HERALD INVESTMENT TRUST plc

REPORT & ACCOUNTS

31 December 2007

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THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to the action you should take you should consult your stockbroker, bank manager, solicitor, accountant or other independent financial advisor authorised under the Financial Services and Markets Act 2000 immediately.

If you have sold or otherwise transferred all of your ordinary shares in Herald Investment Trust plc, please forward this document and the accompanying form of proxy as soon as possible to the purchaser or transferee or to the stockbroker, bank or other agent through whom the sale or transfer was or is being effected for delivery to the purchaser or transferee.

COMPANY SUMMARY

COMPANY DATA AT 31 DECEMBER 2007	
Shareholders' funds	**Market capitalisation**
£343m	**£271m**

Policy and Objective	Herald's objective is to achieve capital appreciation through investments in smaller quoted companies, in the areas of telecommunications, multi-media and technology (TMT). Investments may be made across 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. The Company's investment policy is contained within the Business Review on page 21.
Benchmark	The portfolio benchmark against which performance is measured is ⅔ Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies) and ⅓ Russell 2000 (small cap) Technology Index (in sterling terms). Though we consider this benchmark to provide a reasonable base for measuring the Trust's performance, the portfolio is not modelled on it and outcomes may diverge widely.
Management Details	Herald Investment Management Limited ('HIML') is the appointed investment manager to the Company. The management contract can be terminated at twelve months' notice. Administration of the Company and its investments is contracted by HIML to Baillie Gifford & Co, who also act as Company Secretary.
Capital Structure	The Company's share capital consists of 86,971,010 Ordinary shares of 25p each which are issued and fully paid. The Company has been granted authority to buy back a limited number of its own Ordinary shares for cancellation. During the year 585,000 Ordinary shares were bought back for cancellation. The Directors are seeking to renew this authority at the forthcoming Annual General Meeting.
Management Fee	Herald Investment Management Limited's annual remuneration is 1.0% of the Company's net asset value based on middle market prices, calculated on a monthly basis payable in arrears.
Wind-Up	At the Annual General Meeting of the Company held in April 2007 shareholders voted in favour of the Company continuing to operate as an investment trust. The next continuation vote is in 2010 and every third year thereafter.
AIC	The Company is a member of the Association of Investment Companies.

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

Investment trusts are UK public listed companies and as such comply with the requirements of the UK Listing Authority. They are not authorised or regulated by the Financial Services Authority.

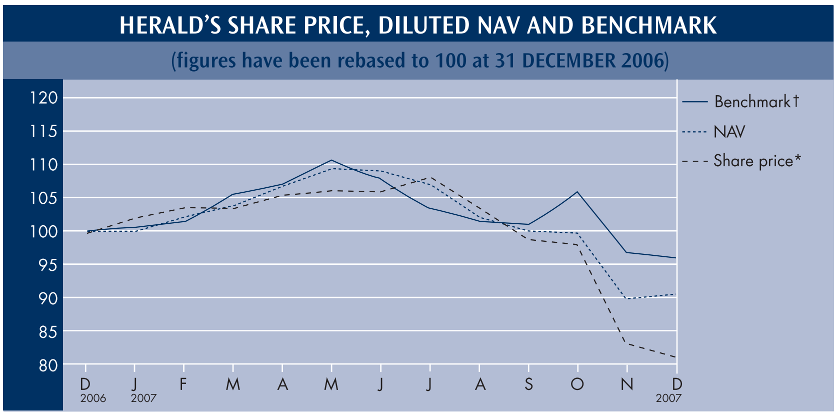
YEAR'S SUMMARY

	31 December 2007	31 December 2006	% change
Total assets (before deduction of bank loans)	£343.5m	£401.2m	
Bank loans	–	£20.0m	
Equity shareholders' funds	£343.5m	£381.2m	
Net asset value per ordinary share	395.0p	435.4p	(9.3)
Share price*	312.0p	383.5p	(18.6)
FTSE 100	6,456.9	6,220.8	3.8
FTSE All-Share	3,286.7	3,221.4	2.0
FTSE Small Cap	3,420.3	3,905.6	(12.4)
Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies)	3,562.9	3,838.3	(7.2)
Russell 2000 (small cap) Technology Index (in sterling terms)	72.1	70.5	2.3
Benchmark composite index			(4.0)
Dividend per Ordinary share	0.50p	1.20p	(58.3)
Revenue per Ordinary share	(1.57)p	2.19p	(171.7)
Expense ratio	1.25%	1.13%	
Discount	21.0%	11.9%	

	Year to 31 December 2007		Year to 31 December 2006	
Year's high and low	**High**	**Low**	**High**	**Low**
Share price*	424.8p	300.0p	412.3p	321.0p
Net asset value	482.3p	376.3p	435.4p	370.3p
Discount	8.6%	21.0%	3.0%	15.1%

	31 December 2007	31 December 2006
Total return per ordinary share		
Revenue	(1.57)p	2.19p
Capital	(37.82)p	24.60p
Total	(39.39)p	26.79p

*At mid market price.



Source: Baillie Gifford & Co
†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).
Dividends are not reinvested.
*At mid market price.

Past performance is no guarantee of future performance.

LONG TERM PERFORMANCE SUMMARY

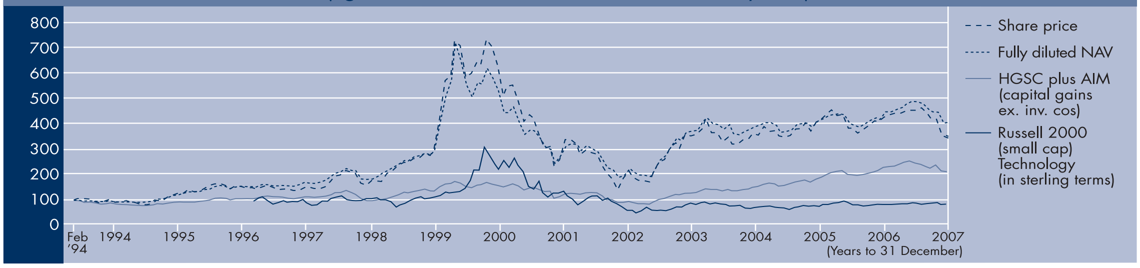
The following charts indicate how an investment in Herald has performed relative to its comparative indices (applied retrospectively) and its underlying fully diluted net asset value over the period since inception of the Company.

