

**HERALD INVESTMENT  
TRUST plc**

**Interim Report**

For the six months ended 30 June 2002

**Investment Policy**

Herald's objective is to achieve capital appreciation through investments in smaller quoted companies, in the areas of communications and multi-media. Investments will be made throughout the world but at least 50% of the portfolio will be invested in the UK and Europe. The business activities of investee companies will include information technology, broadcasting, printing and publishing and the supply of equipment and services to these companies.

## CHAIRMAN'S REVIEW

It is disappointing to report a further decline in the diluted net asset value per share, of 21.0%, in my ninth interim statement. However, there are a number of encouraging aspects. First, the decline in assets was modest compared to the average decline in the target sector, reflecting the defensive approach to stock selection by the Manager. Second, the capitalistic excesses, which had increasingly emerged over the last few years, are rapidly being blown away so that real value is emerging in the portfolio. These have been evident as a result of speculative valuations in the Herald orbit in particular, and increasingly evident as a result of creative accounting across the market. In the experience of the Manager we cannot piously pretend that the excesses have only been in the US. There have been examples in the UK and Europe, albeit more modest in scale than the US, as everything is. When UK companies restate earnings under US GAAP they are normally lower. Third, prospective p/e valuations are as low as they have been in the history of the Trust. Combined with the low level of interest rates this makes it appear superficially an outstanding buying opportunity. However, the caveat is that earnings expectations have been declining sharply. A continuation of this trend is possible if economic conditions deteriorate further, particularly as it could affect the highly leveraged corporates, which are more prevalent in Europe than the US. Even in that scenario other sectors exposed to cyclical demand are likely to be affected more.

We have urged caution on the major markets of mobile phones and pcs, and this remains the same. Corporate capital expenditure has been severely depressed, while consumer spending has been surprisingly robust in the Anglo-Saxon economies. Although the speculative valuations for embryonic companies have evaporated as fast as they came, the sounder long term technology businesses have not in general seen the profits pressure experienced by media companies, where downgrades have been brutal for advertising-led businesses. Many technology valuations in the UK are now rather lower and more tempting than those in the media sector.

### **Capital performance of the Trust from 31 December 2001 to 30 June 2002**

UK Equities	-19.2%
European Equities	-17.6%
US Equities	-41.5%
Other Overseas Equities	-1.2%

The UK portfolio declined a further 20% and Europe nearly as much. In contrast the Far East was flat, while the US was particularly difficult, falling more than 40%, having held up so well last year. In contrast the Hoare Govett Smaller Companies Index declined 7.4%. The FTSE

## CHAIRMAN'S REVIEW *continued*

100 declined 10.8%, but Techmark, the Neuer Markt, the NASDAQ composite and the Russell 2000 small cap technology indices fell 41.0%, 35.9%, 28.4% and 39.0% respectively. US declines in £ were exaggerated by the weakness of the \$.

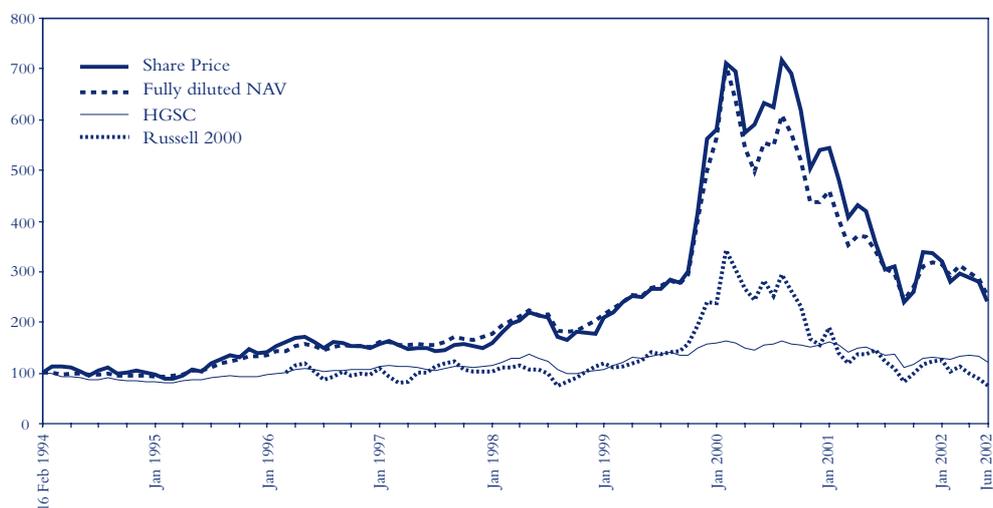
The net cash raised principally in the first half of 2000 has been progressively invested as value has been emerging. Net cash/gilt balances have declined from £58m at the start of 2001 to £43m at the start of 2002, to £25m at the end of June, albeit with nearly £5m to come from cash bids. This has led to a decline in income albeit significantly offset by a decline in fees. The focus of the fund remains on capital growth, and as in previous years an interim dividend will not be paid.

