HERALD INVESTMENT TRUST plc

ANNUAL REPORT & FINANCIAL STATEMENTS

31 December 2009

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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 2009		
Total assets†	**Shareholders' funds**	**Market capitalisation**
£397m	**£341m**	**£274m**

†Before deduction of bank loans and derivative financial instruments

Policy and Objective	Herald's objective is to achieve capital appreciation through investments in smaller quoted companies, in the areas of telecommunications, multimedia and technology (TMT). Investments may be made across the world. The business activities of investee companies will include information technology, broadcasting, printing and publishing and the supply of equipment and services to these companies. The Company's investment policy is contained within the Business Review on page 22.
Benchmark	The portfolio benchmark against which performance is measured is ²/₃ Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies) and ¹/₃ Russell 2000 (small cap) Technology Index (in sterling terms). Though we consider this benchmark to provide a reasonable base for measuring the Trust's performance, the portfolio is not modelled on it and outcomes may diverge widely.
Management Details	Herald Investment Management Limited ('HIML') is the appointed investment manager to the Company. The management contract can be terminated at twelve months' notice. Administration of the Company and its investments is contracted by HIML to Baillie Gifford & Co, who also act as Company Secretary.
Capital Structure	The Company's share capital consists of 81,053,283 Ordinary shares of 25p each which are issued and fully paid. The Company has been granted authority to buy back a limited number of its own Ordinary shares for cancellation. During the year 2,354,840 Ordinary shares were bought back for cancellation. The Directors are seeking to renew this authority at the forthcoming Annual General Meeting.
Management Fee	Herald Investment Management Limited's annual remuneration is 1.0% of the Company's net asset value based on middle market prices, calculated on a monthly basis payable in arrears.
Wind-Up	At the Annual General Meeting of the Company held in April 2007 shareholders voted in favour of the Company continuing to operate as an investment trust. The next continuation vote will be on 21 April 2010 and every third year thereafter.
AIC	The Company is a member of the Association of Investment Companies.

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

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

YEAR'S SUMMARY

	31 December 2009	31 December 2008	% change
Total assets (before deduction of bank loans and derivative financial instruments)	£397.2m	£275.8m	
Bank loans	£50.0m	£50.0m	
Derivative financial instruments	£6.3m	£15.1m	
Shareholders' funds	£340.9m	£210.7m	
Net asset value per Ordinary share	420.6p	252.6p	66.5
Share price*	337.8p	184.0p	83.6
FTSE 100	5,412.9	4,434.2	22.1
FTSE All-Share	2,760.8	2,209.3	25.0
FTSE Small Cap	2,776.9	1,854.2	49.8
Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies)	2,838.2	1,804.3	57.3
Russell 2000 (small cap) Technology Index (in sterling terms)††	678.5	474.2	43.1
Benchmark composite index			53.2
Dividend per Ordinary share	0.30p	1.55p	(80.6)
Special dividend per Ordinary share	–	3.45p	
Revenue earnings per Ordinary share	0.39p	5.59p	
Expense ratio	1.12%	1.13%	
Discount	19.7%	27.2%	

	Year to 31 December 2009		Year to 31 December 2008	
Year's high and low	**High**	**Low**	**High**	**Low**
Share price*	342.0p	181.8p	317.0p	167.0p
Net asset value	422.7p	242.3p	397.6p	231.7p
Discount	30.3%	15.8%	29.6%	12.4%

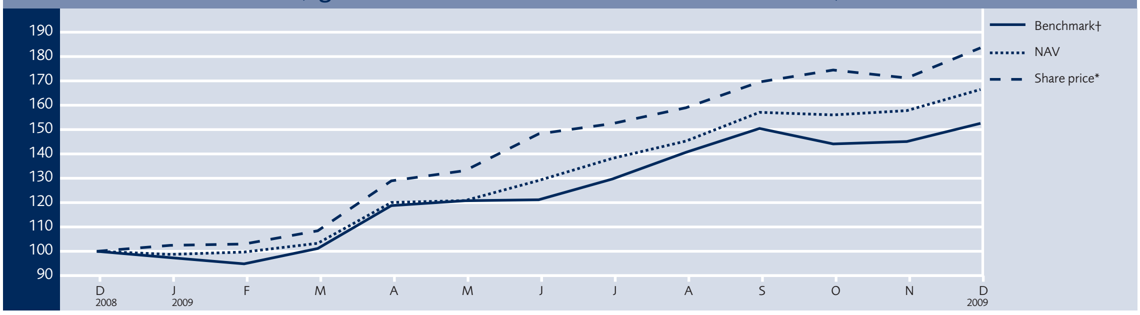
	31 December 2009	31 December 2008
Net return per Ordinary share		
Revenue	0.39p	5.59p
Capital	169.95p	(149.07p)
Total	170.34p	(143.48p)

* At mid market price.

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

HERALD'S SHARE PRICE, NAV AND BENCHMARK

(figures have been rebased to 100 at 31 December 2008)



Source: Baillie Gifford & Co

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

Dividends are not reinvested.

* At mid market price.

Past performance is not a guide to future performance.

LONG TERM PERFORMANCE SUMMARY

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

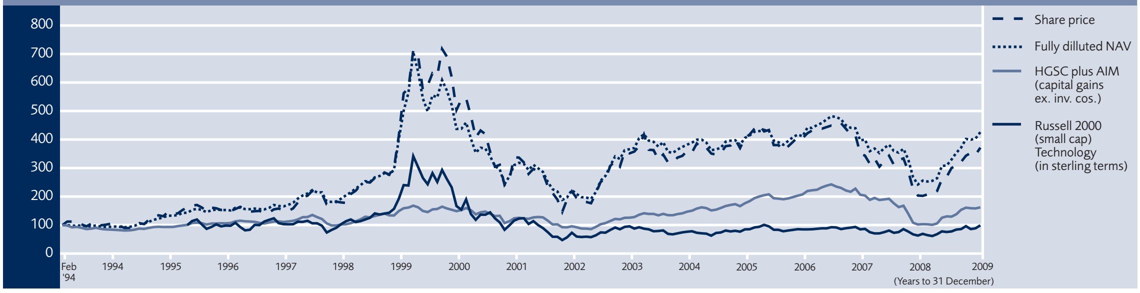
	31 December 2009	Inception 16 February 1994	% change
Net asset value per Ordinary share	420.6p	98.7p	326.1
Share price	337.8p	90.9p	271.6
Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies)	2,838.2	1,750.0	62.2
Russell 2000 (small cap) Technology Index (in sterling terms) ††	678.5	688.7*	(1.5)
FTSE 100	5,412.9	3,417.7	58.4
FTSE All-Share	2,760.8	1,717.8	60.7
FTSE Small Cap	2,776.9	2,076.1	33.8

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

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

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

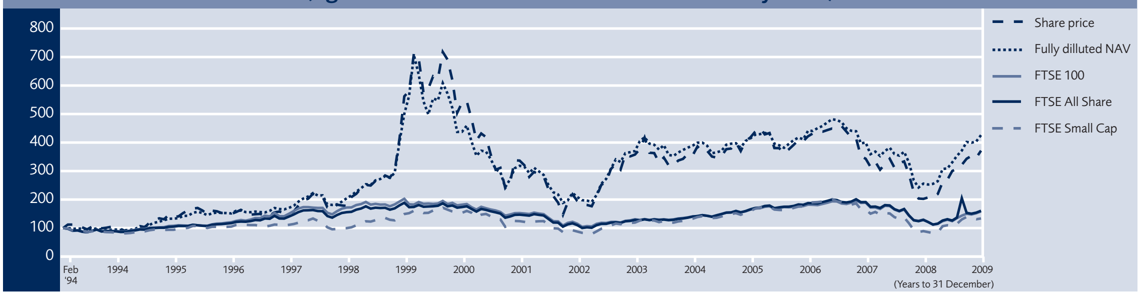
(figures have been rebased to 100 at 16 February 1994)



Source: Thomson Financial Datastream/Baillie Gifford & Co

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

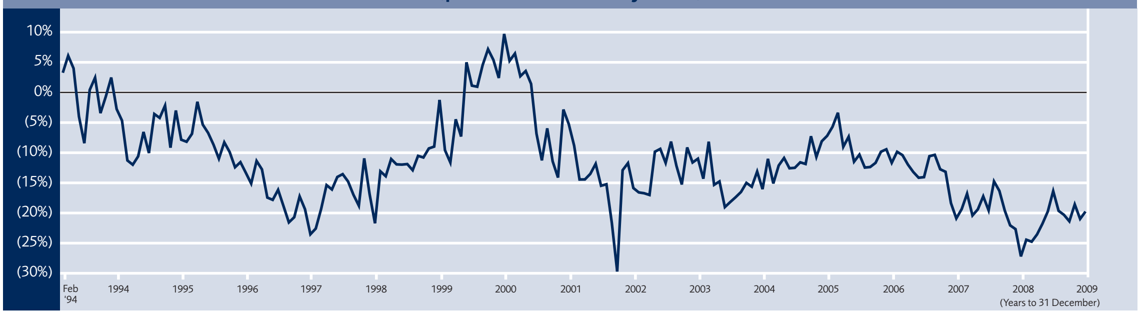
(figures have been rebased to 100 at 16 February 1994)



Source: Thomson Financial Datastream

PREMIUM/(DISCOUNT) TO FULLY DILUTED NET ASSET VALUE

(plotted on a monthly basis)



Source: Thomson Financial Datastream

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

† 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

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

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

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

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

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

Secretary

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

Registered Office

10-11 Charterhouse Square
London EC1M 6EE

Company Number

2879728 (England and Wales)

Manager

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

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

Advisers

Solicitors
Macfarlanes
20 Cursitor Street
London EC4A 1LT

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

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

Stockbroker
JP Morgan Cazenove Ltd
20 Moorgate
London EC2R 6DA

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

CHAIRMAN'S STATEMENT

The total return was 70.1% in 2009. However, this reflects some recovery from the oversold position at the end of 2008, when market valuations reflected distressed sellers rather than any normal valuation of the underlying investee companies. A more relevant statistic is to report that the Herald Investment Trust net asset value per share declined 3.2% since the end of 2006, which was the end of the financial period prior to the onset of the credit squeeze. Encouragingly, over this three year period the portfolio's share of profits per share in underlying investee companies has grown by 20% and the p/e of the portfolio remains modest by historic standards, particularly versus the low yields on cash and bonds.

The total return on the UK portfolio has been 63.5%, which compares with the return of the most relevant index the HGSCI (Hoare Govett Smaller Companies Index including AIM), of 61.4%. The North American portfolio returned 67.8% in US dollars ('$') terms versus a rebased Russell 2000 Technology Index rise of 60.7%. However, sterling ('£') appreciated relative to the $ dragging the US portfolio £ return to 49.6%. The Far East return was 136.8% in £ having declined the most, 41.0% in 2008, while the European portfolio returned 42.3% in local currencies or 32.0% in £. The overall return further benefited from a recovery in the year-end mark to market position of the swap, which reflected a non-cash loss of £15.1m at 31 December 2008, but of only £6.3m at the end of 2009. In addition, the portfolio has been fully invested or modestly geared throughout the year leading to a greater performance for the net asset value per share. The total return of the benchmark was 55.8% giving 14.3% outperformance, and this follows outperformance of 2.6% relative to the benchmark in 2008. In practice the swap masked the degree of portfolio outperformance in 2008 by 4-5% and flattered the outperformance in 2009 by a similar amount. Whilst the negative effect of the swap has been disappointing the borrowing facility has enabled the Company to exploit the rally to the full.

The year has distinctly split into three parts. The first quarter saw continued distressed selling particularly from hedge funds deleveraging or facing redemptions combined with uncertainty about the instability of the banking system. The second and third quarters then saw steady asset appreciation in the smaller company market albeit on low volumes as selling pressures abated. During this period market activity in terms of primary and secondary issues was very low. However, a wall of activity occurred in November when there was a torrent of secondary offerings as brokers identified a window of opportunity that overwhelmed the market and stopped the rally in its tracks. While the new issue market remained closed in the UK, and was only just ajar in the US, the real activity related to the evident squeeze on bank credit lines to small quoted businesses. The majority of Herald's portfolio companies do not have debt, so the impact was largely only the secondary effect of a further small company market liquidity squeeze, and indeed led to a period of outperformance. This did provide opportunities to acquire or increase positions at good valuations, which had been expected to occur, but not in such a concentrated way in one month. It is particularly fulfilling that the borrowing facility has enabled the Trust to support worthwhile fund raisings in a small company market so evidently lacking capital, at valuations that seem extremely promising for Herald investors. The flow of takeovers in the portfolio has continued, but at a more normal rate than in 2007-8, when vultures swooped on a market so willing to realise cash. There was modest year end net gearing of 105.

Earnings per share for the year, including a further small VAT repayment, were 0.39p and the Board is proposing a dividend of 0.30p. Capital appreciation remains the goal of the investment strategy.

Trading in general for portfolio companies has been solid. There have clearly been headwinds from the economy, so that while profits have fallen for some companies, others have continued to grow, albeit at a slower rate than had been anticipated two years ago. In aggregate the profits from consistently profitable companies seem to be more or less flat for 2009, while for the whole portfolio there is some growth. Furthermore analysts' forecasts for growth for financial years ending in calendar year 2010 are quite robust with Herald Investment Trust's share of net profits in always profitable companies expected to be c£23m in 2010. On this basis profits per share are forecast to be 38% higher in 2010 than in 2006, the year end before the credit crunch. This is significantly better than the wider market and the Company's share price and bodes well for the future performance of the portfolio.

Further asset appreciation seems probable while the low level of interest rates encourages cash into what are perceived as riskier asset classes such as small company shares. However 2009 benefited from profit upgrades throughout the year reflecting excessive pessimism when forecasts were set at the start of the year. Consensus analysts' forecast for 2010 average 15.2% for the portfolio. The challenging macroeconomic environment suggests this upgrade pattern will not be repeated in 2010. Nevertheless, we remain optimistic that the technology sector which this portfolio targets offers greater potential for resilient profits than the wider market, which is more vulnerable to a constrained outlook for credit and for consumer and Government spending.

