

HERALD INVESTMENT TRUST plc

REPORT & ACCOUNTS

31 December 2006

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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 2006

Total assets†

£401m

Shareholders' funds

£381m

Market capitalisation

£336m

† before deduction of bank loan.

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	<p>The portfolio benchmark against which performance is measured was changed on 1 January 2006 from $\frac{2}{3}$ Hoare Govett Smaller Companies Index (extended capital gains ex. investment companies) and $\frac{1}{3}$ Russell 2000 (small cap) Technology Index (in sterling terms) to $\frac{2}{3}$ Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies) and $\frac{1}{3}$ Russell 2000 (small cap) Technology Index (in sterling terms).</p> <p>Though we consider this benchmark to provide a reasonable base for measuring the Trust's performance, the portfolio is not modelled on it and outcomes may diverge widely.</p>
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	<p>The Company's share capital consists of 87,556,010 Ordinary shares of 25p each which are issued and fully paid.</p> <p>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.</p>
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 will be on 25 April 2007 and every third year thereafter.
AIC	The Company is a member of the Association of Investment Companies (formerly the Association of Investment Trust Companies – AITC).

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.

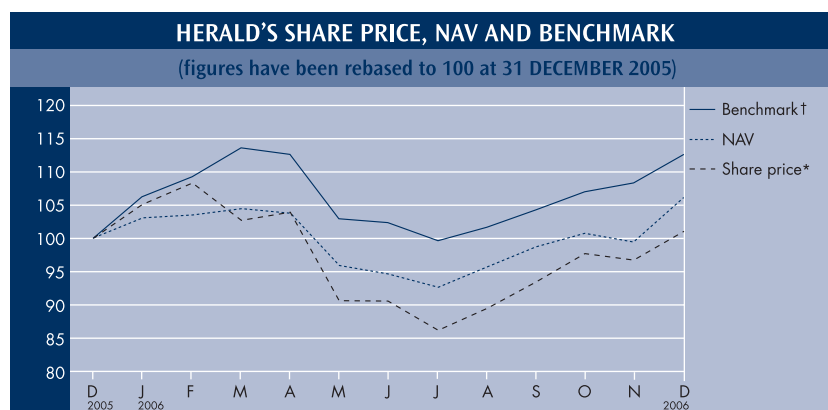
YEAR'S SUMMARY

	31 December 2006	31 December 2005	% change
Total assets (before deduction of bank loans)	£401.2m	£358.3m	
Bank loans	£20.0m	–	
Equity shareholders' funds	£381.2m	£358.3m	6.4
Net asset value per ordinary share	435.4p	409.2p	6.4
Share price*	383.5p	379.8p	1.0
FTSE 100	6,220.8	5,618.8	10.7
FTSE All-Share	3,221.4	2,847.0	13.2
FTSE Small Cap	3,905.6	3,305.5	18.2
Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies)	3,838.3	3,218.7	19.3
Russell 2000 (small cap) Technology Index (in sterling terms)	70.5	71.0	(0.7)
Benchmark composite index			12.5
Dividend per ordinary share	1.20p	0.60p	100.0
Earnings per ordinary share	2.19p	0.64p	242.2
Expense ratio	1.13%	1.16%	
Discount	11.9%	7.2%	

Year's high and low	Year to 31 December 2006		Year to 31 December 2005	
	High	Low	High	Low
Share price*	412.3p	321.0p	382.0p	310.0p
Net asset value	435.4p	370.3p	411.8p	356.4p
Discount	3.0%	15.1%	5.3%	16.4%

	31 December 2006	31 December 2005
Total return per ordinary share		
Revenue	2.19p	0.64p
Capital	24.60p	29.45p
Total	26.79p	30.09p

*At mid market price.



Source: Baillie Gifford & Co

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

Dividends are not reinvested.

*At mid market price.

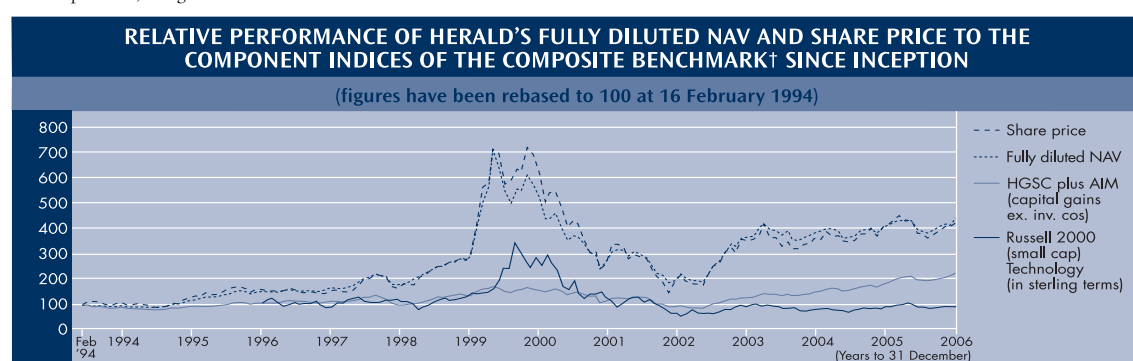
Past performance is no guarantee of future performance.

LONG TERM PERFORMANCE SUMMARY

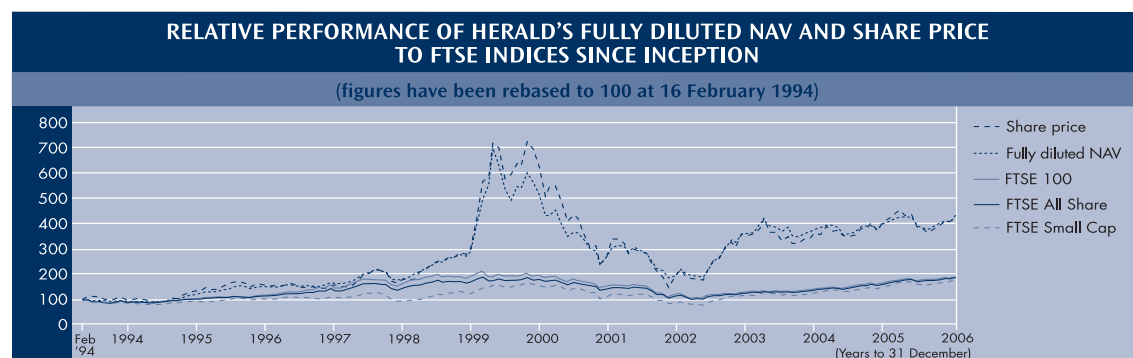
The following charts indicate how an investment in Herald has performed relative to its comparative indices (applied retrospectively) and its underlying fully diluted net asset value over the period since inception of the Company.

	31 December 2006	Inception 16 February 1994	% change
Net asset value per ordinary share	435.4p	98.7p	341.1
Share price	383.5p	90.9p	321.9
Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies)	3,838.3	1,750.0	119.3
Russell 2000 (small cap) Technology Index (in sterling terms)	70.5	83.2*	(15.3)
FTSE 100	6,220.8	3,417.7	82.0
FTSE All-Share	3,221.4	1,717.8	87.5
FTSE Small Cap	3,905.6	2,076.1	88.1

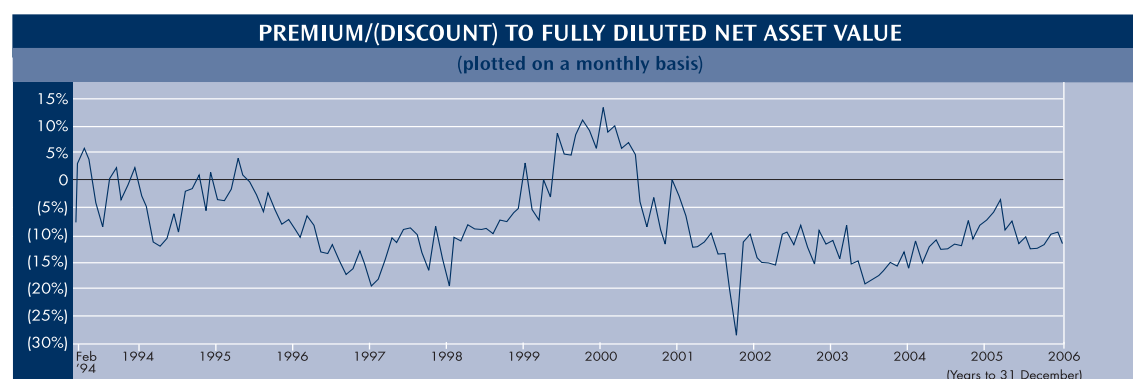
* at 9 April 1996, being the date funds were first available for international investment.



Source: Thomson Financial Datastream/Baillie Gifford & Co.



Source: Thomson Financial Datastream



Source: Thomson Financial Datastream

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

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

DIRECTORS, MANAGER AND ADVISERS

Directors

Martin Boase, MA, FIPA (Chairman), aged 74, 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 Jupiter Dividend and Growth Trust PLC.

Clay Brendish, CBE, aged 59, 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 directorship is with British Telecommunications plc. 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 64, 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 OPENSsystems 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 62, 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 Stramongate 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

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

Registered Office

10-11 Charterhouse Square
London EC1M 6EE

Company Number

2879728 (England and Wales)

Manager

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

Katie Potts

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

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Solicitors

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Auditors

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Ten George Street
Edinburgh EH2 2DZ

Bankers

The Bank of New York
One Canada Square
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Stockbroker

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CHAIRMAN'S STATEMENT

Since inception the NAV per share has appreciated 341% in spite of the dilution from warrants which were issued on the launch of the Trust on a 1 for 5 basis. In contrast the FTSE-100 has appreciated by only 82% in this period and the HGSCI 119%. A further 10.5% has in aggregate been paid in dividends, which is unusual in technology focused funds. It is therefore disappointing to report that 2006 was a year when the NAV return of 6.4% lagged the FTSE-100 which grew 10.7% and the HGSCI plus AIM whose total return was 21.8%. Although fundamentals in the portfolio companies remained generally strong the performance failure reflected two principal factors. First continued underperformance of the sectors in which the fund is targeted and second, the adverse currency movements which depressed the overseas returns, particularly those that were \$ related. The weighted average total return of the target technology, media and telecommunications sectors, in the HGSCI plus AIM was only 2.7%, and the Techmark return was 5.6%. Against these figures the UK total return of 12.5% was more impressive. Similarly the £ return of 3.1% (17.8% in \$) in the US portfolio looks dull, but compares creditably with the Russell 2000 Technology benchmark which declined 0.7% in £ terms although it grew 13.3% in \$; and Nasdaq's \$ return was 9.5%. The £ 6.6% return of the small European portfolio was more than offset by the 12.6% decline on the Far East portfolio.

