

# **HERALD INVESTMENT TRUST plc**

## **Interim Report**

For the six months ended 30 June 2007

### **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.

## SUMMARY OF PERFORMANCE

	At inception 16 February 1994	At 31 December 2006	At 30 June 2007	Performance since 31 December 2006	Performance since inception
NAV per share	98.7p	435.4p	<b>472.9p</b>	8.6%	379.1%
Share price‡	90.9p	383.5p	<b>407.5p</b>	6.3%	348.3%
FTSE 100 Index	3,417.7	6,220.8	<b>6,607.9</b>	6.2%	93.3%
HGSC Index plus AIM (capital gains ex. investment companies)	1,750.0	3,838.3	<b>4,112.2</b>	7.1%	135.0%
Russell 2000 (small cap) Technology Index (in sterling terms)	83.2 *	70.5	<b>76.2</b>	8.1%	(8.4%)

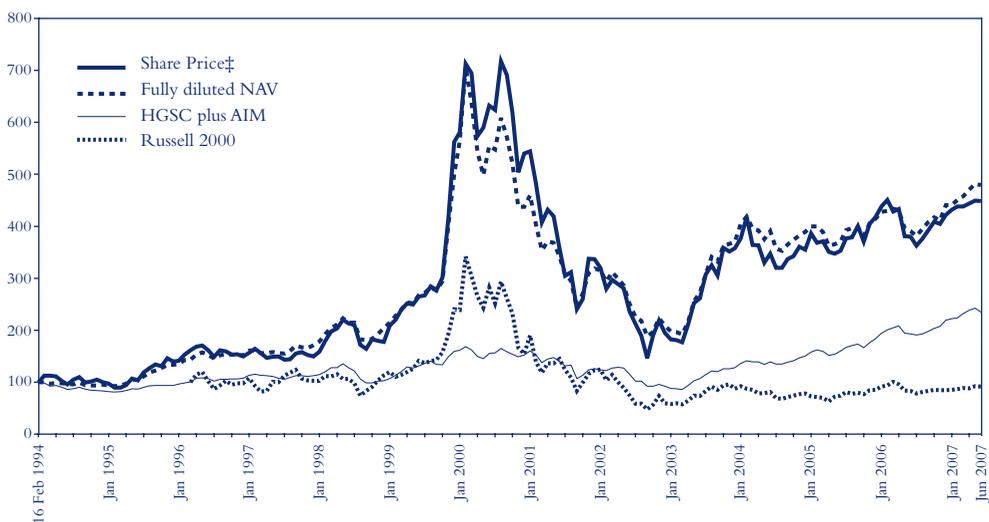
‡ Mid market price.

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

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).

Past performance is no guarantee of future performance.

### 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)



## CHAIRMAN'S REVIEW

The net asset value per share grew 8.6% in the first half against a background of generally strong profits growth in the underlying investee companies and further takeover activity. In particular, the UK bids have been; ICM at a premium of 85% to the price at the end of 2006, Trace at a premium of 80% and SurfControl at a premium of 33%. The last was the premium from the price the shares had appreciated to after announcing that the company was in bid talks. All these values reflect how much more a trade buyer values these shares to the stock market. In the US, Kronos had a cash bid at \$55 versus a year-end price of \$36.65. Earnings growth for the portfolio at the end of June is forecast to be 42.5% in 2007 and the 2007 p/e of profitable companies at 30 June 2007 was 16.9x.

### **Total return by geography from 31 December 2006 to 30 June 2007 was as follows:**

UK Equities	+10.1%
US Equities	+1.3% (+3.9% in US\$)
European Equities	-0.4%
Far East Equities	+29.3%

The performance benefited from solid returns of 10.1% in the UK versus the HGSCI including AIM total return of 8.1%. The weighted return of the sectors targeted was also ahead of the market in the period, having relatively performed very poorly last year. It is noticeable that the pace of new issues has significantly slowed. In Herald's sectors there were 17 new issues versus 53 in the previous year. However, there has still been significant activity with numerous secondary placings. This transfer of interest from primary to secondary placings has helped performance, which stalled while all the attention of fund managers and brokers alike was focused on the avalanche of new issues. Furthermore the number of AIM delistings almost mirrors the new issues so the AIM market has moved to a welcome period of consolidation. The Far East portfolio bounced by nearly 30%, which represented a strong recovery from a difficult year in 2006. The US was underweight versus our benchmark of 1/3rd of the portfolio and delivered minimal sterling returns versus the Russell 2000 technology index return of 8.1% (in sterling). Europe was flat. Overall the return benefited from leverage following the introduction of gearing in October 2006. Since then the NAV has rallied 16%, justifying the gearing so far.