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 7 in the Notice of Annual General Meeting, is being proposed at the AGM of the Company to be held on 21 April 2010 to the effect that the Company should continue as an investment trust. Herald Investment Trust is one of the largest investment trusts specialising in technology, communications and multi-media and is one of the best performing investment trusts since its launch in February 1994. Furthermore it is the only specialist technology orientated investment trust with a material exposure to the United Kingdom. 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 continue to provide attractive long term investment opportunities. The Directors believe that the prospects for investment in the technology and media sectors remain positive and the Company is managed by one of the most experienced and successful managers in the sector. **Your Board strongly recommends that shareholders vote in favour of the resolution and intend to vote their own shareholdings in favour of the resolution for the Company to continue as an investment trust.**

Martin Boase retired in September 2009 after 16 years as Chairman of the Trust. During this period the assets per share grew by a factor of four. Both the Board and the Manager are very grateful for his expert guidance and wise counsel during his tenure as Chairman and we wish him well for the future.

Julian Cazalet

Julian Cazalet
Chairman

25 February 2010

INVESTMENT MANAGER'S REPORT

Herald's aspiration has been to provide a low risk way of gaining exposure to early stage companies with high growth potential, by having a broad portfolio to reduce the stock specific risk. I had not envisaged an environment where share prices could diverge quite so radically from profits performance en masse. Whilst I had the ongoing reassurance of meetings and results from portfolio companies, which filled me with confidence and excitement, because we had some liquidity to exploit bargain valuations, I am sensitive to the fact that many of our shareholders did not have the benefit of such reassurance. I am particularly sympathetic to the professional fund managers with their own reporting requirements, with the valuation decline magnified by a widening discount. As I have tried to reassure my colleagues during the darkest days, you cannot expect to have a wonderful time to buy and sell at the same time. It remains a 'buyers' market, albeit not quite as compelling as it was. As in 2000 when I wish I had managed to sell more of the portfolio in the first quarter, so I wish we had invested a little more in the first quarter of 2009. The defence is that, firstly I think in both periods we were moving decisively in the right direction and secondly, it was easy to be fully (100%) invested, but it seemed foolhardy to invest on debt.

Sector Background

Technology

There are suggestions emerging in the market that the sector should be considered positively, after a dull decade, so a top down view seems appropriate. Simplistically the first market to appear in the information technology world was mainframe computers. When I started following the sector 25 years ago there were still a multitude of names – ICL, Bull, DEC, Data General, Unisys and more that have faded from the memory. IBM accelerated growth starting with its 360 Series which was launched in 1964 and was a bet on compatibility so that users could upgrade. It used strong cash flows from maintenance to diversify effectively. When a new market emerges, following some technological development, it is quite normal for multiple players to address it. It is equally normal for a consolidation process to take place thereafter. Some will fail, others will be acquired and a few become great companies. IBM won the mainframe market and now has a c$170bn market value. The next seismic event was the emergence of the personal computer and the killer applications were word processing and spreadsheets. IBM's use of Microsoft's operating system in 1981 was so successful that it led to Microsoft's operating system becoming a standard and subsequently its word processing and spreadsheet became standard too. Names such as Visicalc, Ashton Tate, Wordperfect are but distant memories and Microsoft's market value is now c$270bn. The next major market was the development of standard networking protocol. Again names have disappeared, but Ethernet became the standard and Cisco the winner for routers and switches. This enabled PCs to communicate, share data and access centralised computer applications initially across a local area network (LAN) and then a wide area network, with telephone links between offices. Cisco's value is now c$140bn. If the 1990s was the decade of the LAN it also saw the emergence of the e-mail, but it is this century that the internet has become the killer application, albeit the stock market recognised its importance in late 1999. This has led to an upgrade cycle for the telephone networks as well as the companies already mentioned, but the outstanding commercial success has been Google, with a market value of $200bn, because they have fended off other search engines such as Yahoo, Alta Vista and Microsoft to become the dominant search engine for the World Wide Web and monetised it accordingly. Whilst these four companies have been the successes in these huge markets, there have been a plethora of other companies that have enabled their success. Significant ones include Intel (microprocessors, c$115bn market value), EMC (storage, c$35bn), Oracle (databases, c$125bn), Adobe (creative software, $20bn), SAP (accounting software, $60bn), Symantec (security), HP (printers and PCs) and Dell (PCs). In addition there are many manufacturing companies in Taiwan, Korea and China, producing components, screens and assembles. In parallel has been the emergence of the mobile phone sector with names such as Qualcomm with a market value of c$80bn,Vodafone ($120bn), RIM ($40bn) and Nokia ($50bn) emerging.

None of these stocks are held in Herald Investment Trust. The questions that are being asked by those less close to the sector are (i) now that penetration of PCs, mobile telephones and the internet is so great is the sector ex-growth compounded by continual price deflation and a cash constrained world? (ii) how can small companies flourish going forwards?

Firstly, preliminary market research by Gartner estimates cite 22.1% YOY volume growth in Q4 for PC volumes, which is scarcely ex-growth for a sluggish economy, ahead of expectations and suggests that Windows 7 is a worthwhile upgrade, after the failure of Vista. However, if IBM was the growth stock of the 1960s, the evolution of the sector has enabled continued growth for a long time. Each of Microsoft, Cisco, Google and Qualcomm were small companies at their IPO and they have demonstrated the greatest growth in their early days when they have exploited a new market as small companies. Going forward there will be greater opportunities for investment profits in emerging markets which young companies tend to exploit, but the incumbent players will continue to profitably dominate their maturing markets. So are there new markets? I draw the analogy with the electricity industry. When houses and offices first received electricity no one imagined the growth in electrical applications that buildings would have. Electricity had to precede TVs, microwaves, PCs et al. Equally cable suppliers have long since been ex-growth, albeit growth has continued in emerging markets. The same cable that used to light a few bulbs is often carrying an order of magnitude more for different applications without further infrastructure investment. It seems inevitable that the internet will mirror this. The telcos are the electricity utilities, Cisco the equivalent of Switchgear. The dynamic markets currently include a revolutionary progression of power efficient internet access from Netbooks and mobile phones. Arguably Apple is at the vanguard of technology innovation currently. Whilst building blocks were being put in place with faster networks, better battery life, power efficient graphics, it was the iPhone and its 'applications' that demonstrated that there was a use for data on mobile phones other than e-mails (Blackberry for investment bankers!). I am 100% confident from some of the early stage companies that we have invested in that there are more big markets in the pipeline, which will exploit the networked world. I am less certain that the companies in which Herald Investment Trust has invested primary capital will necessarily be the commercial victors and the more concerned because of the shortage of available early stage capital in the UK, which is fertile in thought leadership. I suspect we will get adequate returns from takeovers by the well capitalised US sector. Secondly, the major players have in turn opened up an abundance of smaller markets which have been profitably exploited in Herald Investment Trust and will continue to be. For example, there are an array of niche software applications that have been developed for the PC and more for a networked world. There are hundreds of companies that have emerged to supply components and services. Applications that early stage companies are addressing in the portfolio include RF technology, for near field communication to be used in the mobile phone, and in the healthcare sector. Currently most devices on the internet are PCs, but increasingly it will be devices with embedded processors, that will rely on an IP address for remote control and communication.

Media

The media sector has fallen to 10% of the total portfolio currently. This reflects the long held view that traditional media is challenged by structural changes associated with satellite, cable and the internet and is further challenged by the cyclical downturn and fragmentation of the advertising market. The portfolio has for some time been skewed away from advertising led companies and targeted at holdings that can exploit new media rather than be threatened by them.

Portfolio Valuation

Earnings growth	UK	US	EMEA	Asia Pac	Total
2009: Companies always profitable (2008 and 2009)	(4.8%)	15.1%	1.4%	35.3%	0.4%
2010: Companies always profitable (2008 and 2009)	11.7%	20.3%	23.1%	33.6%	15.2%
2010: Companies unprofitable in 2008 and profitable in 2009	14.5%	161.1%	–	18.9%	23.1%
Earnings growth					
Total portfolio 2009*	25.0%	(25.5%)	0.6%	288.7%	21.6%
Total portfolio 2010*	32.9%	60.4%	27.5%	53.9%	38.8%
P/E of profitable stocks in 2008					
2008	11.9x	22.0x	26.0x	17.6x	14.3x
2009	13.6x	30.3x	26.0x	13.5x	16.2x
2010	11.8x	20.8x	20.7x	9.7x	13.3x
P/E of all stocks with estimates					
2008	22.6x	33.0x	38.2x	378.4x	27.3x
2009	17.8x	37.1x	27.1x	14.1x	20.3x
2010	13.4x	22.6x	21.3x	9.2x	14.6x

* The calculation for 2009 and 2010 earnings growth is based only on companies with data available in each of the respective years.
Source: JCF Group and brokers' estimates

We repeat the exercise of evaluating the earnings growth and p/e for the portfolio on a sum of the parts basis. The changing mix in the portfolio and the vagaries of accounting make the accuracy of the numbers somewhat spurious. Broadly those companies that have continued to grow have offset the profit declines seen in certain companies. For us the recession has been more evident in share prices and the Company's own wide discount than it has in the operational performance of portfolio companies.

The NAV was stable during the first quarter, outperforming the wider index and 10% ahead of the FTSE Small Cap reflecting a strong results season. While the portfolio rallied strongly over the next two quarters, it underperformed the FTSE Small Cap index by 15% and then outperformed again in Q4 when the FTSE Small Cap index declined. This reflected a wall of fund raisings in the UK small cap sector, reflecting a difficult market for bank debt. Few companies in the Herald portfolio have debt, hence the outperformance.

Total Return	% Change Q1 2009	% Change Q2-3 2009	% Change Q4 2009	% Change 2009
Herald	5.5%	52.7%	5.8%	70.1%
HGSC plus AIM	2.9%	54.8%	1.2%	61.4%
FTSE Small Cap	(4.7%)	67.8%	(3.3%)	54.7%
Russell 2000 Technology Index	0.0%	40.9%	3.3%	45.5%
Benchmark	1.6%	50.2%	2.0%	55.8%

UK (2009 capital return £81.4m)

The UK total return of 63.5% is marginally ahead of the HGSC Index including AIM of 61.4%, but marginally behind the weighted return of the targeted sectors of 65.9%. This follows 2008 when the Company's UK portfolio outperformed the target sectors and the wider HGSC Index by c12%, so although the absolute return is much better than 2008, the relative return is less satisfactory. The portfolio was repositioned, as much as liquidity would permit, to be more defensive in the fourth quarter of 2007. While this contributed to the strong outperformance in 2008, there were a number of cyclical companies which were not held that bounced strongly in 2009. I do not chastise myself for missing out on some of these moves, and firmly believe that in an uncertain world, with illiquid holdings, it is right to focus on quality companies. The strategy has been to be fully invested and marginally geared in companies which will survive uncertainties in the short term and for the time being this strategy will remain.

In 2007 the worst performing stock in monetary terms was Detica and it was the best in 2008. In 2008 the worst performing stock was Imagination and in 2009 it was the best. Imagination's valuation in the portfolio appreciated by £22.2m in 2009 versus a loss of £7.8m in 2008. The market seems to be recognising the strength of its market position thanks to Intel and Apple both increasing their stakes. However 20 stocks in the UK portfolio appreciated by more than 100%.

The stream of acquisitions has somewhat abated. However we were disappointed by the loss of Research Now to its US competitor eResearch and particularly concerned that the management were able to roll half their holding into the acquiring entity, whereas other shareholders were not. The private equity firm TA Associates were backing the deal with leverage and the chief executive of Research Now will run the group. If capital markets were on a level playing field, Research Now should have acquired eResearch and we consider the ability for management to receive different terms from outside shareholders a worrying travesty. We faced a similar situation on the acquisition of Business Control Solutions.

The UK smaller companies market remains fragile, with few institutions participating in sub £100m market capitalisation companies. Whilst this lack of interest provides exciting valuation anomalies, the time they take to correct can be frustrating. Imagination is the largest holding, and materially increases the average p/e of the portfolio at nearly 60x 2009 earnings. It is a measure of how cheap the UK remains on an average prospective p/e of 11.8x. We are currently enjoying the harvest from investments made in 2002 into loss making companies, such as Imagination, SDL and Alterian, which had raised enough money in the technology bubble to have the resources to become proper businesses. There were further companies seeded by the AIM bubble in 2005-6, which have yet to come through. I am confident that these holdings provide a solid base for progress for the time being. However, I am worried about the starvation of capital into early stage companies to provide a next generation in five to ten years' time. Perhaps the portfolio will be migrating more overseas. The chronic shortage of sector expertise in the London market is both an opportunity and a problem. As a taxpayer I certainly regard it more as a problem, because from my narrow perspective the only hope for the UK economy is export led growth and we have to invest in these sorts of companies if that is to be achieved.

US (2009 capital return £29.4m)

The US portfolio has grown 67.8% in $, some 7.0% ahead of the benchmark (The Russell 2000 Technology Index which has been rebased). This year currency has dragged the £ return down to 49.5%. The performance has been broadly based with 16 investments appreciating in value by more than 100%. Again there was recovery from oversold positions. It is a struggle to be enthused by valuations in the US now, but the US economy seems more broadly based than the UK, and seems more likely to recover. The sector insights gained from covering the US are unquantifiably helpful in guiding us to brave decisions in the UK. Aladdin, Wind River, Omniture and Starent were all acquired by corporates, which contributed to a £3.5m net cash withdrawal from the US. The strength of balance sheets in the technology sector implies takeovers will be a continuing feature. While interest rates are so low, acquisitions can be earnings enhancing for the acquirer and a reasonable price for the seller.

Europe and Far East (2009 capital return: Europe £2.7m, Far East £17.3m)

The European portfolio is small and returned 42.3% in local currency, and 32% in £. The interruption of meetings we were having in the Paris bourse by demonstrating unions in September are stark reminders of the socialist excesses that still prevail in France. Although there are some interesting technology companies, shareholders are not important. I hope the evident capitalist excesses in the UK do not swing too far in the direction of the Continent! However all the European holdings made a positive return in 2009.

The Far East return was the best of all. Having declined 41.0% in £ last year, the portfolio grew 136.8% in 2009. The Far East portfolio remains dominated by holdings in Korea and Taiwan. They are both countries that seem to have progressed up the value chain in an entrepreneurial way, with a cost base challenging for Japan, where we have no exposure. The South Korean portfolio appreciated 220.6% in £, while Taiwan gained 95.0%. KH Vatec has been the most significant performer rising 333% during the year and accounting for a third of the Korean portfolio. In all eight investments in the Far East appreciated 200% and a further seven holdings appreciated 100-200%. In general the Far East portfolio experienced profits downgrades in 2008, but figures exceeded initial expectations in 2009 after the destocking in Q4 2008 and Q1 2009, when demand recovered better than worst fears. The Far East portfolio is skewed to component manufacturing, an area where the Far East now dominates.