The Manager has argued for a while that valuations had become attractive in the portfolio, so the single figure returns are a little disappointing. However, one of the stark features of the year has been the high level of bid activity in the portfolio indicating that corporates and private equity houses see value where equity investors' interest has been elsewhere. There were eleven bids in the UK portfolio with an aggregate value of £25m (c11% of the portfolio), while a further two stocks with a value of c£10m are "in discussions". The average return on these stocks during the year was 31%. In the US portfolio thirteen stocks have been acquired with an aggregate value of \$28m, which astonishingly accounted for c31% of the portfolio. The average \$ return on these stocks during the year was 36.5%. In aggregate about half the capital return on the portfolio related to these bid situations, which contributed significantly to the outperformance relative to the target sectors. A high level of corporate activity is expected to continue. This is a mixed blessing because some of the most interesting companies have been acquired at values which the Manager does not feel satisfactory in relation to their growth prospects. The investment community seems content to sell out for modest premiums in the current environment. In the US the regulatory environment has raised the cost of public status to a very burdensome level, and the sector in general has a very strong balance sheet so there are obvious cost benefits to aggregation. In the UK there are too many quoted companies of sub critical size following the plethora of AIM issues, and as a result illiquidity should continue to drive consolidation.

The only slightly negative fundamental feature of the year is that the average p/e of the portfolio has not fallen as expected. This reflects portfolio changes, many as a result of bids, which have lowered aggregate profits and a few downgrades based on disappointing trading. More anomalously the aggregate profits growth appears to have risen to 56.7% in 2006, and yet the p/e has risen too! This reflects a number of downgrades to 2005 numbers partially as companies have restated historic figures following accounting changes. The Manager identified two changes which were most likely to affect reported profits. First, the capitalisation of R&D and the second, the expensing of options through the profit and loss account. The adverse impact of the latter is conspicuously greater than the former, and at least it is not a cash cost.

Investment income grew by 40%, but this figure is distorted by an exceptional special dividend from Amstrad of c£1.9m, which has led to an anomalously high dividend from the Trust in order to maintain investment trust status.

CHAIRMAN'S STATEMENT *continued*

The introduction of gearing into the portfolio in the second half of last year, followed the belief that there was sound value in the portfolio. It was only the plethora of bids that prevented a higher level of gearing. The Manager is continuing to invest in suitable opportunities, which is intended to increase the level of gearing, and make income profits unlikely in 2007. The purpose remains capital growth.

Overall global growth continues to exceed expectations, driven by emerging market growth, which includes investment in technology infrastructure, surprisingly resilient consumer spending, and the sectors of technology and media which the Trust targets. There continues to be many opportunities for commercial gain albeit not without risk. Judicious stock selection should yield above average return, particularly if the environment of asset price inflation in other sectors abates.

The Company's Articles of Association first gave shareholders the right to vote at the Annual General Meeting (AGM) on 14 April 2004 (and at AGMs to be held in every third year thereafter) as to whether the Company should continue to operate as an investment trust. Accordingly, an ordinary resolution, Resolution 8 in the Notice of Annual General Meeting, is being proposed at the AGM of the Company to be held on 25 April 2007 to the effect that the Company should continue as an investment trust. Herald Investment Trust is the largest investment trust specialising in information technology, communications and multi-media and is one of the best performing investment trusts since its launch in February 1994. The Herald Board believes that the focus of the Trust on smaller capitalisation companies provides exposure to some of the most rapidly growing companies within the Trust's target sectors and should provide attractive long-term investment opportunities and the Directors intend to vote their own shareholdings in favour of the resolution for the Company to continue as an investment trust. I encourage shareholders to give due consideration to this important matter and the Directors believe that the prospects for investment in the IT and multi-media sectors remain positive and the Company is managed by one of the leading managers in the space. Your Board strongly recommends that shareholders vote in favour of the resolution.

Martin Boase

Chairman

28 February 2007

INVESTMENT MANAGER'S REPORT

It has seemed to be a very good year, with a sympathetic economic background and a wholesome environment of companies focusing on sound business fundamentals such as sales and profits growth, cash generation, share buy-backs and cash bids. This is in contrast to the period at the turn of the Century when land grab, and use of inflated paper was more fashionable. It has not seemed necessary to state what seemed obvious in the past, that our raison d'être is to invest. In a world where indexing and closet indexing is increasing, and trading for short term returns is more prevalent, it is becoming more evident that our long term perspective, and inclination to provide primary capital on a long term and highly stock specific basis, seeking sound returns, is becoming a surprising minority intent. Whilst the current background of rising interest rates should refocus attention on growth versus the sectors of inflating assets and bonds, the concern is that the alarming levels of consumer, Government and increasingly private equity debt may stunt economic growth and make the trading background less benign and therefore impact profits. The other concern is the evident re-emergence of salary inflation which may impact corporate profits. On balance the pressures leading to rising interest rates reflect the buoyant environment, which should lead to continued strong growth, but it is obviously a tightrope.

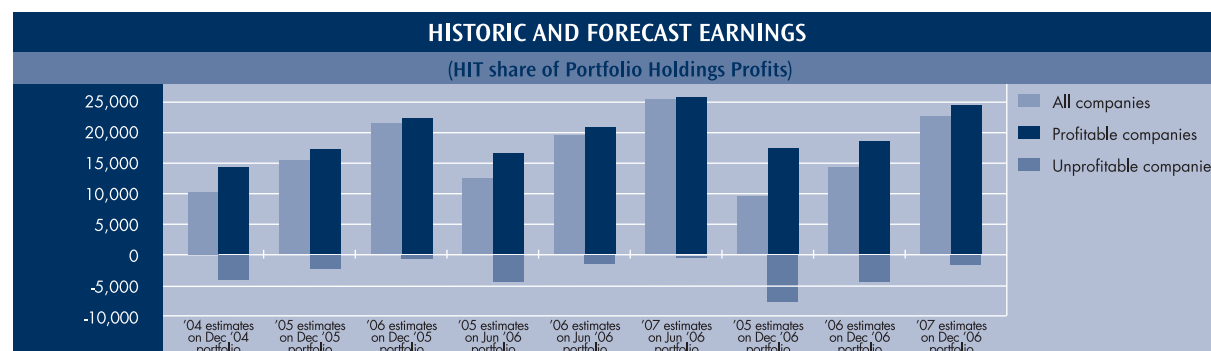
Against this background it is disappointing that the NAV growth is only 6.4%. It is only an upturn in December which led to the return exceeding the building society, which is a rather demoralising return on effort, particularly when other sectors have done so much better. Although our professional pride can take some comfort from returns relative to our sector indices, it is absolute growth in capital that we seek, and on that basis it has been an indifferent year.

Market value as % of total equities	UK	US	Europe	Far East	Total
Companies profitable in 2005 and 2006 (as % of Total Market Value)	54.9%	12.1%	7.2%	7.9%	82.1%
Companies unprofitable in 2005 profitable in 2006 (as % of Total Market Value)	1.1%	1.2%	–	0.3%	2.6%
Companies unprofitable in 2005 and 2006 (as % of Total Market Value)	9.0%	1.6%	0.2%	–	10.8%
Missing Data	1.1%	1.2%	0.3%	0.2%	2.8%
Total	67.0%	16.6%	7.8%	8.6%	100.0%
Earnings growth %					
2006: Companies always profitable (2005 and 2006)	11.3%	8.0%	1.9%	(1.2%)	8.2%
2007: Companies always profitable (2005 and 2006)	22.7%	23.6%	22.2%	27.7%	23.5%
2007: Companies unprofitable in 2005 and profitable in 2006	18.2%	83.5%	–	18.2%	28.5%
Earnings growth %					
Total portfolio 2006*	114.3%	32.1%	15.7%	(3.7%)	56.7%
Total portfolio 2007*	67.7%	56.8%	33.0%	31.5%	58.1%
P/E profitable stocks with estimates only					
2005	19.4x	26.4x	23.1x	10.6x	19.0x
2006	17.7x	26.2x	23.0x	11.4x	18.0x
2007	14.3x	21.0x	18.7x	8.7x	14.4x
P/E of all stocks with estimates					
2005	59.3x	49.5x	29.8x	11.1x	40.2x
2006	27.9x	43.1x	27.0x	11.5x	26.3x
2007	16.6x	27.5x	20.3x	8.7x	16.6x

*The calculation for 2006 and 2007 earnings growth is based only on companies with data available in each of the respective years.

Source: JCF Group and brokers estimates

These numbers require some analysis, because a similar table produced a year ago would have implied a lower p/e in 2006 when the NAV grew only 6.4%.



Portfolio as at respective year ends.

Source: JCF Group and brokers estimates

INVESTMENT MANAGER'S REPORT *continued*

The bar graph on page 7 explains that profit expectations have materially declined for 2006 since June, but only marginally for 2007, albeit the change in profitable company expectations is less. Furthermore the historic profits of the current portfolio is materially less in 2005 than it was. This reflects portfolio changes, and some restatements of historic figures for stock options. In addition it translates overseas earnings at December 2006 exchange rates and not 2005. These changes flatter the growth rate, but affect less the expected outturn for profits in 2007. In addition there have been downgrades. In particular Plasmon and Zoo, which have been poor performers in 2006, only account for 0.4% of the portfolio at the year end and have increased loss expectations by £1m. Overall c60 estimates have been downgraded partially offset by 25 upgrades. Currency translation has not helped overseas earnings. Please note that companies without published estimates have been excluded reducing all numbers a little. In spite of the net downgrades the growth in NAV over the last two years has significantly lagged the growth in profits. Another strong year is expected in 2007.

UK

The UK total return was 12.5%. This was poor relative to the Hoare Govett Smaller Companies Index including AIM of 21.8%. However in 2006 the Trusts target sectors underperformed much more as follows:

	Total return %	Weight in index	Weighted return %
Electronic and Electrical Equipment	14.6	2.49	2.7
Media and Entertainment	6.4	2.95	1.4
Telecommunication Services	(9.8)	1.18	(0.9)
Software & Computer Services	(0.2)	4.94	(0.1)
Technology Hardware & Equipment	(3.8)	1.79	(0.5)
Total		<u>13.35</u>	<u>2.6</u>

UK growth in profits for 2005, according to consensus estimates, was 114.3% albeit the earnings growth for consistently profitable companies was only 11.3%. The kicker to profits is the companies which were loss making in 2005 and became profitable in 2006. Core holdings which contributed well were Detica and Imagination. Their combined appreciation was £10m. Ironically Imagination was a poor performer in the first half. The latter is an example of a company that contributed c£0.5m loss to aggregate Trust profits in 2005, is approaching break-even this year, and should contribute profitably next. In contrast the two worst performing stocks were Plasmon and Alphameric which had their own issues and contributed a decline of £6.2m. The best % returns were microcap stocks – OMG (+125%) and Opsec (+84%) which combined contributed £3.5m. These returns are examples which justify the long tail of small microcap positions. The AIM market has proliferated absurdly and has become rather inefficient. The best returns can be made from buying overlooked companies in the secondary market that have been quietly progressing and grow to the point where they move onto the radar screen. As expected the performance of some of the larger small capitalisation stocks which performed well in 2005 such as CSR and Wolfson have underperformed, and interest has begun at the smaller end. This has contributed to the strong second half outperformance of the sectors.

