

**HERALD INVESTMENT
TRUST plc**

Interim Report

For the six months ended 30 June 1998

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

CHAIRMAN'S REVIEW

The trading background for most of the stocks in the Herald portfolio has continued to be reasonably strong. In the UK generally strong share price movements have mirrored this. However, the US and Far Eastern investments have been volatile. The fourth quarter in these markets was difficult and the early part of 1998 saw some share price recovery as investors thought the Q4 Asian contagion correction was overdone. However, more recently there has been some tangible slippage in growth expectations which partly relates to the knock-on effects of the evaporation of Far Eastern economic growth, but also reflects de-stocking in the PC market, which is clearly such an important driver to much of the technology sector. This has led to a difficult second quarter. 1998 may well be a landmark year, being the first when the PC market declines in S terms. The Trust's exposure to both the Far East and PC related stocks is minimal, and the UK software product and service sector, which started the year as the biggest element of the portfolio at 30.33% and had risen to 32.1% at the end of June, in spite of reducing a number of positions following strength, is relatively immune from these adverse trends in both fundamental and trading terms.

Sector Weighting of the Herald portfolio	31 December 1997	30 June 1998
Electrical & Electronic	17.4%	15.5%
Paper, Packaging & Printing	2.5%	1.6%
Distributors	7.1%	6.1%
Media	22.4%	22.3%
Support Services	39.0%	42.0%
Other	3.0%	4.7%
Cash/Gilts	8.6%	7.8%
Total	100.0%	100.0%

Summary of Performance

	At inception	At	At	Performance	Performance
	16 February	31 December	30 June	since	since
	1994	1997	1998	31 December	inception
				1997	
Basic NAV per share	98.7p	177.34p*	223.84p*	+26.2%	+126.8%
Fully diluted					
NAV per share	98.9p	168.28p*	211.72p*	+25.8%	+114.1%
Share price	90.9p	136.0p	193.5p	+42.3%	+112.9%
Warrant price	45.5p	60.5p	109.0p	+80.2%	+139.6%
FT-SE 100 Index	3,417.7	5,135.5	5,832.5	+13.6%	+70.7%
Hoare Govett					
Smaller Companies Index	1,750.0	1,984.94	2,252.05	+13.5%	+28.7%
Russell 2000					
Technology Index	—	140.26	147.20	+4.9%	—

An additional bonus in the portfolio in the first half was the strong contribution to profits from bid situations. Eleven bids have in aggregate realised c£21 million in cash, which has contributed to a slightly higher turnover in the portfolio than is our custom. These bids have partly resulted from the divergence in valuations between small companies and large companies which was so apparent last year. It also partly reflects the inevitable consolidation of maturing industries. There has also been the expected stream of new issues which is a similar function of dynamic, evolving and often immature markets, which the Trust intended to exploit at the outset.

Last year 1.48 million warrants were bought in for an aggregate consideration of £904,000. In the first half 2.0 million warrants have been bought in for £1.76 million. It is the policy to buy in warrants on a gradual basis, when it can enhance the fully diluted net asset value per share.

Capital Performance of the Trust from 31 December 1997 to 30 June 1998

UK Equities	+35.2%
European Equities	+10.1%
US Equities	+8.5%
Other Overseas Equities	-15.0%
Total Portfolio	+25.8%

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 1999. No corporation tax liability is incurred by the Trust due to management expenses exceeding unfranked income. In the first half last year £77,000 of this was recoverable, but following the changes in the budget last year the Trust is unable to recover tax this year, hence the increased tax charge. In spite of this, and the absence of yield in the US portfolio we are pleased to be able to report a small increase in profit after tax of 10%.

Overall it is satisfactory to report that the Trust's growth in fully diluted net asset value equals the highest of its peer group – UK Smaller and International Smaller Company Investment Trusts, in the first half, and now tops various performance tables over both one and three years. The manager is equally happy to be compared to the specialist technology investment trusts, and remains confident that the chosen field of investment can continue to perform over the longer term. Although certain elements of the portfolio have become more expensive strong growth continues in these situations, while economic growth is slowing in the UK. Some stocks in the orbit have, somewhat worryingly, been put on anomalous concept valuation multiples. However, there are still plenty of attractive value investment opportunities.