Summary

The portfolio seems solid and the prospects for a resumption of economic growth in 2010 make progress probable for portfolio profits and share prices, particularly when valuations remain so low by historic standards and versus interest rates.

We have acquired for cancellation a further 2.4m shares (£6m), taking total buy-backs to 7.4% over the last three years. It seemed entirely rational for the discount to widen to 20% when the market was declining and the portfolio totally illiquid. The worst is past, but the liquidity remains extremely limited. We are confident that patience will be rewarded.

I should particularly like to thank Martin Boase who retired as Chairman of the Trust last year. He was the founder Chairman and bravely agreed to take the Chair before a pound had been raised let alone invested. He has given me time beyond the call of duty and contributed on a scale unparalleled by any other individual over the life of Herald. However, he leaves a strong Board in the Trust and a much stronger infrastructure at Herald Investment Management, so I am confident we remain well placed. The ambition is to quadruple the assets per share again.

PERFORMANCE ATTRIBUTION (in sterling terms)									
	Benchmark allocation		Herald asset allocation		Performance*		Contribution to relative return	Contribution attributable to:	
Equity markets	01.01.09 %	31.12.09 %	01.01.09 %	31.12.09 %	Herald %	Benchmark %	%	Stock selection %	Asset allocation† %
UK	66.7	66.7	60.3	66.2	63.5	61.4	0.6	0.9	(0.3)
Europe ex. UK	–	–	3.2	3.4	32.0	–	(0.5)	–	(0.5)
Americas	33.3	33.3	29.5	25.7	49.6	43.1	1.3	1.2	0.1
Asia Pacific ex. Japan	–	–	7.1	8.5	136.8	–	3.1	–	3.1
Emerging Markets	–	–	0.4	0.4	75.0	–	0.1	–	0.1
Bonds	–	–	15.5	7.7	2.2	–	(4.6)	–	(4.6)
Cash	–	–	15.0	4.7	3.1	–	(3.4)	–	(3.4)
Swap	–	–	(7.2)	(1.9)	n/a	–	5.0	–	5.0
Loans	–	–	(23.8)	(14.7)	3.4	–	7.8	–	7.8
Total	100.0	100.0	100.0	100.0	70.1	55.8	9.2	2.1	7.0

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

* The above returns are calculated on a total return basis with net income reinvested. Dividends and interest are reinvested on a cash basis, unlike the NAV calculation where income is recognised on an accruals basis. Relative performance may differ as a result. Contributions cannot be added together, as they are geometric; for example, to calculate how a return of 70.1% against a benchmark return of 55.8% translates into a relative return of 9.2%, divide the portfolio return of 170.1 by the benchmark return of 155.8 and subtract one.

† Asset allocation includes the contribution attributable to currency movements.

Katie Potts

25 February 2010

INVESTMENT CHANGES (£'000)				
	Valuation at 31 December 2008	**Net acquisitions/ (disposals)**	**Appreciation/ (depreciation)**	**Valuation at 31 December 2009**
Equities*				
UK	126,526	14,367	84,207	225,100
Continental Europe	6,820	2,123	2,689	11,632
Americas	61,819	(938)	26,521	87,402
Asia Pacific	14,961	(3,386)	17,333	28,908
Emerging Markets	753	(49)	684	1,388
Total equities	210,879	12,117	131,434	354,430
Bonds:				
UK bonds	14,900	4,286	434	19,620
Euro bonds	10,027	(10,086)	59	–
US$ bonds	7,470	(73)	(990)	6,407
Total bonds	32,397	(5,873)	(497)	26,027
Total investments	243,276	6,244	130,937	380,457
Net liquid assets	32,513	(16,087)	311	16,737
Total assets	275,789	(9,843)	131,248	397,194

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

* Equities includes convertibles and warrants.

TOP TWENTY EQUITY HOLDINGS

AT 31 DECEMBER 2009

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

Imagination Technologies Group

Imagination creates market-leading embedded graphics, video and display acceleration, multi-threaded processing and multi-standard receiver technologies and licences this IP (Intellectual Property) to global semiconductor and system companies. These technologies are used in the following markets: digital radio and audio, mobile phone multimedia, personal media player, car navigation and driver information, personal navigation, mobile internet device (MID), digital TV and set-top box, and mobile TV. Imagination has been particularly successful in selling graphics technology to the mobile phone and LCD TV sectors and is a pioneer in developing Digital Audio Broadcasting Technology (DAB). Imagination Technology incorporates this technology in its "Pure Digital" radio brand which is the number one supplier of radios in the UK. The adoption of digital radio in other countries, France and Germany in particular, is opening up a bigger international market and they have launched an internet radio range for the US market. The group has a highly skilled workforce of over 500 people, of which over 80% are R&D engineers.

Country		United Kingdom
% of total assets		5.6
% of issued share capital held		3.8
	31/12/09	31/12/08
Valuation (£m)	22.25	9.29
Shares (m)	9.23	14.98

SDL

SDL is the leader in Global Information Management (GIM) solutions that help organisations to accelerate the delivery of high-quality multilingual content to global markets with products and services. Global industry leaders that rely on SDL include: ABN-Amro, Best Western, Bosch, Canon, Chrysler, CNH, Hewlett-Packard, Microsoft, Philips, SAP, Sony, SUN Microsystems and Virgin Atlantic. SDL has implemented more than 500 enterprise GIM solutions, deployed over 150,000 translation software licenses and provides access to on-demand translation portals for 10 million customers per month. Over 1,000 service professionals deliver consulting, implementation and language services through its global infrastructure of more than 50 offices in 32 countries. They have expanded through acquisition into content management and workflow. SDL is in Gartner's leader quadrant for web content management.

Country		United Kingdom
% of total assets		3.8
% of issued share capital held		4.8
	31/12/09	31/12/08
Valuation (£m)	15.23	9.49
Shares (m)	3.71	4.23

Phoenix IT Group

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

Country		United Kingdom
% of total assets		2.1
% of issued share capital held		4.1
	31/12/09	31/12/08
Valuation (£m)	8.21	4.97
Shares (m)	3.10	2.95

Telecom Plus

Telecom Plus supplies fixed wire and mobile telecommunications services, gas and electricity to 300,000 residential and small business customers in the United Kingdom with a unified billing system. Telecom Plus was incorporated in 1996 and began operations in 1997 providing a unique range of low-cost telephony services to the residential and SOHO markets. They use the collective buying power of individual users to negotiate bulk buying deals with major suppliers, passing the benefit back to their customers. Telecom Plus does not advertise and has no shops. Instead, they rely on word of mouth recommendations from satisfied customers and from a network of Independent Distributors. The advanced billing system means the customer receives a single monthly bill covering all the services provided.

Country		United Kingdom
% of total assets		2.0
% of issued share capital held		4.0
	31/12/09	31/12/08
Valuation (£m)	8.06	8.08
Shares (m)	2.74	2.64

Group NBT

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

Country		United Kingdom
% of total assets		2.0
% of issued share capital held		9.8
	31/12/09	31/12/08
Valuation (£m)	7.98	3.97
Shares (m)	2.53	2.03

Alterian

Alterian features in Gartner's Enterprise Marketing Management (EMM) Quadrant. It focuses on campaign management, marketing resource management and online marketing with the use of proprietary databases. It distributes through a number of marketing service providers including Acxiom, Experian, Epsilon, Harte-Hanks, Merkle, Allant, Donnelley Marketing and KnowledgeBase Marketing. It generally licences the products on a one year term. It has some direct customers too. In July 2008 Alterian acquired Mediasurface, a web content management business for £18m in cash and shares; Mediasurface had been a portfolio holding since 2006. Alterian's acquisition of Techrigy in July 2009 augmented Alterian's technology portfolio with a social media monitoring and analytics solution, this enables marketers to get a full view of their marketing landscape by listening to their consumers online.

Country		United Kingdom
% of total assets		1.9
% of issued share capital held		7.1
	31/12/09	31/12/08
Valuation (£m)	7.66	2.46
Shares (m)	4.14	4.31

TOP TWENTY EQUITY HOLDINGS *continued*

AT 31 DECEMBER 2009

StatPro Group

StatPro is a leading provider of portfolio analytics and data solutions for the global asset management industry. Having grown from a one-product company, StatPro now offers clients eight core products. Over the past 15 years, StatPro has developed its products in close collaboration with international asset managers and can offer data and software solutions for risk management, fixed income analysis, performance measurement, attribution analysis, GIPS compliance and reporting. StatPro has around 400 client contracts in 25 countries with 11 offices worldwide. StatPro has grown its annualised rental revenue from less than £1 million in 1999 to £28.3 million at end June 2009. Statpro generally experiences a 94% renewal rate. 2010 will see the delivery of StatPro's next generation Software as a Service (SaaS) solution, enabling service delivery to a broader market more cost effectively.

Country		United Kingdom
% of total assets		1.8
% of issued share capital held		11.7
	31/12/09	31/12/08
Valuation (£m)	6.98	2.58
Shares (m)	6.98	6.98

Advent Software

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

Country		USA
% of total assets		1.6
	31/12/09	31/12/08
Valuation (£m)	6.30	2.78
Shares (m)	2.50	0.20

Euromoney Institutional Investor

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

Country		United Kingdom
% of total assets		1.5
	31/12/09	31/12/08
Valuation (£m)	5.88	2.42
Shares (m)	1.35	1.10

Diploma

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

Country		United Kingdom
% of total assets		1.4
	31/12/09	31/12/08
Valuation (£m)	5.64	4.21
Shares (m)	3.20	3.45

Websense

Websense is a global leader in integrated web, data and e-mail security solutions, providing information security to approximately 40,000 customers with 43 million individual seats. Distributed through its global network of channel partners, Websense software, appliance and Software as a Service (SaaS) security solutions help organisations block malicious code, prevent the loss of confidential information and enforce internet use and security policies. In March 2007 Websense acquired its main competitor SurfControl for $400m in cash; SurfControl had been a portfolio holding since 1998.

Country		USA
% of total assets		1.3
	31/12/09	31/12/08
Valuation (£m)	5.03	4.82
Shares (m)	4.65	0.47

Toumaz

Toumaz has patented AMx (advance mixed signal silicon devices) which provides a system-on-chip (SOC) signal processing solution. It has a dynamically re-configurable mixed signal architecture with analogy elements embedded in a digital fabric. This enables ultra low power consumption and a dramatic reduction in battery size for portable devices, and months or years of active life from a single battery. It also offers reduced complexity and silicon area. The company is currently addressing two markets, wireless medical devices and consumer electronics. The technology was developed at Imperial College.

Country		United Kingdom
% of total assets		1.3
% of issued share capital held		15.5
	31/12/09	31/12/08
Valuation (£m)	5.01	1.50
Shares (m)	71.62	24.07

Intec Telecom Systems

Intec is one of the principal global suppliers of business support systems (BSS), systems that assist customers with mediation, customer care, charging, billing and wholesale business management. A global business, Intec serves over 60 of the world's top 100 telecommunications companies, which they support with 1,600 employees working from 31 offices in 24 countries. Intec's telecommunications customers include: AT&T, The Carphone Warehouse (UK), China Mobile, Deutsche Telekom, Verizon and Vodafone. Intec's technology is also utilised in the billing and settlement needs of many other types of businesses, including transportation and financial services companies.

Country		United Kingdom
% of total assets		1.2
	31/12/09	31/12/08
Valuation (£m)	4.60	0.96
Shares (m)	4.44	3.61

Fidessa Group

Fidessa supplies trading systems to the world's financial markets. It is the leading supplier of multi-asset trading, portfolio analysis, decision support, compliance, market data and connectivity solutions. Fidessa's products and services make it easier to buy, sell and own financial assets of all types on a global basis and uniquely, serves both the buy-side and sell-side communities globally. Fidessa has developed all its products itself from the ground up over 28 years, investing heavily in their continual evolution. Fidessa's products are used by over 85% of tier-one, global financial institutions. Headquartered in London and with regional operations across Europe, North America, Asia and the Middle East, Fidessa supports over 24,000 users across 730 clients, serving a broad spectrum of customers from major investment banks and asset managers through to specialist niche brokers and hedge funds. The product is supplied on a rental basis.

Country		United Kingdom
% of total assets		1.2
	31/12/09	31/12/08
Valuation (£m)	4.57	1.92
Shares (m)	0.39	0.39

Electrocomponents

Electrocomponents is the leading high service distributor of electrical, electronic and industrial supplies. Starting in 1937 in London selling spare parts for radios, the Group now has operations in 27 countries. Turnover is around £975m, with 43% of sales via e-commerce at September 2009. Electrocomponents trades as RS in the UK, most of Europe and Asia, Radiospares in France, Radionics in Republic of Ireland and Allied Electronics in North America. In total Electrocomponents offers 500,000 products which are sold to 1.5m customers.

Country		United Kingdom
% of total assets		1.1
	31/12/09	31/12/08
Valuation (£m)	4.30	3.70
Shares (m)	2.66	2.66

SQS Software Quality Systems

SQS Group ('SQS') was founded in Cologne, Germany, in 1982. SQS is the largest independent provider of software testing and quality management services in the world. The company tests web, e-commerce, infrastructure, security and client server applications. With more than 5,000 successfully completed projects under its belt, SQS has a strong customer base, including half of the DAX 30 companies, almost one third of the STOXX-50 companies and 36 FTSE 100 companies. SQS has around 1,450 employees worldwide. The clients include Barclays, BP, Credit Suisse, Daimler, Deutsche Bank, Deutsche Post, Dresdner Bank, T-Mobile, T-Systems and Zurich Group.

Country		United Kingdom
% of total assets		1.1
% of issued share capital held		7.2
	31/12/09	31/12/08
Valuation (£m)	4.23	4.17
Shares (m)	1.97	1.94

KH Vatec

KH Vatec, a Korean company, was founded in 1992 and is a global leader in miniature die-casting and precision module assembly. The majority of KH Vatec's manufacturing is now based in China. The company's products are used in mobile phones and personal digital assistants (PDAs), audio (MP3) players and Web pads, amongst others. The company produces parts in zinc, magnesium and aluminium. The zinc parts include external components such as laptop hinges and electromagnetic interference (EMI) shields. Magnesium parts include internal and external components and EMI shields. Aluminium parts include external components and stamping parts. Vatec also provides complete assembled modules, Nokia is the main module customer.