	31 December 2007	Inception 16 February 1994	% change
Net asset value per ordinary share	395.0p	98.7p	300.2
Share price	312.0p	90.9p	243.2
Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies)	3,562.9	1,750.0	103.6
Russell 2000 (small cap) Technology Index (in sterling terms)	72.1	83.2*	(13.3)
FTSE 100	6,456.9	3,417.7	88.9
FTSE All-Share	3,286.7	1,717.8	91.3
FTSE Small Cap	3,420.3	2,076.1	64.7

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

RELATIVE PERFORMANCE OF HERALD'S FULLY DILUTED NAV AND SHARE PRICE TO THE COMPONENT INDICES OF THE COMPOSITE BENCHMARK† SINCE INCEPTION

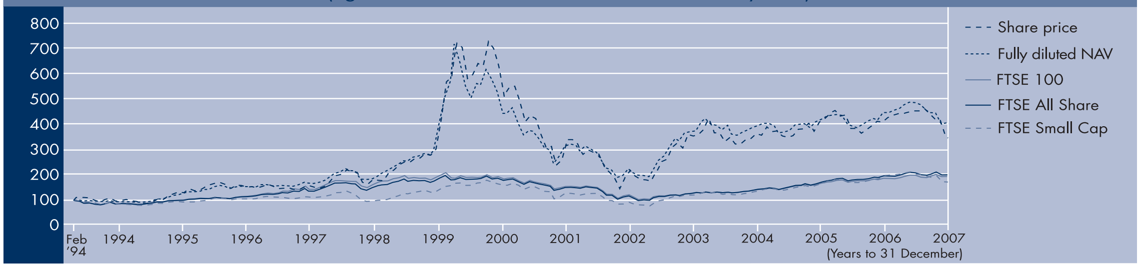
(figures have been rebased to 100 at 16 February 1994)



Source: Thomson Financial Datastream/Baillie Gifford & Co.

RELATIVE PERFORMANCE OF HERALD'S FULLY DILUTED NAV AND SHARE PRICE TO FTSE INDICES SINCE INCEPTION

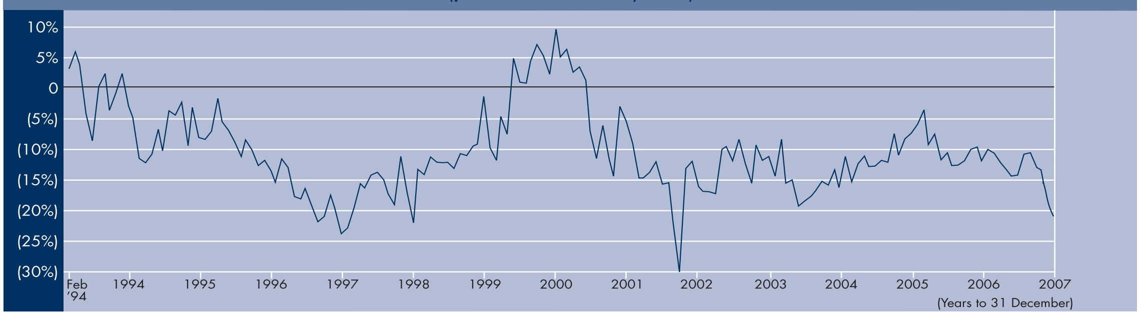
(figures have been rebased to 100 at 16 February 1994)



Source: Thomson Financial Datastream

PREMIUM/(DISCOUNT) TO FULLY DILUTED NET ASSET VALUE

(plotted on a monthly basis)



Source: Thomson Financial Datastream

The premium/(discount) is the difference between Herald's quoted share price and its underlying fully diluted net asset value.

†From 1 January 2006, the benchmark was changed to ⅔ Hoare Govett Smaller Companies Index plus AIM (capital gains ex. investment companies) and ⅓ Russell 2000 (small cap) Technology Index (in sterling terms).

DIRECTORS, MANAGER AND ADVISERS

Directors

Martin Boase, MA, FIPA (Chairman) was appointed to the Board on 11 January 1994 and is Chairman of the Audit Committee and the Nomination Committee. He formed advertising agency Boase Massimi Pollitt plc in 1968 which was floated on the London Stock Exchange in 1983. He was chairman of the Advertising Association from 1987 to 1992 and is currently chairman of Jupiter Dividend and Growth Trust PLC.

Clay Brendish, CBE was appointed to the Board on 23 July 2001. He has been non-executive chairman of Beacon Investment Fund since 1995, Echo Research Limited since July 2003 and Anite plc since October 2005. He is a trustee of the Economist Newspapers Limited together with the Foundation for Liver Research. Clay's other non-executive directorship is with British Telecommunications plc. He has been in the computer systems environment and high technology industry for over 30 years. He was formerly executive chairman of Admiral plc and, in turn, deputy chairman of CMG plc when the companies merged. He has also held a number of Government advisory posts.

Julian Cazalet was appointed to the Board on 18 January 2008. He was Managing Director - Corporate Finance at JPMorgan Cazenove until his retirement in December 2007. After qualifying as a Chartered Accountant he joined Cazenove in 1973 and was made a Partner in 1978. From 1989 he worked in Corporate Finance and advised a number of leading Investment Trusts in addition to his work with industrial and commercial companies. He is a director of the White Ensign Association.

Tim Curtis was appointed to the Board on 22 July 2004. He was chief executive of Zetex plc (formerly Telemetrix PLC), is non-executive chairman of RaceCourse Technical Services Ltd and of IBS OPENSystems plc. Former non-executive directorships were with TVS Entertainment plc, Dobson Park Industries plc, Bournemouth & West Hampshire Water Co., and Pace Micro Technology plc. Tim was previously a director of Unitech plc.

Douglas McDougall, OBE was appointed to the Board on 13 February 2002 and is the senior independent director. He has extensive experience in the fund management industry and is a former senior partner of Baillie Gifford & Co. He is chairman of The Law Debenture Corporation plc, Foreign & Colonial Eurotrust plc, The Independent Investment Trust PLC and The Scottish Investment Trust PLC and is a director of The Monks Investment Trust PLC, Pacific Horizon Investment Trust PLC and Stramongate Assets plc. He is a former chairman of IMRO, of the Association of Investment Companies and of the Fund Managers' Association.

All Directors, with the exception of Mr C J Cazalet, are members of the Audit Committee. All Directors are members of the Nomination Committee.

Secretary

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1 Greenside Row
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Registered Office

10-11 Charterhouse Square
London EC1M 6EE

Company Number

2879728 (England and Wales)

Manager

Herald Investment Trust plc is managed by Herald Investment Management Limited ('HIML'). The senior director of HIML with prime responsibility for the management of Herald Investment Trust is Katie Potts.

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CHAIRMAN'S STATEMENT

Performance

The net asset value per share rose 8.6% in the first half, but the second half proved difficult with a 16.5% decline leading to an overall 9.3% decline for the year. Unfortunately the Manager was optimistic at the time of the interim, reflecting strong trading across the portfolio, and valuations modest by historic standards and relative to the cash generation in investee companies. Thus the portfolio had £50m net debt which was invested. The suddenness of the credit crunch had not been foreseen. However, the seriousness of the situation was recognised quickly and from late August there was an immediate endeavour to raise cash and sell positions perceived as potentially most vulnerable to the changed economic environment. Initially there was a certain amount of liquidity in the market enabling some repositioning of the portfolio. By October the UK market in particular had become very illiquid, which meant a decline was inevitable. November saw the worst of the decline with the NAV declining 9.7% in that month alone. December saw some stabilisation.

