systech	Hong Kong		1,202	
	Sunningdale Tech	Singapore		1,200	
	Wintek	Taiwan		944	
	Wooree ETI	Korea		742	
				19,339	5.4
Engineering and machinery	First Engineering	Singapore		771	
	Hi-P International	Singapore		1,221	
	Huan Hsin	Singapore		594	
	Magnecomp International	Singapore		722	
	Meiban Group	Singapore		596	
	Min Aik Technology	Taiwan		949	
				4,853	1.3
Distributors	Jadason Enterprises	Singapore		776	0.2
Media and entertainment	Globetronics	Malaysia		458	
	Oriental Press Group	Hong Kong		556	
	Star Publications	Malaysia		3,117	
				4,131	1.1
Information technology hardware	Gemtek Technology	Taiwan		1,096	
	GES International	Singapore		725	
	Hana Microelectronics	Thailand		1,224	
	KH Vatec	Korea		929	
	Simm Tech	Korea		851	
	¶Surface Mount Technology	Singapore		845	
	Tripod Technology	Taiwan		1,376	
				7,046	2.0
Software and computer services	Kingdee International Software	Hong Kong		619	
	Reckon	Australia		1,157	
	Springsoft	Taiwan		943	
				2,719	0.8
	TOTAL ASIA PACIFIC EQUITIES			38,864	10.8
	Value of equity stocks		348,636		
	Convertible preference stocks having an element of equity		–		
	Convertible loan stocks having an element of equity		88		
	Warrants having an element of equity		50		
TOTAL EQUITY INVESTMENTS				348,774	97.3
NET LIQUID ASSETS				9,519	2.7
TOTAL ASSETS AT MARKET VALUE (before deduction of bank loan)				358,293	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	Equity shareholders' funds £'000	Net asset value per share p	Diluted net asset value per share† p	Share price p	Warrant price p	(Discount)/ premium‡ %
*1995	89,689	–	89,689	137.98	132.36§	127.00	55.00	(4.0)
1996	130,055	–	130,055	156.89	150.88§	136.00	61.00	(9.9)
1997	147,424	–	147,424	177.84	171.80	136.00	60.50	(20.8)
1998	170,982	–	170,982	206.25	201.70	161.50	77.50	(19.9)
1999	432,620	(3,343)	429,277	517.44	494.22	511.00	411.00	3.4
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)**

* Restated for change in accounting policy to account for income on an xd basis.
† The diluted net asset value per ordinary share figures have been calculated in accordance with FRS14.
‡ (Discount)/premium is the difference between Herald's quoted share price and its underlying diluted net asset value (FRS14).
§ The diluted net asset values at 31 December 1995 and 1996 have been restated with the adoption of FRS14. The previously reported fully diluted net asset values were 131.65p and 149.45p respectively.
¶ Restated, see note 1 page 33.

REVENUE / GEARING RATIOS

Period 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§§
*1995	1,968	780	1.20	0.65	1.32	92	100
1996	2,897	1,035	1.32	0.81	1.46	89	100
1997	3,185	1,118	1.35	0.85	1.29	92	100
1998	3,845	1,134	1.37	0.90	1.36	94	100
1999	3,658¶	717	0.86	0.85	0.95	93	101
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**

* Restated for change in accounting policy to account for income on an xd basis.
** 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 8, page 36).
†† 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) divided by shareholders' funds.
§§ Total assets (including all debt used for investment purposes) divided by shareholders' funds.
¶ Restated for the adoption of FRS16 "Current Tax".

CUMULATIVE PERFORMANCE (taking 1995 as 100)

At 31 December	Diluted net asset value per share†	Share price	Benchmark	Hoare Govett Smaller Cos Index	Russell 2000 Technology Index	Earnings per ordinary share	Dividend per ordinary share net	Retail price index
1995	100	100	100	100	100¶¶	100	100	100
1996	114	107	115	115	98	110	125	102
1997	130	107	132	121	103	113	131	106
1998	152	127	131	111	113	114	138	109
1999	373	402	224	169	240	72	131	111
2000	326	387	197	165	154	78	131	114
2001	238	241	166	140	123	113	131	115
2002	156	139	109	104	60	62	131	118
2003	276	256	155	144	88	27	46	122
2004	287	254	167	168	78	28	46	126
2005	**309**	**299**	**199**	**209**	**85**	**54**	**92**	**129**

Compound Annual Returns

5 year	(2.0)%	(5.2)%	0.3%	4.8%	(11.2)%	(7.2)%	(6.7)%	2.4%
10 year	12.0%	11.6%	7.1%	7.7%	(1.6)%	(6.1)%	(0.8)%	2.6%

¶¶ Index at 9 April 1996, being the first date funds were first available for international investment.

Past performance is no guarantee of future performance.
The figures prior to 2004 have not been restated for the changes in accounting policies detailed in note 1 on page 33.

DIRECTORS' REPORT

The Directors present their report and accounts for the year ended 31 December 2005.

Business Activity

The Company carries on business as an investment trust. It was approved by the Inland Revenue as an investment trust under Section 842 of the Income and Corporation Taxes Act 1988 for the year ended 31 December 2004, subject to any matters that may arise from any subsequent enquiry by the Inland Revenue into the Company's tax returns. 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 842 of the Income and Corporation Taxes Act 1988 each year.

The Company is an investment company within the meaning of Section 266 of the Companies Act 1985.

Investment Policy and Objectives

The objective of the Company's management is to secure an attractive level of overall return for its shareholders primarily from capital growth but also from income over the life of the Company. The Company spreads its risks across a diversified portfolio of quoted securities in smaller companies which specialise in products, services or applications in the communications and multimedia sectors. The Company has certain specific investment guidelines, including that investee companies will have an equity market capitalisation of up to approximately £750 million at the time of initial investment. Securities acquired by the Company will normally be quoted on the Official List (which includes the Alternative Investment Market) of the London Stock Exchange or equivalent markets overseas.