Country		Korea
% of total assets		1.0
	31/12/09	31/12/08
Valuation (£m)	4.11	0.99
Shares (m)	0.16	0.16

Allocate Software

Allocate Software is the leading workforce optimisation and scheduling software provider for global organisations with large, multi-skilled workforces. With over 18 years' experience, Allocate ensures customers can match operational demands with workforce supply. Continually developing workforce optimisation software for new industries, Allocate specialises in resource scheduling solutions for the healthcare, defence, maritime, offshore engineering and cruise and ferry sectors. Over 1,000,000 people are deployed globally using Allocate Software. Customers include: the British Army, NATO, P&O Cruises, A.P. Moller Maersk, HCA, NHS Professionals and over 180 NHS Trusts.

Country		United Kingdom
% of total assets		0.9
% of issued share capital held		12.3
	31/12/09	31/12/08
Valuation (£m)	3.62	1.08
Shares (m)	5.49	3.09

M&C Saatchi

M&C Saatchi is a global marketing services business working for clients across a wide variety of industry sectors. The Company was founded in 1995. Starting with a strong base in the UK and Australia, Saatchi have added new agencies and disciplines in Asia, USA and Europe and employ over 1,100 staff in 15 countries.

Country		United Kingdom
% of total assets		0.9
% of issued share capital held		7.2
	31/12/09	31/12/08
Valuation (£m)	3.52	2.62
Shares (m)	4.40	3.40

Ffastfill

Ffastfill provides software and services to the global financial community. Headquartered in London with offices in Chicago, Prague and Sydney the company supports over 80 financial institutions worldwide using the suite of Ffastfill applications. The company's main expertise and knowledge is in exchange traded derivative instruments, although the multi-asset clearing and trading functionality meets many clients with equity, fixed income, foreign exchange, CFD and OTC needs. The full trade cycle through front, middle, back and risk are covered though the Ffastfill product set and all are delivered through a Software as a Service (SaaS) medium.

Country		United Kingdom
% of total assets		0.9
% of issued share capital held		10.8
	31/12/09	31/12/08
Valuation (£m)	3.43	–
Shares (m)	42.90	–

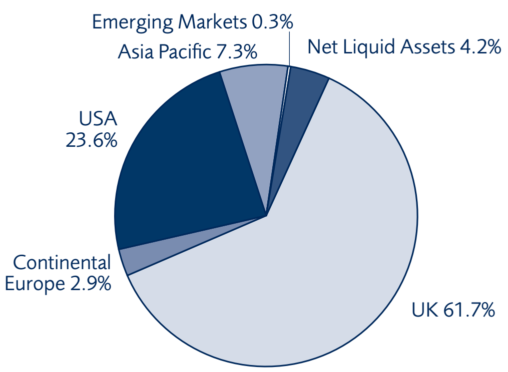
Note: A figure is presented for % issued share capital held only if greater than 3%.

CLASSIFICATION OF INVESTMENTS

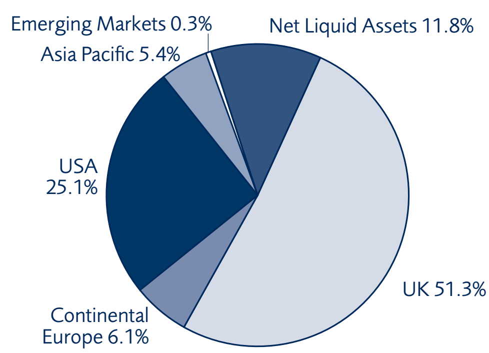
Classification	UK %	Continental Europe %	USA %	Asia Pacific %	Emerging Markets %	2009 Total %	2008 Total %
EQUITIES: (including convertibles and warrants)							
BASIC MATERIALS	**–**	**–**	**–**	**0.5**	**–**	**0.5**	**0.3**
Chemicals	–	–	–	0.5	–	0.5	0.3
INDUSTRIALS	**5.7**	**0.2**	**0.4**	**3.0**	**–**	**9.3**	**9.3**
Aerospace and defence	0.4	–	–	–	–	0.4	0.6
Electronic and electrical equipment	1.2	–	0.1	2.9	–	4.2	3.4
Industrial engineering	–	–	–	0.1	–	0.1	–
Support services	4.1	0.2	0.3	–	–	4.6	5.3
CONSUMER GOODS	**0.1**	**0.1**	**–**	**–**	**–**	**0.2**	**0.1**
Leisure goods	0.1	0.1	–	–	–	0.2	0.1
HEALTH CARE	**0.3**	**–**	**0.2**	**–**	**–**	**0.5**	**0.2**
Health care equipment and services	0.3	–	0.2	–	–	0.5	0.2
CONSUMER SERVICES	**9.1**	**0.5**	**0.7**	**–**	**–**	**10.3**	**9.5**
Media	8.6	0.5	–	–	–	9.1	8.5
Travel and leisure	0.5	–	0.7	–	–	1.2	1.0
TELECOMMUNICATIONS	**3.5**	**–**	**–**	**0.1**	**–**	**3.6**	**4.3**
Fixed line telecommunications	2.9	–	–	–	–	2.9	4.1
Mobile telecommunications	0.6	–	–	0.1	–	0.7	0.2
FINANCIALS	**0.5**	**–**	**–**	**–**	**–**	**0.5**	**0.6**
Equity investment instruments	0.5	–	–	–	–	0.5	0.6
TECHNOLOGY	**37.5**	**2.1**	**20.7**	**3.7**	**0.3**	**64.3**	**52.2**
Software and computer services	26.6	1.3	9.8	0.7	0.3	38.7	33.0
Technology hardware and equipment	10.9	0.8	10.9	3.0	–	25.6	19.2
TOTAL EQUITIES (including convertibles and warrants)	**56.7**	**2.9**	**22.0**	**7.3**	**0.3**	**89.2**	
Total equities – 2008 (including convertibles and warrants)	45.9	2.5	22.4	5.4	0.3		**76.5**
BONDS	**5.0**	**–**	**1.6**	**–**	**–**	**6.6**	**11.7**
NET LIQUID ASSETS	**3.9**	**–**	**–**	**0.3**	**–**	**4.2**	**11.8**
TOTAL ASSETS (before deduction of bank loans and derivative financial instruments)	**65.6**	**2.9**	**23.6**	**7.6**	**0.3**	**100.0**	
Total assets – 2008	62.7	6.3	25.1	5.6	0.3		**100.0**
BANK LOANS	**(12.6)**	**–**	**–**	**–**	**–**	**(12.6)**	**(18.1)**
DERIVATIVE FINANCIAL INSTRUMENTS	**(1.6)**	**–**	**–**	**–**	**–**	**(1.6)**	**(5.5)**
SHAREHOLDERS' FUNDS	**51.4**	**2.9**	**23.6**	**7.6**	**0.3**	**85.8**	
Shareholders' funds – 2008	39.1	6.3	25.1	5.6	0.3		**76.4**
Number of equity investments (including convertibles and warrants)	119	15	67	32	1	234	231

GEOGRAPHICAL SPREAD OF INVESTMENTS

31 December 2009



31 December 2008



DETAILED LIST OF INVESTMENTS

AT 31 DECEMBER 2009

Classification	Name	Value £'000	%
UNITED KINGDOM			
Aerospace and defence	† Cohort	1,569	0.4
Electronic and electrical equipment	† Andor Technology	1,551	
	† Coe Group	274	
	e2v Technologies	1,259	
	Laird	543	
	† Orpak Systems	580	
	† RCG Holdings	720	
		4,927	1.2
Support services	Acal	1,802	
	† Datacash Group	1,218	
	Diploma	5,639	
	† Eckoh Technologies	696	
	Electrocomponents	4,301	
	† Maintel	1,064	
	† Opsec Security	1,277	
	† Tangent Communications	307	
		16,304	4.1
Leisure goods	† ¶ Bright Things	108	
	† Harvard International	240	
		348	0.1
Healthcare equipment and services	† Deltex Medical	1,052	0.3
Media	† Avesco	555	
	Bloomsbury Publishing	1,250	
	† Burst Media	236	
	Centaur Media	705	
	Chime Communications	2,904	
	† Coolabi	164	
	Creston	1,918	
	† Digital Marketing Group	463	
	† Ebiquity	1,632	
	Euromoney Institutional Investor	5,882	
	† First Artist	259	
	† Freshwater UK	169	
	† Independent Media Distribution	1,634	
	* Independent Media Support Group	–	
	† Interactive Prospect Targeting	19	
	† M&C Saatchi	3,520	
	† Media Corporation	316	
	† Next Fifteen Communications	3,139	
	† Phorm	201	
	† Pixel Interactive Media	253	
	† Progressive Digital Media Group	422	
	Quarto Group	1,477	
	† Ten Alps	1,751	
	† The Mission Marketing Group	300	
	† Touch Group	389	
	† UBC Media Group	286	
	† WFCA	237	
	Wilmington Group	2,874	
	† Yougov	1,025	
		33,980	8.6
Travel and leisure	† Mama Group	2,136	0.5

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2009

Classification	Name	Value £'000	%
UNITED KINGDOM (continued)			
Fixed line telecommunications	† Alternative Networks	3,232	
	† Daisy Group	184	
	† Spectrum Interactive	70	
	Telecom Plus	8,056	
		11,542	2.9
Mobile telecommunications	† 2 Ergo Group	486	
	† Avanti	2,002	
		2,488	0.6
Non-life insurance	* ‡ Culver Holdings	29	–
Equity investment instruments	* Herald Ventures II	1,606	
	* HIML Holdings Limited	207	
	* HIML Jersey Ltd	–	
		1,813	0.5
Software and computer services	† @UK	8	
	† Allocate Software	3,622	
	Alphameric	3,342	
	Alterian	7,663	
	† Atlantic Global	94	
	† Bango	2,336	
	† Brady	852	
	* Business Control Solutions	162	
	† Clarity Commerce Solutions	741	
	† Craneware	1,188	
	† Dealogic	992	
	Electronic Data Processing	762	
	† Ffastfill	3,432	
	Fidessa Group	4,571	
	GB Group	1,284	
	Gresham Computing	746	
	† Group NBT	7,980	
	† IDOX	2,867	
	Intec Telecom Systems	4,594	
	* Intechnology	367	
	† Intelligent Environments	1,175	
	*† ‡ Invu	307	
	† Iomart	846	
	† K3 Business Tech	943	
	Kewill Systems	2,398	
	Kofax	3,188	
	† Maxima Holdings	1,889	
	Microgen	1,109	
	NCC Group	1,155	
	† OMG	1,292	
	† OneClickHR	717	
	† Patsystems	2,520	
	Phoenix IT Group	8,207	
	† Portrait Software	1,064	
	† Scisys	900	
	SDL	15,226	
	* †‡ Servicepower Technologies	849	
	† Silanis International	327	
	† Smart Focus	332	
	† SQS Software Quality Systems	4,226	
	† StatPro Group	6,982	
	† Strategic Thought Group	677	
	† Xploite	741	
	* † ‡ Zoo Digital Group	939	
		105,612	26.6

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2009

Classification	Name		Value £'000	%
UNITED KINGDOM (continued)				
Technology hardware and equipment	† Amino Technologies		824	
	BATM Advanced Communications		3,177	
	* Celoxica Holdings		–	
	CML Microsystems		268	
	† Concurrent Technology		281	
	Imagination Technologies Group		22,249	
	† Innovision Research & Technology		2,203	
	† IQE		3,342	
	* Itis		–	
	† MTI Wireless Edge		295	
	Northamber		1,013	
	Pace		1,567	
	† Sandvine		370	
	† Telit Communications		825	
	† Toumaz		5,013	
	Wolfson Microelectronics		1,083	
	Xaar		790	
			43,300	10.9
	TOTAL UNITED KINGDOM EQUITIES		225,100	56.7
CONTINENTAL EUROPE				
Support services	Hologram Industries	France	917	0.2
Leisure goods	Archos	France	368	0.1
Media	High Co	France	373	
	NRJ Group	France	1,006	
	PubliGroupe	Switzerland	173	
	Roularta Media Group	Belgium	344	
			1,896	0.5
Software and computer services	* Atex	Norway	–	
	InfoVista	France	906	
	Isra Vision Systems	Germany	683	
	Norkom	Ireland	1,421	
	Skillsoft	Ireland	260	
	United Internet	Germany	1,958	
			5,228	1.3
Technology hardware and equipment	Logitech International	Switzerland	1,931	
	Nordic Semiconductor	Norway	848	
	Soitec	France	444	
			3,223	0.8
	TOTAL CONTINENTAL EUROPEAN EQUITIES		11,632	2.9
USA				
Electronic and electrical equipment	Powerwave Technologies		178	
	RF Monolithics		125	
			303	0.1
Support services	3 Par Inc		1,137	
	Harris Interactive		219	
			1,356	0.3
Leisure goods	THQ		140	–
Health care equipment and services	SonoSite		584	0.2
Travel and leisure	Ctrip.com International		2,667	0.7

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2009

Classification	Name	Value £'000	%
USA (continued)			
Software and computer services	Actuate	2,387	
	Advent Software	6,298	
	Descartes Systems Group	2,037	
	Epiq Systems	2,601	
	Falconstor Software	754	
	Fundtech	1,690	
	Ilinc Communications	184	
	Keynote Systems	2,497	
	Liveperson	861	
	Mentor Graphics	1,367	
	Netease.com	932	
	NetScout Systems	2,714	
	PDF Solutions	220	
	Pegasystems	2,105	
	Phase Forward	948	
	Phoenix Technologies	170	
	Retalix	905	
	Rovi	1,479	
	¶ Smart Online	–	
	Support.com	1,622	
	Telvent	483	
	Vasco Data Security	775	
	Web.com Group	1,003	
	Websense	5,028	
		39,060	9.8
Technology hardware and equipment	Actel	3,241	
	Adaptec	519	
	ADC Telecommunications	769	
	Alliance Fiber Optic Product	671	
	Alvarion	556	
	Anadigics	1,587	
	Arris Group	1,239	
	Atmi	2,305	
	Ceva	2,253	
	Emulex	182	
	Exar	243	
	Extreme Networks	2,186	
	F5 Networks	3,277	
	Finisar	462	
	Harris Stratex Net	1,088	
	Lantronix	320	
	Mellanox	887	
	Micros Systems	1,922	
	Mindspeed Technologies	1,602	
	MIPS Technologies	1,078	
	MRV Communications	978	
	On Semiconductor	1,637	
	Power Integrations	787	
	Radisys	623	
	Radware	2,898	
	Rimage	322	
	RIT Technologies	41	
	Silicon Graphics	217	
	Silicon Image	111	
	Silicon Motion Technology	1,669	
	Sonicwall	2,094	
	STEC	1,007	
	Supertex	2,399	
	Trident Microsystems	458	
	Visat	983	
	Virage Logic	681	
		43,292	10.9
	TOTAL USA EQUITIES	87,402	22.0

