

**HERALD INVESTMENT
TRUST plc**

Interim Report

For the six months ended 30 June 1997

Investment Policy

The policy of the Company is to achieve capital appreciation through investments in smaller quoted companies, principally in the UK but also in the rest of the world, in the areas of communications and multi-media. 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 trading background for most of the stocks in the Herald portfolio has been reasonably strong but the stock market environment has been difficult. It is disappointing to report that four out of five core Herald sectors have also been four of the five worst performing sectors in the UK market. The sector weighting of the portfolio is as follows:—

	31 December 1996	30 June 1997	FT-SE-sector Performance over period
Electrical & Electronic	16.7%	24.6%	-9.5%
Paper, Packaging & Printing	3.3%	2.6%	-20.5%
Distributors	6.5%	7.2%	-6.8%
Media	24.2%	23.5%	-6.5%
Support Services	34.0%	30.8%	+7.3%
Other	4.8%	3.5%	
Cash/Gilts	10.5%	7.7%	
Total	100.0%	100.0%	

To compound the difficulty, smaller companies have conspicuously underperformed larger companies with the Hoare Govett Smaller Companies Index rising only 0.3% versus the FT-SE 100 Index rising 11.8%. Even the smaller companies Russell 2000 Technology Index declined 0.5% providing no easy escape route. Against this background, the manager is pleased to be able to report a rise in assets of 3.4% (undiluted), which compares favourably

Summary of Performance

	At inception 16 February 1994	At 31 December 1996	At 30 June 1997	Performance since 31 December 1996	Performance since inception
Basic NAV per share	98.7p	156.89p	162.15p*	+3.4%	+64.3%
Fully diluted					
NAV per share	98.9p	149.45p	154.02p*	+3.1%	+55.7%
Share price	90.9p	136.0p	136.0p	0.0%	+49.6%
Warrant price	45.5p	61.0p	59.0p	-3.3%	+29.7%
FT-SE 100 Index	3,417.7	4,118.5	4,604.6	+11.8%	+34.7%
Hoare Govett					
Smaller Companies Index	1,750.0	1,877.4	1,883.8	+0.3%	+7.6%
Russell 2000					
Technology Index	—	138.89	138.13	-0.5%	—

*The NAV figures at 30 June 1997 are stated on a capital only basis, and do not include any income retention at that date. This is because the Company only pays one dividend per year and no provision has been made at this stage. However, the NAV figures given after the Balance Sheet do include the Revenue Reserve uplift for the period.

with the most relevant smaller companies indices in the UK and the US in spite of the difficulties within the target sectors. The three broad strategic moves to reduce exposure to the UK media sector, radio in particular, to retain a major exposure to UK support services, although reduced recently, and to increase exposure to value oriented technology stocks overseas have proved highly beneficial. It is particularly satisfactory to report a sterling return of 25.0% in the US portfolio and an identical return from the Far East, whilst the small exposures to France, Holland and Switzerland have also all delivered growth, albeit reduced by currency, offset by a decline in Norway. The UK return also showed a small decline. In this reporting period the strategic benefits of the geographic diversification associated with last year's 'C' share issue are clear to see.

Capital Performance of the Trust from 31 December 1996 to 30 June 1997

UK Equities	-1.5%
European Equities	-1.8%
US Equities	+25.0%
Other Overseas Equities	+25.0%
Total Portfolio	+3.4%

In spite of the short term stock market difficulties, the argument that over the long term above average opportunities exist for capital gains in smaller companies in the chosen field remains firmly intact. Although there have been certain obvious adverse effects from currency movements, the manager believes that the essentially flat performance over the last year largely reflects a period of consolidation after the very strong share price performances in the 12 months to May 1996.

Herald's current policy is to pay annual dividends only, reflecting the emphasis on capital growth. The dividend in respect of the current year is expected to be paid in April 1998. No corporation tax liability is incurred by the Trust due to management expenses exceeding unfranked investment income. The extent of this excess was recoverable in previous years against surplus franked investment income. This relief amounted to £126,000 in 1996. Following the Budget this relief will no longer be available, and will adversely affect the tax charge, and hence distributable profits. However, the Trust has hitherto not used financial gearing, and has no current plans to do so. This implies that the Trust will not suffer from being unable to recover tax against interest expense, and it does benefit from certain overseas investments which further reduces the adverse effect on the Trust.