Eleven stocks were bid for with a combined realisation value of £25m. The most significant in size for the Trust were 365 Media, Biotrace, Incisive Media, Metal Bulletin and TRL. The Trust had been invested in 365 Media in 2002, and Teamtalk prior to that, Biotrace since 1995 albeit most of the position was acquired in 1999, Incisive Media since 2001, Metal Bulletin since 2002 and TRL since flotation in 2004. In addition ICM and SurfControl have announced that they are in bid talks. The Trust's exposure to these stocks is over £10m. In addition more than 10% of the portfolio has intimated that they have been approached by private equity companies for management buy-outs, most notably Northgate Information Systems. By definition the focus of these approaches is profitable cash generative companies, often with more dynamic management teams. It is a trend we are disturbed by, and are generally encouraging management to resist such approaches. Unfortunately other investors appear more receptive. We prefer reliable cash generative business to use leverage while remaining public than lose profits to private equity!

US

The US portfolio outperformed by 3.8% its benchmark the Russell 2000 Technology Index, which rose 13.3% in \$, but declined 0.7% in £. This year the smaller stocks outperformed the large capitalisation Russell 1000 Index, which grew but only by 9.7%, and declined 3.8% in £. This was against a background of profits growth in the US portfolio of 32%, and the consistently profitable companies grew by only 8%, again on consensus forecasts for 2006. However, the dominant effect has been bids. The thirteen companies that were bid for include RSA which was first held in 1998, M-Systems, which was first held in 1997 and Redback which was only acquired in 2005. These stocks had a combined realised or year end value of \$17m, and other bid value collectively total a further \$15m. The cost of public company compliance and the extremely robust balance sheets imply the wave of corporate activity will continue. Valuations are generally immediately usefully earnings enhancing for the acquirer. In contrast the worst stocks Powerwave and Jupitermedia have declined by \$2.8m combined.

INVESTMENT MANAGER'S REPORT *continued*

Europe

United Internet, the German based internet company, that trades in the UK as 1&1, continued to be the star performer. The local currency return for the portfolio was 9.8% offset by currency to 6.6%.

Far East

The Far East return overall has been disappointing with a local currency decline of 5.7% compounded by currency declines to 12.6%. However, virtually all of this weakness has occurred in Korea which declined 32% in £. Unfortunately this returned the sparkling profit of 2005! Korea is the one market where there seem to be systemic downgrades reflecting pressures in the important memory, flash and LCD markets.

Market background

The main driver to growth continues to be the widespread adoption of the internet. If growth in the 1990s in the technology sector was based on the roll-out of pcs and the internet within the enterprise, growth this decade relates to consumer and third world adoption. The consumer market is more oriented to entertainment, and requires rich media-video and graphics more than text, and hence is pushing the technical boundaries. It is obviously also leading to structural changes in the advertising, entertainment and shopping markets. Technology is disruptive in a number of markets. For example becoming obsolete are cathode ray tube TVs, analogue radios and pre digital cameras. Soon DVDs will follow CDs as the world moves to downloads. Emerging new "toys" in 2007 will be the Apple TV and the iPhone, Windows Vista, WiMAX, flash drive PCs. Internet web-sites will get richer. Technology in the corporate world is less disruptive – more storage, more security, more software as a service is required. Through broadband BT, and similar incumbent operators, have now restored the requirement for a copper line. Mobile phones cannot act as a substitute when the requirement for video streaming has emerged in the home. Now the mobile phone operators are challenged to maintain tariffs in a VOIP/WiMAX/wifi world. International roaming charges are unsustainable.

We continue to view the sector with optimism and excitement. Nevertheless, large markets are maturing, so stock selection remains key. The macro scenario appears increasingly fragile, but we err on the optimistic side because the flywheels of merging economies are in motion, and consumers in these countries yearn to catch up.

PERFORMANCE ATTRIBUTION (in sterling terms)									
Equity markets	Benchmark allocation		Herald asset allocation		Performance*		Contribution to relative return %	Contribution attributable to:	
	01.01.06 %	31.12.06 %	01.01.06 %	31.12.06 %	Herald %	Benchmark %		Stock selection %	Asset allocation† %
UK	66.7	66.7	64.2	69.5	12.5	21.8	(5.1)	(4.9)	(0.2)
Europe ex. UK	–	–	6.9	6.5	6.6	–	(0.4)	–	(0.4)
Americas	33.3	33.3	15.6	17.2	3.1	(0.7)	2.8	0.6	2.2
Asia Pacific ex. Japan	–	–	10.8	8.4	(12.6)	–	(2.7)	–	(2.7)
Cash	–	–	2.5	3.6	2.8	–	(0.3)	–	(0.3)
Loans	–	–	–	(5.2)	1.5	–	0.3	–	0.3
Total	100.0	100.0	100.0	100.0	7.8	14.0	(5.4)	(4.3)	(1.1)

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 7.8% (against a benchmark return of 14.0%) translates into a relative return of (5.4%), divide the portfolio return of 107.8 by the benchmark return of 114.0 and subtract one.

† Asset allocation includes the contribution attributable to currency movements.

28 February 2007

INVESTMENT CHANGES (£'000)				
	Valuation at 31 December 2005	Net acquisitions (disposals)	Realised and unrealised appreciation (depreciation)	Valuation at 31 December 2006
Equities*:				
UK	228,919	10,740	25,268	264,927
Continental Europe	24,853	(1,650)	1,636	24,839
Americas	56,138	8,801	820	65,759
Asia Pacific	38,864	(1,099)	(5,945)	31,820
Total investments	348,774	16,792	21,779	387,345
Net liquid assets	9,519	4,605	(241)	13,883
Total assets	358,293	21,397	21,538	401,228

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

*Equities includes convertibles and warrants.

TOP TWENTY HOLDINGS

AT 31 DECEMBER 2006

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

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	£15,506,000
% of total assets	3.9
% of issued share capital held	3.7

(Valuation at 31 December 2005
£10,500,000)

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	£14,390,000
% of total assets	3.6
% of issued share capital held	6.2

(Valuation at 31 December 2005
£9,813,000)

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, 90% of UK local authorities and more than 50% of FTSE 100 companies. Headquartered in Hemel Hempstead, Northgate has over 3,200 staff operating throughout the UK and in California, USA.

Country	United Kingdom
Valuation	£12,384,000
% of total assets	3.1

(Valuation at 31 December 2005
£14,921,000)

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	£12,343,000
% of total assets	3.1
% of issued share capital held	8.5

(Valuation at 31 December 2005
£10,700,000)

Amstrad

Founded by Chairman Sir Alan Sugar in 1968 as an electrical goods trader. Today, Amstrad is a manufacturer and supplier of Telecoms, Audio, TV, Video and Digital Satellite products; notably set-top satellite decoders for Sky including the Sky Plus box. The Sky Plus box targets the growth area of Personal Video Recorders (PVR). Its products are sold primarily in the UK and Italy.

Country	United Kingdom
Valuation	£9,236,000
% of total assets	2.3
% of issued share capital held	7.1

(Valuation at 31 December 2005
£9,958,000)

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. In October 2006 the Company completed the acquisition of Metal Bulletin plc for £230 million.

Country	United Kingdom
Valuation	£8,744,000
% of total assets	2.2

(Valuation at 31 December 2005
£5,424,000)

IBS OPENSsystems

A dedicated supplier of software solutions to Local Authorities and Housing Organisations throughout the UK. IBS OPENSsystems is a market leader with 25 years experience and over 200 customers and over 300 software solutions installed. These include solutions for the collection of local taxes, payment of benefits, housing management, works management, financials and project accounting and more recently workflow and mobile working.

Country	United Kingdom
Valuation	£7,020,000
% of total assets	1.7
% of issued share capital held	9.8

(Valuation at 31 December 2005
£4,582,000)

TOP TWENTY HOLDINGS *continued*

AT 31 DECEMBER 2006

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 across all business sectors, making their systems the most comprehensive and technologically advanced in the world.

Country	United Kingdom
Valuation	£7,017,000
% of total assets	1.7
% of issued share capital held	9.5
(Valuation at 31 December 2005 £5,494,000)	

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 sectors the company focuses on are life sciences, seals and controls.

Country	United Kingdom
Valuation	£7,000,000
% of total assets	1.7
% of issued share capital held	3.5
(Valuation at 31 December 2005 £6,236,000)	

SurfControl

Provides a portfolio of security solutions that protect customers from Internet threats, deliver business and regulatory compliance, and enable business continuity. SurfControl delivers protection at multiple points: "In the internet cloud" with on-demand security services; in the network with software and appliances and on desktops and mobile clients. All of SurfControl's solutions for web, e-mail and endpoint security are backed by industry-leading threat detection technologies. The company protects more than 14.5 million users in over 23,000 customers worldwide, and employs more than 600 people in offices across Europe, the Americas, and Asia Pacific.

Country	United Kingdom
Valuation	£6,633,000
% of total assets	1.7
% of issued share capital held	4.4
(Valuation at 31 December 2005 £5,024,000)	

Wilmington Group

One of the UK's leading providers of information and training for professional business markets. The Group provides training, arranges industry events and publishes magazines, directories, databases, and special reports focused primarily on its principal sectors of Legal & Regulatory, Healthcare, Media & Entertainment and Design & Construction.

Country	United Kingdom
Valuation	£6,318,000
% of total assets	1.6
% of issued share capital held	3.2
(Valuation at 31 December 2005 £4,339,000)	

Telecom plus

Supplies fixed wire and mobile telecommunications services, gas, and electricity to residential and small business customers in the United Kingdom. Telecom plus PLC was incorporated in 1996 and began operations in 1997 providing a unique range of low-cost telephony services to the residential and SOHO markets. They use the collective buying power of lots of individual small users to negotiate bulk buying deals with major suppliers, passing the benefit back to their customers. An advanced billing system means the customer receives a single monthly bill covering all the services provided.

Country	United Kingdom
Valuation	£5,974,000
% of total assets	1.5
% of issued share capital held	4.6
(Valuation at 31 December 2005 £3,308,000)	

Logitech International

Designs, manufactures and markets personal peripherals. Logitech's origins lie in the OEM sector, which remains an important part of its business, and represented 11.6 per cent of the company's total sales in Fiscal 2006. Logitech continues to broaden its product offering and its presence in the retail sector. This is fuelled by a trend among consumers to enhance their basic PC systems with more fully featured personal peripherals that add functionality and cordless freedom to their desktops. Logitech's retail business also includes personal peripherals for platforms beyond the PC, such as gaming consoles, portable music players, mobile phones and home-entertainment systems. Today, Logitech's retail business accounts for 88.4 per cent of its revenue.

Country	Switzerland
Valuation	£5,289,000
% of total assets	1.3
(Valuation at 31 December 2005 £4,909,000)	

Phoenix IT Group

Established in 1980, Phoenix is a leading provider of a range of high quality IT support services, including network and systems management, network services, service desks, field services and professional services. These services are frequently sold and delivered as a managed service where Phoenix, in conjunction with a partner, manages the end-user's entire IT infrastructure rather than providing individual support services. During the year the Group added business continuity services including disaster recovery to its portfolio, in the form of NDR (Holdings) Limited ('NDR').

Country	United Kingdom
Valuation	£4,800,000
% of total assets	1.2
(Valuation at 31 December 2005 £3,407,000)	

TOP TWENTY HOLDINGS *continued*

AT 31 DECEMBER 2006

StatPro Group

Founded in 1994, StatPro provides portfolio analytics for the global asset management industry. The company offers applications and reports based around a data hub as well as integrated reporting solutions to automate and improve portfolio report production. StatPro has over 200 clients worldwide.