While the volatility of markets is unnerving in many ways, in other ways it is an exceptionally exciting environment where valuations are in some cases very modest in terms of expectations of growth. This is throwing up real opportunities, albeit selection remains the key. Although there are inevitably concerns at the macro level, we are increasingly excited about prospects.

**Martin Boase**

*24 July 2002*

**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)**



## STATEMENT OF TOTAL RETURN

(Unaudited and incorporating the revenue account\*)

	for the six months ended 30 June 2002		
	Revenue £'000	Capital £'000	Total £'000
(Losses) on investments	—	(58,491)	(58,491)
Unrealised (losses)/gains on loan	—	(127)	(127)
Currency (losses)/gains	—	(30)	(30)
Income	1,884	—	1,884
Investment management fee	(1,413)	—	(1,413)
Other administrative expenses	(129)	—	(129)
<b>Net return before finance costs and taxation</b>	<b>342</b>	<b>(58,648)</b>	<b>(58,306)</b>
Finance costs of borrowings	(37)	—	(37)
<b>Return on ordinary activities before taxation</b>	<b>305</b>	<b>(58,648)</b>	<b>(58,343)</b>
Tax on ordinary activities	(24)	—	(24)
<b>Return on ordinary activities after taxation</b>	<b>281</b>	<b>(58,648)</b>	<b>(58,367)</b>
Ordinary dividend payable (note 2)	—	—	—
<b>Transfer to/(from) reserves</b>	<b>281</b>	<b>(58,648)</b>	<b>(58,367)</b>
<b>Return per Ordinary share</b> (note 3)			
Basic	0.33p	(69.44p)	(69.11p)
Diluted (FRS 14)	0.32p	(67.75p)	(67.43p)
Dividend per Ordinary share	—	—	—

\* The revenue 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.

## SUMMARY OF PERFORMANCE

	At inception 16 February 1994	At 31 December 2001	At 30 June 2002	Performance	Performance
				since 31 December 2001	since inception
Basic NAV per share	98.7p	322.9p	253.8p	(21.4%)	+157.1%
Diluted NAV (FRS 14)	98.7p	314.5p	248.5p	(21.0%)	+151.8%
Fully diluted NAV per share	98.7p	314.4p	247.9p	(21.1%)	+151.2%
Share price	90.9p	306.0p	214.5p	(29.9%)	+136.0%
Warrant price	45.5p	212.5p	115.0p	(45.9%)	+152.7%
FTSE 100 Index	3,417.7	5,217.4	4,656.4	(10.8%)	+36.2%
HGSC Index (ext. cap gains ex. investment companies)	1,750.0	2,283.4	2,113.8	(7.4%)	+20.8%
Russell 2000 (small cap)					
Technology Index (in sterling terms)	83.2*	102.1	62.3	(39.0%)	(25.1%)

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

## STATEMENT OF TOTAL RETURN

(Unaudited and incorporating the revenue account)

for the six months ended 30 June 2001			for the year ended 31 December 2001		
Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
—	(84,324)	(84,324)	—	(103,929)	(103,929)
—	88	88	—	341	341
—	2	2	—	(61)	(61)
2,957	—	2,957	4,728	—	4,728
(1,787)	—	(1,787)	(3,205)	—	(3,205)
(137)	—	(137)	(272)	—	(272)
1,033	(84,234)	(83,201)	1,251	(103,649)	(102,398)
(39)	—	(39)	(75)	—	(75)
994	(84,234)	(83,240)	1,176	(103,649)	(102,473)
(18)	—	(18)	(31)	—	(31)
976	(84,234)	(83,258)	1,145	(103,649)	(102,504)
—	—	—	(718)	—	(718)
976	(84,234)	(83,258)	427	(103,649)	(103,222)
1.16p	(100.20p)	(99.04p)	1.36p	(123.01p)	(121.65p)
1.12p	(96.77p)	(95.65p)	1.32p	(119.45p)	(118.13p)
—	—	—	0.85p	—	—

## SUMMARISED BALANCE SHEET

(Unaudited)