Martin Boase

29th July 1998

STATEMENT OF TOTAL RETURN

for the six months ended 30 June 1998 (Unaudited)

	Six months to 30 June 1998			Six months to 30 June 1997		
	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
Gains on investments	—	39,963	39,963	—	4,359	4,359
Currency losses	—	(61)	(61)	—	—	—
Loss on warrant repurchase	—	(850)	(850)	—	—	—
Income	1,957	—	1,957	1,503	—	1,503
Investment management fee	(1,037)	—	(1,037)	(800)	—	(800)
Other expenses	(83)	—	(83)	(66)	—	(66)
Net return before tax	837	39,052	39,889	637	4,359	4,996
Tax	(285)	—	(285)	(135)	—	(135)
Return on ordinary activities after tax	552	39,052	39,604	502	4,359	4,861
Return per Ordinary share						
— Basic	0.67p	47.11p	47.78p	0.61p	5.26p	5.87p
— Fully diluted	0.82p	43.67p	44.49p	0.87p	5.53p	6.40p

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 1998, the weighted average number of Ordinary shares was 82.9 million (91.9 million fully-diluted), and for the period to 30 June 1997 the weighted average number of shares was 82.9 million (95.4 million fully-diluted). The comparative figures have been restated for capitalised distributions.

SUMMARISED BALANCE SHEET

at 30 June 1998 (Unaudited)

	30 June 1998 £'000	31 December 1997 £'000
Investments	175,108	136,673
Net current assets	11,014	10,751
Shareholders' funds	<u>186,122</u>	<u>147,424</u>
Capital and Reserves:		
Share Capital	20,725	20,725
Share Premium	67,827	67,823
Warrant Reserve	4,094	5,005
Capital Reserve		
—Realised	45,485	29,960
—Unrealised	46,192	22,664
Revenue Reserve	1,799	1,247
	<u>186,122</u>	<u>147,424</u>
Net Asset Value per Ordinary share		
— Basic	224.51p	177.84p
— Fully diluted	212.32p	168.72p

TOP TWENTY HOLDINGS

in companies, by market value at 30 June 1998

Company	Sector	£'000	% of portfolio
Admiral	Software and computer consultancy	11,543	6.2
Lynx Group	Computer systems	6,547	3.5
Sherwood International	Insurance software	6,126	3.3
Northamber	Computer distributor	4,406	2.4
Rebus Group	Human resource and insurance software	3,630	2.0
IBC Group	Conference/training	3,507	1.9
MMT Computing	Computer consultancy	3,185	1.7
Maiden Group	Outdoor advertising	3,026	1.6
Tempus Group	Media buying	3,008	1.6
Alba	Consumer electronic distributor	2,941	1.6
Spring Group*	IT recruitment and training	2,916	1.6
Wilmington Group	Magazine publisher	2,808	1.5
SDX Business Systems	Digital communications systems	2,682	1.5
Telemetrix	ISDN equipment and ASICS	2,602	1.4
Superscape VR	Computer software and systems	2,477	1.3
Pegasus Group	Accounting software	2,444	1.3
Anite Group	Consultancy and system integration	2,440	1.3
IMS Group	Telephone information services	2,427	1.3
GWR Group	Commercial radio operator	2,240	1.2
Acal	Electronic products marketing	2,233	1.2
		<u>73,188</u>	<u>39.4</u>

* formerly CRT Group

GEOGRAPHIC SPREAD OF INVESTMENTS



DIRECTORS, MANAGER AND ADVISERS

DIRECTORS

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

SECRETARY

Stewart Ivory & Company Limited
45 Charlotte Square
Edinburgh EH2 4HW
Tel: 0131-226 3271
Fax: 0131-226 5120

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: 0171-553 6300
Fax: 0171-490 8026
Web-site: www.heralduk.com
E-mail: info@heralduk.com

SOLICITORS

Macfarlanes
10 Norwich Street
London EC4A 1BD

AUDITORS

Ernst & Young
Ten George Street
Edinburgh EH12 2DZ

BANKERS

RBS Trust Bank Limited
67 Lombard Street
London EC3P 3DL

STOCKBROKERS

Warburg Dillon Read
1 Finsbury Avenue
London EC2M 2PP

REGISTRARS

Northern Registrars Limited
Northern House
Penistone Road
Fenay Bridge
Huddersfield HD8 0LA
Tel: 01484 606 664
Fax: 01484 608 764

Year 2000 Compliance

The ability of computer systems to cope with the change to a new Millennium has recently attracted publicity. The Company's accounting records are maintained on computer by Stewart Ivory & Company Limited. As the Year 2000 issue could potentially affect all the Company's accounting records the directors have sought assurances from Stewart Ivory that its systems will be Year 2000 compliant. Stewart Ivory is planning to have all of its in-house electronic systems Year 2000 compliant by 31 December 1998. The ability of external service providers to cope with Year 2000 is also being assessed. The Company will not bear any of the costs associated with ensuring that the computer systems used by it are Year 2000 compliant.