At the Annual General Meeting held on 16 April 2003 shareholders approved the amendment to the Articles of Association of the Company increasing the maximum level of gearing from 20% to 30% of total capital and reserves. At 31 December 2005 the Company had no borrowings (2004 – US$47,350,000 (£24.7 million)).

The Company's policy is to adopt a long-term approach to investment.

Continuation of the Company

The Directors consider it desirable that shareholders be given the opportunity to consider the future of the Company at regular intervals. Accordingly, an ordinary resolution was passed at the Annual General Meeting of the Company in 2004 to the effect that the Company should continue as an investment trust. The next continuation vote will be in 2007 and every third year thereafter. If such resolution is not passed, the Directors will prepare and submit to shareholders (for approval by special resolution) proposals for the unitisation or other reconstruction of the Company. If these proposals are not approved the Company will be wound up.

Results and Dividend

The net revenue after tax for the period was £556,000 (2004 – £301,000).

The Directors recommend a dividend of 0.60p per Ordinary share for the year ended 31 December 2005, which, if approved at the Annual General Meeting, will be payable on 19 April 2006 to holders registered on 31 March 2006. The ex-dividend date is 29 March 2006. The payment will amount to £525,000.

The net asset value (NAV) of the Company at 31 December 2005 represented a value of 409.22p per Ordinary share. This represented an increase of 7.9% during the year and a rise of 314.6% since the date of committal of funds (16 February 1994) after allowing for launch expenses of 1.3p per share.

Investment Report and Outlook

The Chairman's Statement and the Investment Manager's Report incorporate a review of the highlights of the year to 31 December 2005, and the outlook for the Company.

The Board

The Directors at the beginning of the year and at the year end, and their interests in the Company, all of which are beneficially owned, were as follows:

Name	Number of Ordinary Shares 31 December 2005	31 December 2004
Martin Boase	50,000	50,000
Clay Brendish	14,700	14,700
Timothy Curtis (appointed 22 July 2004)	2,000	–
Douglas McDougall	225,000	200,000

In accordance with the Combined Code on Corporate Governance Mr M Boase, who is 73 and who has served on the Board for more than nine years, retires and offers himself for re-election.

The Board has reviewed the performance of Mr Boase. His performance continues to be effective and he remains committed to the Company. His contribution to the Board is valued highly and the Board recommends his re-election to shareholders.

Mr J P Dukes and Mr C A Parritt retired from the Board on 13 April 2005.

There have been no changes intimated in the Directors' interests up to 13 February 2006.

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 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.

At 31 December 2005 the Company was the beneficial owner of 12.89% of the Ordinary share capital 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.

The Board considers the Company's 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 Herald Investment Management Limited 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.

Significant Shareholdings

At 13 February 2006 the Directors have been notified of the following shareholdings comprising 3% or more of the issued share capital of the Company:

Name	Ordinary Shares	% of issue
Legal & General Group plc	2,731,180	3.1
British Empire Securities and General Trust plc	2,702,876	3.1
The Royal Bank of Scotland Group plc as Trustee of the Charishare Common Investment Fund	2,650,000	3.0

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 2004 or 2005.

Auditors

The Auditors, Ernst & Young LLP, are willing to continue in office and in accordance with sections 385 and 390A of the Companies Act 1985 resolutions concerning their reappointment and remuneration will be submitted to the Annual General Meeting.

Annual General Meeting

At the Annual General Meeting of the Company to be held on 12 April 2006 the following resolution will be proposed as a special resolution.

Authority to Repurchase the Company's Ordinary Shares

At the Company's Annual General Meeting held on 13 April 2005 it was resolved that the Company be authorised to purchase in the market up to 13,124,645 Ordinary shares (14.99% of its Ordinary share capital in issue at that time). During the year to 31 December 2005, and between 1 January 2006 and the date of this report, the Company has not bought back any shares. The Board continues to believe, however, 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 7 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 2007. 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 not more than 5% above the average middle-market quotation for the five business days preceding the day of purchase. The authority being sought, the full text of which can be found in Resolution 7 in the Notice of Annual General Meeting, will last until the date of the Annual General Meeting in 2007. 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.

The Directors consider that the implementation of the facility to repurchase the Company's own Ordinary shares is in the interests of shareholders as a whole and unanimously recommend all holders to vote in favour of the resolution 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 before the time of the Annual General Meeting.

By order of the Board

Baillie Gifford & Co

Secretaries

13 February 2006

DIRECTORS' REMUNERATION REPORT

Directors' Remuneration Report

The Board has prepared this report, in accordance with the requirements of Schedule 7A to the Companies Act 1985. 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 28 and 29.

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 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 2006 and subsequent years.

The fees for the non-executive Directors are determined within the limits set out in the Company's Articles of Association. Shareholders' approved an increase of the aggregate limit to £100,000 at the Annual General Meeting held on 14 April 2004. Non-executive Directors are not eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits.

The Board carried out a review of the level of Directors' fees in 2005, and concluded that the fees should be increased from £15,000 to £22,500 for the Chairman and from £11,000 to £15,000 per Director. The increase was effective from 1 July 2005.