There have been unusually divergent performances between stocks within the portfolio. In particular Amstrad and Thomson Intermedia, which have been stellar performers in previous years, lost £5.7m between them in the UK, while Simpletech, which contributed very positively in the US last year, declined by US\$1.9m. In contrast SDL, which was highlighted as a poor

## CHAIRMAN'S REVIEW *continued*

performer this time last year appreciated £9m, and Silicon Motion in the US offset Simpletech. South Korea, which proved problematic last year, has rebounded 40% this year. In particular Seoul Semiconductor appreciated 235%.

The discount widened a little during the period to 14% from 12% at the year end. The Trust repurchased 585,000 shares at an average price of 404.8p. Whilst a formal buy-back mechanism is inappropriate for a relatively illiquid portfolio of smaller companies, the Manager may buy back shares opportunistically. The cost of borrowing has been expensed and has led to the adverse return in the revenue column of the Income Statement. As usual no interim dividend will be paid. Historically a final dividend had been paid, but the cost of gearing puts that in doubt this year. The principal goal of the Trust is capital appreciation.

The portfolio remains on a p/e comparable to the wider market in spite of significantly higher growth rates. In the absence of a further derating, continued solid progress should be expected. The risk as ever is that expectations prove too optimistic in an uncertain world. Contrary to a number of pessimistic expectations the trading environment generally remains very positive for the portfolio. The wider sector has been dull for the last five years. For example the sterling increase in the Morgan Stanley IT index was 24% in the 5 years to the end of June 2007. Over that period NASDAQ appreciated by 35% and the FTSE-All Share Index by 50.4%, while the Trust's net assets/share have appreciated 86%. This reflects a global derating for the TMT sector more than the absence of profit growth, albeit certain subsectors have been hit by price deflation, while others face competition induced by technology changes. Such is the sector. In a world of interest rates edging up, investor attention could well refocus on growth, and the US derating seems unlikely to continue.

**Martin Boase**

*25 July 2007*

# TOP TWENTY EQUITY HOLDINGS

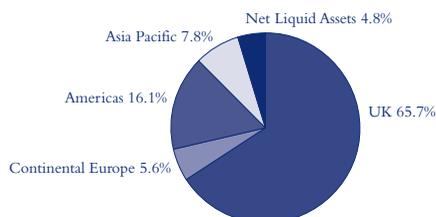
at 30 June 2007

Company	Business	Value £'000	% of total assets*
SDL	Internet software and website globalisation services	17,682	3.8
Imagination Technologies Group	Licenser of semiconductor intellectual property	15,684	3.4
Detica Group	IT services business focused on security and CRM	15,679	3.4
Northgate Information Solutions	Application software products and services	11,448	2.5
Euromoney Institutional Investor	Magazine publisher	10,577	2.3
SurfControl	Web and e-mail filtering software	10,490	2.3
Phoenix IT Group	IT support and business continuity services	10,091	2.2
IBS OPENSystems	Software and services for management of benefits and housing	7,527	1.6
Diploma	Distributor	7,224	1.6
Amstrad	Consumer electronics designer and manufacturer	7,082	1.5
Wilmington Group	Business magazine publisher and training company	6,074	1.3
Telecom plus	Supplier of telecommunications services and other utilities	5,886	1.3
Alterian	Developer of analytical marketing software	5,528	1.2
Group NBT	Provider of domain name registration and internet-related services	5,207	1.1
United Internet	Internet service provider and web hosting services	4,985	1.1
M&C Saatchi	Full service global advertising agency	4,914	1.1
Logitech International	Manufacturer of PC peripheral devices	4,795	1.0
Alternative Networks	UK business communications service provider	4,590	1.0
SThree	Provider of information, communication and technology staffing services	4,241	0.9
Opsec Security	Supplier of anti-counterfeiting technologies and services	3,994	0.9
		<u>163,698</u>	<u>35.5</u>

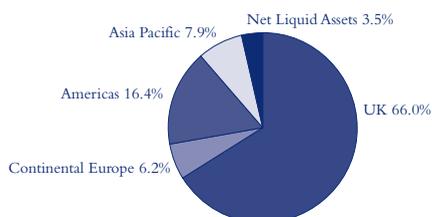
## GEOGRAPHIC SPREAD OF INVESTMENTS

(Distribution of total assets\*)

30 June 2007



31 December 2006



\* Total assets before deduction of bank loans.

