HERALD INVESTMENT TRUST plc

Interim Report

For the six months ended 30 June 2006

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. 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

Disappointingly and somewhat surprisingly the net assets declined 5.8% in the first half. Surprising because the trading performance has continued to be strong for most companies in the portfolio, and in general they have delivered the strong earnings growth that was expected. In aggregate the Trust's underlying earnings estimates for 2006 have declined by a similar percentage to the assets, but still represent a strong increase on 2005. In fact a 36% increase on the level of profits is estimated for 2005 for the portfolio at the start of the year. Arguably the market was discounting an even higher level of growth, but this argument seems difficult to accept when earnings growth exceeded share price growth in 2004 and 2005 by around 80%. In reality investor attention has continued to focus elsewhere, particularly oil, gas and other commodities. Herald's UK portfolio, which accounts for nearly two thirds of the portfolio, was the principal drag, returning -5.1%. In contrast the HGSC Index, which is 2/3rds of our benchmark, grew 6.1% in total return terms, albeit the weighted average of the most relevant sectors for our remit showed a decline of 6.6%. The software and computer services sector in the UK, which is important to Herald, was one of the worst performing sectors in the HGSC benchmark declining 12.5%. In contrast this sector within the Herald portfolio declined 7.8%. Most of this decline came from three holdings Alterian, Northgate and SDL, with very little justification in terms of their operational performance, albeit it was totally unforeseen that Northgate should find its head office and data centre demolished by the explosion of its neighbouring oil terminal in Hemel Hempstead, and management should be congratulated on delivering unaffected operational earnings. The three UK holdings that have had material earnings downgrades for 2005 and 2006 were Imagination, Plasmon and Screen FX. The latter two had material disappointments. The US return was adequate with the Russell 2000 Technology index up 5.3%, and the Trust's US portfolio up 7.0%, however the $ gains were obliterated in £ by the $ weakness. The European return was modestly positive, having been strongly up in Q1, but having a poor Q2. The Far East returns disappointingly gave back last year's gains.

Total return by geography from 31 December 2005 to 30 June 2006

UK Equities	-5.1%
US Equities	-0.7% (+7.0% in US$)
European Equities	+2.0%
Far East Equities	-17.6%

The p/e based on consensus earnings estimates for 2006 for the profitable stocks in the portfolio, which account for 84% of the portfolio, has fallen from 14.6x at the start of the year (as in last year's accounts) to 14.1x reflecting declines in share prices, but minimal changes in earnings estimates. In contrast the p/e of the overall portfolio has risen slightly to 16x. This reflects a combination of downgrades in estimates for certain loss making holdings, who are delivering profits slower than previously envisaged, as well as the sale of certain profitable stocks and the acquisition of loss making stocks. In particular three long standing holdings have been sold – Informa and Taylor Nelson in the UK and RSA in the US. The original purchases were all made at least eight years ago and were sold for multiples of the original purchase price. None can now be described as small companies any more – Herald's definition being less than £750m market capitalisation at time of purchase. RSA was sold following the announcement of a cash bid from EMC. It demonstrates that the Manager's style is to invest in growing businesses for long term growth. These funds will be recycled into the plethora of emerging opportunities.

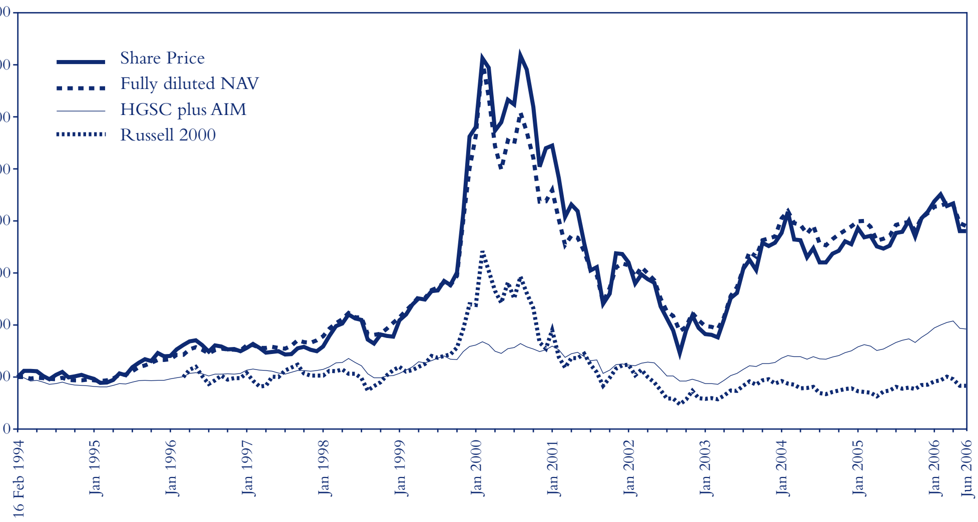
Valuations in terms of p/es in the US are now lower than they have been for many years. On the basis of brokers' estimates for 2007, the p/e on the portfolio will decline to just over 12x