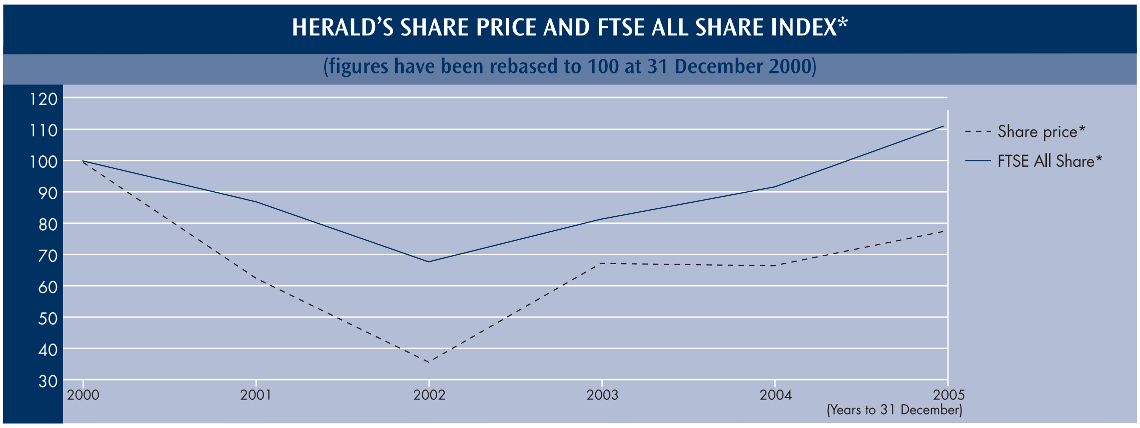
Directors' service contracts

It is the Board's policy that none of the Directors have a service contract. All of the Directors have been provided with revised appointment letters dated 10 November 2004. The terms of their appointment provide that a Director shall retire and be subject to re-election at the first Annual General Meeting after their appointment. Directors are thereafter obliged to retire by rotation, and, if they wish, to offer themselves for re-election, at least every three years after that. There is no notice period and no provision for compensation upon early termination of appointment.

	Date of appointment	Due date for re-election
Martin Boase	11 January 1994	AGM April 2006
Clay Brendish	23 July 2001	AGM 2007
Timothy Curtis	22 July 2004	AGM 2008
Douglas McDougall	13 February 2002	AGM 2008

Company performance

The graph below compares, for the five financial years ended 31 December 2005, 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: Datastream

*Total return (assuming all dividends are reinvested)

Past performance is no guarantee of future performance.

Directors' emoluments for the year (audited)

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

	Fees 2005 £	Fees 2004 £
Directors who served during the year:		
Martin Boase (Chairman)	18,750	15,000
Clay Brendish	13,000	11,000
Timothy Curtis (appointed 22 July 2004)	13,000	4,912
Justin Dukes (retired 13 April 2005)	3,104	11,000
Douglas McDougall	13,000	11,000
Clive Parritt (retired 13 April 2005)	3,104	11,000
	63,958	63,912
Past Directors:		
Colin McCarthy (retired 14 April 2004)	–	3,165
	63,958	67,077

Sums paid to third parties (audited)

The Directors' fees payable to Mr C M Brendish and Mr J P Dukes were paid to Technology Management Services and ECIC Management Limited respectively. The payments were for making their services available as Directors of the Company.

Approval

The Directors' Remuneration Report on pages 22 and 23 was approved by the Board of Directors on 8 February 2006 and signed on its behalf by

Douglas McDougall
Director

CORPORATE GOVERNANCE

Compliance

The Board has considered the principles set out in the revised Combined Code on Corporate Governance (the "Code") and the AITC Code on Corporate Governance (the "AITC Code") both of which were published in July 2003.

The Board believes that the Company has complied throughout the year under review with the provisions set out in Section 1 of the Code except that there is no remuneration committee and no limit has been imposed on the overall length of service of Directors. These issues are explained below.

The Board is also adhering to the principles of the AITC Code in all material respects.

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 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 comprised entirely of non-executive Directors, there is no chief executive officer. Mr D C P 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. The Company also maintains Directors' and Officers' Liability insurance.

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.

The Chairman, Martin Boase, was independent at the date of his appointment and, notwithstanding that Mr Boase holds 5.6% of the ordinary share capital of the investment management company, the Board has concluded that he continues to be independent. The Board believes that Mr Boase's shareholding has not, in the past, given rise to a conflict of interest or affected his independent judgement, nor is it expected to do so in the future. As Mr Boase has been a Director for more than nine years and is over 70 years of age, he has agreed to offer himself for re-election annually. The Board subscribes to the view expressed in the AITC Code that long-serving directors should not be prevented from forming part of an independent majority. Following a formal performance evaluation, the Board is of the view that Mr Boase continues to be independent. The Board considers that none of Mr Boase's other commitments interfere with the discharge of his responsibilities to the Company and is satisfied that he makes sufficient time available to serve the Company effectively. There has been no significant change to the Chairman's other commitments during the year.

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, marketing, 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	**4**	**2**	**1**
Martin Boase	4	2	1
Clay Brendish	2	1	1
Timothy Curtis	4	2	1
Justin Dukes (retired 13 April 2005)	2	1	–
Douglas McDougall	4	2	1
Clive Parritt (retired 13 April 2005)	2	1	–

Mr J P Dukes and Mr C A Parritt attended all the meetings held up to the date of their retiral.

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 terms of reference are available 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 D C P 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.

Terms of Appointment and Re-election

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

A Director appointed during the year is required, under the provisions of the Company's Articles of Association, to retire and seek election by shareholders at the next Annual General Meeting. The Articles also require that one third of the Directors retire by rotation each year and seek re-election at the Annual General Meeting. In addition, all Directors are required to submit themselves for re-election at least every three years. Directors who have served for more than nine years offer themselves for re-election annually. 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 add significantly to the strength of the Board.

Mr Boase will retire at the Annual General Meeting and is offering himself for re-election. The reasons why the Board supports the re-election are set out on page 20.

Induction and Training

Training for new Directors is tailored to the particular circumstances of the individual appointee. Directors receive other relevant training as necessary.

Remuneration

Since all the Directors are non-executive, a remuneration committee is considered unnecessary and Directors' fees are considered by the Board as a whole. The Company's policy on remuneration is set out in the Directors' Remuneration Report on pages 22 and 23.

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 risk 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 Control: 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.

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, as detailed in the Directors' Report. The Board acknowledges its responsibilities to supervise and control the discharge by the Manager and Secretaries of their obligations.

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

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 system of internal controls which is documented within an internal controls report. 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.

