

HERALD INVESTMENT TRUST plc

Interim Report

For the six months ended 30 June 2003

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

The Trust targets the IT, media and communications sectors, which peaked dramatically in March 2000, and have subsequently fallen precipitously. However our Manager believed that the correction had been overdone and that September and October 2002 provided an outstanding buying opportunity. This led to the fund becoming fully invested at that time, having had c£43m net cash at the start of 2002. Furthermore at the October 2002 Trust board meeting the board approved a £20m multi-currency loan, which was drawn down in US\$ at an interest rate of 2.1% for a year. Although there was a useful rally in the Autumn the first quarter was poor with the assets declining 8% reflecting the macro economic/Gulf war concerns seen throughout the market. This provided an opportunity to gear the fund further, with the Manager drawing down the US\$ equivalent of an additional £10m at 1.85% following the AGM in April. However, although the assets dropped to £163m at the end of March, this was around 10% higher than the October low. Furthermore market liquidity was desperately lacking, and stock was difficult to buy in the required size in March and April, and the Manager struggled to invest the proceeds of four cash bids received in February followed by the borrowed funds. The market rallied strongly in the second quarter when the basic NAV per share grew 39%. While it was definitely a buyers market in September and October, the market is now seeing healthy two way business.

Total return by geography of the Trust from 31 December 2002 to 30 June 2003

| | |
|-------------------|---------|
| UK Equities | +31.52% |
| US Equities | +26.27% |
| European Equities | +13.68% |
| Far East Equities | +10.48% |

The fully diluted NAV per share rose 30.5% in the first half. The UK performed well ahead of the relevant indices. The total return of the Hoare Govett Smaller Companies Index was +19.2% over the same period, albeit the weighted average of the sectors most relevant to the Trust within the index was 21.4%, and the FTSE-Techmark 100 was +21.1%. The performance benefited from significant stakes in three of the four best performing stocks in Techmark – Gresham Computing, Amstrad and Imagination – albeit no single stock contributed as much as 3% of the overall 30.5% growth in the Trust. It is particularly pleasing that this outperformance of the sectors in the UK in a rising market was nearly as much as the outperformance in last year's declining markets. The US also performed well with a return of 26.3% in £; the US\$ declined by 2.5% but this was cushioned by the US\$ debt. The Russell 2000 Technology Small Companies Index grew 23.0% (in £), whereas the large company equivalent grew only 14.2%, and Nasdaq grew 18.5%. Valuations in the US were and remain superficially higher, but there is a high level of operational gearing to sales volumes, and the economy seems more robust than elsewhere. The European portfolio is small, and underperformed the Trust overall with local returns of 9.9%, but benefited from the strong Euro which increased the return to 13.7%. The economic background in Europe remains difficult. The Far East performance was relatively disappointing with our holdings skewed to economies affected by SARS.

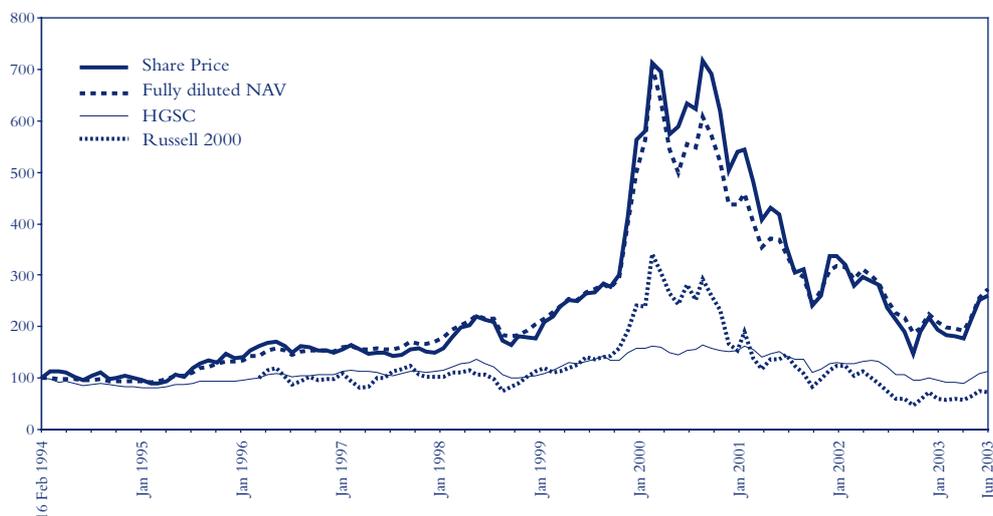
CHAIRMAN'S REVIEW *continued*

The outstanding warrants were exercised in April. There was a 93% take up with the residue being placed. The equity will suffer from no further dilution. As in previous years an interim dividend will not be paid. In recent years significant revenues have come from gilt and interest income. Now that the fund is fully invested this is no longer the case and, of course, interest rates are very low anyway.