16x. This reflects a further 18.7% growth in earnings for the consistently profitable companies, which account for 84% of the portfolio giving an average 2007 p/e of 11.9% on those holdings. The overall earnings growth will be faster than that reflecting the kicker from loss making companies reaching profitability.

There are a number of macro clouds such as Middle East instability, rising commodity prices and the scale of interest rate rises, which seem to imply a forthcoming slowdown in economic growth. Much of the growth in the portfolio reflects structural shifts to new business models or new products, so most of the holdings are expected to make progress even if world GDP growth slows. One explanation for the poor UK performance in spite of continued excellent profits growth is the technical factor associated with the plethora of AIM issues. There have been 53 new issues in the period in the Herald remit, raising some £530m. There have also been a number of very poor share price performances masked by a few stronger returns from companies with a larger weighting. On balance selection is very important, and the flood of issues must abate if there is to be any secondary market performance or liquidity even in the worthwhile companies. Offsetting this there have been a few exits from corporate acquirers at significant premiums e.g TRL, WILink, ADIC, RSA and since the end of June ADVO. This will accelerate if valuations remain at these levels. On balance it is fulfilling to see a number of companies blossoming from an investment made at a much riskier stage, albeit frustrating that it has not been reflected in valuations. In the long term we remain optimistic that that will benefit Herald Investment Trust shareholders too.

Martin Boase
26 July 2006

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)



Past performance is no guarantee of future performance.

INCOME STATEMENT*

(Unaudited)

	For the six months ended 30 June 2006 Revenue £'000	Capital £'000	Total* £'000
(Losses)/gains on investments	—	(20,134)	(20,134)
Losses on loans	—	—	—
Currency (losses)/gains	—	(181)	(181)
Income	2,128	—	2,128
Investment management fee	(1,985)	—	(1,985)
Other administrative expenses	(127)	—	(127)
Net return before finance costs and taxation	16	(20,315)	(20,299)
Finance costs of borrowings	—	—	—
Return on ordinary activities before taxation	16	(20,315)	(20,299)
Tax on ordinary activities	(31)	—	(31)
Return on ordinary activities after taxation	(15)	(20,315)	(20,330)
Return per ordinary share (note 2)	(0.02p)	(23.20p)	(23.22p)
Weighted average number of ordinary shares in issue during each period	87,556,010		

* The total 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.
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.

SUMMARY OF PERFORMANCE

	At inception 16 February 1994	At 31 December 2005	At 30 June 2006	Performance since 31 December 2005	Performance since inception
NAV per share	98.7p	409.2p	**385.4p**	(5.8%)	290.5%
Share price‡	90.9p	379.8p	**345.8p**	(9.0%)	280.4%
FTSE 100 Index	3,417.7	5,618.8	**5,833.4**	3.8%	70.7%
HGSC Index plus AIM (capital gains ex. investment companies)	1,750.0	3,218.7†	**3,370.0†**	4.7%	92.6%
Russell 2000 (small cap) Technology Index (in sterling terms)	83.2*	71.0	**69.3**	(2.4%)	(16.7%)

‡ Mid market price.

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

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

Past performance is no guarantee of future performance.