A detailed risk map is prepared which identifies the significant risks faced by the Company and the key controls to manage these risks are confirmed as in place and operating effectively.

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, are operating effectively 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 and continues to believe that the compliance and internal control systems in place within the Investment Manager and Company Secretaries 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 trust, 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 27 to 29.

The accounts have been prepared on the going concern basis as it is the Directors' opinion that the Company has adequate resources to continue in operational existence for the foreseeable future.

An Audit Committee has been established in compliance with the Combined Code consisting of all the non-executive Directors, all of whom are considered to be independent. Its authority and duties are clearly defined within its written terms of reference which are available on the Manager's website: **www.heralduk.com**. The Chairman of the Board is Chairman of the Audit Committee. The Committee's responsibilities, which were discharged during the year, include:

- monitoring and reviewing the integrity of the interim and annual financial statements and the internal financial controls;
- 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 provided in the period) and 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.

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 and the Board announces the level of proxies lodged. 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: **www.heralduk.com**.

Voting Policy and Socially Responsible Investment

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. HIML give consideration to socially responsible investment when making investment decisions, but the overriding objective is to produce good investment returns for shareholders. The Manager's policy has been reviewed and endorsed by the Board.

On behalf of the Board

Douglas McDougall
Director

13 February 2006

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RELATION TO THE FINANCIAL STATEMENTS

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the year and of the surplus or deficit for the year. In preparing the financial statements, the Directors are required to:

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

The Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. 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.

INDEPENDENT AUDITORS' 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 2005 which comprise the Income Statement, Balance Sheet, Reconciliation of Movement in Shareholders' Funds, Cash Flow Statement and the related notes 1 to 20. These financial statements have been prepared on the basis of the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. 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 auditors' 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

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Company Summary, Year's Summary, Long Term Performance Summary, Directors, Manager and Advisers, Chairman's Statement, Investment Manager's Report, Top Twenty Holdings, Classification of Investments, Geographical Spread of Investments, Detailed List of Investments, Ten Year Record, Directors' Report, unaudited part of the Directors' Remuneration Report, Corporate Governance Statement, Notice of Annual General Meeting and Further Shareholder Information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes an examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

INDEPENDENT AUDITORS' REPORT *continued*

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2005 and of its profit for the year then ended;
- and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

ERNST & YOUNG LLP
Registered Auditor
Edinburgh

13 February 2006

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005 Revenue £'000	2005 Capital £'000	2005 Total £'000	2004 Revenue £'000	2004 Capital Restated† £'000	2004 Total Restated† £'000
Gains on investments	9	–	27,708	27,708	–	14,645	14,645
Exchange difference on loans	15	–	(1,989)	(1,989)	–	1,813	1,813
Currency gains/(losses)	15	–	70	70	–	(29)	(29)
Income	2	5,368	–	5,368	4,776	–	4,776
Investment management fee	3	(3,741)	–	(3,741)	(3,671)	–	(3,671)
Other administrative expenses	4	(275)	–	(275)	(267)	–	(267)
Net return before finance costs and taxation		1,352	25,789	27,141	838	16,429	17,267
Finance costs of borrowings	5	(724)	–	(724)	(501)	–	(501)
Return on ordinary activities before taxation		628	25,789	26,417	337	16,429	16,766
Tax on ordinary activities	6	(72)	–	(72)	(36)	–	(36)
Return on ordinary activities after taxation		556	25,789	26,345	301	16,429	16,730
Return per Ordinary share	8	0.64p	29.45p	30.09p	0.34p	18.73p	19.07p

The Board proposed on 8 February 2006 a dividend of 0.60p per Ordinary Share (31 December 2004 – 0.30p) and the total payable will be £525,000 (31 December 2004 – £263,000).

†Various changes in accounting policies, as disclosed in note 1 on page 33, have had the cumulative effect of reducing reported net assets by £4,359,000 for the year ended 31 December 2004.

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.

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 33 to 41 are an integral part of this statement.

BALANCE SHEET

AT 31 DECEMBER 2005

	Notes	2005 £'000	2005 £'000	2004 Restated† £'000	2004 Restated† £'000
Fixed assets					
Investments	9		348,774		320,546
Current assets					
Debtors	11	786		1,880	
Cash and short term deposits	10	9,089		34,907	
		9,875		36,787	
Creditors:					
Amounts falling due within one year	12	(356)		(25,122)	
Net current assets			9,519		11,665
TOTAL NET ASSETS			358,293		332,211
Capital and reserves					
Called-up share capital	14		21,889		21,889
Share premium	15		73,738		73,738
Capital redemption reserve	15		63		63
Capital reserve – realised	15		209,639		202,442
Capital reserve – unrealised	15		50,309		31,717
Revenue reserve	15		2,655		2,362
EQUITY SHAREHOLDERS' FUNDS			358,293		332,211
NET ASSET VALUE PER ORDINARY SHARE	16		409.22p		379.43p

The accounts were approved by the Board of Directors and signed on their behalf on 13 February 2006.

Douglas McDougall
Director

RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005 £'000	2004 £'000
Shareholders' funds at 1 January as previously stated		336,570	320,884
Prior year adjustments:			
Revaluation of investments at bid prices		(4,622)	(4,660)
Reversal of provision of final dividend		263	263
Shareholders' funds at 1 January – restated		332,211	316,487
Total recognised gains for the year		26,345	16,730
Shares purchased for cancellation		–	(743)
Dividends appropriated in the year	7	(263)	(263)
SHAREHOLDERS' FUNDS AT 31 DECEMBER		358,293	332,211

†See note 1 on page 33.