The outstanding anomalies in valuation have unfortunately disappeared, as the irrational pessimism of the Autumn has changed to a more normal market. Further good performance is still probable, but should be based on companies making solid progress. This will not occur across the board while the major economies remain sluggish, but it is encouraging that the number of earnings surprises on the upside have exceeded disappointments in the recent past, and corporate capital expenditure is certainly at a sub-normal level. There is also evidence that some investors are worried about being underexposed to the Trust's area, and weight of money could again drive valuations to unexpected levels. The fund has outperformed the FTSE-100 by 28% in the first half, and in a low growth competitive world niche small companies may still offer the best potential.

Martin Boase
23 July 2003

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 2003 | | |
|--|---------------------------------------|------------------|----------------|
| | Revenue £'000 | Capital £'000 | Total £'000 |
| Gains/(losses) on investments | — | 53,931 | 53,931 |
| Unrealised gains/(losses) on loans | — | 1,021 | 1,021 |
| Currency losses | — | — | — |
| Income | 1,772 | — | 1,772 |
| Investment management fee | (1,069) | — | (1,069) |
| Other administrative expenses | (130) | — | (130) |
| Net return before finance costs and taxation | 573 | 54,952 | 55,525 |
| Finance costs of borrowings | (282) | — | (282) |
| Return on ordinary activities before taxation | 291 | 54,952 | 55,243 |
| Tax on ordinary activities | (18) | — | (18) |
| Return on ordinary activities after taxation | 273 | 54,952 | 55,225 |
| Ordinary dividend payable (note 2) | — | — | — |
| Transfer to/(from) reserves | 273 | 54,952 | 55,225 |
| Return per Ordinary share (note 3) | | | |
| Basic | 0.32p | 64.20p | 64.52p |
| Diluted (FRS 14) | 0.32p | | |
| 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 this statement derive from continuing operations.

SUMMARY OF PERFORMANCE

| | At inception | | Performance since | | Performance since inception |
|---|------------------|------------------|-------------------|------------------|-----------------------------|
| | 16 February 1994 | 31 December 2002 | At 30 June 2003 | 31 December 2002 | |
| Basic NAV per share | 98.7p | 210.2p | 268.9p | 27.9% | 172.4% |
| Diluted NAV (FRS 14) | 98.7p | 206.7p | 268.9p | 30.1% | 172.4% |
| Fully diluted NAV per share | 98.7p | 206.0p | 268.9p | 30.5% | 172.4% |
| Share price | 90.9p | 177.0p | 237.5p | 34.2% | 161.3% |
| Warrant price | 45.5p | 79.0p | — | — | — |
| FTSE 100 Index | 3,417.7 | 3,940.4 | 4,031.2 | 2.3% | 18.0% |
| HGSC Index (ext. cap gains ex. investment companies) | 1,750.0 | 1,693.9 | 1,981.9 | 17.0% | 13.3% |
| Russell 2000 (small cap) Technology Index (in sterling terms) | 83.2* | 49.6 | 61.0 | 23.0% | (26.7%) |

* 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 2002 | | | for the year ended 31 December 2002 | | |
|---------------------------------------|------------------|----------------|-------------------------------------|------------------|----------------|
| Revenue £'000 | Capital £'000 | Total £'000 | Revenue £'000 | Capital £'000 | Total £'000 |
| — | (58,491) | (58,491) | — | (95,509) | (95,509) |
| — | (127) | (127) | — | 582 | 582 |
| — | (30) | (30) | — | (146) | (146) |
| 1,884 | — | 1,884 | 3,539 | — | 3,539 |
| (1,413) | — | (1,413) | (2,470) | — | (2,470) |
| (129) | — | (129) | (262) | — | (262) |
| 342 | (58,648) | (58,306) | 807 | (95,073) | (94,266) |
| (37) | — | (37) | (149) | — | (149) |
| 305 | (58,648) | (58,343) | 658 | (95,073) | (94,415) |
| (24) | — | (24) | (31) | — | (31) |
| 281 | (58,648) | (58,367) | 627 | (95,073) | (94,446) |
| — | — | — | (718) | — | (718) |
| 281 | (58,648) | (58,367) | (91) | (95,073) | (95,164) |
| 0.33p | (69.44p) | (69.11p) | 0.74p | (112.55p) | (111.81p) |
| 0.32p | | | 0.73p | | |
| — | | | 0.85p | | |