Country	United Kingdom
Valuation	£4,662,000
% of total assets	1.2
% of issued share capital held	8.7
(Valuation at 31 December 2005 £1,297,000)	

M&C Saatchi

Launched in 1995, with the aim of becoming the world's most sought after advertising agency. The company is now the world's largest independent network, with headquarters in London and regional centres covering America, Asia Pacific and Europe. M&C Saatchi employs over 750 people and works for more than 200 clients.

Country	United Kingdom
Valuation	£4,347,000
% of total assets	1.1
% of issued share capital held	5.9
(Valuation at 31 December 2005 £325,000)	

United Internet

A premium Internet Service Provider (ISP), with over 6.1 million customer contracts concentrated on the German market. The Group's value-added internet services are directed at private users, small offices/home offices (SOHO) and small to mid-size enterprises (SME). These groups are served by the established brands GMX, WEB.DE and 1&1. Outsourcing comprises purely B-to-B activities. InterNetX offers other webhosters white label hosting products and Twenty4help acts as a service provider for major companies in the field of CRM. In online marketing, United Internet supply advertising customers with a wide range of marketing and sales solutions: Display Marketing via AdLINK, Affiliate Marketing via Affilinet and Domain Marketing via Sedo.

Country	Germany
Valuation	£4,046,000
% of total assets	1.0
(Valuation at 31 December 2005 £3,567,000)	

Alternative Networks

A UK business communications service provider. The Group offers a full range of fixed line, mobile, voice and data products. Launched in 1994, Alternative Networks has achieved a track record of consistently profitable growth and in February 2005 listed on the Alternative Investment Market. Alternative Networks is a reseller for providers such as BT, Verizon, Cable & Wireless, Avaya, O2 and Vodafone. The Group caters to a broad range of telecoms needs, including both stand alone products and fully converged solutions, for larger SMEs and smaller corporate customers in the UK. It's over 4,000 business customers include clients such as JC Decaux, Channel 4, Miele and Securitas. The Group has grown rapidly over the past 10 years, now employing over 300 people, across five UK sites.

Country	United Kingdom
Valuation	£3,969,000
% of total assets	1.0
% of issued share capital held	6.0
(Valuation at 31 December 2005 n/a)	

Alterian

A leading global provider of software for analytics led integrated marketing makes it practical and cost effective for marketers to gain insight into their data and use this to drive an integrated marketing strategy. Alterian was founded in 1997 and created a database technology system which enables data to be processed at very high speeds. Customers include market leaders like Princess Cruises, General Motors, Zurich, HSBC, Dell, and Vodafone. The group's technology is sold through an assortment of business partners, who customize the products to meet the customer's specific requirements. Alterian's network of over 70 partners include Accenture, Acxiom, Allant Group, Carlson Marketing Group, Experian, Epsilon, infoUSA, Harte-Hanks, Merkle, Ogilvy One and Euro RSCG Worldwide. Alterian has over 100 employees and is headquartered in Bristol, with North American headquarters in Chicago.

Country	United Kingdom
Valuation	£3,752,000
% of total assets	0.9
% of issued share capital held	7.9
(Valuation at 31 December 2005 £4,224,000)	

ICM Computer Group

The Group provides IT Assurance which comprises a combination of IT solutions, IT support and Business Continuity services. IT Assurance allows companies to maintain system availability and to safeguard their business systems. ICM achieved public listing on the London Stock Exchange in May 1998. The company has since grown both organically and through acquisition. ICM operates from a network of support centres, strategically located throughout the UK.

Country	United Kingdom
Valuation	£3,728,000
% of total assets	0.9
% of issued share capital held	6.0
(Valuation at 31 December 2005 £4,198,000)	

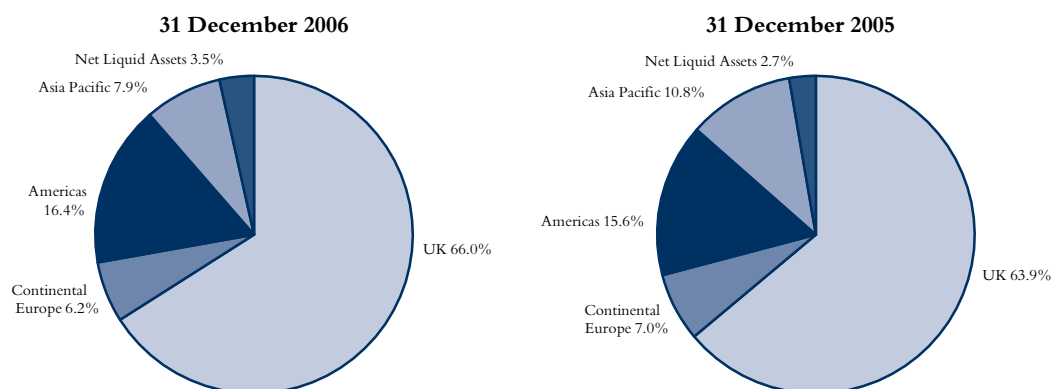
Note: A figure is presented for % of issued share capital held only if greater than 3%.

CLASSIFICATION OF INVESTMENTS

Classification	UK %	Continental Europe %	Americas %	Asia Pacific %	2006 Total %	2005 Total† %
EQUITIES: (including convertibles and warrants)						
BASIC MATERIALS	–	–	–	0.8	0.8	0.2
Chemicals	–	–	–	0.8	0.8	0.2
INDUSTRIALS	9.6	0.3	0.7	1.7	12.3	12.1
Aerospace and defence	0.4	–	–	–	0.4	0.1
Electronic and electrical equipment	2.6	0.3	0.5	1.7	5.1	6.8
Industrial engineering	–	–	–	–	–	1.1
Support services	6.6	–	0.2	–	6.8	4.1
CONSUMER GOODS	2.6	–	0.5	–	3.1	3.6
Leisure goods	2.6	–	0.5	–	3.1	3.6
HEALTH CARE	0.3	–	0.2	–	0.5	1.2
Health care equipment and services	–	–	0.2	–	0.2	1.1
Pharmaceuticals and biotechnology	0.3	–	–	–	0.3	0.1
CONSUMER SERVICES	14.8	1.4	1.2	0.1	17.5	33.8
Media	13.6	1.4	1.0	0.1	16.1	28.5
Travel and leisure	1.2	–	0.2	–	1.4	5.3
TELECOMMUNICATIONS	3.9	–	–	–	3.9	1.5
Fixed line telecommunications	3.5	–	–	–	3.5	1.5
Mobile telecommunications	0.4	–	–	–	0.4	–
FINANCIALS	0.3	–	–	–	0.3	6.6
Non-life insurance	–	–	–	–	–	1.3
General financial	–	–	–	–	–	1.3
Equity investment instruments	0.3	–	–	–	0.3	4.0
INFORMATION TECHNOLOGY	34.5	4.5	13.8	5.3	58.1	40.8
Software and computer services	28.5	2.1	4.9	1.1	36.6	25.7
Technology hardware and equipment	6.0	2.4	8.9	4.2	21.5	15.1
TOTAL EQUITIES (including convertibles and warrants)	66.0	6.2	16.4	7.9	96.5	
Total equities – 2005 (including convertibles and warrants)	63.9	7.0	15.6	10.8		97.3
NET LIQUID ASSETS	3.2	–	–	0.3	3.5	2.7
TOTAL ASSETS (before deduction of bank loans)	69.2	6.2	16.4	8.2	100.0	
Total assets – 2005	65.9	7.0	15.6	11.5		100.0
BANK LOANS	(5.0)	–	–	–	(5.0)	–
EQUITY SHAREHOLDERS' FUNDS	64.2	6.2	16.4	8.2	95.0	
Equity shareholders' funds – 2005	65.9	7.0	15.6	11.5		100.0
Number of equity investments (including convertibles and warrants)	136	21	74	37	268	262

†Restated, FTSE sectors reclassified January 2006.

GEOGRAPHICAL SPREAD OF INVESTMENTS



DETAILED LIST OF INVESTMENTS

AT 31 DECEMBER 2006

Classification	Name	Value £'000	%	
UNITED KINGDOM				
Aerospace and defence	†Cohort	1,432	0.4	
Electronic and electrical equipment	†Andor Technology	229		
	Dialight	854		
	e2v Technologies	1,754		
	†ID Data	721		
	†Innovision Research & Technology	1,838		
	†Screen Technology	1,249		
	†SPI Lasers	1,463		
	†Vigilant Technology	128		
	Xaar	2,391		
		10,627	2.6	
Support services	Acal	2,667		
	†Datacash Group	1,038		
	Diploma	7,000		
	†Eckoh Technologies	2,332		
	Harvey Nash Group	623		
	†Lorien	758		
	†Maintel Holdings	969		
	Mice Group	1,208		
	OPD Group	2,338		
	†Opsec Security	3,673		
	SThree	3,463		
	†Visual Defence	133		
	†Xpertise Group	98		
		26,300	6.6	
Leisure goods	Alba	1,016		
	Amstrad	9,236		
	†Bright Things	183		
		10,435	2.6	
Pharmaceuticals and biotechnology	†Osmetech	1,078	0.3	
Media	Aegis Group	2,785		
	†Apace Media	533		
	Bloomsbury Publishing	2,560		
	†Burst Media	229		
	Centaur Media	2,062		
	Chime Communications	3,647		
	†Coolabi	105		
	Creston	1,437		
	Euromoney Institutional Investor	8,744		
	†Expomedia Group	612		
	†First Artist	300		
	GCAP Media	307		
	†Independent Media Distribution	262		
	†Independent Media Support Group	100		
	ITE Group	2,249		
	†JumpTV	1,646		
	†Local Radio Company	842		
	†M & C Saatchi	4,347		
	*Motionposter	-		
	†Pixel Interactive Media	574		
	Quarto Group	3,075		
	†Screen Fx	462		
	†SPG Media	331		
	†Ten Alps	2,359		
	†Thomson Intermedia	7,017		
	†Touch Group	528		
	†UBC Media Group	984		
	Wilmington Group	6,318		
	† Yoomeia	217		
			54,632	13.6
	Travel and leisure	†365 Media Group	3,568	
		†Mama Group	390	
		†Media Corporation	791	
		4,749	1.2	