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2009

Classification	Name		Value £'000	%
ASIA PACIFIC				
Chemicals	Techno Semichem	Korea	1,765	0.5
Electronic and electrical equipment	BSE Holdings	Korea	494	
	Dae Duck Electronics	Korea	426	
	Fine Dnc	Korea	299	
	Huan Hsin	Singapore	370	
	Innotek	Singapore	463	
	KH Vatec	Korea	4,110	
	Simm Tech	Korea	713	
	Surface Mount Technology	Singapore	128	
	Tripod Technology	Taiwan	1,240	
	UJU Electronics	Korea	1,735	
	Unimicron Technology	Taiwan	1,154	
	Wooree ETI	Korea	447	
			11,579	2.9
Industrial engineering	Fine Technix	Korea	286	0.1
Mobile telecommunications	Citic 1616	Hong Kong	544	0.1
Software and computer services	Cyberlink	Taiwan	278	
	Reckon	Australia	1,306	
	Springsoft	Taiwan	1,344	
			2,928	0.7
Technology hardware and equipment	Ardentec	Taiwan	541	
	Core Logic	Korea	121	
	D-Link	Taiwan	1,362	
	EMW Antenna	Korea	878	
	Gemtek Technology	Taiwan	741	
	Global Testing	Singapore	375	
	Jadason Enterprises	Singapore	689	
	King Yuan Electronics	Taiwan	426	
	Kinsus Interconnect Technology	Taiwan	733	
	Min Aik Technology	Taiwan	1,168	
	Mitac International	Taiwan	582	
	Nepes	Korea	1,177	
	Powertech Technology	Taiwan	2,342	
	ZyXEL Communications	Taiwan	671	
			11,806	3.0
	TOTAL ASIA PACIFIC EQUITIES		28,908	7.3
EMERGING MARKETS				
Software and computer services	Datatec	South Africa	1,388	0.3
	TOTAL EMERGING MARKETS EQUITIES		1,388	0.3

					At 31 December 2008 £'000	%
	Value of equity stocks	353,660			210,217	
	Convertible loan stocks having an element of equity	769			661	
	Warrants having an element of equity	1			1	
TOTAL EQUITY INVESTMENTS			354,430	89.2	210,879	76.5
FIXED INTEREST	Daily Mail 5.75% 2018	1,484				
	Daily Mail 7.5% 2013	1,607				
	UK Treasury 4% 2016	8,268				
	UK Treasury 4.25% 2011	6,242				
	US Treasury Note 4.5% 2010	6,407				
	WPP Group 6% 2017	2,019				
TOTAL FIXED INTEREST			26,027	6.6	32,397	11.7
TOTAL INVESTMENTS			380,457	95.8	243,276	88.2
NET LIQUID ASSETS			16,737	4.2	32,513	11.8
TOTAL ASSETS AT MARKET VALUE (before deduction of bank loans and derivative financial instruments)			397,194	100.0	275,789	100.0

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

TEN YEAR RECORD

CAPITAL								
At 31 December	Total assets £'000	Bank loans £'000	Shareholders' funds £'000	Net asset value per share p	Diluted net asset value per share* p	Share price p	Warrant price p	(Discount)/ premium† %
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)
2007	343,497	–	343,497	394.96	394.96	312.00	–	(21.0)
2008	275,789	(65,079)#	210,710	252.63	252.63	184.00	–	(27.2)
2009	**397,194**	**(56,298)#**	**340,896**	**420.58**	**420.58**	**337.75**	**–**	**(19.7)**

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

REVENUE						GEARING RATIOS	
Year to 31 December	Gross revenue £'000	Available for ordinary shareholders £'000	Earnings per ordinary share net** p	Dividend per ordinary share net p	Expense ratio†† %	Actual gearing‡‡	Potential gearing§§
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
2007	5,167	(1,370)	(1.57)	0.50	1.25	93	100
2008	7,629	4,742	5.59	1.55‡	1.13	101	131
2009	**6,077**	**324**	**0.39**	**0.30**	**1.12**	**105**	**117**

** The calculation of earnings per ordinary share is based on the revenue from ordinary activities after taxation and the weighted average number of ordinary shares in issue (see note 9, page 43).
†† Ratio of total operating costs against average shareholders' funds.
‡‡ Total assets (including all debt used for investment purposes) less all cash and fixed interest securities (excluding convertibles and corporate bonds) divided by shareholders' funds.
§§ Total assets (including all debt used for investment purposes) divided by shareholders' funds.
¶ Restated for the adoption of FRS16 'Current Tax'.
‡ The 2008 dividend excludes the special dividend of 3.45p.

CUMULATIVE PERFORMANCE (taking 1999 as 100)								
At 31 December	Diluted net asset value per share*	Share price p	Benchmark¶¶	Hoare Govett Smaller Cos & AIM Index	Russell 2000 Technology IndexΔ	Earnings per ordinary share	Dividend per ordinary share net	Retail price index
1999	100	100	100	100	100	100	100	100
2000	87	96	88	96	64	108	100	103
2001	64	60	74	79	51	158	100	104
2002	42	35	49	58	25	86	100	107
2003	74	64	69	81	36	37	35	110
2004	77	63	74	95	33	40	35	114
2005	83	74	89	116	36	74	71	116
2006	88	75	100	138	35	255	141	121
2007	80	61	96	128	36	(183)	59	126
2008	51	36	57	65	29	638	182	127
2009	**85**	**66**	**87**	**102**	**41**	**46**	**35**	**130**
Compound Annual Returns								
5 year	2.1%	1.0%	3.3%	1.5%	4.8%	2.8%	–	2.8%
10 year	(1.6%)	(4.0%)	(1.3%)	0.2%	(8.5%)	(7.6%)	(9.9%)	2.7%

Past performance is not a guide to future performance.

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

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

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

DIRECTORS' REPORT

The Directors present their Report together with the financial statements of the Company for the year to 31 December 2009.

Business Review

Business and Status

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

The Company carries on business as an investment trust. It was approved by HM Revenue & Customs as an investment trust under Section 842 of the Income and Corporation Taxes Act 1988 for the year ended 31 December 2008, 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.

Objective

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

Investment Policy

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

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

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

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

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

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

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

Performance

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

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

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

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

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

Review of the Year and Future Trends

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

Principal Risks and Uncertainties

The Company's assets consist mainly of listed securities and its principal risks are therefore market related and include market risk (comprising currency risk, interest rate risk and other price risk), liquidity risk and credit risk. An explanation of those risks and how they are managed is contained in note 21 to the accounts on pages 47 to 52.

Other risks faced by the Company include the following:

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

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

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

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

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

Employees

The Company has no employees. The executive responsibility for investment management has been delegated to Herald Investment Management Limited.

Social and Community Issues

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

Financials

The net revenue return after tax was £324,000 (2008 – net revenue return of £4,742,000) and the capital gain £140,029,000 (2008 – capital loss of £126,538,000) giving a total gain of £140,353,000 (2008 – total loss of £121,796,000) for the period. The net asset value (NAV) of the Company at 31 December 2009 was 420.58p per Ordinary share (2008 – 252.63p). This represented an increase of 66.5% during the year, compared to an increase in the benchmark of 53.2%, and a rise of 326.1% since the date of committal of funds (16 February 1994) after allowing for launch expenses of 1.3p per share. The discount narrowed from 27.2% to 19.7%.

Dividend

The Directors recommend a dividend of 0.30p (2008 –1.55p) per Ordinary share for the year ended 31 December 2009. If approved at the Annual General Meeting the final dividend will be payable on 29 April 2010 to holders registered on 9 April 2010. The ex-dividend date is 7 April 2010.

Corporate Governance

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

Compliance

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

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

The Board

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

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

Terms of Appointment

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

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

Independence of Directors

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

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

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

Meetings

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

	Board	Audit Committee	Nomination Committee
Number of meetings	**5**	**2**	**1**
Martin Boase (retired 1 September 2009)	3	2	–
Julian Cazalet	5	2	1
Clay Brendish	4	1	1
Timothy Curtis	5	2	1
Douglas McDougall	5	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 Committee is responsible for considering Directors' potential conflicts of interest and for making recommendations to the Board on whether or not the potential conflicts should be authorised. The terms of reference are available on request and on the Manager's website: **www.heralduk.com**.

Performance Evaluation

The Nomination Committee met to assess the performance of the Chairman, each Director, the Board as a whole and its Committees, after inviting each Director and the Chairman to consider and respond to a set of questions. The appraisal of the Chairman was led by Mr 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.

Induction and Training

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

Remuneration

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

Internal Controls and Risk Management

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

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

The Directors confirm that they have reviewed the effectiveness of the system and they have procedures in place to review its effectiveness on a regular basis.

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

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

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

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

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 Secretary provide sufficient assurance that a sound system of internal control, which safeguards shareholders' investment and the Company's assets, is maintained. An internal audit function, specific to the Company, is therefore considered unnecessary.

Accountability and Audit

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

Going Concern

The Company's principal risks are market related and include market risk, liquidity risk and credit risk. An explanation of these risks and how they are managed is contained in note 21 to the financial statements.

The Company's assets, the majority of which are investments in quoted securities which are readily realisable, exceed its liabilities significantly. All borrowings require the prior approval of the Board. Gearing levels and compliance with loan convenants are reviewed by the Board on a regular basis. The loan facilities currently drawn down expire in May 2011 and May 2013. In accordance with the Company's Articles of Association, shareholders have the right to vote on the continuation of the Company every three years with the next vote at the Annual General Meeting to be held on 21 April 2010.

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

Audit Committee

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

- monitoring and reviewing the integrity of the half-yearly and annual financial statements and any formal announcements relating to the Company's financial performance;
- reviewing standards of internal control and risk management;
- making recommendations to the Board in relation to the appointment of the external auditors and approving the remuneration and terms of their engagement;
- developing and implementing policy on the engagement of the external auditors to supply non-audit services (there were no non-audit services 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.

Ernst & Young LLP have been the Company's auditors since 1994. Having considered the experience and tenure of the audit partner and staff and level of service provided, the Committee remains satisfied with the auditors' effectiveness. Accordingly the Committee has not considered it necessary to date to require Ernst & Young LLP to tender for the audit work. The audit partners responsible for the audit are rotated every 5 years and the current lead audit partner has been in place for 4 years. There are no contractual obligations restricting the Company's choice of external auditor. The Committee receives confirmation from the auditors that they have complied with the relevant UK professional and regulatory requirements on independence. The Committee does not believe that there has been any impairment to the auditors' independence.

Relations with Shareholders

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

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

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.

Conflicts of Interest

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

Directors

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

Name	Number of Ordinary Shares 31 December 2009	1 January 2009
Julian Cazalet	75,000	50,000
Clay Brendish	14,700	14,700
Timothy Curtis	10,000	6,500
Douglas McDougall	233,500	233,500

There have been no changes intimated in the above Directors' interests up to 24 February 2010.

Mr TM Curtis retires by rotation and, being eligible, offers himself for re-election.

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

Deeds of Indemnity and Insurance

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

The Company maintains Directors' and Officers' Liability insurance.

Management and Administration

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

The management contract is subject to 12 months' notice by either party. The senior director of HIML with prime responsibility for the management of Herald Investment Trust is Katie Potts, who is also a substantial shareholder of HIML. HIML is remunerated at a monthly rate of 0.08333% of the Company's net asset value calculated using middle market prices. Compensation fees would only be payable in respect of this 12 month period if termination were to occur sooner. Careful consideration has been given by the Board as to the basis on which the management fee is charged. The Board considers that maintaining a relatively low total expense ratio is in the best interest of all shareholders. The Board is also of the view that calculating the fee with reference to performance would be unlikely to exert a positive influence over the long term performance. At 31 December 2009, Katie Potts held 249,035 ordinary shares of Herald Investment Trust plc.

At 31 December 2009, the Company was the beneficial owner of 14.13% of the Ordinary share capital of HIML Holdings Limited. HIML Holdings Limited is the parent company of HIML.

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

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

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

Major Interests in the Company's Shares

At 24 February 2010 the Directors have been notified of the following shareholdings which represent 3% or more of the Company's issued share capital:

Name	Ordinary Shares	% of issue†
Rathbone Brothers Plc (Indirect)	4,306,555	5.3
1607 Capital Partners (Direct)	4,243,147	5.2
Asset Value Investors Limited (Direct)*	4,071,714	5.0
Lloyds Banking Group plc (Indirect)	3,235,073	4.0
(Direct)	3,193,266	3.9
Legal & General Group Plc (Direct)	3,162,493	3.9

* Includes British Empire Securities & General Trust plc.

† Based on issued share capital at 31 December 2009 of 81,053,283 Ordinary shares.

Share Capital

Capital Structure

At 31 December 2009 the Company's capital structure consisted of 81,053,283 Ordinary shares of 25p each (2008 – 83,408,123 Ordinary shares). During the year 2,354,840 shares were bought back and cancelled. There are no restrictions concerning the holding or transfer of the Company's Ordinary shares and there are no special rights attached to any of the shares.

Dividends

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

Capital Entitlement

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

Voting

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

Information on the deadlines for proxy appointments can be found on page 54.

Annual General Meeting

At the Annual General Meeting of the Company to be held on 21 April 2010 the following resolutions will be proposed as special business.

Continuation of the Company

In accordance with the Company's Articles of Association, shareholders have the right to vote on the continuation of the Company every three years with the next vote at the Annual General Meeting on 21 April 2010. Accordingly, an ordinary resolution, Resolution 7 in the Notice of Annual General Meeting, is being proposed 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 22 April 2009 it was resolved that the Company be authorised to purchase in the market up to 12,382,957 Ordinary shares (14.99% of its Ordinary share capital in issue at that time). During the year to 31 December 2009 the Company bought back 2,354,840 Ordinary shares (nominal value £588,710 which comprised 2.8% of the issued share capital at 1 January 2009) on the London Stock Exchange for cancellation. Between 1 January 2010 and the date of this report, the Company bought back a further 230,000 Ordinary shares (nominal value £57,500 which comprised 0.3% of the issued share capital at 1 January 2010) on the London Stock Exchange for cancellation. The Board continues to believe that the ability of the Company to purchase its own Ordinary shares in the market will potentially benefit all shareholders of the Company. The repurchase of Ordinary shares at a discount to the underlying net asset value ('NAV') should enhance the NAV per Ordinary share of the remaining shares and may also enable the Company to address more effectively any imbalance between supply and demand for the Company's Ordinary shares.