In the first half of the year there were several notable takeover bids announced, some of which were completed for cash in the second half. Two further significant takeover bids were announced in the second half – Amstrad and Northgate Information Systems – so that during the year three of the top ten holdings at the start of the year were bid for cash. This helped achieve a repositioning so that the fund moved from £50m debt to effectively £40m cash at the year end, if the Northgate proceeds of the cash bid announced in December and Government Bonds are included. Half of this £90m reversal has come from bids. The strong positive message is that, apart from the coveted cash realisation, significant premiums were generally attained highlighting solid intrinsic value. The concern is first that the lack of investing cash flows in the smaller companies market is a continuing feature leading to poor valuations and smaller companies underperforming in all regions, and second that the degree of shock to the financial system implies that a sharp economic slowdown or even recession seems almost inevitable, and profit downgrades should be expected. This has not yet been seen, but more cautious statements must be expected. This is to some extent discounted in share prices and the unusually wide discount to net assets for the Trust (21.0% at the year end). While liquidity has returned to a degree, albeit at lower valuations, balance sheets in investee companies are generally strong, with the Trust's share of debt and cash in investee companies amounting to around £20m net cash. Most importantly much of the portfolio still has a growth profile in a slower economy with some very appealing valuations.

The UK portfolio was the worst area declining 9.9% over the year. In comparison the total return of HGSC Smaller Companies Index including AIM, rose 8.1% in the first half but declined 5.6% by the year end, with the electronic equipment sector declining 8.0%, the media sector declining 19.3%, the IT software sector rising 2.9% and the IT hardware sector declining 9.7%. There was a particularly painful period when large capitalisation technology companies in the US rose while the UK portfolio was declining, but small capitalisation US stocks were not much better than in the UK. The US portfolio declined 6.9% in the year, the European portfolio declined 4.9% and the Far East portfolio alone rose by 2.4%. The overall decline has continued into 2008, but the UK has outperformed all other territories and seems somewhat more stable.

The dividend related to 2006, which was paid in 2007, was boosted by a special £1.9m dividend from Amstrad. In 2007, higher interest charges contributed to a loss on the revenue account. The Board is proposing a dividend of 0.50p per share payable out of reserves in respect of 2007. Capital appreciation is the priority of the Company and there is no certainty that dividends will be paid in future years.

Gearing

In order to provide greater flexibility in the gearing strategy, the Board is recommending an increase in the maximum amount the Trust can borrow and is seeking shareholder approval to amend the Articles of Association, by way of Special Resolution, to increase the maximum level of gearing from the current level of 30% to 50% of shareholders' funds. However, at the time of investment, borrowings are not expected to exceed 30% of net assets, but the Board take the view that the current combination of low valuations and relatively low interest rates provide opportunities to exploit. Details of the Special Resolution can be found in the Notice of Annual General Meeting on page 51.

Buybacks

During the year, a total of 585,000 shares were bought back at a cost of £2.4m. This is discussed in more detail in the Investment Manager's Report on page 10. The Board is seeking powers at the AGM to renew the authority to buy back shares.

VAT

During the year, the European Court of Justice ruled that investment trust management fees should be exempt from VAT, bringing them in line with open ended funds. HM Revenue and Customs now accept this decision so the Company will be able to recover some of the VAT suffered on management fees in the past. The terms of, and procedure for, reclaim are still to be clarified. The amount of the refund is still uncertain, but it will not be material. Consequently, no provision has been made for any refund in this set of financial statements.

The Board

I am pleased to welcome Julian Cazalet to the Board. He has recently retired as Managing Director – Corporate Finance at JP Morgan Cazenove having advised a number of investment trusts in addition to working with industrial and commercial companies. Shareholders will be asked to vote on his appointment at the Annual General Meeting.

Outlook

Inevitably the macro environment remains an overriding concern, and a number of economic indicators particularly in the UK are worrying. However, the valuations are being driven by a lack of investors' liquidity not by fundamentals. Managers of open ended funds envy the investment trust characteristic of not being a forced seller. Herald capitalised on this in 2002 when leverage enabled a geared return on the upswing when open ended funds were forced sellers. The £50m borrowing facility remains in place, but is undrawn, and a further £40m in cash, Government Bonds and potential proceeds from bids, should enable the fund to exploit opportunities. The temptation is to buy, but the economic shock currently being experienced makes a short term recovery improbable. The strategy will be cautiously to invest when distressed sellers appear, and we remain confident that there are many strong companies in the portfolio in a position to weather the storm. The biggest fear is that there will be further takeovers at prices which are fundamentally too low.

Martin Boase

Chairman

3 March 2008

INVESTMENT MANAGER'S REPORT

The year has proved unexpectedly challenging. The second half has seen a break-down in the smaller companies sector leading to a 9.3% decline in the net asset value (NAV). There has been a divergence in poor share price performances across the portfolio versus generally strong trading performances in an economy that has been strong with structural growth drivers benefiting many companies. We have previously argued that the strong profits growth was not reflected in valuations. For consistency the table giving a snapshot of brokers' forecasts on the portfolio at the year end is shown below, but takes some explanation.

Market value as % of total equities	UK	US	Europe	Far East	Total
Companies profitable in 2006 and 2007 (as % of Total Market Value)	47.9%	12.7%	8.2%	7.5%	76.3%
Companies unprofitable in 2006 profitable in 2007 (as % of Total Market Value)	7.4%	2.7%	0.6%	0.4%	11.0%
Companies unprofitable in 2006 and 2007 (as % of Total Market Value)	4.9%	2.3%	0.3%	0.4%	7.8%
Missing Data	2.5%	0.3%	0.1%	0.1%	3.0%
Total	64.1%	18.1%	9.1%	8.6%	100.0%
Earnings growth %					
2007: Companies always profitable (2006 and 2007)	10.2%	15.0%	6.5%	4.4%	9.1%
2008: Companies always profitable (2006 and 2007)	19.6%	39.5%	24.3%	21.1%	22.5%
2008: Companies unprofitable in 2006 and profitable in 2007	103.8%	44.2%	152.9%	79.6%	89.9%
Earnings growth %					
Total portfolio 2007*	78.4%	75.0%	18.7%	5.7%	51.0%
Total portfolio 2008*	56.3%	98.9%	32.9%	38.2%	56.7%
P/E profitable stocks with estimates only					
2006	14.4x	28.6x	19.2x	10.6x	15.5x
2007	13.6x	25.4x	18.1x	11.0x	14.7x
2008	11.0x	18.1x	14.5x	8.7x	11.6x
P/E of all stocks with estimates					
2006	38.4x	78.7x	25.5x	12.0x	33.4x
2007	20.5x	45.2x	21.5x	11.5x	21.5x
2008	12.7x	22.7x	15.5x	8.3x	13.4x

*The calculation for 2007 and 2008 earnings growth is based only on companies with data available in each of the respective years.
Source: JCF Group and brokers estimates

Overall this shows profits growth forecast of 51.0% in 2007 on the portfolio as at 31 December 2007 versus a growth of 58.1% forecast a year ago on the portfolio as at 31 December 2006, with a more modest 9.1% growth for consistently profitable companies. These numbers have been analysed in great detail. The data is devalued by the fact that historic and forecast profits are increasingly distorted by inconsistencies in reporting, particularly associated with the migration to IFRS. Some historic numbers appear in the database net of share option expenses, while brokers often, but not always, omit this item in forecasts. In general the historic numbers are more prudent than hitherto. In last year's accounts the p/e was forecast to be 14.4x on profitable companies for 2007. The revised number is now 14.7x. However the portfolio has declined 9.3% implying an 11% decline in forecasts. In practice it is more complicated because the portfolio has changed. In particular Amstrad was a significant holding on a very low p/e – the take-out value being c8–9x profits, and loss making businesses have been acquired. This has also distorted the overall portfolio p/e which has risen from 16.6x to 21.5x for 2007, albeit down from 26.3x a year ago. There have also been net downgrades. The market value of the worst 10 performing holdings declined in aggregate by £21.8m, which is c60% of the total portfolio decline. Although the aggregate earnings of these companies still grew it was less than forecast but the valuation declined by c50x the movement in earnings forecasts.