INCOME STATEMENT*

(Unaudited)

For the six months ended 30 June 2005			For the year ended 31 December 2005		
Revenue £'000	Capital £'000	Total* £'000	Revenue £'000	Capital £'000	Total* £'000
—	(9,946)	(9,946)	—	27,708	27,708
—	(1,753)	(1,753)	—	(1,989)	(1,989)
—	(7)	(7)	—	70	70
2,839	—	2,839	5,368	—	5,368
(1,828)	—	(1,828)	(3,741)	—	(3,741)
(118)	—	(118)	(275)	—	(275)
893	(11,706)	(10,813)	1,352	25,789	27,141
(392)	—	(392)	(724)	—	(724)
501	(11,706)	(11,205)	628	25,789	26,417
(40)	—	(40)	(72)	—	(72)
461	(11,706)	(11,245)	556	25,789	26,345
0.53p	(13.37p)	(12.84p)	0.64p	29.45p	30.09p
87,556,010			87,556,010		

SUMMARISED BALANCE SHEET

(Unaudited)

	At 30 June 2006 £'000	At 30 June 2005 £'000	At 31 December 2005 £'000
Fixed assets			
Investments	**313,620**	317,723	348,774
Current assets			
Debtors	**13,059**	1,225	786
Cash and short term deposits	**11,859**	29,887	9,089
	24,918	31,112	9,875
Creditors: Amounts falling due within 1 year			
(excluding short-term borrowings)	**(1,100)**	(1,716)	(356)
Total assets (before deduction of bank loans)	**337,438**	347,119	358,293
Bank loans (note 3)	**—**	(26,416)	—
Total net assets	**337,438**	320,703	358,293
Capital and reserves			
Called-up share capital	**21,889**	21,889	21,889
Share premium	**73,738**	73,738	73,738
Capital redemption reserve	**63**	63	63
Capital reserve – realised	**226,923**	209,754	209,639
Capital reserve – unrealised	**12,710**	12,699	50,309
Revenue reserve	**2,115**	2,560	2,655
Equity shareholders' funds	**337,438**	320,703	358,293
Net Asset Value per ordinary share	**385.40p**	366.28p	409.22p
Ordinary shares in issue (note 4)	**87,556,010**	87,556,010	87,556,010

SUMMARISED RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

(Unaudited)

	Six months to 30 June 2006 £'000	Six months to 30 June 2005 £'000	Year to 31 December 2005 £'000
Shareholders' funds at 1 January	**358,293**	332,211	332,211
Return on ordinary activites after taxation	**(20,330)**	(11,245)	26,345
Dividends paid during the period (note 5)	**(525)**	(263)	(263)
SHAREHOLDERS' FUNDS AT 30 JUNE/31 DECEMBER	**337,438**	320,703	358,293

SUMMARISED CASH FLOW STATEMENT

(Unaudited)

	For six months ended 30 June 2006 £'000	For six months ended 30 June 2005 £'000	For year ended 31 December 2005 £'000
Net cash (outflow)/inflow from operating activities	**(136)**	828	1,322
Net cash outflow from servicing of finance	**—**	(328)	(841)
Financial investment			
Purchase of investments	**(47,141)**	(31,889)	(75,037)
Sale of investments	**50,572**	26,632	75,653
Net cash inflow/(outflow) from financial investment	**3,431**	(5,257)	616
Equity dividend paid	**(525)**	(263)	(263)
Net cash inflow/(outflow) before financing	**2,770**	(5,020)	834
Financing			
Loans drawn down	**—**	24,771	24,771
Loans repaid	**—**	(24,771)	(51,423)
Net cash outflow from financing	**—**	—	(26,652)
INCREASE/(DECREASE) IN CASH	**2,770**	(5,020)	(25,818)
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS			
Increase/(decrease) in cash in period	**2,770**	(5,020)	(25,818)
Decrease in bank loans	**—**	—	26,652
Exchange movement on loans	**—**	(1,753)	(1,989)
MOVEMENT IN NET FUNDS IN PERIOD	**2,770**	(6,773)	(1,155)
NET FUNDS AT 1 JANUARY	**9,089**	10,244	10,244
NET FUNDS AT 30 JUNE/31 DECEMBER	**11,859**	3,471	9,089
RECONCILIATION OF NET REVENUE BEFORE FINANCE COSTS AND TAXATION TO NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES			
Net return on ordinary activities before finance costs and taxation	**(20,299)**	(10,813)	27,141
Losses/(gains) on investments	**20,315**	11,706	(25,789)
Changes in debtors and creditors	**60**	(14)	(53)
Income tax (suffered)/repaid	**—**	(4)	25
Realised currency (loss)/profit	**(181)**	(7)	70
Overseas tax suffered	**(31)**	(40)	(72)
NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES	**(136)**	828	1,322