The accompanying notes on pages 33 to 41 are an integral part of these statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005 £'000	2005 £'000	2004 £'000	2004 £'000
Net cash inflow from operating activities	17		1,322		762
Servicing of Finance					
Loan interest		(841)		(495)	
Net cash outflow from servicing of finance			(841)		(495)
Financial investment					
Purchase of investments		(75,037)		(65,423)	
Sale of investments		75,653		85,279	
Net cash inflow from financial investment			616		19,856
Equity dividend paid			(263)		(263)
Net cash inflow before financing			834		19,860
Financing					
Loans drawn down		24,771		25,769	
Loans repaid		(51,423)		(28,618)	
Shares repurchased		–		(743)	
Net cash outflow from financing			(26,652)		(3,592)
(DECREASE)/INCREASE IN CASH	18		(25,818)		16,268
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET (DEBT)/FUNDS	18				
(Decrease)/increase in cash in period			(25,818)		16,268
Decrease in bank loans			26,652		2,849
Exchange movement on loans			(1,989)		1,813
MOVEMENT IN NET (DEBT)/FUNDS IN PERIOD			(1,155)		20,930
NET FUNDS/(DEBT) AT 1 JANUARY			10,244		(10,686)
NET FUNDS AT 31 DECEMBER			9,089		10,244

The accompanying notes on pages 33 to 41 are an integral part of this statement.

NOTES TO THE ACCOUNTS

1. Accounting policies

A number of new UK Financial Reporting Standards have been introduced which the Company must comply with this year. These standards are part of the UK convergence programme with International Accounting Standards and have required most UK listed companies to restate prior year figures to reflect the new accounting treatment. The Financial Statements for the year to 31 December 2005 have been prepared on the basis of the accounting policies set out in the Company's Annual Financial Statements at 31 December 2004 except as detailed below:

- Investments have been valued at fair value through profit or loss in accordance with FRS 26, ''Financial Instruments: Measurement''. The effect is to move from a mid to a bid basis of valuation, resulting in a reduction in the value of investments and unrealised capital reserves of £3,830,000 (31 December 2004 – £4,622,000).
- In compliance with FRS 21, ''Events After The Balance Sheet Date'', dividends declared after the period end are no longer treated as a liability at the period end. The effect is to reduce creditors and increase revenue reserves by £525,000 (31 December 2004 – £263,000).
- The implementation of FRS 21 and the 2005 SORP has resulted in changes in the presentation of total returns. Previously dividends paid and payable in respect of a year were disclosed on the face of the Statement of Total Return and the revenue column of that statement was deemed to be the profit and loss account of the Company. We now present an Income Statement which does not show on its face the distribution in respect of equity shares and whilst it still shows information on capital and revenue returns it is the total return column which is regarded as the profit and loss account of the Company.

The overall effect of the above changes is to decrease equity shareholders funds by £3,305,000 (31 December 2004 – £4,359,000). The effect on the profit and loss account is an increase in unrealised gains on investments of £31,000 (31 December 2004 – £38,000) which is shown in the capital returns.

The amount recognised as a distribution in the year to 31 December 2005 was the final dividend for the year ended 2004 of 0.30p (£263,000) which was paid on 19 April 2005 (year to 31 December 2004 was the final dividend for the year ended 2003 of 0.30p (£263,000) which was paid on 20 April 2004).

(a) Accounting convention

The accounts are prepared under the historical cost convention, as modified by the revaluation of investments. The accounts have been prepared in accordance with applicable accounting standards and the AITC's revised Statement of Recommended Practice ''Financial Statements of Investment Trust Companies'' issued in December 2005.

(b) Investments

Listed investments are valued at fair value through profit or loss, the fair value of listed investments is the bid price, or in the case of FTSE 100 constituents, last traded prices issued by the London Stock Exchange. Investments on the Alternative Investment Market are included at their bid prices. Where material unlisted investments are valued by Directors on the basis of latest information in line with the relevant principles of the British Venture Capital Association Guidelines.

(c) Income

Dividend income is accounted for when the entitlement to the income is established (normally on the ex-dividend date). Interest receivable is accounted for on an accruals basis.

(d) Capital reserves

The Company is precluded by its Articles from making any distribution of capital profits by way of dividend. Realised profits and losses on disposals of investments are dealt with in the realised capital reserve. Unrealised revaluation movements are dealt with through the unrealised capital reserve. Special dividends representing repayments of capital are dealt with through the unrealised capital reserve. Purchases of the Company's own shares for cancellation are also funded from this reserve.

(e) Investment management fees

Investment management fees are charged wholly to revenue.

(f) Finance costs

Finance costs are accounted for on an accruals basis and are charged through the revenue account.

(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.

2. Income

	2005 £'000	2004 £'000
Income from investments		
Franked dividends from listed investments	2,699	2,559
Franked dividends from unlisted investments (inc AIM)	82	14
Unfranked income from unlisted (inc AIM) UK convertible bonds	145	123
Overseas dividend income	1,268	753
	4,194	3,449
Other income		
Deposit interest	1,172	1,310
Underwriting commission	2	17
	1,174	1,327
Total income	5,368	4,776
Total income comprises:		
Dividends	4,049	3,326
Interest from investments	145	123
Other	1,174	1,327
	5,368	4,776
Income from investments		
Listed UK	2,699	2,559
Listed overseas	1,268	753
Unlisted	227	137
	4,194	3,449

3. Investment management fee – *all charged to revenue*

	2005 £'000	2004 £'000
Investment management fee	3,345	3,314
Irrecoverable VAT thereon	396	357
	3,741	3,671

Herald Investment Management Limited are appointed investment managers 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 and is subject to VAT at the appropriate rate.

4. Other administrative expenses – *all charged to revenue*

	2005 £'000	2004 £'000
Custodian's fees	54	39
Registrars' fees	20	23
Directors' fees	64	67
Auditors' fees – audit work	11	11
Miscellaneous expenses	126	127
	275	267

5. Finance costs of borrowings – *all charged to revenue*

	2005 £'000	2004 £'000
Bank loans repayable within one year	724	501

6. Taxation

	2005 £'000	2004 £'000
Overseas taxation	72	36

The tax charge for the year is lower than the standard rate of corporation tax in the UK (30%).