The weakness of the $ has been a drag on £ translated earnings in previous years, but in 2007 the $ declined less than 2%. With only 17.5% of the portfolio quoted in the US this sounds irrelevant. However a number of UK companies have significant overseas sales. The companies most exposed to the weakness of the $ have been the UK companies with a predominantly £ cost base, but predominantly US$ revenues. For example this applies to the largest remaining holding in the portfolio Imagination Technologies. The 2006 $ weakness has proved a big drag on earnings growth in 2007 in such companies. I draw attention to this because we are required by FRS29 to disclose the currency exposure. This is impossible to quantify but it is worth stressing that the companies most exposed to currency movements are companies with a mismatch of costs and revenues. On this basis the disclosure required by FRS29 might be misinterpreted. It also implies that the acceleration in growth in 2008 is not as surprising, because the underlying growth was stronger in 2007. In 2006 the $ declined nearly 14% relative to £. With the deteriorating UK trade deficit £ now appears vulnerable, which could make brokers' forecasts less ambitious for 2008.

The majority of the Company's assets are equity shares and other investments which neither pay interest nor have a maturity date. On average the investee companies are not financially leveraged because the sector generally does not have tangible fixed assets to secure bank debt, so there is modest direct exposure to interest rate movements. However, if interest rate changes affect demand this will affect trading in the underlying investee companies. Many investee companies have very high gross margins so a small change in demand can affect profits materially.

Whatever the vagaries of statistics the earnings growth in 2007 has been robust and brokers continue to forecast strong growth in 2008.

UK

The UK declined 9.9%, and the capital loss was £27.3m. Nearly £10m of this fall was accounted for by two holdings – Detica and Thomson Intermedia. Ironically these have been stars in previous years. The former has reported strong earnings growth thus far but warned that 15% of their business is exposed to the banking sector which was vulnerable in the second half. Thomson Intermedia remains an interesting company but has experienced growing pains, and now seems surprisingly cheap. SPI Lasers is the only loss that exceeds £1m where there has been genuinely disappointing news, because the competition has aggressively cut prices.

Three of the biggest holdings at the end of 2006 were subject to takeover bids. First Amstrad has proved to be an outstanding investment. Originally £1.25m was invested. Through profit taking in the bubble and subsequent reinvestment the return has been 10x and in addition there have been good dividends including the special one of £1.9m in 2006 which led to an unusually high dividend for Herald in 2007, which will not recur in 2008.

SurfControl has been another strong performer, with returns nearly as great, which was acquired by its main competitor Websense in October. They first announced talks in December 2006 and reiterated that talks continued in April. The premium was still nearly 40% on the day of the bid. They had lost shareholder support in London, and indeed some were aggressively selling the stock prior to the bid. It is conspicuous that in the first quarter post acquisition by Websense they have pre-announced numbers ahead of guidance. A similar situation arose with Northgate Information Solutions where there was significant short interest at below 50p, and yet KKR bid at 95p. As long standing shareholders in both companies we are grateful for the efforts of management, and for the excellent returns. We felt the lack of support was unjustified and are reassured that our view was vindicated by informed buyers. It is nevertheless concerning that the current state of the London stock market is quite so unsupportive of real businesses, which in these cases had strong recurring revenues and are ideal recession investments. On the other hand our raison d'etre is to identify anomalies, the cash is useful and we cannot expect to have it all ways.

There is a structural problem in the UK market, which is probably a reflection of the proliferation of companies on AIM. A recent search identified 267 companies on AIM in our target sector which is far too many to have an orderly secondary market. Alas many should not be quoted, and have a bleak future. It is perhaps understandable why investors have developed such a jaundiced view, but it has become indiscriminating. AIM is now pretty well closed for new listings, many companies will not receive required further funding and will disappear, while others will be taken over or merge. A more worrying potential trend is that management have approached us to take businesses private. This has been publicly demonstrated by Trace which was acquired by the management team for 156p in spite of receiving a cash bid at 180p because they scraped together the support of 50% of shareholders. Herald owned nearly 8%. Intechnology has made a tender offer at a small premium to take that business private.

After considerable discussion we have decided to retain a holding in the business as a private company. Although it is not a precedent we like, there is huge upside potential, and a trade buyer will be found more easily for a private entity without an anomalously low market price. I fear there are more to come.

It is surprising that the UK has remained such a large part of the portfolio. This reflects the large orbit of companies that raised money in the technology bubble in 2000, many of which have emerged as real businesses. Unfortunately most have not, but we remain optimistic that for many there is excellent value. The current market is bad for Herald's investors, and bad for the Manager's nerves, but in the long run it should be good for returns because it is probable that the coming months will offer outstanding opportunities. It is inherent in the nature of economic and investment cycles that it is unusual for markets simultaneously to offer attractive valuations at which both to buy and sell. The current instability will throw up bargains which we will endeavour to ensure patient investors will benefit from.

US

In 2006 there were 13 bids in the portfolio, and a strong performance was significantly offset by currency. In 2007 the performance has been dull declining by 6.9% in £. The Russell 1000 large capitalisation technology index comprising 100 stocks grew by 15.8% in $, driven by strong performances from Apple and RIMM. The Russell 2000 small capitalisation technology index comprising 277 stocks lagged, rising by 4%, and smaller microcap companies underperformed even more. Smaller companies outperformed while the large capitalisation stocks languished when there was a plethora of bids, and larger stocks have since caught up somewhat. The US has started 2008 poorly both small and large stocks alike. At the small capitalisation end the bear market is evident with brokers visibly more challenged than those in the UK. The sector now appears to offer the best value that I have seen, with robust balance sheets. There is of course a risk that the economy continues to deteriorate and profits are challenged, but the strategy has been to target defensive businesses with robust recurring revenue, strong cash flow and balance sheets. The US portfolio will increase as a percentage of the fund. Like the UK there have been redemptions and distressed sellers at the microcap end, which is exciting. The stronger balance sheets offer support through share buy backs.

Europe

The European portfolio, which was down 4.9%, has been insulated from some horrible performances at the microcap end by having heavy weightings in some stocks which have become quite large. In particular Logitech in Switzerland and United Internet in Germany which have both been outstanding long term investments both performed well and have been used as a source of cash late in the year. The French portfolio was poor.

Far East

The Far East scraped a positive performance, and the exposure was reduced just before the year-end. The financial turmoil has been spawned in the West, and it would be surprising if the profits that are most vulnerable are the volume sensitive manufacturers in the East. Although longer term this market is exciting, short term the outlook is uncertain.