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2006

Classification	Name	Value £'000	%
UNITED KINGDOM (continued)			
Fixed line telecommunications	†Alternative Networks	3,969	
	†Pipex Communications	1,125	
	†Spectrum Interactive	323	
	†Telecom plus	5,974	
	†Thus Group	2,644	
		14,035	3.5
Mobile telecommunications	†2 Ergo Group	1,508	0.4
Non-life insurance	‡Culver Holdings	36	–
General financial	†Zyzygy	11	–
Equity investment instruments	*Herald Investment Management Ltd	207	
	*Herald Venture 2	1,089	
	*HIML Jersey Ltd	–	
		1,296	0.3
Software and computer services	†@UK	142	
	Alphameric	2,732	
	Alterian	3,752	
	Anite Group	899	
	†Atlantic Global	75	
	†Bango	737	
	†Business Control Solutions	747	
	†Clarity Commerce Solutions	618	
	†Corpora	43	
	†Datatec	1,245	
	†Dealogic	960	
	Detica Group	15,506	
	Dicom Group	1,266	
	Electronic Data Processing	1,091	
	†Fujin Technology	576	
	Gresham Computing	2,786	
	†Group NBT	3,528	
	*Harrier Group	343	
	†IBS OPENSystems	7,020	
	ICM Computer Group	3,728	
	†IDOX	880	
	†IMS Maxims	10	
	Intec Telecom Systems	1,660	
	†InTechnology	283	
	†Intelligent Environments	575	
	*Interactive Digital Solutions	–	
	†Invu	1,739	
	†Iomart	891	
	†Manpower Software	608	
	†Maxima Holdings	1,237	
	†Mediasurface	330	
	*Netcentric Systems	58	
	†NetServices	65	
	Northgate Information Solutions	12,384	
	†OMG	3,291	
	†OneClickHR	269	
	†Patsystems	1,088	
	Phoenix IT Group	4,800	
	†Portrait Software	462	
	†Redline Communications	970	
	†Redstone	690	
	RM	1,935	
	SDL	12,343	
	Servicepower Technologies	576	
	†SQS Software Quality Systems	1,330	
	†SSP Holdings	1,204	
	†StatPro Group	4,662	
†Strategic Thought Group	1,439		
SurfControl	6,633		
Trace Group	1,094		
Xansa	1,984		
†Z Group	525		
†‡Zoo Digital Group	575		
		114,384	28.5

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2006

Classification	Name	Value £'000	%
UNITED KINGDOM (continued)			
Technology hardware and equipment	†Amino Technologies	1,275	
	Arc International	1,137	
	†Celoxica Holdings	640	
	Imagination Technologies Group	14,390	
	†I-Mate	583	
	†IQE	731	
	†MTI Wireless Edge	510	
	†Nanoscience	907	
	Northamber	2,089	
	Plasmon	1,119	
	†Sandvine	486	
	*UbiNetics	–	
Zetex	537		
		24,404	6.0
	TOTAL UNITED KINGDOM EQUITIES	264,927	66.0
CONTINENTAL EUROPE			
Electronic and electrical equipment	Eltek	619	
	Nordic Semiconductor	574	
		1,193	0.3
Media	High Co	449	
	Impresa SGPS	940	
	NRJ Group	1,846	
	PubliGroupe	1,248	
	Roularta Media Group	1,009	
		5,492	1.4
General financial	Inspire Investments	169	–
Software and computer services	*Atex	–	
	Horizon Technology Group	321	
	InfoVista	1,148	
	Iona Technologies	745	
	Isra Vision Systems	795	
	SkillSoft	127	
	Teleplan International	337	
	Trolltech	677	
	United Internet	4,046	
		8,196	2.1
Technology hardware and equipment	Icos Vision Systems	3,116	
	Logitech International	5,289	
	SEZ Holding	476	
	Soitec	908	
		9,789	2.4
	TOTAL CONTINENTAL EUROPEAN EQUITIES	24,839	6.2
AMERICAS			
Electronic and electrical equipment	Jaco Electronics	150	
	On Track Innovations	364	
	Pemstar	590	
	Powerwave Technologies	757	
	‡Reptron Electronics	63	
		1,924	0.5
Support services	Harris Interactive	769	0.2
Leisure goods	Ituran Location & Control	1,065	
	THQ	747	
		1,812	0.5
Health care equipment and services	SonoSite	632	0.2
Media	Digitas	753	
	Jupitermedia	1,711	
	Multivision Communications	1	
	WebSideStory	1,616	
		4,081	1.0

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2006

Classification	Name	Value £'000	%
AMERICAS (continued)			
Travel and leisure	Ctrip.com International	956	0.2
Mobile telecommunications	*Adaptive Broadband	2	–
Software and computer services	@Road	1,164	
	Advent Software	1,800	
	Aladdin Knowledge Systems	1,591	
	Digital River	2	
	Epiq Systems	1,732	
	Fundtech	1,113	
	Iline Communications	787	
	Intraware	569	
	Keynote Systems	459	
	Kronos	983	
	Macrovision	2,165	
	Manhattan Associates	491	
	Mentor Graphics	460	
	Ness Technologies	1,088	
	Netease.com	382	
	NetScout Systems	1,481	
	PDF Solutions	700	
	Pegasystems	502	
	Retalix	1,090	
	Sourcecorp	351	
	Vitria Technology	185	
	Website Pros	693	
		19,788	4.9
Technology hardware and equipment	Actel	2,711	
	Actions Semiconductor	426	
	Adaptecc	594	
	Agilysys	512	
	Anadigics	1,358	
	Arris Group	1,118	
	Asyst Technologies	708	
	Atmi	1,558	
	CAM Commerce Solutions	558	
	Cirrus Logic	527	
	Credence Systems	265	
	Lantronix	833	
	Micros Systems	1,346	
	MIPS Technologies	1,058	
	Mobility Electronics	853	
	MRV Communications	2,056	
	NMS Communications	450	
	Nova Measuring Instruments	209	
	On Semiconductor	1,352	
	Power Integrations	238	
	Rackable Systems	790	
	Redback Networks	2,101	
	Remec	98	
	Rimage	398	
	RIT Technologies	247	
	SanDisk	1,594	
	Silicon Image	454	
	Silicon Motion Technology	1,616	
	Simpletech	1,934	
	Sipex	399	
	Skyworks Solutions	722	
	Sonicwall	2,339	
	Spectralink	542	
	Stratex Networks	1,601	
	Supertex	697	
	Virage Logic	945	
	Xyratex	588	
		35,795	8.9
	TOTAL AMERICAN EQUITIES	65,759	16.4

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2006

Classification	Name	Value £'000	%	
ASIA PACIFIC				
Chemicals	Kingboard Chemical Holdings	Hong Kong	995	
	Nepes	Korea	733	
	Techno Semichem	Korea	1,677	
		3,405	0.8	
Electronic and electrical equipment	Dae Duck Electronics	Korea	489	
	Fine Dnc	Korea	714	
	Huan Hsin	Singapore	640	
	Magnecomp International	Singapore	616	
	Simm Tech	Korea	1,060	
	† Surface Mount Technology	Singapore	350	
	Tripod Technology	Taiwan	892	
	UJU Electronics	Korea	546	
	Unimicron Technology	Taiwan	880	
	Woorec ETI	Korea	601	
		6,788	1.7	
Leisure goods	Action Asia	Singapore	29	
Media	Star Publications	Malaysia	576	
		1,105	0.1	
Software and computer services	BSE Holdings	Korea	801	
	Plantynet	Korea	1,042	
	Reckon	Australia	1,357	
	Springsoft	Taiwan	4,305	
		5,03	1.1	
Technology hardware and equipment	Ardentec	Taiwan	835	
	Core Logic	Korea	1,471	
	D-Link	Taiwan	688	
	EMW Antenna	Korea	656	
	Gemtek Technology	Taiwan	783	
	Global Testing	Singapore	1,476	
	Jadason Enterprises	Singapore	1,037	
	KH Vatec	Korea	532	
	King Yuan Electronics	Taiwan	601	
	Kinsus Interconnect Technology	Taiwan	1,019	
	Min Aik Technology	Taiwan	1,001	
	Mitac International	Taiwan	875	
	Mogem	Korea	766	
	Phicom	Korea	2,071	
	Powertech Technology	Taiwan	1,305	
	Seoul Semiconductor	Korea	379	
	STS Semiconductor and Telecommunications	Korea	719	
	ZyXEL Communications	Taiwan		
			16,717	4.2
	TOTAL ASIA PACIFIC EQUITIES			31,820
	Value of equity stocks	386,873		
	Convertible loan stocks having an element of equity	468		
	Warrants having an element of equity	4		
TOTAL EQUITY INVESTMENTS		387,345	96.5	
NET LIQUID ASSETS		13,883	3.5	
TOTAL ASSETS AT MARKET VALUE (before deduction of bank loan)		401,228	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† %
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)
2006	401,228	(20,000)	381,228	435.41	435.41	383.50	–	(11.9)

* 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.

‡ The diluted net asset value at 31 December 1996 has been restated with the adoption of FRS14. The previously reported fully diluted net asset value was 149.45p.

§ The figures prior to 2004 have not been restated for the changes in accounting policies implemented in 2005.

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§§
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
2006	6,492	1,922	2.19	1.20	1.13	102	105

** 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 40).

†† 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 1996 as 100)								
At 31 December	Diluted net asset value per share†	Share price	Benchmark¶¶	Hoare Govett Smaller Cos & AIM Index	Russell 2000 Technology Index	Earnings per ordinary share	Dividend per ordinary share net	Retail price index
1996	100	100	100	100	100	100	100	100
1997	114	100	115	105	105	102	105	104
1998	134	119	114	96	116	104	111	106
1999	328	376	195	148	246	65	105	108
2000	286	361	171	142	158	70	105	112
2001	208	225	144	117	126	103	105	112
2002	137	130	95	86	61	56	105	115
2003	242	239	135	119	90	24	37	119
2004	251	237	145	140	80	26	37	123
2005	271	279	173	171	87	48	74	126
2006	289	282	195	204	87	166	148	131

Compound Annual Returns

5 year	6.7%	4.6%	6.2%	11.8%	(7.1)%	10.0%	7.1%	3.2%
10 year	11.2%	10.9%	6.9%	7.4%	(1.4)%	5.2%	4.0%	2.8%

Past performance is no guarantee of future performance.

The figures prior to 2004 have not been restated for the changes in accounting policies implemented in 2005.

¶¶ From 1 January 2006 the benchmark was changed to $\frac{2}{3}$ Hoare Govett Smaller Companies Index plus AIM (capital gains on investment companies) and $\frac{1}{3}$ Russell 2000 (small cap) Technology Index (in sterling terms).

DIRECTORS' REPORT

The Directors present their report and accounts for the year ended 31 December 2006.

Business Review

Business Activity

The Company carries on business as an investment trust. It was approved by HM Revenue & Customs as an investment trust under Section 842 of the Income and Corporation Taxes Act 1988 for the year ended 31 December 2005, subject to any matters that may arise from any subsequent enquiry by HM Revenue & Customs 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 2006 borrowings comprised £20,000,000 (2005 – Nil).

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

Gearing

Borrowings are invested in equity markets when it is considered that investment grounds merit the Company taking a geared position to equities. Gearing levels, and the extent of equity gearing, are discussed by the Board and Managers at every Board meeting and adjusted accordingly.

Performance

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

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

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

A historical record of these measures are shown on pages 2, 3 and 19.

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

A review of the year and the investment outlook is contained in the Chairman's Statement and the Investment Manager's Report on pages 5 to 9.

Principal Risks and Uncertainties

The principal risks facing the Company relate to the Company's investment activities and include market risk, interest rate risk, credit risk, liquidity risk, foreign currency risk and loss of investment trust status.