The differences are explained below.

	2005 £'000	2004 £'000
Revenue return on ordinary activities before taxation	628	337
Revenue return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2004 – 30%)	188	101
Income not taxable	(834)	(772)
Overseas withholding tax claimed as a deduction	(22)	(11)
Overseas withholding tax written off	72	36
Excess expenses in period not provided for as an asset	668	682
Current tax charge for the year	72	36

Capital returns are not included in the above analysis; as an Investment Trust, the Company's capital gains are not taxable.

There is no corporation tax charge at 31 December 2005 or 31 December 2004 as the Company has unrelieved management expenses which are available to be carried forward. The tax charge for 31 December 2005 and 2004 comprises overseas withholding taxes written off.

At 31 December 2005 the Company had surplus management expenses of £12m (2004 – £10m) 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.

7. Ordinary dividend

	2005	2004 Restated	2005 £'000	2004 Restated £'000
Amounts recognised as distributions in the period				
Previous year's final (paid 19 April 2005)	0.30p	0.30p	263	263
Current year's proposed final dividend	0.60p	0.30p	525	263

The current year's proposed dividend will be paid on 19 April 2006 to all shareholders on the register as at the close of business on 31 March 2006. The ex-dividend date is 29 March 2006.

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. Previously dividends were recognised in respect of the period to which they relate.

We also set out below the total dividends payable in respect of the financial year, which is the basis on which the requirements of Section 842 of the Income and Corporation Taxes Act 1988 are considered.

	2005 £'000	2004 £'000
Revenue available for distribution by way of dividends for the year	556	301
Proposed final dividend for the year ended 31 December 2005 of 0.60p (2004 – 0.30p)	525	263

8. Return per Ordinary share

	2005 Revenue	2005 Capital	2005 Total	2004 Revenue	2004 Capital Restated	2004 Total Restated
	0.64p	29.45p	30.09p	0.34p	18.73p	19.07p

Revenue return per Ordinary share is based on the net revenue on ordinary activities after taxation of £556,000 (2004 – £301,000) and on 87,556,010 Ordinary shares (2004 – 87,745,357) being the weighted average number of Ordinary shares in issue during the year.

Capital return per Ordinary share is based on the net capital gain for the financial year of £25,789,000 (2004 – £16,429,000) and on 87,556,010 Ordinary shares (2004 – 87,745,357) being the weighted average number of Ordinary shares in issue during the year.

9. Fixed assets – investments

	2005 £'000	2004 Restated £'000
Listed at market valuation on the London Stock Exchange	163,724	165,072
Listed at market valuation on other recognised Stock Exchanges	120,070	105,262
AIM	64,394	47,881
Unquoted*	586	2,331
Total fixed asset investments	348,774	320,546

	Listed in UK £'000	Listed overseas £'000	AIM £'000	Unquoted £'000	Total £'000
Cost of investments at 1 January 2005	108,182	117,018	58,422	6,312	289,934
Unrealised appreciation/(depreciation) at 1 January 2005 – restated	56,890	(11,756)	(10,541)	(3,981)	30,612
Value of investments at 1 January 2005 – restated	165,072	105,262	47,881	2,331	320,546
Movements in the year:					
Purchases at cost	21,622	27,386	25,381	648	75,037
Sales – proceeds	(33,744)	(28,468)	(9,499)	(2,806)	(74,517)
– realised profit/(loss)	11,448	(3,578)	387	(246)	8,011
Increase in unrealised appreciation/(depreciation)	(256)	19,468	1,690	(1,205)	19,697
Change in listing	(418)	–	(1,446)	1,864	–
Value of investments held at 31 December 2005	163,724	120,070	64,394	586	348,774
Cost of investments at 31 December 2005	107,090	112,358	73,245	5,772	298,465
Unrealised appreciation/(depreciation) at 31 December 2005	56,634	7,712	(8,851)	(5,186)	50,309
Value of investments at 31 December 2005	163,724	120,070	64,394	586	348,774

Gains on investments	2005 £'000	2004 Restated £'000
Realised gains on sales	8,011	18,466
Increase/(decrease) in unrealised appreciation/(depreciation)	19,697	(3,821)
	27,708	14,645

Of the realised gains on sales of £8,011,000 (2004 – gain of £18,466,000) during the year, a net loss of £405,000 (2004 – gain of £9,293,000) was included in unrealised appreciation/(depreciation) at the previous year end.

* The unquoted balance comprises Herald Investment Management Limited, Herald Venture 2 and HIML Jersey Ltd included at their aggregated cost of £550,000, UbiNetics at zero, Culver Holdings at £36,000 and Atex (grey market value at 31 December 2005 of £36,000) at zero.

At 31 December 2005 the Company was the beneficial owner of 12.89% (2004 – 12.89%) of the Ordinary share capital of both HIML and HIML Jersey Ltd. HIML is incorporated in the United Kingdom whereas HIML Jersey Ltd is incorporated in Jersey.

9. Fixed assets – investments (continued)

Transaction costs	2005 £'000	2004 £'000
The following transaction costs were incurred during the period and are included in the purchases and sales figures above		
Purchases	241	203
Sales	153	251
	394	454

10. Financial assets

A full list of the Company's investments is given on pages 13 to 17. 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 contained in the investment review section on pages 9 to 12. All financial assets are included in the accounts at fair value (see note 1).