	30 June 2002 £'000	30 June 2001 £'000	31 December 2001 £'000
Investments at market value	212,808	284,478	258,901
Net current assets	4,598	11,363	16,723
Total assets (before deduction of bank loan)	217,406	295,841	275,624
Overseas currency loan (note 4)	(3,019)	(3,145)	(2,892)
<b>Total net assets</b>	<b>214,387</b>	<b>292,696</b>	<b>272,732</b>
<b>Capital and reserves</b>			
Called-up share capital	21,119	21,113	21,113
Share premium	69,723	69,698	69,698
Warrant reserve	1,516	1,525	1,525
Capital reserve - realised	203,571	219,652	204,113
Capital reserve - unrealised	(83,962)	(21,980)	(25,856)
Revenue reserve	2,420	2,688	2,139
<b>Equity shareholder's funds</b>	<b>214,387</b>	<b>292,696</b>	<b>272,732</b>
<b>Net Asset Value per Ordinary share (note 5)</b>			
<b>Basic</b>	<b>253.79p</b>	<b>346.58p</b>	<b>322.94p</b>
<b>Diluted (FRS 14)</b>	<b>248.55p</b>	<b>337.31p</b>	<b>314.53p</b>
<b>Fully diluted</b>	<b>247.95p</b>	<b>337.16p</b>	<b>314.42p</b>
<b>Ordinary shares in issue (note 6)</b>	<b>84,475,145</b>	<b>84,453,686</b>	<b>84,453,686</b>

## SUMMARISED CASH FLOW STATEMENT

(Unaudited)

	For six months ended 30 June 2002	For six months ended 30 June 2001	For year ended 31 December 2001
	£'000	£'000	£'000
<b>Net cash inflow from operating activities</b>	275	955	1,571
<b>Net cash outflow from servicing of finance</b>	(36)	(41)	(79)
<b>Financial investment</b>			
Purchase of investments	(56,046)	(40,689)	(124,980)
Sale of investments	42,733	39,681	130,695
Currency movement	(30)	2	(61)
<b>Net cash (outflow)/inflow from financial investment</b>	(13,343)	(1,006)	5,654
<b>Equity dividend paid</b>	(718)	(713)	(713)
<b>Net cash (outflow)/inflow before use of liquid resources and financing</b>	(13,822)	(805)	6,433
<b>Management of liquid resources<sup>†</sup></b>			
Decrease in term deposits	—	4,000	4,000
<b>Financing</b>			
Issue of Ordinary shares	22	580	580
<b>(DECREASE)/INCREASE IN CASH</b>	<u>(13,800)</u>	<u>3,775</u>	<u>11,013</u>
<b>RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS</b>			
(Decrease)/increase in cash in period	(13,800)	3,775	11,013
Decrease in short term investments	—	(4,000)	(4,000)
Exchange movement on loan	(127)	88	341
<b>MOVEMENT IN NET FUNDS IN PERIOD</b>	(13,927)	(137)	7,354
<b>NET FUNDS AT 1 JANUARY</b>	16,351	8,997	8,997
<b>NET FUNDS AT 30 JUNE/31 DECEMBER</b>	<u>2,424</u>	<u>8,860</u>	<u>16,351</u>

<sup>†</sup>The Company includes as liquid resources term deposits of less than one year.

### NOTES

1 The accounting policies applied in calculating the interim figures are consistent with those used in the Annual Financial Statements.

The Interim Report was approved by the Board on 24 July 2002.

2 No interim dividend will be declared.

3 The basic return per Ordinary share calculations are based on a weighted average number of shares in issue during each period. For the period to 30 June 2002, the weighted average number of Ordinary shares was 84,460,918 (30 June 2001 - 84,068,024, 31 December 2001 - 84,262,972).

The diluted returns per Ordinary share have been calculated on the weighted average warrants in issue during the period adjusted by the difference between the average price of the Ordinary shares during the period and the Subscription price of 100p, giving a weighted average of 86,563,625 (30 June 2001 - 87,045,021, 31 December 2001 - 86,769,677) shares. The unadjusted fully-diluted number of shares at 30 June 2002 was 87,807,349 compared to 87,807,349 at 30 June 2001 and 31 December 2001.

4 The overseas currency loan of yen 551,550,000 becomes due for repayment on 7 January 2004.

5 The diluted net asset value per Ordinary share has been calculated in accordance with FRS 14 'Earnings per share'. The calculation determines the potential number of dilutive shares which would be issued on the exercise of warrants by reference to the share price (fair value) at each period end.

The fully diluted net asset value per Ordinary share has been calculated on the assumption that the 3,332,204 warrants in issue at 30 June 2002 (30 June 2001 and 31 December 2001 - 3,353,663) were fully exercised at 100p at each period end.

6 During the period 21,459 ordinary shares were issued in respect of warrants exercised on 30 April 2002. Each warrant entitles the holder to subscribe for one Ordinary share at 100p on 30 April 2003, which is the final subscription date.