SUMMARISED BALANCE SHEET

(Unaudited)

| | 30 June 2003 £'000 | 30 June 2002 £'000 | 31 December 2002 £'000 |
|--|--------------------------|--------------------------|------------------------------|
| Investments at market value | 258,023 | 212,808 | 191,988 |
| Net current assets | 9,413 | 4,598 | 7,912 |
| Total assets (before deduction of bank loans) | 267,436 | 217,406 | 199,900 |
| Bank loans (note 4) | (31,289) | (3,019) | (22,310) |
| Total net assets | 236,147 | 214,387 | 177,590 |
| Capital and reserves | | | |
| Called-up share capital | 21,952 | 21,119 | 21,119 |
| Share premium | 73,738 | 69,723 | 69,723 |
| Warrant reserve | — | 1,516 | 1,516 |
| Capital reserve - realised | 178,134 | 203,571 | 186,381 |
| Capital reserve - unrealised | (39,998) | (83,962) | (103,197) |
| Revenue reserve | 2,321 | 2,420 | 2,048 |
| Equity shareholder's funds | 236,147 | 214,387 | 177,590 |
| Net Asset Value per Ordinary share (note 5) | | | |
| Basic | 268.94p | 253.79p | 210.23p |
| Diluted (FRS 14) | 268.94p | 248.55p | 206.68p |
| Fully diluted | 268.94p | 247.95p | 206.04p |
| Ordinary shares in issue (note 6) | 87,807,348 | 84,475,145 | 84,475,145 |

SUMMARISED CASH FLOW STATEMENT

(Unaudited)

| | For six months ended 30 June 2003 | For six months ended 30 June 2002 | For year ended 31 December 2002 |
|--|---|---|---------------------------------------|
| | £'000 | £'000 | £'000 |
| Net cash inflow from operating activities | 501 | 275 | 790 |
| Net cash outflow from servicing of finance | (249) | (36) | (84) |
| Financial investment | | | |
| Purchase of investments | (37,145) | (56,046) | (99,858) |
| Sale of investments | 23,880 | 42,733 | 69,514 |
| Currency movement | — | (30) | (146) |
| Net cash outflow from financial investment | (13,265) | (13,343) | (30,490) |
| Equity dividend paid | (718) | (718) | (718) |
| Net cash outflow before financing | (13,731) | (13,822) | (30,502) |
| Financing | | | |
| Issue of Ordinary shares | 3,332 | 22 | 22 |
| Loans drawn down | 10,000 | — | 20,000 |
| Net cash inflow from financing | 13,332 | 22 | 20,022 |
| DECREASE IN CASH | (399) | (13,800) | (10,480) |
| RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET (DEBT)/FUNDS | | | |
| Decrease in cash in period | (399) | (13,800) | (10,480) |
| Increase in bank loans | (10,000) | — | (20,000) |
| Exchange movement on loans | 1,021 | (127) | 582 |
| MOVEMENT IN NET (DEBT)/FUNDS IN PERIOD | (9,378) | (13,927) | (29,898) |
| NET (DEBT)/FUNDS AT 1 JANUARY | (13,547) | 16,351 | 16,351 |
| NET (DEBT)/FUNDS AT 30 JUNE/31 DECEMBER | (22,925) | 2,424 | (13,547) |