TOP TWENTY EQUITY HOLDINGS

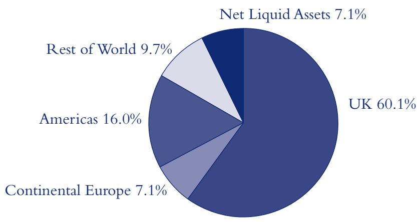
at 30 June 2006

Company	Business	Market value £'000	% of total assets *
Northgate Information Solutions	Application software products and services	11,160	3.3
Amstrad	Consumer electronics designer and manufacturer	10,977	3.3
Detica Group	IT services business focused on security and CRM	10,917	3.2
SDL	Internet software and website globalisation services	8,750	2.6
Imagination Technologies Group	Licenser of semiconductor intellectual property	7,245	2.2
Thomson Intermedia	Media monitoring services	6,062	1.8
Diploma	Distributor	5,760	1.7
SurfControl	Web and e-mail filtering software	5,661	1.7
IBS OPENSystems	Software and services for management of benefits and housing	4,872	1.4
Euromoney Institutional Investor	Magazine publisher	4,560	1.4
Wilmington Group	Business magazine publisher and training company	4,526	1.3
Alphameric	Leisure and hospitality software and services	4,164	1.2
Logitech International	Manufacturer of PC peripheral devices	3,750	1.1
United Internet	Internet service provider and web hosting services	3,727	1.1
Telecom Plus	Supplier of telecommunications services and other utilities	3,580	1.1
ICOS Vision Systems	Machine vision and inspection products	3,574	1.1
Phoenix IT Group	IT support and business continuity services	3,570	1.1
Bloomsbury Publishing	Book publishing	3,193	0.9
Quarto Group	International book producer and publisher	3,180	0.9
ICM Computer Group	IT assurance and disaster recovery services	3,139	0.9
		112,367	33.3

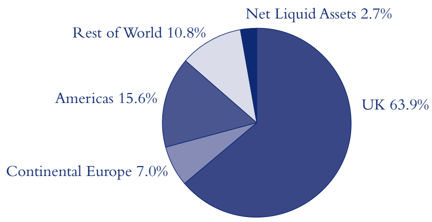
GEOGRAPHIC SPREAD OF INVESTMENTS

(Distribution of total assets*)

30 June 2006



31 December 2005



* Total assets before deduction of bank loans.

NOTES

1 The financial statements for the six months to 30 June 2006 have been prepared on the basis of the accounting policies set out in the Company's Annual Financial Statements at 31 December 2005.

2 The capital and revenue returns per ordinary share calculations are based on a weighted average number of ordinary shares in issue during each period.

3 The Company had no outstanding bank loans at 30 June 2006 and 31 December 2005. At 30 June 2005 the Company had a 364 day £30 million multi-currency loan facility with ING Bank N.V. which expired on 25 October 2005, there were outstanding drawings of US$47.35 million at that date.

4 At the AGM held on 12 April 2006 the Company's authority to buy back shares was renewed in respect of 13,124,645 ordinary shares (equivalent to 14.99% of its issued share capital at that date). No shares have been bought back during the period and therefore at 30 June 2006 the Company's authority to buy back shares remains unchanged at 13,124,645.

5 The amount recognised as a distribution in the six months to 30 June 2006 was the final dividend for the year ended 2005 of 0.60p (£525,000) which was paid on 19 April 2006 (six months to 30 June 2005 and year to 31 December 2005 was the final dividend for the year ended 2004 of 0.30p (£263,000) which was paid on 19 April 2005).
No interim dividend will be declared.

6 Transaction costs incurred on the purchase and sale of investments are added to the purchase cost or deducted from the sale proceeds, as appropriate. During the period transaction costs on purchases amounted to £251,000 (30 June 2005 – £143,000; 31 December 2005 – £241,000) and transaction costs on sales amounted to £267,000 (30 June 2005 – £62,000; 31 December 2005 – £153,000).

7 The financial information contained within this interim report does not constitute statutory accounts as defined in section 240 of the Companies Act 1985. The financial information for the year ended 31 December 2005 has been extracted from the statutory accounts which have been filed with the Registrar of Companies and which contain an unqualified Auditors' Report and do not contain a statement under sections 237 (2) or (3) of the Companies Act 1985.

8 The Interim Report was approved by the Board on 26 July 2006.
None of the views expressed in this document should be construed as advice to buy or sell a particular investment.

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