Accordingly, the Directors are now recommending in Resolution 8 that this authority to purchase the Company's own Ordinary shares should be renewed and should now expire at the Company's Annual General Meeting to be held in 2011. 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 immediately 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 8 in the Notice of Annual General Meeting, will last until the date of the Annual General Meeting in 2011. 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.

Adoption of New Articles of Association

It is proposed in Resolution 9 to adopt new Articles of Association (the 'New Articles') in order to update the Company's current Articles of Association (the 'Current Articles') primarily to take account of the coming into force of the Companies (Shareholders' Rights) Regulations 2009 (the 'Shareholders' Rights Regulations') and the implementation of the last parts of the Companies Act 2006.

A copy of the New Articles will be available for inspection at the offices of Herald Investment Management Limited, 10-11 Charterhouse Square, London, EC1M 6EE during normal business hours on any day (Saturdays, Sundays and public holidays excepted) from the date of the notice of the Annual General Meeting (the 'Notice') until the conclusion of the Annual General Meeting.

The principal changes introduced in the New Articles are summarised in the Appendix to the Notice on page 55. Other changes, which are of a minor, technical or clarifying nature and also some more minor changes which merely reflect changes made by the Companies Act 2006 or the Shareholders' Rights Regulations have not been noted in the Appendix.

Recommendation

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

Payment of Suppliers

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

The Company did not have any trade creditors at 31 December 2008 or 2009.

Disclosure of Information to Auditors

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

Independent Auditors

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

By order of the Board

Julian Cazalet
Chairman

25 February 2010

DIRECTORS' REMUNERATION REPORT

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

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

Remuneration Committee

The Company has four Directors all of whom are non-executive (see page 4). There is no separate Remuneration Committee and the Board as a whole considers changes to Directors' fees from time to time. The Company Secretary, Baillie Gifford & Co, provides advice 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 2010 and subsequent years.

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

The Board reviewed Directors' fees during the year and concluded that the fees should be increased from £22,500 to £25,500 for the Chairman and from £15,000 to £17,000 for each Director. This increase was effective from 1 July 2009.

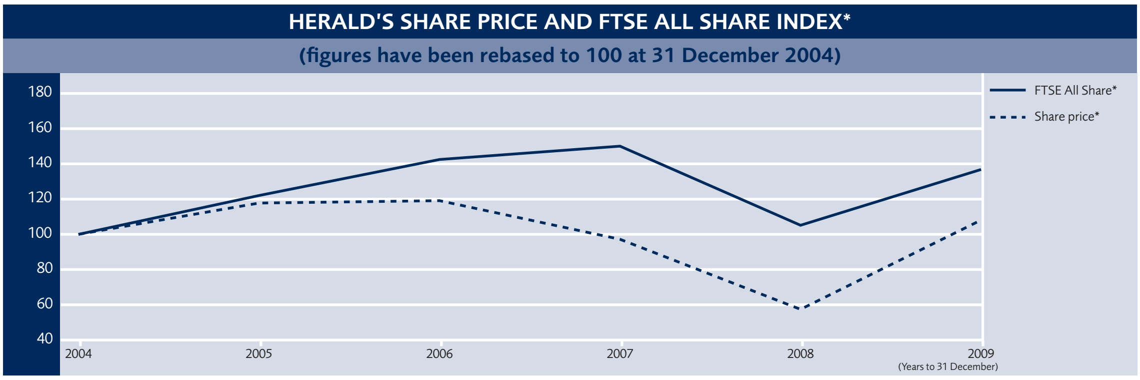
Directors' Service Contracts

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

Name	Date of appointment	Due date for re-election
Julian Cazalet	18 January 2008	AGM 2011
Clay Brendish	23 July 2001	AGM 2011
Timothy Curtis	22 July 2004	AGM 2010
Douglas McDougall	13 February 2002	AGM 2011

Company Performance

The graph below compares, for the five financial years ended 31 December 2009, 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 not a guide to 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 2009 £	Fees 2008 £
Directors who served during the year:		
Martin Boase (retired 1 September 2009)	15,582	22,500
Julian Cazalet (appointed 18 January 2008)	18,833	14,325
Clay Brendish	16,000	15,000
Timothy Curtis	16,000	15,000
Douglas McDougall	16,000	15,000
	82,415	81,825

Approval

The Directors' Remuneration Report on pages 31 and 32 was approved by the Board of Directors on 25 February 2010 and signed on its behalf by

Julian Cazalet

Chairman

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

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

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

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

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

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

By order of the Board

Julian Cazalet

25 February 2010

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 2009 which comprise the Income Statement, the Balance Sheet, the Reconciliation of Movements in Shareholders' Funds, the Cash Flow Statement and the related notes 1 to 21. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

Respective Responsibilities of Directors and Auditors

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

Scope of the Audit of the Financial Statements

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

Opinion on Financial Statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2009 and of its net return for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

- the Directors' Statement, set out on page 26, in relation to going concern; and
- the part of the Corporate Governance Statement on pages 24 to 27 relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Sue Dawe (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP
Statutory Auditor
Edinburgh

25 February 2010

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 Revenue £'000	2009 Capital £'000	2009 Total £'000	2008 Revenue £'000	2008 Capital £'000	2008 Total £'000
Gains/(losses) on investments	10 & 15	–	139,718	139,718	–	(126,592)	(126,592)
Currency gains	15	–	311	311	–	54	54
Income	2	6,077	–	6,077	7,629	–	7,629
Investment management fee	3	(2,773)	–	(2,773)	(2,808)	–	(2,808)
VAT Recovered	4	292	–	292	2,506	–	2,506
Other administrative expenses	5	(313)	–	(313)	(321)	–	(321)
Net return before finance costs and taxation		3,283	140,029	143,312	7,006	(126,538)	(119,532)
Finance costs of borrowings	6	(2,875)	–	(2,875)	(2,128)	–	(2,128)
Net return on ordinary activities before taxation		408	140,029	140,437	4,878	(126,538)	(121,660)
Tax on ordinary activities	7	(84)	–	(84)	(136)	–	(136)
Net return on ordinary activities after taxation		324	140,029	140,353	4,742	(126,538)	(121,796)
Net return per Ordinary share	9	0.39p	169.95p	170.34p	5.59p	(149.07p)	(143.48p)

The Board proposed on 16 February 2010 a dividend of 0.30p per Ordinary Share (31 December 2008 – 1.55p). More information on dividend distributions can be found in note 8 on page 43.

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

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

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

The accompanying notes on pages 40 to 52 are an integral part of the financial statements.

BALANCE SHEET

AT 31 DECEMBER 2009

		2009		2008	
	Notes	£'000	£'000	£'000	£'000
Fixed assets					
Investments held at fair value through profit or loss	10		380,457		243,276
Current assets					
Debtors	11	1,593		1,803	
Cash and short term deposits	18	18,551		31,547	
		20,144		33,350	
Creditors:					
Amounts falling due within one year	12	(53,407)		(50,837)	
Derivative financial instruments	13	(6,298)		(15,079)	
		(59,705)		(65,916)	
Net current liabilities			(39,561)		(32,566)
TOTAL NET ASSETS			340,896		210,710
Capital and reserves					
Called-up share capital	14		20,263		20,852
Share premium	15		73,738		73,738
Capital redemption reserve	15		1,689		1,100
Capital reserve	15		243,064		109,072
Revenue reserve	15		2,142		5,948
SHAREHOLDERS' FUNDS			340,896		210,710
NET ASSET VALUE PER ORDINARY SHARE (including income)	16		420.58p		252.63p
NET ASSET VALUE PER ORDINARY SHARE (excluding income)			420.19p		247.04p

The financial statements of Herald Investment Trust plc (Company Registration No. 2879728) were approved by the Board of Directors and authorised for issue on 25 February 2010 and signed on their behalf by

Julian Cazalet

Chairman

The accompanying notes on pages 40 to 52 are an integral part of the financial statements.

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

FOR THE YEAR ENDED 31 DECEMBER 2009

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

FOR THE YEAR ENDED 31 DECEMBER 2008

	Notes	Called up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Share-holders' funds £'000
Shareholders' funds at 1 January 2008		21,743	73,738	209	246,171	1,636	343,497
Net return on ordinary activities after taxation		–	–	–	(126,538)	4,742	(121,796)
Shares bought back	14	(891)	–	891	(10,561)	–	(10,561)
Dividends paid during the year	8	–	–	–	–	(430)	(430)
Shareholders' funds at 31 December 2008		20,852	73,738	1,100	109,072	5,948	210,710

The accompanying notes on pages 40 to 52 are an integral part of the financial statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 £'000	2009 £'000	2008 £'000	2008 £'000
Net cash inflow from operating activities	17		3,729		6,092
Servicing of finance					
Loan interest		(2,871)		(1,614)	
Net cash outflow from servicing of finance			(2,871)		(1,614)
Financial investment					
Purchase of investments		(59,037)		(100,426)	
Sale of investments		55,350		76,331	
Net cash outflow from financial investment			(3,687)		(24,095)
Equity dividend paid	8		(4,130)		(430)
Net cash outflow before financing			(6,959)		(20,047)
Financing					
Shares repurchased	14	(6,037)		(10,561)	
Loans drawn down		–		50,000	
Net cash (outflow)/inflow from financing			(6,037)		39,439
(Decrease)/increase in cash	18		(12,996)		19,392
Reconciliation of net cash flow to movement in net debt	18				
(Decrease)/increase in cash for period			(12,996)		19,392
Net cash inflow from bank loans			–		(50,000)
Movement in net debt in period			(12,996)		(30,608)
Net (debt)/funds at 1 January			(18,453)		12,155
Net debt at 31 December			(31,449)		(18,453)

The accompanying notes on pages 40 to 52 are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting policies

The Financial Statements for the year to 31 December 2009 have been prepared on the basis of the accounting policies set out below, which are consistent with those in the Company's Annual Financial Statements at 31 December 2008.

(a) Accounting convention

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

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

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

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

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

(b) Investments

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

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

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

(c) Income

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

(d) Expenses

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

(e) Finance costs

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

(f) Financial instruments

The Company uses interest rate swaps to hedge the cash flow risk arising from interest rate fluctuations. The swap is marked to the value at which the position can be closed out daily. The fair value calculation is based on an external model and external prices which are regularly checked to the swap providers valuation. The current intention is to hold the swap for the long term, it is marked to the close out valuation daily. Gains or losses arising on the fair value of the interest rate swap during the year are taken to the profit and loss account via the capital reserve.

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

(g) Deferred taxation

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

(h) Foreign currency

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

1. Accounting policies (continued)

(i) Capital reserve

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

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

2. Income

	2009 £'000	2008 £'000
Income from investments		
Franked dividends from listed investments	2,465	2,425
Franked dividends from unlisted investments (inc AIM)	1,022	1,051
Unfranked income from unlisted (inc AIM) UK convertible bonds	22	22
UK unfranked investment income	248	315
Overseas dividend income	584	1,002
UK interest	939	151
Overseas interest	398	565
	5,678	5,531
Other income		
Deposit interest	373	2,066
Underwriting commission	26	32
	399	2,098
Total income	6,077	7,629
Total income comprises:		
Dividends from equity securities designated at fair value through profit or loss	4,319	4,793
Interest from financial assets designated at fair value through profit or loss	1,359	738
Deposit interest	373	2,066
Underwriting commission	26	32
	6,077	7,629

3. Investment management fee

	2009 £'000	2008 £'000
Investment management fee	2,773	2,808

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

4. VAT recovered

In 2007 the European Court of Justice ruled that investment trust management fees should be exempt from VAT. During the year, HMRC has accepted the Manager's repayment claims for the period from 1994 to 1996. £292,000 of VAT together with £171,000 of interest was reimbursed to the Company in respect of this period and recognised in the current year.

In the year to 31 December 2008, £2,506,000 of VAT together with £370,000 of interest was received by the Company in respect of the repayment claims for the period from 2001 to 2007.

5. Other administrative expenses

	2009 £'000	2008 £'000
Custodian's fees	29	30
Registrars' fees	21	19
Directors' fees	82	82
Auditors' fees – statutory audit	17	16
Miscellaneous expenses	164	174
	313	321

6. Finance costs of borrowings

	2009 £'000	2008 £'000
Bank loans repayable within one year	1,261	2,460
Interest on swap	1,614	(332)
	2,875	2,128

7. Tax on ordinary activities

	2009 £'000	2008 £'000
Analysis of charge in year		
Overseas taxation	84	136

Factors affecting tax charge for year

The tax charge for the year is lower than the standard rate of corporation tax in the UK of 28% (2008 – 28.49%).

The differences are explained below:

	2009 £'000	2008 £'000
Net return on ordinary activities before taxation	140,437	(121,660)
Net return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 28% (2008 – 28.49%)	39,322	(34,661)
Capital returns not taxable	(39,208)	36,051
Income not taxable - UK franked investment income	(976)	(990)
Income not taxable - overseas dividends not subject to tax from 1 July 2009	(112)	–
Overseas withholding tax claimed as a deduction	(24)	(39)
Overseas withholding tax	84	136
Movement in excess management expenses	995	(359)
Overseas income taxable on receipt	3	(2)
Current tax charge for the year	84	136

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

There is no UK corporation tax charge at 31 December 2009 or 31 December 2008 as the Company has unrelieved management expenses which are available to be carried forward. The tax charge for 31 December 2009 and 2008 comprises overseas withholding taxes written off.

At 31 December 2009 the Company had surplus management expenses of £22 million (2008 – £18 million) which have not been recognised as a deferred tax asset. This is because the Company is not expected to generate taxable income in a future period in excess of the deductible expenses of that future period and, accordingly, it is unlikely that the Company will be able to reduce future tax liabilities through the use of existing surplus expenses.

8. Ordinary dividends

	2009	2008	2009 £'000	2008 £'000
Amounts recognised as distributions in the period:				
Previous year's final (paid 30 April 2009)	5.00p	0.50p	4,130	430

Set out below are 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. The revenue available for distribution by way of dividend for the year ended 31 December 2009 is £324,000 (2008 – £4,742,000).