At the AGM on 17 April 2002 the Company's authority to buy back shares was renewed in respect of 12,659,607 Ordinary shares. No shares have been bought back during the period.

There were 3,332,204 warrants in issue at 30 June 2002 (30 June 2001 and 31 December 2001 - 3,353,663).

7 The financial information for the year ended 31 December 2001 has been extracted from the full accounts, which have been filed with the Registrar of Companies and which contain an unqualified Auditors' Report.

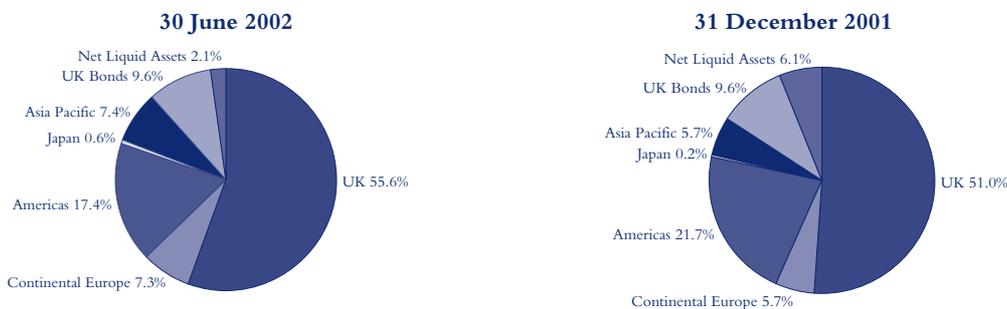
## TOP TWENTY EQUITY HOLDINGS

at 30 June 2002

Company	Sector	Market value £'000	% of total assets
Acal	Electronic products distribution	7,021	3.2
Azlan Group	Networking products distribution	6,028	2.8
Alba	Consumer electronics	4,526	2.1
Linx Printing Technologies	Manufacturer of continuous ink jet printers	4,138	1.9
Jazz FM	Commercial radio operator	3,679	1.7
Alphameric	Application software products	3,668	1.7
Logitech* (Switzerland)	Computer peripheral manufacturer	3,661	1.7
Scottish Radio Holdings	Commercial radio operator	3,602	1.7
Biotrace International	Rapid hygiene and biological testing	3,588	1.6
Telemetrix	ISDN testers and semiconductors	3,444	1.6
Diploma	Distributor	3,413	1.6
Taylor Nelson Sofres	Market research	3,353	1.5
Northgate Information Solutions	Application software products and services	3,100	1.4
Star Publications* (Malaysia)	Newspaper publisher	2,962	1.4
N.R.J. Groupe* (France)	Commercial radio operator	2,950	1.4
OneSource Information* (United States)	On-line database provider	2,805	1.3
Plasmon	Optical data storage	2,666	1.2
Asyst Technology Corp.* (United States)	Factory automation equipment	2,537	1.2
Ingenta	Online distributor of academic publishing	2,407	1.1
Project Telecom	Independent telecoms broker	2,351	1.1
		<u>71,899</u>	<u>33.2</u>

\*Primary listing outwith the UK

## GEOGRAPHIC SPREAD OF INVESTMENTS



## **DIRECTORS, MANAGER AND ADVISERS**

### **DIRECTORS**

M Boase (Chairman)  
C M Brendish CBE  
J P Dukes  
C M McCarthy  
D C P McDougall OBE  
C A Parritt

### **SECRETARY**

Baillie Gifford & Co.  
1 Rutland Court  
Edinburgh EH3 8EY  
Tel: 0131 222 4000

### **REGISTERED OFFICE**

12 Charterhouse Square  
London EC1M 6AX

### **COMPANY NUMBER**

2879728 (England and Wales)

### **INVESTMENT MANAGER**

Katie Potts  
Herald Investment Management Limited  
12 Charterhouse Square  
London EC1M 6AX  
Tel: 020 7553 6300  
Fax: 020 7490 8026  
Web-site: [www.heralduk.com](http://www.heralduk.com)  
E-mail: [info@heralduk.com](mailto:info@heralduk.com)

### **SOLICITORS**

Macfarlanes  
10 Norwich Street  
London EC4A 1BD

### **AUDITORS**

Ernst & Young LLP  
Ten George Street  
Edinburgh EH2 2DZ

### **BANKERS**

The Bank of New York  
One Canada Square  
London E14 5AL

### **STOCKBROKER**

Cazenove & Co. Ltd  
12 Tokenhouse Yard  
London EC2R 7AN

### **REGISTRARS**

Northern Registrars Limited  
Northern House  
Woodsome Park  
Fenay Bridge  
Huddersfield HD8 0LA  
Tel: 01484 600 900  
Fax: 01484 600 911