Exposure to currency risk through asset allocation is indicated below:

Portfolio (currency of listing):	2005 £'000	2004 Restated £'000
Sterling	230,257	215,284
US dollars	55,440	54,760
Euros	15,416	13,447
Norwegian krone	2,145	4,695
Israeli shekels	307	276
Swiss francs	6,344	4,259
Japanese yen	–	2,643
Australian dollars	1,157	1,551
Hong Kong dollars	3,617	4,029
Korean won	9,702	2,404
Malaysian ringitt	3,576	3,218
Singapore dollars	8,971	9,482
Taiwan dollars	10,618	3,648
Thailand baht	1,224	850
	348,774	320,546
Cash:		
UK deposits	6,671	34,776
Foreign deposits – US dollars	9	–
– Taiwan dollars	2,322	48
– Israeli shekels	87	83
	9,089	34,907

The cash deposits generally comprise call or overnight deposit accounts which are payable on demand. The benchmark rate which determines the interest payments received on cash balances is the bank base rate.

The following currency amounts are included in net current assets.

	2005 Income accrued	2005 Sales for subsequent settlement	2005 Other debtors and prepayments	2004 Income accrued	2004 Sales for subsequent settlement	2004 Other debtors and prepayments
Sterling	497	–	90	500	409	108
US dollars	3	–	–	3	791	–
Hong Kong dollars	–	–	–	26	–	–
Korean won	57	–	–	22	–	–
Euros	–	–	14	–	–	21
Australian dollars	61	64	–	–	–	–
	618	64	104	551	1,200	129

10. Financial assets (continued)

The interest rate risk profile of the Company's financial assets at 31 December was:

	2005 Fair value £'000	2005 Weighted average interest rate/ interest rate	2005 Weighted average period until maturity/ maturity date	2004 Fair value Restated £'000	2004 Weighted average interest rate/ interest rate	2004 Weighted average period until maturity/ maturity date
Fixed rate:						
UK convertible bonds	63	8%	3 years	1,634	7%	3 years
US convertible bond	25	7%	3 years	60	7%	4 years

Included within the analysis provided above and on pages 13 to 17 is the Company's holding in warrants which confer the right to convert into equity shares. An analysis of the currency exposure and maturity profile of these warrants at 31 December is provided below.

	2005 Fair value £'000	2005 Maturity date	2004 Fair value Restated £'000	2004 Maturity date
Warrants:				
Sterling	12	31/12/06	–	–
Hong Kong dollar	20	31/12/06	27	31/12/06
Hong Kong dollar	–	–	15	03/11/06
Singapore dollar	18	13/08/09	32	13/08/09

11. Debtors

	2005 £'000	2004 £'000
Due within one year:		
Income accrued	618	551
Sales for subsequent settlement	64	1,200
Taxation recoverable	19	38
Other debtors and prepayments	85	91
	786	1,880

12. Creditors

	2005 £'000	2004 Restated £'000
Amounts falling due within one year:		
Bank loans (see note 13)	–	24,663
Other creditors and accruals	356	459
	356	25,122

Included in other creditors and accruals is £299,000 (2004 – £278,000) in respect of the investment management fee.

13. Financial liabilities

The Company had a 364 day US$47.35 million multi-currency loan facility with ING Bank N.V. which expired on 25 October 2005.

The interest rate risk profile of the Company's financial liabilities at 31 December was:

	2005			2004		
	£'000	Interest rate	Period until maturity	£'000	Interest rate	Period until maturity
Bank loans:						
US$ 47,350,000 – fixed rate	–	–	–	24,663	2.62%	4 months

	2005 £'000	2004 £'000
The maturity profile of the Company's financial liabilities at 31 December was:		
In one year or less, or on demand	–	24,663

Interest on the multi-currency loan was payable in half yearly instalments in April and October. The loan was with ING Bank N.V. and was repaid in October 2005. The estimated repayment value of the loan at 31 December 2004 was £24,989,000. The indicative costs of repaying the loan as at 31 December 2004 were not material in the context of the above figures.

The following covenants related to the loan with ING Bank N.V.:

(i) Total borrowings shall not exceed 30% of the Company's net asset value.
(ii) The Company's minimum net asset value shall be £100,000,000.
(iii) No one listed investment owned by the Company should represent more than 7.5% of the Company's total assets.

The fair value of the loan was not materially different from the carrying value.

Short term debtors and creditors have been excluded from the disclosure of financial instruments as allowed by FRS 13 other than for currency disclosures which include £117,000 of US$ at 31 December 2004 in respect of loan interest.

Gains and losses on hedges

At 31 December 2005 and 2004 there were no unrecognised gains/losses on hedges. Realised currency gains/losses are taken to the capital reserve and are not reflected in the profit and loss account unless they are of a revenue nature.

14. Called-up share capital

		2005	2004
Authorised:			
Ordinary shares of 25p:	Number	109,000,000	109,000,000
	£'000	27,250	27,250
Allotted, issued and fully paid:			
Ordinary shares of 25p:	Number	87,556,010	87,556,010
	£'000	21,889	21,889

At the Annual General Meeting in April 2005 Shareholders granted the Company authority to purchase shares in the market up to 13,124,645 Ordinary shares (equivalent to 14.99% of its issued share capital at that date). No shares were bought back in the year to 31 December 2005 (2004 – a total of 251,338 Ordinary shares with a nominal value of £62,835 were bought back at a total cost of £742,567). At 31 December 2005 the Company had authority to buy back a further 13,124,645 Ordinary shares. Under the provisions of the Company's Articles share buy-backs are funded from the realised capital reserve. The nominal value of the share capital is maintained by the provision of a capital redemption reserve.

15. Reserves

	Share premium £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000
At 1 January 2005 as previously stated	73,738	63	202,442	36,339	2,099
Effects of change in accounting policy					
Revaluation of investments at bid prices	–	–	–	(4,622)	–
Reversal of provision of final dividend	–	–	–	–	263
At 1 January 2005 – restated	73,738	63	202,442	31,717	2,362
Net gain on realisation of investments	–	–	8,011	–	–
Increase in unrealised appreciation	–	–	–	19,697	–
Exchange difference on currency loans	–	–	(884)	(1,105)	–
Other exchange differences	–	–	70	–	–
Ordinary dividend paid	–	–	–	–	(263)
Net revenue for the year	–	–	–	–	556
Balance at 31 December 2005	73,738	63	209,639	50,309	2,655

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:

	2005	2004 Restated	2005 £'000	2004 Restated £'000
Ordinary shares	409.22p	379.43p	358,293	332,211

Net asset value per Ordinary share is based on net assets as shown above and 87,556,010 Ordinary shares, being the number of Ordinary shares in issue at each date.