	2009	2008	2009 £'000	2008 £'000
Amounts paid and proposed in respect of the period:				
Proposed final dividend per Ordinary share	0.30p	1.55p	243	1,293
Proposed special dividend per Ordinary share#	–	3.45p	–	2,877
	0.30p	5.00p	243	4,170
Adjustment to provision for 2008 final dividend re shares bought back			–	(40)
			243	4,130

The current year's proposed dividend will be paid on 29 April 2010 to all shareholders on the register at the close of business on 9 April 2010. The ex-dividend date is 7 April 2010.

#In 2008 the special dividend of 3.45p represented the recovery of VAT from HMRC – see note 4 on page 41.

9. Net return per Ordinary share

2009 Revenue	2009 Capital	2009 Total	2008 Revenue	2008 Capital	2008 Total
0.39p	169.95p	170.34p	5.59p	(149.07p)	(143.48p)

Revenue return per Ordinary share is based on the net revenue gain on ordinary activities after taxation of £324,000 (2008 – revenue gain of £4,742,000) and on 82,397,262 Ordinary shares (2008 – 84,885,186) being the weighted average number of Ordinary shares in issue during the year.

Capital return per Ordinary share is based on the net capital gain for the financial year of £140,029,000 (2008 – net capital loss of £126,538,000) and on 82,397,262 Ordinary shares (2008 – 84,885,186) being the weighted average number of Ordinary shares in issue during the year.

There are no dilutive or potentially dilutive shares in issue.

10. Fixed assets – investments

	2009 £'000	2008 £'000
Financial assets designated at fair value through profit or loss on initial recognition		
Listed UK – equity investments – London Stock Exchange	123,001	70,405
– AIM	98,988	53,223
– debt investments	19,620	14,900
Listed Overseas – equity investments	129,330	84,353
– debt investments	6,407	17,497
Unquoted*	3,111	2,898
Total investments in financial assets at fair value through profit or loss	380,457	243,276

10. Fixed assets – investments (continued)

	Listed in UK £'000	Listed overseas £'000	AIM £'000	Unquoted £'000	Total £'000
Cost of investments at 1 January 2009	98,510	147,786	110,814	9,877	366,987
Investment holding losses at 1 January 2009	(13,205)	(45,936)	(57,591)	(6,979)	(123,711)
Fair value of investments at 1 January 2009	85,305	101,850	53,223	2,898	243,276
Movements in the year:					
Purchases at cost	11,002	19,194	30,578	815	61,589
Sales – proceeds	(13,220)	(31,544)	(8,848)	(1,738)	(55,350)
– gains/(losses) on sales	6,874	(5,166)	(7,650)	(1,639)	(7,581)
Amortisation of fixed income book cost	63	(58)	–	–	5
Changes in investment holding gains/(losses)	55,183	51,461	31,486	388	138,518
Change in listing	(2,586)	–	199	2,387	–
Fair value of investments at 31 December 2009	142,621	135,737	98,988	3,111	380,457
Cost of investments at 31 December 2009	100,643	130,212	125,093	9,702	365,650
Investment holding gains/(losses) at 31 December 2009	41,978	5,525	(26,105)	(6,591)	14,807
Fair value of investments at 31 December 2009	142,621	135,737	98,988	3,111	380,457

	2009 £'000	2008 £'000
Gains/(losses) on investments designated at fair value through profit or loss on initial recognition		
Realised (losses)/gains on sales	(7,581)	10,580
Changes in investment holding gains/(losses)	138,518	(122,093)
	130,937	(111,513)

*The unquoted balance comprises Business Control Solutions at £162,000, Celoxica at zero, Culver Holdings at £29,000, HIML Holdings Limited and HIML Jersey Ltd at their aggregated cost of £207,000, Herald Ventures II at £1,606,000, Independent Media Support Group at zero, INVU Convertible loan notes at £240,000, Itis at zero, Intechnology at £367,000, Servicepower Technology Convertible loan stock at £205,000, Zoo Digital at £295,000 and Atex at zero.

At 31 December 2009 the Company was the beneficial owner of 14.13% (2008 – 13.86%) of the Ordinary share capital of both HIML Holdings Limited and HIML Jersey Ltd. HIML Holdings Limited is incorporated in the United Kingdom whereas HIML Jersey Ltd is incorporated in Jersey.

	2009 £'000	2008 £'000
Transaction costs		
The following transaction costs were incurred during the period		
Purchases	339	546
Sales	141	189
	480	735

11. Debtors

	2009 £'000	2008 £'000
Due within one year:		
Income accrued	1,541	1,650
Taxation recoverable	17	10
Swap interest	–	94
Other debtors and prepayments	35	49
	1,593	1,803

The carrying amount of debtors is a reasonable approximation of fair value.

12. Creditors

	2009 £'000	2008 £'000
Amounts falling due within one year:		
Purchases for subsequent settlement	2,552	–
Bank loans	50,000	50,000
Swap interest	389	–
Other creditors and accruals	466	837
	53,407	50,837

Included in other creditors and accruals is £286,000 (2008 – £173,000) in respect of the investment management fee.

The Company has a £75 million multi-currency variable rate loan facility with The Royal Bank of Scotland plc, which comprises three £25 million tranches expiring on 31 May 2010, 2011 and 2013.

At 31 December 2009, there were outstanding drawings of £50 million (2008 – £50 million). Interest on the loans is payable in quarterly instalments in January, April, July and October. A non-utilisation fee of 0.30% is payable on the £25 million undrawn. The estimated repayment value of the loan at 31 December 2009 was £50 million. The indicative costs of repaying the loan as at 31 December 2009 were not material in the context of the above figures.

The interest on £50 million of this facility has been fixed for the long term through a 30 year interest rate swap but may vary on periodic renewals of the debt facility to the extent that the mark up over LIBOR charged by a lending bank varies. The fair value of the interest rate swap contract at 31 December 2009 was an estimated liability of £6 million (2008 – £15 million) which was based on the marked to market value.

The main covenant relating to the loan is:

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

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

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

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

13. Derivative financial instruments

	2009				2008			
	Notional contract amount £'000	Fair value assets £'000	Fair value liabilities £'000	Fair value balance £'000	Notional contract amount £'000	Fair value assets £'000	Fair value liabilities £'000	Fair value balance £'000
Total derivative assets/(liabilities) held for trading	50,000	34,211	(40,509)	(6,298)	50,000	31,054	(46,133)	(15,079)

14. Called-up share capital

		2009	2008
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	81,053,283	83,408,123
	£'000	20,263	20,852

At the Annual General Meeting in April 2009, Shareholders granted the Company authority to purchase shares in the market up to 12,382,957 Ordinary shares (equivalent to 14.99% of its issued share capital at that date). In the year to 31 December 2009, a total of 2,354,840 (2008 – 3,562,887) Ordinary shares with a nominal value of £588,710 (2008 – £890,722) were bought back at a total cost of £6,037,000 (2008 – £10,561,000). At 31 December 2009 the Company had authority to buy back a further 10,828,117 Ordinary shares. Under the provisions of the Company's Articles share buy-backs are funded from the capital reserve.

15. Capital and reserves

	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000
At 1 January 2009	73,738	1,100	109,072	5,948
Shares purchased for cancellation	–	589	(6,037)	–
Losses on sales	–	–	(7,581)	–
Changes in investment holding gains	–	–	138,518	–
Movement in fair value of interest rate swap	–	–	8,781	–
Other exchange differences	–	–	311	–
Dividends appropriated during the year	–	–	–	(4,130)
Revenue return on ordinary activities after taxation	–	–	–	324
Balance at 31 December 2009	73,738	1,689	243,064	2,142

The capital reserve includes investment holding gains of £14,807,000 (2008 – losses of £123,711,000) as disclosed in note 10.

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

16. Net asset value per Ordinary share

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

	2009	2008	2009 £'000	2008 £'000
Ordinary shares	420.58p	252.63p	340,896	210,710

Net asset value per Ordinary share is based on net assets as shown above and on 81,053,283 (2008 – 83,408,123) Ordinary shares, being the number of Ordinary shares in issue at each date.

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

	2009 £'000	2008 £'000
Net return on ordinary activities before finance costs and taxation	143,312	(119,532)
(Gains)/losses on investments	(139,718)	126,592
Currency gains	(311)	(54)
Decrease/(increase) in accrued income	102	(887)
Decrease in other debtors	14	14
Increase/(decrease) in creditors	109	(103)
Amortisation of fixed income book cost	(5)	148
Income tax suffered	(1)	(4)
Overseas tax suffered	(84)	(136)
Realised currency profit	311	54
Net cash inflow from operating activities	3,729	6,092

18. Analysis of changes in net debt

	At 1 January 2009 £'000	Cash flows £'000	At 31 December 2009 £'000
Cash at bank and in hand	31,547	(12,996)	18,551
Loans due within one year	(50,000)	–	(50,000)
	(18,453)	(12,996)	(31,449)

19. Contingent liabilities, guarantees and financial commitments

At 31 December 2009 and 31 December 2008 the Company had a commitment to participate in Herald Ventures II Limited Partnership. The Company's commitment is limited to £3 million, drawn down in tranches. The first tranche was drawn down in October 2004, with a total of £1,950,000 being drawn down at 31 December 2008 with a further £450,000 in the year to 31 December 2009. The commitment will be fully drawn down in June 2011.

20. Capital management

The Company does not have any externally imposed capital requirements. The capital of the Company is the Ordinary share capital as detailed in note 14. It is managed in accordance with its investment policy in pursuit of its investment objective, both of which are detailed on page 22, and shares may be repurchased as explained on pages 29 and 30.

21. Financial instruments

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

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

A. Market Risk

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

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

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

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

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

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

A. Market Risk

(i) Other Price Risk

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

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

Other Price Risk Sensitivity

34.7% of the Company's equity investments at 31 December 2009 (2008 – 33.4%) were listed on the main list of the London Stock Exchange and a further 27.9% (2008 – 25.2%) on AIM. The NASDAQ Stock Exchange accounts for 23.9% (2008 – 28.5%) and other stock exchanges 12.6% (2008 – 11.6%). A 10% increase in stock prices at 31 December 2009 would have increased total net assets and net return on ordinary activities after taxation by £35,000,000 (2008 – £21,000,000). A decrease of 10% would have had an equal but opposite effect. The portfolio does not target any exchange as a benchmark, and the performance of the portfolio has a low correlation to generally used indices.

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

21. Financial instruments (continued)

(ii) Interest Rate Risk

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

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

At the year end the Company had borrowings of £50 million (2008 – £50 million). Under the terms of an interest rate swap, the interest payable on the bank loans has been fixed.

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

Financial Assets

		2009			2008	
	Fair value £'000	Weighted average interest rate/ interest rate	Weighted average period until maturity/ maturity date	Fair value £'000	Weighted average interest rate/ interest rate	Weighted average period until maturity/ maturity date
Fixed rate:						
UK bonds	19,620	4.7%	5 years	14,900	4.1%	5 years
European bonds	–	–	–	10,027	5.5%	4 months
US bonds	6,407	4.5%	11 months	7,470	4.5%	2 years
UK convertible bonds	769	6.9%	4 years	405	7.0%	3 years
Cash:						
Other overseas currencies	1,041			563		
Sterling	17,510	0.3%		30,984	4.6%	
	18,551			31,547		

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

Financial Liabilities

		2009			2008	
	£'000	Net Interest rate paid	Loan Facility expires	£'000	Net Interest rate paid	Loan Facility expires
Bank Loan	25,000	2.3%	May 2011	25,000	6.5%	May 2011
	25,000	2.4%	May 2013	25,000	6.6%	May 2013
	50,000	2.4%		50,000	6.6%	
Swap	50,000	3.2%		50,000	(1.0%)	
Total		5.6%			5.6%	

The effective fixed rate of interest on the loans of 5.6% (2008 – 5.6%) reflects a weighted average variable interest rate paid of 2.4% (2008 – 6.6%), with a further weighted average of 3.2% paid on the swap (2008 – (1.0%) received from the swap). The Company's facilities are rolling on a quarterly basis with the facility on a £25 million tranche expiring in May 2011 and a £25 million tranche expiring in May 2013. While the 30 year swap remains in place, the net interest payable will effectively be fixed for the duration of the term of the facility.

21. Financial instruments (continued)

(ii) Interest Rate Risk (continued)

	2009				2008			
	Notional contract amount £'000	Fair value assets £'000	Fair value liabilities £'000	Fair value balance £'000	Notional contract amount £'000	Fair value assets £'000	Fair value liabilities £'000	Fair value balance £'000
Total derivative assets/(liabilities) held for trading	50,000	34,211	(40,509)	(6,298)	50,000	31,054	(46,133)	(15,079)

Interest rate risk sensitivity

(a) Cash

An increase of 100 basis points in interest rates as at 31 December 2009 would have a direct effect on net assets. Based on the position at 31 December 2009, over a full year, an increase of 100 basis points would have increased the net return on ordinary activities after taxation by £186,000 (2008 – increased net return on ordinary activities after taxation by £315,000) and would have increased the net asset value per share by 0.23p (2008 – increased the net asset value per share by 0.38p). A decrease of 100 basis points would have had an equal but opposite effect. The calculations are based on the cash balances as at the respective balance sheet dates and are not representative of the year as a whole.

(b) Fixed rate bonds

An increase of 100 basis points in bond yields as at 31 December 2009 would have decreased total net assets and total return on ordinary activities by £803,000 (2008 – decreased total net assets and total return on ordinary activities by £825,000) and would have decreased the net asset value per share by 0.99p (2008 – decreased the net asset value per share by 0.99p). A decrease in bond yields would have had an equal and opposite effect. The Convertible loan stocks having an element of equity are not included in this analysis as given the nature of the businesses and the risk profile of the balance sheets they are considered to have more equity like characteristics.

(c) Bank loans

The effect of an increase or decrease of 100 basis points in 3 month LIBOR interest rates as at 31 December 2009 on the interest cost of the bank loans and the net income return has been eliminated through a 30 year floating interest rate to fixed interest rate swap. The swap generates payments or charges that offset changes in the 3 month LIBOR interest rate, so that the interest payable on the bank loans is effectively converted to a fixed rate loan at 4.8975% (2008 – 4.8975%) plus margin cost. The initial term of the swap on commencement at 30 years did not match the term of the loans, therefore, hedge accounting is not used and mark to market gains or losses on the swap are captured in the net return on ordinary activities as set out in (d) below.