Market Background

There are fundamental drivers that continue to propel the sector. The widespread adoption of the internet, the emergence of web 2.0 and the requirement to upgrade to enable convergence and richer media is feeding through to demand for faster processors, more memory, upgraded software (Vista and Leopard), smart mobile devices, storage demand, security, media shifts and so on. This opens up avenues for small companies which have stronger growth prospects than the large companies, which will be more exposed to overall capital and consumer expenditure.

An attraction of this fund's target sectors is that the markets served are diverse – consumers, businesses both revenue and capital, and Governments. The last includes education, health and defence. All regions are customers. It is evident that though the western consumer has driven demand hitherto, upside is more likely to come from the Middle East and other emerging market customers in the short term.

The Manager remains as enthused as ever about the long term attractions of the sector, but is dispirited that the investment skills and interest in the UK investment community are so limited. This is of course two edged. It can lead to attractive valuations at which to invest but at times it means that a more appropriate valuation is only realised by a takeover, which has been a feature in 2007 as in previous years. It also leads to a shortage of capital for businesses that we firmly believe should get funding.

Buy-backs

During the year 585,000 shares were bought back and cancelled at an average price of 405p. We believe it inappropriate to maintain a discount target when the liquidity of the portfolio is limited, and it is a major protection to all shareholders to avoid being forced sellers. However, it is an important aim of the Manager to maximise the liquidity in Herald Investment Trust shares. This was the catalyst for buying in shares. In addition when the discount appears attractive relative to other investment opportunities shares may from time to time be repurchased opportunistically.

Conclusion

While it is disappointing that we were unable to liquidate more of the portfolio back in September, it is exciting to have £40m in cash, Government Bonds and potential bid proceeds together with a further £50m in loan facilities to exploit market anomalies. In the short term there remains fragility as the world adjusts to a weaker US economy and tighter credit, so patience is called for.

PERFORMANCE ATTRIBUTION (in sterling terms)

Equity markets	Benchmark allocation 01.01.07 %	Benchmark allocation 31.12.07 %	Herald asset allocation 01.01.07 %	Herald asset allocation 31.12.07 %	Performance* Herald %	Performance* Benchmark %	Contribution to relative return %	Contribution attributable to: Stock selection %	Contribution attributable to: Asset allocation† %
UK	66.7	66.7	69.5	62.4	(9.9)	(5.6)	(3.2)	(3.0)	(0.2)
Europe ex. UK	–	–	6.5	5.0	(4.9)	–	(0.1)	–	(0.1)
Americas	33.3	33.3	17.2	17.5	(6.9)	2.3	(2.5)	(1.7)	(0.8)
Asia Pacific ex. Japan	–	–	8.4	7.8	2.4	–	0.5	–	0.5
Bonds	–	–	–	3.7	3.8	–	0.1	–	0.1
Cash	–	–	3.6	3.6	5.3	–	0.4	–	0.4
Loans	–	–	(5.2)	–	8.9	–	(0.6)	–	(0.6)
Total	100.0	100.0	100.0	100.0	(8.2)	(2.9)	(5.4)	(4.7)	(0.7)

Past performance is no guarantee of future performance.
Source: HSBC.

*The above returns are calculated on a total return basis with net income reinvested. Dividends and interest are reinvested on a cash basis, unlike the NAV calculation where income is recognised on an accruals basis. Relative performance may differ as a result.

Contributions cannot be added together, as they are geometric; for example, to calculate how a return of (8.2%) against a benchmark return of (2.9%) translates into a relative return of (5.4%), divide the portfolio return of 91.8 by the benchmark return of 97.1 and subtract one.

† Asset allocation includes the contribution attributable to currency movements.

3 March 2008

INVESTMENT CHANGES (£'000)

	Valuation at 31 December 2006	Net acquisitions (disposals)	Realised and unrealised appreciation (depreciation)	Valuation at 31 December 2007
Equities*:				
UK	264,927	(23,685)	(27,225)	214,017
Continental Europe	24,839	(5,866)	(1,696)	17,277
Americas	65,759	(589)	(4,982)	60,188
Asia Pacific	31,820	(5,953)	716	26,583
Total equities	387,345	(36,093)	(33,187)	318,065
Bonds:				
Euro bonds	–	7,443	102	7,545
US$ bonds	–	5,036	187	5,223
Total bonds	–	12,479	289	12,768
Total investments	387,345	(23,614)	(32,898)	330,833
Net liquid assets	13,883	(1,170)	(49)	12,664
Total assets	401,228	(24,784)	(32,947)	343,497

The figures above for total assets comprise assets less current liabilities before deduction of bank loans.
*Equities includes convertibles and warrants.

TOP TWENTY HOLDINGS

AT 31 DECEMBER 2007

A brief description of the twenty largest holdings in companies is as follows:

Northgate Information Solutions

Provides specialist software, outsourcing and information technology (IT) services to the human resources, local government, education and public safety markets. Northgate has approximately 4,500 large/medium customers and approximately 10,500 small/medium enterprise (SME) customers worldwide. Customers Northgate works closely with include approximately 1 in 5 of the Fortune 500, 90% of the UK local authorities and all of the UK's regional police forces. In July 2007 in a transformational deal, Northgate acquired Arinso for approximately £250m. Arinso is a leading global provider of HR software and outsourcing services. On 21 December 2007 Northgate announced that KKR, a leading US venture capitalist, intended to acquire Northgate for a consideration of 95p per share in cash.

Country	United Kingdom
Valuation	£16,969,000
% of total assets	4.9
% of issued share capital held	3.2

(Valuation at 31 December 2006 £12,384,000)

Imagination Technologies Group

Develops 2D/3D graphics, digital signal processing, video and audio technologies and licenses this IP (Intellectual Property) to global semiconductor and system companies. These technologies are used in multimedia devices. Imagination has been particularly successful in selling graphics technology to the mobile phone and LCD TV sectors and is a pioneer in developing Digital Audio Broadcasting Technology (DAB). Imagination Technology incorporates this technology in its 'Pure Digital' radio brand.

Country	United Kingdom
Valuation	£15,402,000
% of total assets	4.5
% of issued share capital held	5.7

(Valuation at 31 December 2006 £14,390,000)

SDL

Provides multilingual website globalisation software in addition to support databases, training and translation services. Its 'Realtime' and 'Workflow' are leading solutions in this field. Its comprehensive and integrated offerings include multilingual content management solutions, real-time translation technologies, translation memory and a full range of internationalisation and localisation services.

Country	United Kingdom
Valuation	£11,534,000
% of total assets	3.4
% of issued share capital held	5.6

(Valuation at 31 December 2006 £12,343,000)

Detica Group

A specialty provider of business consulting, systems design and implementation services. The company focuses on helping organisations harness technology to identify, attract, develop and retain customers through effective integration with business processes. The company is also a provider of information and systems security services, notably in the UK National Security market. Detica aims to combine independent advice with the design and delivery of effective solutions.

Country	United Kingdom
Valuation	£7,865,000
% of total assets	2.3
% of issued share capital held	3.1

(Valuation at 31 December 2006 £15,506,000)

Diploma

A group of specialised distribution businesses serving industries with long term growth potential and with the opportunity for sustainable superior margins through the quality of customer service, depth of technical support and value-adding activities. The three sectors the company focuses on are life sciences, seals and controls.