The Company operates as an investment trust company in accordance with s842 of the Income and Corporation Taxes Act. As such, the Company is exempt from capital gains tax on the sale of its investments. The Manager monitors investment movements and the secretaries monitor the level of

DIRECTORS' REPORT *continued*

forecast income and expenditure and the amount of the proposed dividends to ensure that the provisions of s842 are not breached. An explanation of market risk, interest rate risk, liquidity risk and foreign currency risk and how they are managed are contained in note 18 to the accounts on pages 43 to 45.

Financials

The financial highlights for the year under review are as follows: the net asset value per share increased by 6.4% during the year, compared to an increase in the benchmark of 12.5%, dividends increased by 100.0% to 1.20p per share and the discount widened from 7.2% to 11.9%.

Results and Dividend

The net revenue return after tax was £1,922,000 (2005 – £556,000) and the capital return £21,538,000 (2005 – £25,789,000) giving a total return of £23,460,000 (2005 – £26,345,000) for the period.

The Directors recommend a dividend of 1.20p per Ordinary share for the year ended 31 December 2006, which, if approved at the Annual General Meeting, will be payable on 3 May 2007 to holders registered on 13 April 2007. The ex-dividend date is 11 April 2007.

The net asset value (NAV) of the Company at 31 December 2006 represented a value of 435.4p per Ordinary share. This represented an increase of 6.4% during the year and a rise of 341.1% since the date of committal of funds (16 February 1994) after allowing for launch expenses of 1.3p per share.

The Board

The Directors 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 2006	31 December 2005
Martin Boase	50,000	50,000
Clay Brendish	14,700	14,700
Timothy Curtis	2,000	2,000
Douglas McDougall	225,000	225,000

Mr C M Brendish retires by rotation and, being eligible, offers himself for re-election.

In accordance with the Combined Code on Corporate Governance Mr M Boase, who is 74 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 Messrs Boase and Brendish. Their performance continues to be effective and each remains committed to the Company. Their contribution to the Board is valued highly and the Board recommends their re-election to shareholders.

There have been no changes intimated in the Directors' interests up to 27 February 2007.

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.

DIRECTORS' REPORT *continued*

At 31 December 2006 the Company was the beneficial owner of 13.86% of the Ordinary share capital of HIML Holdings.

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 27 February 2007 the Directors have been notified of the following major shareholdings in the Company:

Name	Ordinary Shares	% of issue
Asset Value Investors Limited (Indirect)	6,103,115	7.0
Rathbone Investment Management Ltd (Indirect)	4,682,345	5.4
Société Générale (Direct)	3,512,700	4.0
Legal & General Group Plc (Direct)	3,347,218	3.8
HBOS (Indirect)	3,358,677	3.8
(Direct)	2,619,925	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 2005 or 2006.

Disclosure of Information to Auditors

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

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 25 April 2007 the following resolutions will be proposed as special business.

Continuation of the Company

The Company's Articles of Association first gave shareholders the right to vote at the Annual General Meeting (AGM) on 14 April 2004 (and at AGMs to be held in every third year thereafter) as to whether the Company should continue to operate as an investment trust. Accordingly, an ordinary

DIRECTORS' REPORT *continued*

resolution, Resolution 8 in the Notice of Annual General Meeting, is being proposed at the AGM of the Company to be held on 25 April 2007 to the effect that the Company should continue as an investment trust.

Authority to Repurchase the Company's Ordinary Shares

At the Company's Annual General Meeting held on 12 April 2006 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 2006 no shares were bought back in the Company. Between 1 January 2007 and the date of this report, the Company bought back 190,000 Ordinary shares (nominal value £47,500 which comprised 0.22% of the issued share capital at 1 January 2007) on the London Stock Exchange for cancellation. 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 9 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 2008. Authority will be sought to purchase up to 14.99% of the Company's Ordinary shares in issue at the date of the passing of the resolution (the maximum permitted under the Listing Rules of the UK Listing Authority) at a price that is not less than 25p per share (the nominal value of each share) and must not exceed the higher of (a) 105% of the average of the middle-market quotation (as derived from the Daily Official List of the London Stock Exchange) for the five business days preceding the day of purchase and (b) the higher of the last independent trade and the highest current independent trade on the London Stock Exchange. The authority being sought, the full text of which can be found in Resolution 9 in the Notice of Annual General Meeting, will last until the date of the Annual General Meeting in 2008. The decision as to whether the Company repurchases any shares will be at the absolute discretion of the Board and will only be considered when it is in the interests of the Company and its shareholders as a whole. It is the intention that purchases will only be made at a discount to net asset value.

Recommendation

The Directors consider that the continuation of the Company and the renewal 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 these resolutions and all other resolutions to be proposed at the Annual General Meeting by completing and returning the enclosed form of proxy. The proxy form should be returned to the Company's Registrar as soon as possible but in any event so as to arrive no later than 48 hours before the time of the Annual General Meeting.

By order of the Board

Baillie Gifford & Co

Secretaries

28 February 2007

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 31 and 32.

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 2007 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 during the year and concluded that the fees should remain unchanged at £22,500 for the Chairman and £15,000 for each Director.

Directors' Service Contracts

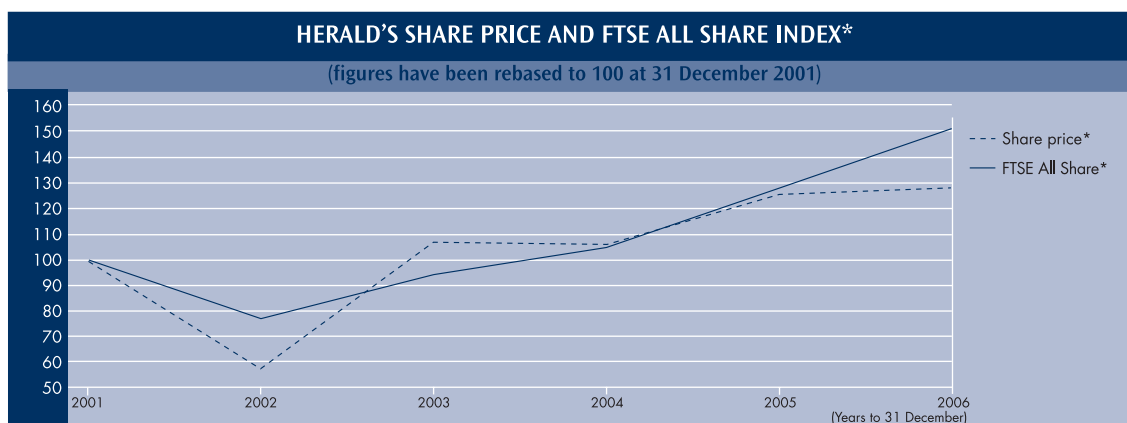
It is the Board's policy that none of the Directors have a service contract. All of the Directors have been provided with revised appointment letters dated 10 November 2004. The terms of their appointment provide that a Director shall retire and be subject to re-election at the first Annual General Meeting 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 2007
Clay Brendish	23 July 2001	AGM April 2007
Timothy Curtis	22 July 2004	AGM 2008
Douglas McDougall	13 February 2002	AGM 2008

DIRECTORS' REMUNERATION REPORT *continued*

Company Performance

The graph below compares, for the five financial years ended 31 December 2006, the total return (assuming all dividends are reinvested) to ordinary shareholders compared to the total shareholder return on a notional investment made up of shares in the component parts of the FTSE All-Share Index. This index was chosen for comparison purposes, as it is the best measure of performance for UK listed companies.



Source: Thomson Financial 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 2006 £	Fees 2005 £
Directors who served during the year:		
Martin Boase (Chairman)	22,500	18,750
Clay Brendish	15,000	13,000
Timothy Curtis	15,000	13,000
Douglas McDougall	15,000	13,000
	<u>67,500</u>	<u>57,750</u>
Past Directors:		
Justin Dukes (retired 13 April 2005)	—	3,104
Clive Parritt (retired 13 April 2005)	—	3,104
	<u>67,500</u>	<u>63,958</u>

Sums Paid to Third Parties (audited)

The Directors' fees payable to Mr C M Brendish were paid to ECIC Management Limited. The payment was for making his services available as a Director of the Company.

Approval

The Directors' Remuneration Report on pages 24 and 25 was approved by the Board of Directors on 21 February 2007 and signed on its behalf by

Martin Boase
Chairman

CORPORATE GOVERNANCE

Compliance

The Board is committed to achieving and demonstrating high standards of Corporate Governance. This statement outlines how the principles of The Combined Code on Corporate Governance, published in June 2006 (the “Combined Code”) were applied throughout the financial year.

The Board believes that the Company has complied throughout the year with the provisions of the Combined Code, except that no limit has been imposed on the overall length of service of Directors.

The Directors recognise the importance of succession planning for company boards and the Board composition is reviewed 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 be a benefit to the Board. Consequently, no limit has been imposed on the overall length of service. All Directors are, however, required to retire and, if appropriate seek re-election at least every three years. Directors who have more than nine years’ service submit themselves for re-election annually.

The Board is also adhering to the principles of the AIC 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 6.03% 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 AIC Code that long-serving directors should not be prevented from being considered as independent. 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, except Mr Brendish, attended the Annual General Meeting.

CORPORATE GOVERNANCE *continued*

	Board	Audit Committee	Nomination Committee
Number of meetings	4	2	1
Martin Boase	4	2	1
Clay Brendish	3	2	1
Timothy Curtis	4	2	1
Douglas McDougall	4	2	1

Nomination Committee

The Nomination Committee consists of all the Directors and the Chairman of the Board is Chairman of the Committee. The Committee meets on an annual basis and at such other times as may be required. The Committee has written terms of reference which include reviewing the Board, identifying and nominating new candidates for appointment to the Board, Board appraisal, succession planning and training. The Committee also considers whether Directors should be recommended for re-election by shareholders. The 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.

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

The names of the Directors retiring and offering themselves for re-election together with the reasons why the Board supports the re-elections are set out on page 21.

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, the provisions of the Combined Code in respect of Directors' remuneration are not relevant to the Company except to the extent that they relate specifically to non-executive directors. Consequently there is no requirement for a separate remuneration committee. Directors' fees are considered by the Board as a whole within the limits approved by shareholders. The Company's policy on remuneration is set out in the Directors' Remuneration Report on pages 24 and 25.

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 Controls: Revised Guidance for Directors on the Combined Code."

CORPORATE GOVERNANCE *continued*

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

The 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 (FRAG 21). 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. The Committee continues to believe that the compliance and internal control systems and the internal audit function in place within the Investment Manager and Company 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 30 to 32.

In accordance with the Company's Articles of Association, shareholders will be given the opportunity, at the forthcoming Annual General Meeting, to vote on whether to continue the Company. After making enquiries and notwithstanding the above, the accounts have been prepared on the going concern basis as it is the Directors' opinion that the Company will continue in operational existence for the foreseeable future.

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;

CORPORATE GOVERNANCE *continued*

- 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);
- reviewing and monitoring the independence, objectivity and effectiveness of the external auditors;
- reviewing the arrangements in place within HIML whereby their staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters insofar as they may affect the Company;
- reviewing the terms of the Investment Management Agreement; and
- considering annually whether there is a need for the Company to have its own internal audit function.