Although stock market conditions continue to be uncertain, the underlying growth in the industries in which the Trust invests still present opportunities to achieve above average long term growth. In particular growth rates in the US are very high, and contrary to the perception of some, valuations are not always as demanding as those in Europe. Nevertheless, the remit of the Trust remains to invest at least 50% of the portfolio in the UK.

STATEMENT OF TOTAL RETURN

for the six months ended 30 June 1997 (Unaudited)

	Six months to 30 June 1997			Six months to 30 June 1996		
	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
Gains on investments	—	4,359	4,359	—	11,428	11,428
Income	1,626	—	1,626	1,331	—	1,331
Investment Management fee	(800)	—	(800)	(670)	—	(670)
Other expenses	(66)	—	(66)	(74)	—	(74)
Net return before tax	760	4,359	5,119	587	11,428	12,015
Tax	(164)	—	(164)	(120)	—	(120)
Return on ordinary activities after tax	596	4,359	4,955	467	11,428	11,895
Return per Ordinary share						
— Basic	0.72p	5.26p	5.98p	0.64p	15.61p	16.25p
— Fully diluted	1.30p	4.57p	5.87p	1.30p	13.34p	14.64p

In April 1996, £30 million was raised by way of a 'C' share issue. The 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 1997, the weighted average number of Ordinary shares was 82.9 million (95.4 million fully-diluted), and for the period to 30 June 1996 the weighted average number of shares was 73.2 million (85.7 million fully-diluted).

SUMMARISED BALANCE SHEET

at 30 June 1997 (Unaudited)

	30 June 1997 £'000	31 December 1996 £'000
Investments	127,296	128,151
Net current assets	7,718	1,904
Shareholders' funds	135,014	130,055
Capital and Reserves:		
Share Capital	20,725	20,724
Share Premium	67,823	67,819
Warrant Reserve	5,678	5,679
Capital Reserve		
— Realised	23,096	15,411
— Unrealised	16,262	19,588
Revenue Reserve	1,430	834
	135,014	130,055
Net Asset Value per Ordinary share		
— Basic	162.87p	156.89p
— Fully diluted	154.64p	149.45p

The Balance Sheet at 31 December 1996 is an abridged version of that contained in the full Accounts for that year, which received an unqualified audit report and which have been filed with the Registrar of Companies.

TOP TWENTY HOLDINGS
in companies, by market value at 30 June 1997

Company	Sector	£'000	% of portfolio
Admiral	Software and computer consultancy	6,085	4.8
Micro Focus	Cobol based software products	3,852	3.0
Elec & Eltek (Hong Kong)	PCB manufacturer	3,712	2.9
GGT	Advertising agency	3,571	2.8
Northamber	Computer distributor	3,200	2.5
IBC Group	Conference/training	3,124	2.5
Lynx Holdings	Computer systems	2,816	2.2
Burr Brown (USA)	Analogue ASICS	2,798	2.2
MMT Computing	Computer consultancy	2,695	2.1
Draka (Netherlands)	Cables	2,584*	2.0
Diploma	Distributor	2,424	1.9
Linx Printing Technologies	Inkjet printers	2,232	1.8
CIA	Media buying	2,051	1.6
Wilmington	Magazine publisher	2,048	1.6
Sherwood International	Insurance software	1,949	1.5
Maiden Group	Outdoor advertising	1,909	1.5
Dorling Kindersley	Book and CD-ROM publisher	1,795	1.4
Telemetrix	ISDN equipment and ASICS	1,782	1.4
Pegasus Group	Accounting software	1,745	1.4
Rebus Group	Human resource and insurance software	1,698	1.3
		54,070	42.4

*Ordinary shares and 4½% Convertible Bond 2001.

GEOGRAPHIC SPREAD OF INVESTMENTS



DIRECTORS, MANAGER AND ADVISERS

DIRECTORS

Martin Boase (Chairman)
Timothy George Abell
Justin Paul Dukes
Colin Michael McCarthy
Clive Anthony Parritt

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