# INCOME STATEMENT

(Unaudited)

	<b>For the six months ended 30 June 2007</b>		
	<b>Revenue</b>	<b>Capital</b>	<b>Total</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Gains/(losses) on investments	—	34,540	34,540
Currency losses	—	(62)	(62)
Income	2,352	—	2,352
Investment management fee	(2,201)	—	(2,201)
Other administrative expenses	(132)	—	(132)
<b>Net return before finance costs and taxation</b>	<b>19</b>	<b>34,478</b>	<b>34,497</b>
Finance costs of borrowings	(983)	—	(983)
<b>Return on ordinary activities before taxation</b>	<b>(964)</b>	<b>34,478</b>	<b>33,514</b>
Tax on ordinary activities	(51)	—	(51)
<b>Return on ordinary activities after taxation</b>	<b>(1,015)</b>	<b>34,478</b>	<b>33,463</b>
<b>Return per ordinary share</b> (note 2)	<b>(1.16p)</b>	<b>39.51p</b>	<b>38.35p</b>
<b>Weighted average number of ordinary shares in issue during each period</b>	<b><u>87,261,341</u></b>		

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.

# STATEMENT

(audited)

## For the six months ended 30 June 2006

Revenue £'000	Capital £'000	Total £'000
—	(20,134)	(20,134)
—	(181)	(181)
2,128	—	2,128
(1,985)	—	(1,985)
(127)	—	(127)
16	(20,315)	(20,299)
—	—	—
16	(20,315)	(20,299)
(31)	—	(31)
(15)	(20,315)	(20,330)
(0.02p)	(23.20p)	(23.22p)

87,556,010

## For the year ended 31 December 2006

Revenue £'000	Capital £'000	Total £'000
—	21,779	21,779
—	(241)	(241)
6,492	—	6,492
(3,927)	—	(3,927)
(262)	—	(262)
2,303	21,538	23,841
(284)	—	(284)
2,019	21,538	23,557
(97)	—	(97)
1,922	21,538	23,460
2.19p	24.60p	26.79p

87,556,010

# BALANCE SHEET

(Unaudited)

	At 30 June 2007 £'000	At 30 June 2006 £'000	At 31 December 2006 £'000
<b>Fixed assets</b>			
Investments at fair value through profit or loss	439,185	313,620	387,345
<b>Current assets</b>			
Debtors	472	13,059	2,776
Cash and short term deposits	23,549	11,859	11,778
	<u>24,021</u>	<u>24,918</u>	<u>14,554</u>
<b>Creditors:</b>			
<b>Amounts falling due within one year</b> (note 3)	<u>(51,929)</u>	<u>(1,100)</u>	<u>(20,671)</u>
<b>Net current (liabilities)/assets</b>	<u>(27,908)</u>	<u>23,818</u>	<u>(6,117)</u>
<b>Total net assets</b>	<u>411,277</u>	<u>337,438</u>	<u>381,228</u>
<b>Capital and reserves</b>			
Called-up share capital	21,743	21,889	21,889
Share premium	73,738	73,738	73,738
Capital redemption reserve	209	63	63
Capital reserve – realised	235,506	226,923	233,361
Capital reserve – unrealised	78,090	12,710	48,125
Revenue reserve	1,991	2,115	4,052
<b>Equity shareholders' funds</b>	<u>411,277</u>	<u>337,438</u>	<u>381,228</u>
<b>Net Asset Value per ordinary share</b>	472.89p	385.40p	435.41p
<b>Ordinary shares in issue</b> (note 4)	86,971,010	87,556,010	87,556,010

# RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

(Unaudited)

## For the six months ended 30 June 2007

	Called-up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000	Total share- holders' funds £'000
Shareholders' funds at 1 January 2007	21,889	73,738	63	233,361	48,125	4,052	381,228
Return on ordinary activities after taxation	—	—	—	4,513	29,965	(1,015)	33,463
Shares bought back†	(146)	—	146	(2,368)	—	—	(2,368)
Dividends paid during the period‡	—	—	—	—	—	(1,046)	(1,046)
<b>Shareholders' funds at 30 June 2007</b>	<b>21,743</b>	<b>73,738</b>	<b>209</b>	<b>235,506</b>	<b>78,090</b>	<b>1,991</b>	<b>411,277</b>

## For the six months ended 30 June 2006

	Called-up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000	Total share- holders' funds £'000
Shareholders' funds at 1 January 2006	21,889	73,738	63	209,639	50,309	2,655	358,293
Return on ordinary activities after taxation	—	—	—	17,284	(37,599)	(15)	(20,330)
Dividends paid during the period‡	—	—	—	—	—	(525)	(525)
<b>Shareholders' funds at 30 June 2006</b>	<b>21,889</b>	<b>73,738</b>	<b>63</b>	<b>226,923</b>	<b>12,710</b>	<b>2,115</b>	<b>337,438</b>

## For the year ended 31 December 2006

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

† See note 4.