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

	2005 £'000	2004 Restated £'000
Net revenue on ordinary activities before finance costs and taxation	27,141	17,267
Gains on investments	(25,789)	(16,429)
(Increase) in accrued income	(73)	(49)
Decrease in debtors	6	29
Increase in creditors	14	20
Income tax repaid/(suffered)	25	(11)
Overseas tax suffered	(72)	(36)
Realised currency profit/(loss)	70	(29)
Net cash inflow from operating activities	1,322	762

18. Analysis of changes in net (debt)/funds

	At 1 January 2005 £'000	Cash flows £'000	Exchange movement £'000	At 31 December 2005 £'000
Cash at bank and in hand	34,907	(25,818)	–	9,089
Loans due within one year	(24,663)	26,652	(1,989)	–
	10,244	834	(1,989)	9,089

19. Contingent Liabilities, Guarantees and Financial Commitments

At 31 December 2005 and 31 December 2004 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, over a 5 year period. The first tranch of £300,000 was drawn down on 27 October 2004 and a further £150,000 during the year to 31 December 2005.

20. Derivatives and Other Financial Instruments

In accordance with the corporate objective of maximising total returns the Company invests in securities on a worldwide basis. The Company makes use of gearing to achieve improved performance in rising markets. Other financial instruments consist of cash, short term debtors and creditors.

The main risks arising from the Company's financial instruments are market price, foreign currency, liquidity and interest rate risks. The Manager's policies for managing these risks, which have been applied throughout the year, are summarised below.

Market 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, where material unlisted investments are valued by the Directors on the basis of the latest information in line with the relevant principles of the British Venture Capital Association Guidelines (Accounting Policy (b)). These valuations also represent the fair value of the investments.

The Company has authority to write options against individual shares held within the portfolio. No such transactions were undertaken in the year under review.

Foreign Currency Risk

Herald invests on a worldwide basis and the balance sheet can be affected by movements in foreign currency exchange rates. The list of equity investments on pages 13 to 17 shows the countries in which the Company is invested. The securities in the portfolio are priced in local currency.

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 this currency risk.

The main foreign currency exposure at 31 December 2005 is detailed in note 10 Financial assets and note 13 Financial liabilities.

Liquidity Risk

The Company's assets mainly comprise readily realisable securities. Cash balances are held with The Bank of New York, The Bank of Scotland, Lloyds TSB and Rabobank. Short term flexibility is achieved by an overdraft facility of £2 million with The Bank of New York.

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 has held Treasury Stocks, the interest rate and maturity dates of which are detailed in note 10 Financial assets. Interest is accrued on sterling cash balances at a rate linked to the UK base rate.

At the year end the Company had no borrowings (2004 – £24,663,000 (US$47,350,000) which was repaid in October 2005 (see note 13)).

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Herald Investment Trust plc will be held at 12 Charterhouse Square, London EC1M 6AX on 12 April 2006 at 11.30 am for the following purposes:

Ordinary Business

1. To receive and adopt the Directors' report, the annual accounts and the Auditors' report in respect of the year ended 31 December 2005.
2. To approve the Directors' Remuneration Report for the year to 31 December 2005.
3. To declare a dividend of 0.60p per share in respect of the year ended 31 December 2005.

To consider resolution No. 4, special notice having been received of the intention to propose the resolution as an ordinary resolution (see note 4).

4. To re-elect Mr M Boase, who is aged 73, as a Director of the Company.
5. To reappoint Ernst & Young LLP as Auditors to the Company.
6. To authorise the Directors to determine the remuneration of the Auditors.

Special Business

To consider and, if thought fit, pass the following resolution as a Special Resolution:

7. THAT, the Company be generally and subject as hereinafter appears unconditionally authorised in accordance with Section 166 of the Companies Act 1985 (the ''Act'') to make market purchases (within the meaning of Section 163 of the Act) of its issued shares of 25p each in the capital of the Company in substitution for any existing authority under section 166 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 which may be paid for a share shall be an amount equal to 105% of the average of the middle market quotations for a share taken from and calculated by reference to the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the share is purchased;

   (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 2007; 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
Secretaries

Registered Office:
12 Charterhouse Square
London EC1M 6AX

2 March 2006

NOTES

1. A shareholder entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, to vote in his stead. Such proxy need not be a member of the Company.
2. A form of proxy is enclosed and to be valid must be lodged with the Registrars of the Company not less than forty-eight hours before the time fixed for the meeting.
3. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that only those shareholders entered on the Register of Members of the Company as at 11.30 am on 10 April 2006 or, in the event that the meeting is adjourned, on the Register of Members 48 hours before the time of any adjourned meeting, shall be entitled to attend or vote at the meeting in respect of the number of ordinary shares registered in their name at that time. Changes to the entries on the Register of Members after 11.30 am on 10 April 2006 or, in the event that the meeting is adjourned, in the Register of Members 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend or vote at this meeting, notwithstanding any provisions in any enactment, the Articles of Association of the Company or other instrument to the contrary.
4. In accordance with section 293 of the Companies Act 1985 special notice has been given to the Company of the resolution to reappoint a Director who is over the age of 70.
5. 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 Trust Companies.

- **Key Dates** Ordinary shareholders normally receive a dividend in respect of each financial year which is normally paid in April. 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/PEPs** The Ordinary shares of the Company are qualifying investments for individual saving accounts and personal equity plans. PEPs ceased to be available for further investment from 5 April 1999. Any individual contemplating investment should consult his or her own adviser.

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.

NOTES

Pillans & Waddies, Edinburgh. 308842