Country	United Kingdom
Valuation	£7,094,000
% of total assets	2.1
% of issued share capital held	3.4

(Valuation at 31 December 2006 £7,000,000)

IBS OPENSystems

A dedicated supplier of software solutions to Local Authorities and Housing Organisations throughout the UK. IBS OPENSystems is a market leader with 25 years experience and over 200 customers and over 300 software solutions installed. These include solutions for the collection of local taxes, payment of benefits, housing management, works management, financials and project accounting and more recently workflow and mobile working.

Country	United Kingdom
Valuation	£6,333,000
% of total assets	1.8
% of issued share capital held	9.7

(Valuation at 31 December 2006 £7,020,000)

Phoenix IT Group

Established in 1980, the Group provides a growing range of complementary IT infrastructure support services including systems management, communications, remote telephone support, high-touch field services, project and consultancy services and business continuity and disaster recovery services. Often these services are sold and delivered as a managed service where Phoenix manages complex IT infrastructures to agreed levels of service under long term contracts. In May 2007 Phoenix acquired ICM for £130m in cash and shares, ICM had been a portfolio holding since 2002.

Country	United Kingdom
Valuation	£5,366,000
% of total assets	1.6

(Valuation at 31 December 2006 £4,800,000)

Wilmington Group

One of the UK's leading providers of information and training for professional business markets. The Group provides training, arranges industry events and publishes magazines, directories, databases, and special reports focused primarily on its principal sectors of Legal & Regulatory, Healthcare, Media & Entertainment and Design & Construction.

Country	United Kingdom
Valuation	£5,258,000
% of total assets	1.5
% of issued share capital held	3.0

(Valuation at 31 December 2006 £6,318,000)

Telecom plus

Supplies fixed wire and mobile telecommunications services, gas and electricity to residential and small business customers in the United Kingdom. Telecom plus PLC was incorporated in 1996 and began operations in 1997 providing a unique range of low-cost telephony services to the residential and SOHO markets. They use the collective buying power of lots of individual small users to negotiate bulk buying deals with major suppliers, passing the benefit back to their customers. An advanced billing system means the customer receives a single monthly bill covering all the services provided.

Country	United Kingdom
Valuation	£5,254,000
% of total assets	1.5
% of issued share capital held	4.3

(Valuation at 31 December 2006 £5,974,000)

StatPro Group

A leading provider of portfolio analytics solutions for the global asset management industry. Over the past 13 years, StatPro has developed its products in close collaboration with international asset managers and can offer data and software solutions for risk management, fixed income analysis, performance measurement, attribution analysis, GIPS compliance and reporting. StatPro has around 400 client contracts in 25 countries with 11 offices worldwide. StatPro has grown its recurring revenue from less than £1.0 million in 1999 to £18.7 million in 2007.

Country	United Kingdom
Valuation	£4,400,000
% of total assets	1.3
% of issued share capital held	9.8

(Valuation at 31 December 2006 £4,662,000)

Arc International

One of the world leaders in configurable processor technology. ARC licenses patented configurable multimedia subsystems and CPU/DSP processors that enable customers to design products that give them a strategic competitive advantage in the marketplace. Using ARC's configurable subsystems and cores, licensees can develop highly differentiated ARC-Based™ system-on-chips (SoCs) that consume less power, are less expensive to produce and provide protection from cloning – distinct advantages over non-configurable, ''fixed architecture'' alternatives. ARC's broad product portfolio is used by over 140 customers that collectively ship more than 200 million ARC-Based™ chips every year to high-growth embedded markets. They include wireless computing applications, mobile audio and video players, flash storage devices, digital set-top boxes, networking appliances, electronic toys and educational games, and government satellites.

Country	United Kingdom
Valuation	£4,199,000
% of total assets	1.2
% of issued share capital held	8.1

(Valuation at 31 December 2006 £1,137,000)

M&C Saatchi

Launched in 1995, with the aim of becoming the world's most sought after advertising agency. The company is now the world's largest independent network, with headquarters in London and regional centres covering America, Asia Pacific and Europe. M&C Saatchi employs over 750 people and works for more than 200 clients.

Country	United Kingdom
Valuation	£3,906,000
% of total assets	1.1
% of issued share capital held	5.3

(Valuation at 31 December 2006 £4,347,000)

Alterian

A leading global provider of software for analytics led integrated marketing makes it practical and cost effective for marketers to gain insight into their data and use this to drive an integrated marketing strategy. Alterian was founded in 1997 and created a database technology system which enables data to be processed at very high speeds. Customers include market leaders like Princess Cruises, General Motors, Zurich, HSBC, Dell and Vodafone. The group's technology is sold through an assortment of business partners, that include companies such as Accenture, Experian, and Ogilvy One. Alterian has over 100 employees and is headquartered in Bristol, with North American headquarters in Chicago.

Country	United Kingdom
Valuation	£3,853,000
% of total assets	1.1
% of issued share capital held	7.6

(Valuation at 31 December 2006 £3,752,000)

Euromoney Institutional Investor

The group's principal activity is business publishing that focuses primarily on international finance. It publishes more than 100 magazines, newsletters and journals as well as surveys, directories, books and maps. It also runs conferences, seminars and training courses and provides electronic business information through its capital market databases and emerging markets information services. In October 2006 the Company completed the acquisition of Metal Bulletin plc for £230 million.

Country	United Kingdom
Valuation	£3,740,000
% of total assets	1.1

(Valuation at 31 December 2006 £8,744,000)

SQS Software Quality Systems

Founded in Cologne, Germany, in 1982, SQS has more than 1,000 employees around the world. SQS is Europe's largest independent provider of software testing and quality management services. The company tests web, e-commerce, infrastructure, security and client server applications. With over 4,000 successfully completed projects under its belt, SQS now has approximately 450 customers. Within this high quality customer base are blue-chip enterprises, including half of the DAX 30 companies, 30% of the STOXX-50 and 5 of the top 10 FTSE 100 companies. Spread across several key vertical markets, they include names like Barclays, BP, Credit Suisse, Deutsche Bank, Deutsche Telekom, Mercedes-Benz, and Zurich Group.

Country	United Kingdom
Valuation	£3,738,000
% of total assets	1.1
% of issued share capital held	6.2

(Valuation at 31 December 2006 £1,330,000)

Group NBT

A leading provider of domain names and internet-related services. Established in 1995, the company has registered hundreds of thousands of domain names and hosts tens of thousands of websites. Group NBT's clients come from many industries and include well-known companies such as British Airways, The New Statesman and Centrica. Group NBT plc currently has over 250 employees worldwide spread among the following companies: NetBenefit, provides high quality managed hosting services; NetNames, provides registration services for every Top Level Domain available and providing corporate domain name management to large organisations through its NetNames Platinum Service, which is now used by over 30% of the FTSE 100; Easily.co.uk, a top UK provider of cost effective web hosting and domain name services; Speednames, the dominant provider of domain name services in Denmark; Ascio, which is responsible for the provision of domain name services indirectly through partnerships such as web hosting companies and ISPs; and Envisional, whose services monitor the Internet for brand abuse, fraud, counterfeiting and piracy.