‡ See note 5.

# SUMMARISED CASH FLOW STATEMENT

(Unaudited)

	For six months ended 30 June 2007 £'000	For six months ended 30 June 2006 £'000	For year ended 31 December 2006 £'000
<b>Net cash inflow/(outflow) from operating activities</b>	173	(136)	2,107
<b>Net cash outflow from servicing of finance</b>	(576)	—	(10)
<b>Financial investment</b>			
Purchase of investments	(47,162)	(47,141)	(115,977)
Sale of investments	<u>32,564</u>	<u>50,572</u>	<u>97,094</u>
<b>Net cash (outflow)/inflow from financial investment</b>	(14,598)	3,431	(18,883)
<b>Equity dividend paid</b> (note 5)	<u>(1,046)</u>	<u>(525)</u>	<u>(525)</u>
<b>Net cash (outflow)/inflow before financing</b>	(16,047)	2,770	(17,311)
<b>Financing</b>			
Shares bought back	(2,182)	—	—
Loans drawn down	<u>30,000</u>	<u>—</u>	<u>20,000</u>
<b>Net cash inflow from financing</b>	<u>27,818</u>	<u>—</u>	<u>20,000</u>
<b>INCREASE IN CASH</b>	<u><u>11,771</u></u>	<u><u>2,770</u></u>	<u><u>2,689</u></u>
<b>RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET (DEBT)/FUNDS</b>			
Increase in cash in period	11,771	2,770	2,689
Increase in bank loans	<u>(30,000)</u>	<u>—</u>	<u>(20,000)</u>
<b>MOVEMENT IN NET (DEBT)/FUNDS IN PERIOD</b>	(18,229)	2,770	(17,311)
<b>NET (DEBT)/FUNDS AT 1 JANUARY</b>	(8,222)	9,089	9,089
<b>NET (DEBT)/FUNDS AT 30 JUNE/31 DECEMBER</b>	<u><u>(26,451)</u></u>	<u><u>11,859</u></u>	<u><u>(8,222)</u></u>
<b>RECONCILIATION OF NET REVENUE BEFORE FINANCE COSTS AND TAXATION TO NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES</b>			
Net return on ordinary activities before finance costs and taxation	34,497	(20,299)	23,841
(Gains)/losses on investments – securities	(34,540)	20,134	(21,779)
Currency losses	62	181	241
Changes in debtors and creditors	257	60	142
Income tax repaid	9	—	—
Realised currency loss	(62)	(181)	(241)
Overseas tax suffered	(50)	(31)	(97)
<b>NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES</b>	<u><u>173</u></u>	<u><u>(136)</u></u>	<u><u>2,107</u></u>

## NOTES

1 The financial statements for the six months to 30 June 2007 have been prepared on the basis of the accounting policies set out in the Company's Annual Financial Statements at 31 December 2006.

The Interim Report was approved by the Board on 25 July 2007.

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

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. There are no dilutive or potentially dilutive shares in issue.

3 The Company has a 364 day £50 million multi-currency loan facility with The Royal Bank of Scotland which expires on 4 October 2007. At 30 June 2007 there were outstanding drawings of £50 million (30 June 2006 – nil and 31 December 2006 – £20 million).

4 At the AGM held on 25 April 2007 the Company's authority to buy back shares was renewed in respect of 13,058,689 ordinary shares (equivalent to 14.99% of its issued share capital at that date). In the six months to 30 June 2007 a total of 585,000 ordinary shares with a nominal value of £146,000 were bought back at a total cost of £2,368,000. At 30 June the Company had authority to buy back a further 12,913,689 ordinary shares.

5 Dividends	<b>Six months ended 30 June 2007 £'000</b>	Six months months ended 30 June 2006 £'000	Year ended 31 December 2006 £'000
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Amounts recognised as distributions in the period:

Final dividend for the year ended 31 December 2006 of 1.20p (2005 – 0.60p) paid 3 May 2007	1,046	525	525
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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 £239,000 (30 June 2006 – £251,000; 31 December 2006 – £687,000) and transaction costs on sales amounted to £114,000 (30 June 2006 – £267,000; 31 December 2006 – £376,000).

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 2006 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.

# DIRECTORS, MANAGER AND ADVISERS

## DIRECTORS

M Boase (Chairman)  
C M Brendish CBE  
T M Curtis  
D C P McDougall OBE

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## COMPANY NUMBER

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## INVESTMENT MANAGER

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