The Committee considers the experience and tenure of the audit partner and staff and the nature and level of services provided. The Committee receives confirmation from the auditors that they have complied with the relevant UK professional and regulatory requirements on independence.

Relations with Shareholders

The Board places great importance on communication with shareholders. The Company's Manager meets regularly with institutional shareholders and reports to the Board. The Chairman is available to meet with shareholders as appropriate. Shareholders wishing to communicate with the Chairman or any other Director may do so by writing to him at the registered office of the Company which is shown on page 4. The Company's Annual General Meeting provides a forum for communication with all shareholders. The level of proxies lodged for each resolution is announced at the meeting and is published on the Managers' website subsequent to the meeting. The notice period for the Annual General Meeting is at least twenty working days. Shareholders and potential investors may obtain up-to-date information on the Company from the Manager's website: 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. The Company believes that it is in the shareholders' interests to consider environmental, social and governance factors when selecting and retaining investments and has asked the Manager to take these issues into account as long as the investment objectives are not compromised. The Manager does not exclude companies from its investment universe purely on the grounds of environmental, social and governance issues but adopts a positive engagement approach whereby matters are discussed with management with the aim of improving the relevant policies and management systems. The Manager's policy has been reviewed and endorsed by the Board.

On behalf of the Board

Martin Boase
Chairman

28 February 2007

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RELATION TO THE FINANCIAL STATEMENTS

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

Company law requires the Directors to prepare financial statements for each financial year 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 net return 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 2006 which comprise the Income Statement, Balance Sheet, Reconciliation of Movement in Shareholders' Funds, Cash Flow Statement and the related notes 1 to 18. These financial statements have been prepared under 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' responsibilities 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) are 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 whether the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, 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 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 risks 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 2006 and of the net return for the year then ended;
- 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; and
- the information given in the Directors' Report is consistent with the financial statements.

ERNST & YOUNG LLP

Registered Auditor

Edinburgh

28 February 2007

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

		2006			2005		
	Notes	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
Gains on investments	9	–	21,779	21,779	–	27,708	27,708
Exchange difference on loans		–	–	–	–	(1,989)	(1,989)
Currency (losses)/gains	13	–	(241)	(241)	–	70	70
Income	2	6,492	–	6,492	5,368	–	5,368
Investment management fee	3	(3,927)	–	(3,927)	(3,741)	–	(3,741)
Other administrative expenses	4	(262)	–	(262)	(275)	–	(275)
Net return before finance costs and taxation		2,303	21,538	23,841	1,352	25,789	27,141
Finance costs of borrowings	5	(284)	–	(284)	(724)	–	(724)
Return on ordinary activities before taxation		2,019	21,538	23,557	628	25,789	26,417
Tax on ordinary activities	6	(97)	–	(97)	(72)	–	(72)
Return on ordinary activities after taxation		1,922	21,538	23,460	556	25,789	26,345
Return per Ordinary share	8	2.19p	24.60p	26.79p	0.64p	29.45p	30.09p

The Board proposed on 21 February 2007 a dividend of 1.20p per Ordinary Share (31 December 2005 – 0.60p).

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 37 to 45 are an integral part of this statement.

BALANCE SHEET

AT 31 DECEMBER 2006

	Notes	2006		2005	
		£'000	£'000	£'000	£'000
Fixed assets					
Investments at fair value through profit or loss	9		387,345		348,774
Current assets					
Debtors	10	2,776		786	
Cash and short term deposits	18	11,778		9,089	
		<u>14,554</u>		<u>9,875</u>	
Creditors:					
Amounts falling due within one year	11	<u>(20,671)</u>		<u>(356)</u>	
Net current (liabilities)/assets			<u>(6,117)</u>		<u>9,519</u>
TOTAL NET ASSETS					
			<u>381,228</u>		<u>358,293</u>
Capital and reserves					
Called-up share capital	12		21,889		21,889
Share premium	13		73,738		73,738
Capital redemption reserve	13		63		63
Capital reserve – realised	13		233,361		209,639
Capital reserve – unrealised	13		48,125		50,309
Revenue reserve	13		<u>4,052</u>		<u>2,655</u>
EQUITY SHAREHOLDERS' FUNDS					
			<u>381,228</u>		<u>358,293</u>
NET ASSET VALUE PER ORDINARY SHARE					
	14		435.41p		409.22p

The accounts were approved by the Board of Directors and authorised for issue on 28 February 2007 and signed on their behalf by

Martin Boase
Chairman

The accompanying notes on pages 37 to 45 are an integral part of this statement.

RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	Called-up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000	Total share- holders' funds £'000
Shareholders' funds at 1 January 2006		21,889	73,738	63	209,639	50,309	2,655	358,293
Return on ordinary activities after taxation	13	–	–	–	23,722	(2,184)	1,922	23,460
Dividends paid during the year	7	–	–	–	–	–	(525)	(525)
Shareholders' funds at 31 December 2006		<u>21,889</u>	<u>73,738</u>	<u>63</u>	<u>233,361</u>	<u>48,125</u>	<u>4,052</u>	<u>381,228</u>

FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	Called-up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000	Total share- holders' funds £'000
Shareholders' funds at 1 January 2005		21,889	73,738	63	202,442	31,717	2,362	332,211
Return on ordinary activities after taxation		–	–	–	7,197	18,592	556	26,345
Dividends paid during the year	7	–	–	–	–	–	(263)	(263)
Shareholders' funds at 31 December 2005		<u>21,889</u>	<u>73,738</u>	<u>63</u>	<u>209,639</u>	<u>50,309</u>	<u>2,655</u>	<u>358,293</u>

The accompanying notes on pages 37 to 45 are an integral part of this statement.

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006		2005	
		£'000	£'000	£'000	£'000
Net cash inflow from operating activities	15		2,107		1,322
Servicing of Finance					
Loan interest		(10)		(841)	
Net cash outflow from servicing of finance			(10)		(841)
Financial investment					
Purchase of investments		(115,977)		(75,037)	
Sale of investments		97,094		75,653	
Net cash (outflow)/inflow from financial investment			(18,883)		616
Equity dividend paid	7		(525)		(263)
Net cash (outflow)/inflow before financing			(17,311)		834
Financing					
Loans drawn down		20,000		24,771	
Loans repaid		–		(51,423)	
Net cash inflow/(outflow) from financing			20,000		(26,652)
INCREASE/(DECREASE) IN CASH	16		2,689		(25,818)
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET (DEBT)/FUNDS	16				
Increase/(decrease) in cash in period			2,689		(25,818)
(Increase)/decrease in bank loans			(20,000)		26,652
Exchange movement on loans			–		(1,989)
MOVEMENT IN NET (DEBT)/FUNDS IN PERIOD			(17,311)		(1,155)
NET FUNDS AT 1 JANUARY			9,089		10,244
NET (DEBT)/FUNDS AT 31 DECEMBER			(8,222)		9,089

The accompanying notes on pages 37 to 45 are an integral part of this statement.

NOTES TO THE ACCOUNTS

1. Accounting policies

The Financial Statements for the year to 31 December 2006 have been prepared on the basis of the accounting policies set out in the Company's Annual Financial Statements at 31 December 2005.

(a) Accounting convention

The accounts are prepared on the assumption that approval as an investment trust will continue to be granted.

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

The accounts have been prepared in accordance with The Companies Act 1985, applicable UK accounting standards and the AIC's revised Statement of Recommended Practice "Financial Statements of Investment Trust Companies" issued in 2003, revised 2005.

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

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

(b) Investments

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

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

(c) Income

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

(d) Expenses

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

(e) Finance costs

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

(f) 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.

(g) 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.

(h) 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. Purchases of the Company's own shares for cancellation are also funded from the realised capital reserve.

NOTES TO THE ACCOUNTS *continued*

2. Income	2006 £'000	2005 £'000
Income from investments		
Franked dividends from listed investments*	4,508	2,699
Franked dividends from unlisted investments (inc AIM)	318	82
Unfranked income from unlisted (inc AIM) UK convertible bonds	5	145
Overseas dividend income	1,037	1,268
	5,868	4,194
Other income		
Deposit interest	619	1,172
Underwriting commission	5	2
	624	1,174
Total income	6,492	5,368
Total income comprises:		
Dividends	5,863	4,049
Interest from investments	5	145
Other	624	1,174
	6,492	5,368
Income from investments		
Listed UK	4,508	2,699
Listed overseas	1,037	1,268
Unlisted	323	227
	5,868	4,194

*2006 includes a special dividend of £1,889,000 from Amstrad.

3. Investment management fee – all charged to the revenue column of the income statement	2006 £'000	2005 £'000
Investment management fee	3,578	3,345
Irrecoverable VAT thereon	349	396
	3,927	3,741

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 the revenue column of the income statement	2006 £'000	2005 £'000
Custodian's fees	61	54
Registrars' fees	17	20
Directors' fees	68	64
Auditors' fees – audit work	13	11
Miscellaneous expenses	103	126
	262	275

5. Finance costs of borrowings – all charged to the revenue column of the income statement	2006 £'000	2005 £'000
Bank loans repayable within one year	284	724
	284	724

NOTES TO THE ACCOUNTS *continued*

6. Taxation

	2006	2005
	£'000	£'000
Overseas taxation	97	72
The tax charge for the year is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below.		
Revenue return on ordinary activities before taxation	2,019	628
Revenue return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2005 – 30%)	606	188
Income not taxable	(1,448)	(834)
Overseas withholding tax claimed as a deduction	(29)	(22)
Overseas withholding tax written off	97	72
Excess expenses in period not provided for as an asset	871	668
Current tax charge for the year	97	72

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 2006 or 31 December 2005 as the Company has unrelieved management expenses which are available to be carried forward. The tax charge for 31 December 2006 and 2005 comprises overseas withholding taxes written off.

At 31 December 2006 the Company had surplus management expenses of £15m (2005 – £12m) 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

	2006	2005	2006	2005
			£'000	£'000
Amounts recognised as distributions in the period				
Previous year's final (paid 19 April 2006)	0.60p	0.30p	525	263
Current year's proposed final dividend	1.20p	0.60p	1,051	525

The current year's proposed dividend will be paid on 3 May 2007 to all shareholders on the register as at the close of business on 13 April 2007. The ex-dividend date is 11 April 2007.

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.

	2006	2005
	£'000	£'000
Revenue available for distribution by way of dividends for the year	1,922	556
Proposed final dividend for the year ended 31 December 2006 of 1.20p (2005 – 0.60p)	1,051	525

NOTES TO THE ACCOUNTS *continued*

8. Return per Ordinary share

2006			2005		
Revenue	Capital	Total	Revenue	Capital	Total
2.19p	24.60p	26.79p	0.64p	29.45p	30.09p

Revenue return per Ordinary share is based on the net revenue on ordinary activities after taxation of £1,922,000 (2005 – £556,000) and on 87,556,010 Ordinary shares (2005 – 87,556,010) being the number of Ordinary shares in issue during each year.

Capital return per Ordinary share is based on the net capital gain for the financial year of £21,538,000 (2005 – £25,789,000) and on 87,556,010 Ordinary shares (2005 – 87,556,010) being the number of Ordinary shares in issue during each year.