Country	United Kingdom
Valuation	£3,566,000
% of total assets	1.0
% of issued share capital held	7.1

(Valuation at 31 December 2006 £3,528,000)

OMG

A group of technology companies producing image understanding solutions for the entertainment, defence, life science and engineering industries. Be it for capturing the movements of actors (for the movie industry), sportsmen (for video games or improving team performance), children with Cerebral Palsy, rehab patients and animals (for medical, life science and research industries) or virtual reality displays (for engineering and development). The Group trades through three operating subsidiaries – Vicon, the world's biggest motion capture and movement analysis company, 2d3, a manufacturer of specialised image understanding software for entertainment and defence applications and Yotta, a 3D mapping business.

Country	United Kingdom
Valuation	£3,526,000
% of total assets	1.0
% of issued share capital held	9.2

(Valuation at 31 December 2006 £3,291,000)

Alphameric

Alphameric is the fully listed holding company of Alphameric Leisure and Alphameric Hospitality two UK-based solutions specialists, providing enterprise wide solutions to some of the UK's leading organisations. The company's extensive blue chip client base includes many of the UK's leading retailers in the leisure sector such as Coral, Ladbrokes, William Hill, Stanleybet, Totesport and Betfred, and key hospitality brands Costa Coffee, Pret a Manger, Enterprise Inns and TGI Fridays. Alphameric also has a significant investment in the joint venture company Amalgamated Racing. Amalgamated Racing is the owner of certain Licensed Betting Office media rights from 31 British racecourses. The joint venture sells horse racing media rights and services to the bookmaking industry.

Country	United Kingdom
Valuation	£3,443,000
% of total assets	1.0
% of issued share capital held	5.1

(Valuation at 31 December 2006 £2,732,000)

Logitech International

Logitech is a world leader in personal peripherals, driving innovation in PC navigation, Internet communications, digital music, home-entertainment control, gaming and wireless devices. The company's products combine essential core technologies, continuing innovation, award-winning industrial design and excellent value. Logitech started in the OEM sector, which remains an important part of the business, and represented 11 per cent of the company's total sales in Fiscal 2007. Logitech's retail business accounts for 89 per cent of its revenue. The company's original presence and growth in retail was driven by a trend among consumers to enhance their basic desktop PC systems with more fully featured personal peripherals that add functionality and cordless freedom to their desktop. Now, consumers are also purchasing supplementary devices designed for new applications and specific purposes such as gaming, digital music, multimedia and audio and visual communication over the Internet.

Country	Switzerland
Valuation	£3,316,000
% of total assets	1.0

(Valuation at 31 December 2006 £5,289,000)

SSP Holdings

A leading provider of IT solutions to the global insurance and financial services industries. With over two decades' experience, SSP has a reputation for delivering innovative solutions from 'carrier to consumer' that improve business control, productivity and efficiency. More than 41,000 users in over 50 countries use SSP for insurance businesses worldwide. With over 1,400 individual customers, SSP has the largest share, by revenue, of the UK retail general insurance broker and intermediary systems market as well as the largest installed base of general insurance systems in the UK.

Country	United Kingdom
Valuation	£3,292,000
% of total assets	1.0

(Valuation at 31 December 2006 £1,204,000)

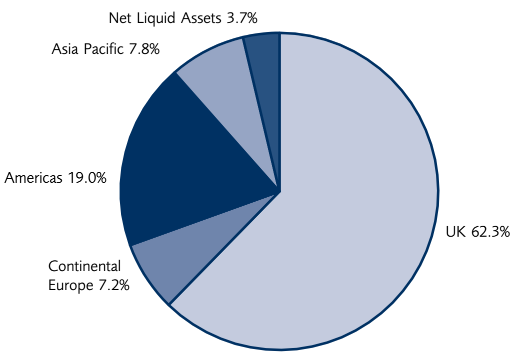
Note: A figure is presented for % of issued share capital held only if greater than 3%.

CLASSIFICATION OF INVESTMENTS

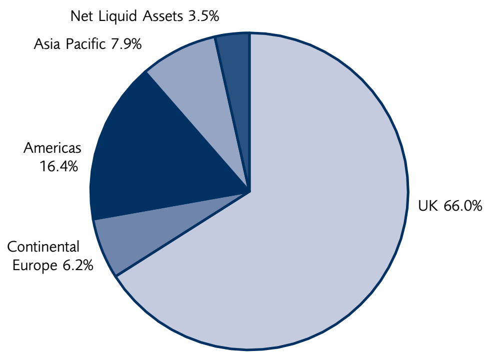
Classification	UK %	Continental Europe %	Americas %	Asia Pacific %	2007 Total %	2006 Total %
EQUITIES: (including convertibles and warrants)						
BASIC MATERIALS	**–**	**–**	**–**	**0.8**	**0.8**	**0.8**
Chemicals	–	–	–	0.8	0.8	0.8
INDUSTRIALS	**6.8**	**0.2**	**0.5**	**2.1**	**9.6**	**12.3**
Aerospace and defence	0.4	–	–	–	0.4	0.4
Electronic and electrical equipment	2.0	0.2	0.3	2.1	4.6	5.1
Support services	4.4	–	0.2	–	4.6	6.8
CONSUMER GOODS	**0.1**	**–**	**0.2**	**–**	**0.3**	**3.1**
Leisure goods	0.1	–	0.2	–	0.3	3.1
HEALTH CARE	**–**	**–**	**0.2**	**–**	**0.2**	**0.5**
Health care equipment and services	–	–	0.2	–	0.2	0.2
Pharmaceuticals and biotechnology	–	–	–	–	–	0.3
CONSUMER SERVICES	**12.1**	**0.8**	**0.7**	**0.2**	**13.8**	**17.5**
Media	11.5	0.8	0.2	0.2	12.7	16.1
Travel and leisure	0.6	–	0.5	–	1.1	1.4
TELECOMMUNICATIONS	**3.0**	**–**	**–**	**–**	**3.0**	**3.9**
Fixed line telecommunications	2.7	–	–	–	2.7	3.5
Mobile telecommunications	0.3	–	–	–	0.3	0.4
FINANCIALS	**0.4**	**0.1**	**–**	**–**	**0.5**	**0.3**
General financial	–	0.1	–	–	0.1	–
Equity investment instruments	0.4	–	–	–	0.4	0.3
INFORMATION TECHNOLOGY	**39.9**	**3.9**	**15.9**	**4.7**	**64.4**	**58.1**
Software and computer services	30.6	1.8	7.5	1.0	40.9	36.6
Technology hardware and equipment	9.3	2.1	8.4	3.7	23.5	21.5
TOTAL EQUITIES (including convertibles and warrants)	**62.3**	**5.0**	**17.5**	**7.8**	**92.6**	
Total equities – 2006 (including convertibles and warrants)	66.0	6.2	16.4	7.9		**96.5**
BONDS	**–**	**2.2**	**1.5**	**–**	**3.7**	**–**
NET LIQUID ASSETS	**3.5**	**0.1**	**–**	**0.1**	**3.7**	**3.5**
TOTAL ASSETS (before deduction of bank loans)	**65.8**	**7.3**	**19.0**	**7.9**	**100.0**	
Total assets – 2006	69.2	6.2	16.4	8.2		**100.0**
BANK LOANS	**–**	**–**	**–**	**–**	**–**	**(5.0)**
EQUITY SHAREHOLDERS' FUNDS	**65.8**	**7.3**	**19.0**	**7.9**	**100.0**	
Equity shareholders' funds – 2006	64.2	6.2	16.4	8.2		**95.0**
Number of equity investments (including convertibles and warrants)	123	20	62	33	238	268