(d) Floating interest rate to fixed interest rate swap

A decrease of 100 basis points on 30 year interest rates as at 31 December 2009 would have a direct mark to market effect on the value of the swap and net assets. Based on the position as at 31 December 2009, over a full year, a decrease of 100 basis points would have decreased the gains on investments and net return on ordinary activities after taxation by £9,059,000 (2008 – decreased the gains on investments and net return on ordinary activities after taxation by £10,994,000) and would have decreased the net asset value per share by 11.18p (2008 – decreased the net asset value per share by 13.18p). An increase of 100 basis points would have had an equal but opposite effect.

(iii) Foreign Currency Risk

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

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

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

21. Financial instruments (continued)

(iii) Foreign Currency Risk (continued)

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

At 31 December 2009

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

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

At 31 December 2008

	Investments £'000	Cash and deposits £'000	Loans £'000	Other debtors and creditors* £'000	Net exposure £'000
US dollar	69,489	23	–	41	69,553
Norwegian krone	10,312	–	–	344	10,656
Taiwan dollar	7,021	540	–	–	7,561
Korean won	4,686	–	–	–	4,686
Euro	4,151	–	–	19	4,170
Other overseas currencies	6,191	–	–	9	6,200
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	101,850	563	–	413	102,826
Sterling	141,426	30,984	(50,000)	(14,526)	107,884
	243,276	31,547	(50,000)	(14,113)	210,710

*Includes net non-monetary assets of £29,000.

Foreign currency risk sensitivity

At 31 December 2009, had sterling strengthened by 10% (2008: 10%) in relation to all currencies, with all other variables held constant, total net assets and net return on ordinary activities after taxation would have decreased by the amounts shown below based solely on translation of securities quoted in currencies overseas. A 10% (2008: 10%) weakening of sterling against all currencies, with all other variables held constant, would have had an equal but opposite effect on the financial statement amounts. However companies whose cost base diverges in currency terms from its sales will in the longer term have a significantly greater effect on valuation than simple translation. In the short term investee companies generally cover their currency exposure to varying degrees. There is insufficient publicly disclosed information to quantify this, but in the long term this effect is expected to dwarf simple translation of foreign listings in terms of both risk and reward, because many investee companies trade globally. Furthermore the country of listing is not necessarily an indication of the geography of some or even any operational activities for investee companies. The Manager does not use financial instruments to protect against currency movements. From time to time financial leverage has been made using debt in overseas currencies.

21. Financial instruments (continued)

(iii) Foreign Currency Risk (continued)

	2009 £'000	2008 £'000
US dollar	9,411	6,955
Taiwan dollar	1,359	756
Korean won	1,252	469
Euro	843	417
Other overseas currencies	822	1,686
	13,687	10,283

B. Credit Risk

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

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

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

Credit Risk Exposure

The exposure to credit risk at 31 December was:

	2009 £'000	2008 £'000
Fixed interest investments	26,027	32,397
Cash and short term deposits	18,551	31,547
Debtors and prepayments	1,593	1,803
	46,171	65,747

The maximum exposure in fixed interest investments was £28,417,000 (2008 – £24,772,000) and the minimum £15,948,000 (2008 – £2,874,000). The maximum exposure in cash was £32,900,000 (2008 – £61,128,000) and the minimum £13,008,000 (2008 – £10,046,000).

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

C. Liquidity Risk

The Company's policy with regard to liquidity is to provide a degree of flexibility so that the portfolio can be repositioned when appropriate and that most of the assets can be realised without an excessive discount to the market price. The Company's unlisted investments are not readily realisable, but these only amount to 0.9% of the Company's total assets at 31 December 2009 (2008: 1.1%).

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

The market valuation of each underlying security gives an indication of value, but the price at which an investment can be made or realised can diverge materially from the bid or offer price depending on market conditions generally and particularly to each investment. 36% (£135 million) (2008: 36% (£88 million)) of the portfolio is invested in stocks with a market capitalisation below £100 million, where liquidity is expected to be more limited. If these stocks had on average a realisable value 20% below the bid price the value of the total fund would be adversely affected by 7.1% (2008: 7.2%).

21. Financial instruments (continued)

C. Liquidity Risk (continued)

Liquidity Risk Exposure

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

	2009					2008				
	One year or less £'000	In more than one year but not more than two years £'000	In more than two years but not more than five years £'000	Five years or more £'000	Total £'000	One year or less £'000	In more than one year but not more than two years £'000	In more than two years but not more than five years £'000	Five years or more £'000	Total £'000
Bank loans	737	26,184	26,853	–	53,774	2,061	1,592	53,351	–	57,004
Derivative financial instruments	2,042	1,243	1,017	6,335	10,637	717	1,187	2,018	19,321	23,243
Other creditors	2,888	–	–	–	2,888	228	–	–	–	228
	5,667	27,427	27,870	6,335	67,299	3,006	2,779	55,369	19,321	80,475

Fair Value of Financial Instruments
Fair values are measured using the following fair value hierarchy:

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

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

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

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

The table below sets out the fair value measurements using the fair value hierarchy.

At 31 December 2009

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

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

At 31 December 2009

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

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

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Herald Investment Trust plc will be held at 10-11 Charterhouse Square, London EC1M 6EE on 21 April 2010 at 10.30 am for the following purposes:

To consider and, if thought fit, approve resolutions 1 to 7 as ordinary resolutions and resolutions 8 and 9 as special resolutions.

Ordinary Business

1. To receive and adopt the Directors' report, the Financial Statements and the Auditors' Report in respect of the year ended 31 December 2009.
2. To approve the Directors' Remuneration Report for the year ended 31 December 2009.
3. To declare a dividend of 0.30p per share in respect of the year ended 31 December 2009.
4. To re-elect Mr TM Curtis as a Director of the Company.
5. To reappoint Ernst & Young LLP as Independent Auditors to the Company to hold office until the conclusion of the next Annual General Meeting at which financial statements are laid before the Company.
6. To authorise the Directors to determine the remuneration of the Independent Auditors.

Special Business

7. That, pursuant to article 174 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 2013.
8. That, the Company be generally and subject as hereinafter appears unconditionally authorised in accordance with Section 701 of the Companies Act 2006 (the 'Act') to make market purchases (within the meaning of Section 693(4) of the Act) of its issued shares of 25p each in the capital of the Company in substitution for any existing authority under section 701 of the Act but without prejudice to any exercise of any such authority prior to the date hereof.

   PROVIDED ALWAYS THAT

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

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

   (iii) the maximum price (exclusive of expenses) which may be paid for a share shall not be more than the higher of (a) 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 2011; 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.
9. That:

   (i) the Articles of Association of the Company be amended by deleting all the provisions of the Company's Memorandum of Association which, by virtue of section 28 Companies Act 2006, are to be treated as part of the Company's Articles of Association; and

   (ii) the Articles of Association produced to the meeting and initialled by the Chairman of the meeting for the purpose of identification be adopted as the Articles of Association of the Company in substitution for, and to the exclusion of, the existing Articles of Association.

By order of the Board

Baillie Gifford & Co
Secretaries

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

11 March 2010

NOTES

1. As a member you are entitled to appoint a proxy or proxies to exercise all or any of your rights to attend, speak and vote at the AGM. A proxy need not be a member of the Company but must attend the AGM to represent you. You may appoint more than one proxy provided each proxy is appointed to exercise rights attached to different shares. You can only appoint a proxy using the procedure set out in these notes and the notes to the proxy form. You may not use any electronic address provided either in this notice or any related documents (including the circular and proxy form) to communicate with the Company for any purpose other than those expressly stated.
2. To be valid any proxy form or other instrument appointing a proxy, together with any power of attorney or other authority under which it is signed or a certified copy thereof, must be received by post or (during normal business hours only) by hand at the Registrars of the Company at Capita Registrars, PXS, 34 Beckenham Road, Beckenham, BR3 4TU no later than 48 hours (excluding non-working days) before the time of the meeting or any adjourned meeting.
3. Shareholders may also use the online proxy voting service offered by Capita Registrars at www.capitashareportal.com to vote or appoint a proxy online. Votes must be received no later than 48 hours (excluding non-working days) before the time of the meeting or any adjourned meeting. To vote online, the unique personal identification Investor code printed on the proxy form will be required.
4. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual and/or by logging on to the website www.euroclear.com/CREST. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.
5. In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with Euroclear UK & Ireland Limited's specifications, and must contain the information required for such instruction, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the Company's registrar (ID RA10) no later than 48 hours (excluding non-working days) before the time of the meeting or any adjournment. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Application Host) from which the Company's registrar is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.
6. CREST members and, where applicable, their CREST sponsors, or voting service providers should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member, or sponsored member, or has appointed a voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.
7. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.
8. The return of a completed proxy form or other instrument of proxy will not prevent you attending the AGM and voting in person if you wish.
9. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001 and Section 311 of the Companies Act 2006 the Company specifies that to be entitled to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast), shareholders must be registered in the Register of Members of the Company no later than 48 hours (excluding non-working days) prior to the commencement of the AGM or any adjourned meeting. Changes to the Register of Members after the relevant deadline shall be disregarded in determining the rights of any person to attend and vote at the meeting.
10. Any person to whom this notice is sent who is a person nominated under Section 146 of the Companies Act 2006 to enjoy information rights (a 'Nominated Person') may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights.
11. The statement of the rights of shareholders in relation to the appointment of proxies in Notes 1 and 2 above does not apply to Nominated Persons. The rights described in those Notes can only be exercised by shareholders of the Company.
12. The members of the Company may require the Company to publish, on its website, (without payment) a statement (which is also passed to the auditors) setting out any matter relating to the audit of the Company's accounts, including the auditors' report and the conduct of the audit. The Company will be required to do so once it has received such requests from either members representing at least 5% of the total voting rights of the Company or at least 100 members who have a relevant right to vote and hold shares in the Company on which there has been paid up an average sum per member of at least £100. Such requests must be made in writing and must state your full name and address and be sent to the Company at 10-11 Charterhouse Square, London, ECIM 6EE.
13. Information regarding the Annual General Meeting, including information required by Section 311A of the Companies Act 2006, is available from the Company's page of the Managers' website at www.heralduk.com.
14. Members have the right to ask questions at the meeting in accordance with Section 319A of the Companies Act 2006.
15. As at 23 February 2010 (being the last practicable date prior to the publication of this notice) the Company's issued share capital consisted of 80,823,283 ordinary shares, carrying one vote each. Therefore, the total voting rights in the Company as at 23 February 2010 were 80,823,283 votes.
16. Any person holding 3% or more of the total voting rights of the Company who appoints a person other than the Chairman of the meeting as his proxy will need to ensure that both he and his proxy complies with their respective disclosure obligations under the UK Disclosure and Transparency Rules.
17. A copy of the proposed new Articles of Association of the Company will be available at 10-11 Charterhouse Square, London, ECIM 6EE during normal business hours on any day (Saturdays, Sundays and public holidays excepted) from the date of this notice of the AGM until the conclusion of the AGM.
18. No Director has a contract of service with the Company.

APPENDIX TO THE NOTICE OF ANNUAL GENERAL MEETING

Explanatory Notes of Principal Changes to the Company's Articles of Association

1. **The Company's Objects**

   Up until 1 October 2009 the provisions regulating the operations of the Company were set out in the Company's memorandum and articles of association. The Company's memorandum used to contain, among other things, the objects clause which set out the scope of the activities the Company is authorised to undertake. This was drafted to give a wide scope.

   The Companies Act 2006 (the '2006 Act') significantly reduces the constitutional significance of a company's memorandum. The 2006 Act provides that a memorandum will record only the names of subscribers and the number of shares each subscriber has agreed to take in the company. Under the 2006 Act, with effect from 1 October 2009, the objects clause and all other provisions which used to be contained in the memorandum of a company are now deemed to be contained in the company's articles of association but the company can remove these provisions by special resolution.

   Further the 2006 Act states that unless a company's articles provide otherwise, a company's objects are unrestricted. This abolishes the need for companies to have objects clauses. For this reason the Company is proposing to remove its objects clause together with all other provisions of its memorandum which, by virtue of the 2006 Act, are treated as forming part of the Company's articles of association as of 1 October 2009. Resolution 9 confirms the removal of these provisions for the Company. As the effect of this resolution will be to remove the statement currently in the Company's memorandum of association regarding limited liability, the New Articles also contain an express statement regarding the limited liability of shareholders.

2. **Authorised Share Capital and Unissued Shares**

   The 2006 Act abolishes the requirement for a company to have an authorised share capital and the New Articles reflect this. Directors will still be limited as to the number of shares they can at any time allot because allotment authority continues to be required under the 2006 Act.

3. **Redeemable Shares**

   Under the Companies Act 1985 (the '1985 Act'), if a company wished to issue redeemable shares, it had to include in its articles the terms and manner of redemption. The 2006 Act enables Directors to determine such matters instead provided they are so authorised by the articles. The New Articles contain such an authorisation. The Company has no plans to issue redeemable shares but if it did so the Directors would need shareholders' authority to issue new shares in the usual way.

4. **Authority to Purchase Own Shares, Consolidate and Sub-divide Shares and Reduce Share Capital**

   Under the 1985 Act a company required specific enabling provisions in its articles to purchase its own shares, to consolidate or sub-divide its shares and to reduce its share capital or other undistributable reserves as well as shareholder authority to undertake the relevant action. The Current Articles include these enabling provisions. Under the 2006 Act a company will only require shareholder authority to do any of these things and it will no longer be necessary for articles to contain enabling provisions. Accordingly the relevant enabling provisions have been removed in the New Articles.

5. **Use of Seals**

   The New Articles provide an alternative option for execution of documents (other than share certificates). Under the New Articles, when the seal is affixed to a document it may be signed by a director in the presence of a witness, whereas previously the requirement was for signature by either a director and the secretary or two directors.

6. **Chairman's Casting Vote**

   The New Articles remove the provision giving the Chairman a casting vote in the event of an equality of votes as this is no longer permitted under the 2006 Act.

7. **Notice of General Meetings**

   At last year's Annual General Meeting the Company amended its articles of association so that general meetings to consider a special resolution could be convened on 14 days' notice, whereas previously 21 days' notice was required. The Shareholders' Rights Regulations amend the 2006 Act to require the Company to offer members an electronic voting facility if it is to continue to be allowed to hold general meetings to consider special resolutions on 14 days' notice. Accordingly, the New Articles amend the provisions of the Current Articles to be consistent with the new requirements.

8. **Adjournments for Lack of Quorum**

   Under the 2006 Act as amended by the Shareholders' Rights Regulations, general meetings adjourned for lack of quorum must be held at least 10 clear days after the original meeting. The Current Articles have been changed to reflect this requirement.

FURTHER SHAREHOLDER INFORMATION

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

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

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