There are no dilutive or potentially dilutive shares in issue.

9. Fixed assets – investments

	2006	2005
	£'000	£'000
Listed at market valuation on the London Stock Exchange	168,829	163,724
Listed at market valuation on other recognised Stock Exchanges	122,416	120,070
AIM	94,401	64,394
Unquoted*	1,699	586
Total fixed asset investments	387,345	348,774

	Listed in UK £'000	Listed overseas £'000	AIM £'000	Unquoted £'000	Total £'000
Cost of investments at 1 January 2006	107,090	112,358	73,245	5,772	298,465
Unrealised appreciation/(depreciation) at 1 January 2006	56,634	7,712	(8,851)	(5,186)	50,309
Value of investments at 1 January 2006	163,724	120,070	64,394	586	348,774
Movements in the year:					
Purchases at cost	24,946	56,289	33,992	750	115,977
Sales – proceeds	(38,789)	(49,782)	(10,578)	(36)	(99,185)
– realised profit/(loss)	19,040	3,955	2,795	(1,827)	23,963
Increase/(decrease) in unrealised appreciation/ (depreciation)	6,586	(7,446)	(375)	(949)	(2,184)
Change in listing	(6,678)	(670)	4,173	3,175	–
Value of investments held at 31 December 2006	168,829	122,416	94,401	1,699	387,345
Cost of investments at 31 December 2006	105,609	122,150	103,627	7,834	339,220
Unrealised appreciation/(depreciation) at 31 December 2006	63,220	266	(9,226)	(6,135)	48,125
Value of investments at 31 December 2006	168,829	122,416	94,401	1,699	387,345

	2006	2005
	£'000	£'000
Gains on investments		
Realised gains on sales	23,963	8,011
(Decrease)/increase in unrealised appreciation/(depreciation)	(2,184)	19,697
	21,779	27,708

Of the realised gains on sales of £23,963,000 (2005 – gain of £8,011,000) during the year, a net gain of £14,845,000 (2005 – loss of £405,000) 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 £1,296,000, Harrier Group at £343,000, Interactive Digital Solutions at zero, Motionposter at zero, Netcentric at £58,000, UbiNetics at zero, Adaptive Broadband at £2,000 and Atex (grey market value at 31 December 2006 of £82,000) at zero.

At 31 December 2006 the Company was the beneficial owner of 13.86% (2005 – 12.89%) of the Ordinary share capital of both HIML Holdings and HIML Jersey Ltd. HIML Holdings is incorporated in the United Kingdom whereas HIML Jersey Ltd is incorporated in Jersey.

NOTES TO THE ACCOUNTS *continued*

9. Fixed assets – investments (continued)

	2006	2005
Transaction costs	£'000	£'000
The following transaction costs were incurred during the period		
Purchases	687	241
Sales	376	153
	1,063	394
	1,063	394

10. Debtors

	2006	2005
Due within one year:	£'000	£'000
Income accrued	502	618
Sales for subsequent settlement	2,155	64
Taxation recoverable	14	19
Other debtors and prepayments	105	85
	2,776	786
	2,776	786

11. Creditors

	2006	2005
Amounts falling due within one year:	£'000	£'000
Bank loans	20,000	–
Other creditors and accruals	671	356
	20,671	356
	20,671	356

Included in other creditors and accruals is £317,000 (2005 – £299,000) in respect of the investment management fee.

The Company has a 364 day £50 million multi-currency loan facility with The Royal Bank of Scotland which expires on 4 October 2007.

Interest on the multi-currency loan is payable in half yearly instalments in April and October. The loan is due for repayment in April 2007. The estimated repayment value of the loan at 31 December 2006 was £20,000,000. The indicative costs of repaying the loan as at 31 December 2006 were not material in the context of the above figures.

The main covenant relating to the loan is:

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

- (i) the market value of any unlisted investments;
- (ii) the amount by which the market value of any single investment represents more than 7.5% of the Company's gross assets; and
- (iii) the amount by which the aggregate market value of the ten largest investments exceeds 45% of gross assets.

NOTES TO THE ACCOUNTS *continued*

12. Called-up share capital

		2006	2005
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 2006 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 2006 (2005 – Nil). At 31 December 2006 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.

13. Capital and Reserves

	Share premium £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000
At 1 January 2006	73,738	63	209,639	50,309	2,655
Net gain on realisation of investments	–	–	23,963	–	–
Decrease in unrealised appreciation	–	–	–	(2,184)	–
Other exchange differences	–	–	(241)	–	–
Ordinary dividend paid	–	–	–	–	(525)
Net revenue for the year	–	–	–	–	1,922
	73,738	63	233,361	48,125	4,052

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

14. 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:

	2006	2005	2006 £'000	2005 £'000
Ordinary shares	435.41p	409.22p	381,228	358,293

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.

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

	2006 £'000	2005 £'000
Net revenue on ordinary activities before finance costs and taxation	23,841	27,141
Gains on investments – securities	(21,779)	(27,708)
Currency losses	241	1,919
Decrease/(increase) in accrued income	121	(73)
(Increase)/decrease in debtors	(20)	6
Increase in creditors	41	14
Income tax repaid	–	25
Overseas tax suffered	(97)	(72)
Realised currency (loss)/profit	(241)	70
Net cash inflow from operating activities	2,107	1,322

NOTES TO THE ACCOUNTS *continued*

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

	At 1 January 2006	Cash flows £'000	Exchange movement £'000	At 31 December 2006 £'000
Cash at bank and in hand	9,089	2,689	–	11,778
Loans due within one year	–	(20,000)	–	(20,000)
	9,089	(17,311)	–	(8,222)

17. Contingent Liabilities, Guarantees and Financial Commitments

At 31 December 2006 and 31 December 2005 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 tranche of £300,000 was drawn down on 27 October 2004, with a further £150,000 during the year to 31 December 2005 and £750,000 in the year to 31 December 2006.

18. 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.

Gearing

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

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 International Private Equity and Venture Capital Valuation 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 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 2006 is detailed below.

Liquidity Risk

The Company's policy with regard to liquidity is to ensure continuity of funding. Short term flexibility is achieved by an overdraft facility of £2 million with The Bank of New York. The Company's assets mainly comprise readily realisable securities which can be sold freely to meet funding commitments if necessary.

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 below. Interest is accrued on sterling cash balances at a rate linked to the UK base rate.

At the year end the Company had borrowings totalling £20,000,000 (2005 – Nil) which becomes due for repayment in April 2007.

NOTES TO THE ACCOUNTS *continued*

18. Derivatives and Other Financial Instruments (continued)

Foreign Currency Risk

Exposure to currency risk through asset allocation is detailed below:

Financial Assets

	2006			2005		
	Investments £'000	Cash and deposits £'000	Short-term debtors £'000	Investments £'000	Cash and deposits £'000	Short-term debtors £'000
Sterling	264,927	10,881	2,738	230,257	6,671	587
US dollar	66,631	–	2	55,440	9	3
Euro	14,915	–	7	15,416	–	14
Norwegian kroner	1,870	–	–	2,145	–	–
Israel shekels	169	–	–	307	87	–
Swiss francs	7,013	–	–	6,344	–	–
Australian dollar	1,042	–	–	1,157	–	125
Hong Kong dollar	995	–	–	3,617	–	–
Korean won	13,611	–	26	9,702	–	57
Malaysian ringitt	576	9	–	3,576	–	–
Singapore dollar	3,894	–	3	8,971	–	–
Taiwan dollars	11,702	888	–	10,618	2,322	–
Thai baht	–	–	–	1,224	–	–
	<u>387,345</u>	<u>11,778</u>	<u>2,776</u>	<u>348,774</u>	<u>9,089</u>	<u>786</u>

Included within the analysis provided above and on pages 14 to 18 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.

	2006		2005	
	Fair value £'000	Maturity date	Fair value £'000	Maturity date
Warrants:				
Sterling	–	–	12	31/12/06
Hong Kong dollar	–	–	20	31/12/06
Singapore dollar	<u>4</u>	<u>13/08/09</u>	<u>18</u>	<u>13/08/09</u>

Financial Liabilities

The following currency amounts are included in current and long term liabilities:

	2006		2005	
	Bank loans £'000	Other creditors and accruals £'000	Bank loans £'000	Other creditors and accruals £'000
Sterling	<u>20,000</u>	<u>671</u>	<u>–</u>	<u>356</u>

Short term debtors and creditors have been excluded from the disclosure of financial instruments other than for currency disclosures.

NOTES TO THE ACCOUNTS *continued*

18. Derivatives and Other Financial Instruments (continued)

Interest Rate Risk

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

Financial Assets

	2006			2005		
	Weighted average interest rate/ interest rate	Weighted average period until maturity/ maturity date	Fair value £'000	Weighted average interest rate/ interest rate	Weighted average period until maturity/ maturity date	Fair value £'000
Fixed rate:						
UK convertible bonds	7%	4 years	405	8%	3 years	63
US convertible bond	7%	2 years	63	7%	3 years	25

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

Financial Liabilities

	2006			2005		
	£'000	Interest rate	Period until maturity	£'000	Interest rate	Period until maturity
Bank loans:						
£20,000,000 – fixed rate	20,000	5.811%	3 months	–	–	–

The maturity profile of the Company's financial liabilities at 31 December was:
In one year or less, or on demand

2006 £'000	2005 £'000
20,000	–

Fair Value of Financial Assets and Liabilities

The Directors are of the opinion that the financial assets and liabilities of the Company are stated at fair value in the balance sheet.

A full list of the Company's investments is given on pages 14 to 18. 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 10 to 13.

Gains and losses on hedges

At 31 December 2006 and 2005 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.

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Herald Investment Trust plc will be held at 10–11 Charterhouse Square, London EC1M 6EE on 25 April 2007 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 2006.
 2. To approve the Directors' Remuneration Report for the year ended 31 December 2006.
 3. To declare a final dividend of 1.20p per share in respect of the year ended 31 December 2006.
- 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 74, as a Director of the Company.
 5. To re-elect Mr C M Brendish as a Director of the Company.
 6. To reappoint Ernst & Young LLP as Auditors to the Company.
 7. To authorise the Directors to determine the remuneration of the Auditors.

Special Business

To consider and, if thought fit, pass the following resolution as an Ordinary Resolution:

8. THAT, pursuant to article 153 of the Articles of Association of the Company, the Company will continue to operate as an investment trust company until the conclusion of the Annual General Meeting of the Company to be held in 2010.

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

9. 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 (exclusive of expenses) which may be paid for a share shall not be more than the higher of (a) 105% of the average of the middle market quotations (as derived from the Daily Official List of the London Stock Exchange) for the shares for the five business days immediately preceding the date of purchase and (b) the higher of the last independent trade and the highest current independent trade on the London Stock Exchange;
- (iv) any purchase of shares will be made in the market for cash at prices below the prevailing net asset value per share (as determined by the Directors);
- (v) unless previously varied, revoked or renewed, the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2008; 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:
10–11 Charterhouse Square
London EC1M 6EE
15 March 2007

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 later 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 23 April 2007 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 23 April 2007 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 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.

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