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 23 July 2003.
- 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 2003, the weighted average number of Ordinary shares was 85,598,153 (30 June 2002 - 84,460,918, 31 December 2002 - 84,468,090).
The diluted return per Ordinary share is calculated using the weighted average number of warrants in issue during the period adjusted by the difference between the average price of the Ordinary shares during the period (186.9p (30 June 2002 - 269.1p, 31 December 2002 - 221.6p)) and the Subscription price of 100p, to give a weighted average of 86,625,581 (30 June 2002 - 86,563,625, 31 December 2002 - 86,300,599) shares.
- 4 The Company has arranged multi-currency loan facilities with The Royal Bank of Scotland plc. These comprise a 364 day £30 million facility which expires on 31 October 2003 and a five year £3 million facility which expires on 7 January 2004. At 30 June 2003 there were outstanding drawings of US\$ 47,038,000 and Yen 551,550,000 under these facilities (30 June 2002 - Yen 551,550,000, 31 December 2002 - US\$ 31,268,000 and Yen 551,550,000).
- 5 Net asset value per ordinary share is based on the net assets and 87,807,348 (30 June 2002 and 31 December 2002 - 84,475,145) ordinary shares, being the number of ordinary shares in issue at each date.
The diluted net asset value per Ordinary share has been calculated in accordance with FRS 14 'Earnings per share'. The calculation is based on net assets and the number of ordinary shares in issue at the period end plus the notional number of ordinary shares that would have been issued for no consideration using the share price (fair value) (237.5p (30 June 2002 - 214.5p, 31 December 2002 - 177.0p)) at each period end.
The fully diluted net asset value per Ordinary share has been calculated on the assumption that the 3,332,203 warrants in issue at 30 June 2002 and 31 December 2002 were fully exercised at 100p at each period end.
At 30 June 2003 there were no outstanding warrants and hence no dilution under either method.
- 6 During the period 3,332,203 ordinary shares were issued in respect of warrants exercised on 30 April 2003. Each warrant entitled the holder to subscribe for one Ordinary share at 100p on 30 April in any of the years 1995 to 2003. 30 April 2003 was the final date for the exercise of the warrants.
There were no warrants in issue at 30 June 2003 (30 June 2002 and 31 December 2002 - 3,332,203).
- 7 The financial information for the year ended 31 December 2002 has been extracted from the full accounts, which have been filed with the Registrar of Companies and which contain an unqualified Auditors' Report.

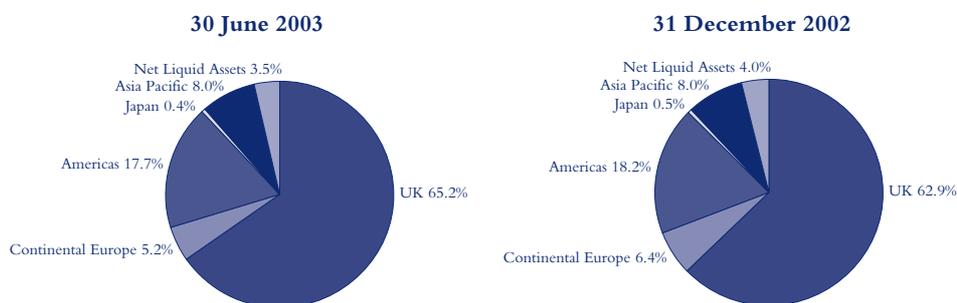
TOP TWENTY EQUITY HOLDINGS

at 30 June 2003

| Company | Business | Market value £'000 | % of total assets |
|---|--|-----------------------|----------------------|
| SurfControl | Web and email filtering software | 6,906 | 2.6 |
| Imagination Technologies Group | Licensor of semiconductor intellectual property | 6,508 | 2.4 |
| Gresham Computing | Software for real time banking transactions | 6,433 | 2.4 |
| Acal | Electronic products distribution | 6,271 | 2.3 |
| Amstrad | Consumer electronics designer and manufacturer | 5,790 | 2.2 |
| Alba | Consumer electronics manufacturer and retailer | 5,729 | 2.1 |
| Northgate Information Solutions | Application software products and services | 4,829 | 1.8 |
| Plasmon | Optical data storage | 4,355 | 1.6 |
| Linx Printing Technologies | Manufacturer of continuous ink jet printers | 4,249 | 1.6 |
| Biotrace International | Rapid hygiene and biological testing | 4,148 | 1.6 |
| Diploma | Distributor | 3,772 | 1.4 |
| Taylor Nelson Sofres | Market research | 3,705 | 1.4 |
| Incisive Media | Magazine publisher | 3,471 | 1.3 |
| Scottish Radio Holdings | Commercial radio operator | 3,449 | 1.3 |
| Detica Group | IT services business focused on security and CRM | 3,203 | 1.2 |
| Euromoney Institutional Investor | Magazine publisher | 3,164 | 1.2 |
| Anite Group | IT software products and services | 3,076 | 1.2 |
| OneSource Information Services* (United States) | On-line database provider | 2,896 | 1.1 |
| SDL Group | Multilingual website globalisation | 2,775 | 1.0 |
| THUS Group | Telecom service provider | 2,775 | 1.0 |
| | | <u>87,504</u> | <u>32.7</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

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