GEOGRAPHICAL SPREAD OF INVESTMENTS

31 December 2007



31 December 2006



DETAILED LIST OF INVESTMENTS

AT 31 DECEMBER 2007

Classification	Name	Value £'000	%
UNITED KINGDOM			
Aerospace and defence	†Cohort	1,415	0.4
Electronic and electrical equipment	†Andor Technology	121	
	†Coe Group	263	
	e2v Technologies	1,141	
	†ID Data	470	
	†Innovision Research & Technology	1,449	
	†Orpak Systems	856	
	†Screen Technology	51	
	†SPI Lasers	859	
	†Vigilant Technology	70	
	Xaar	1,709	
		6,989	2.0
Support services	Acal	743	
	†Datacash Group	1,878	
	Diploma	7,094	
	†Eckoh Technologies	598	
	†Maintel Holdings	836	
	†Opsec Security	2,387	
	†Tangent Communications	481	
	†Thirdforce	890	
	†Xpertise Group	283	
		15,190	4.4
Leisure goods	Alba	343	
	†Bright Things	39	
		382	0.1
Media	†Apace Media	300	
	Bloomsbury Publishing	1,515	
	†Burst Media	287	
	Centaur Media	1,395	
	Chime Communications	2,409	
	†Coolabi	723	
	Creston	469	
	†Digital Marketing Group	876	
	Euromoney Institutional Investor	3,740	
	†Expomedia Group	540	
	†First Artist	308	
	†Freshwater UK	476	
	†Independent Media Distribution	368	
	†Independent Media Support Group	95	
	†Interactive Prospect Targeting	1,650	
	ITE Group	1,075	
	†JumpTV	602	
	†Local Radio Company	1,465	
	†M&C Saatchi	3,906	
	†Media Corporation	443	
	†Pixel Interactive Media	781	
	Quarto Group	2,954	
	†Research Now	848	
	† ¶Screen Fx	124	
	†Ten Alps	2,490	
	†Thomson Intermedia	2,538	
	†TMN Group	560	
	†Touch Group	528	
	†UBC Media Group	508	
	Wilmington Group	5,258	
	† ¶Yoomedia	12	
		39,243	11.5
Travel and leisure	†Mama Group	2,034	0.6

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2007

Classification	Name	Value £'000	%
UNITED KINGDOM (continued)			
Fixed line telecommunications	†Alternative Networks	3,272	
	†Pipex Communications	762	
	†Spectrum Interactive	118	
	Telecom plus	5,254	
		9,406	2.7
Mobile telecommunications	†2 Ergo Group	889	
	† Broca	177	
		1,066	0.3
Non-life insurance	*‡Culver Holdings	36	–
Equity investment instruments	*Herald Investment Management Ltd	207	
	*Herald Ventures 2	1,259	
	*HIML Jersey Ltd	–	
		1,466	0.4
Software and computer services	†@UK	58	
	Alphameric	3,443	
	Alterian	3,853	
	†Atlantic Global	75	
	†Bango	440	
	†Business Control Solutions	293	
	†Clarity Commerce Solutions	291	
	†Datatec	1,472	
	†Dealogic	1,088	
	Detica Group	7,865	
	Dicom Group	1,660	
	Electronic Data Processing	987	
	Gresham Computing	1,514	
	†Group NBT	3,566	
	*Harrier Group	343	
	†IBS OPENSystems	6,333	
	†IDOX	2,921	
	Intec Telecom Systems	1,597	
	†Intechnology	1,139	
	†Intelligent Environments	800	
	†Invu	1,578	
	Kewill Systems	978	
	†Manpower Software	1,636	
	†Maxima Holdings	2,691	
	†Mediasurface	163	
	Northgate Information Solutions	16,969	
	†OMG	3,526	
	†OneClickHR	251	
	†Patsystems	1,664	
	Phoenix IT Group	5,366	
	†Portrait Software	429	
	†RCG Holdings	968	
	†Redline Communications	624	
	†Redstone	687	
	RM	1,620	
	SDL	11,534	
	Servicepower Technologies	495	
	†SQS Software Quality Systems	3,738	
	†SSP Holdings	3,292	
	†Silanis International	441	
	†StatPro Group	4,400	
	†Strategic Thought Group	595	
	†Xploite	920	
	* † ‡Zoo Digital Group	687	
		104,990	30.6

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2007

Classification	Name		Value £'000	%
UNITED KINGDOM (continued)				
Technology hardware and equipment	†Amino Technologies		1,150	
	Arc International		4,199	
	BATM Advanced Communications		992	
	†Celoxica Holdings		320	
	CML Microsystems		196	
	Imagination Technologies Group		15,402	
	†IQE		3,222	
	†Itis		546	
	†MTI Wireless Edge		780	
	†Nanoscience		1,263	
	Northamber		1,836	
	Plasmon		839	
	†Sandvine		950	
	*UbiNetics		–	
	Zetex		105	
			31,800	9.3
	TOTAL UNITED KINGDOM EQUITIES		214,017	62.3
CONTINENTAL EUROPE				
Electronic and electrical equipment	Eltek	Norway	326	
	Nordic Semiconductor	Norway	278	
			604	0.2
Media	High Co	France	357	
	NRJ Group	France	1,044	
	PubliGroupe	Switzerland	562	
	Roularta Media Group	Belgium	922	
			2,885	0.8
General financial	Inspire Investments	Israel	199	0.1
Software and computer services	*Atex	Norway	–	
	Horizon Technology Group	Ireland	250	
	InfoVista	France	657	
	Iona Technologies	Ireland	491	
	Isra Vision Systems	Germany	566	
	LBI International	Sweden	672	
	SkillSoft	Ireland	192	
	Trolltech	Norway	465	
	United Internet	Germany	2,930	
			6,223	1.8
Technology hardware and equipment	Icos Vision Systems	Belgium	3,232	
	Logitech International	Switzerland	3,316	
	SEZ Holding	Switzerland	512	
	Soitec	France	306	
			7,366	2.1
	TOTAL CONTINENTAL EUROPEAN EQUITIES		17,277	5.0
AMERICAS				
Electronic and electrical equipment	Benchmark Eltn.		428	
	Powerwave Technologies		467	
	RF Monolithics		313	
			1,208	0.3
Support services	Harris Interactive		639	0.2
Leisure goods	THQ		637	0.2
Health care equipment and services	SonoSite		675	0.2
Media	Jupitermedia		806	
	Multivision Communications	Canada	1	
			807	0.2

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2007

Classification	Name	Value £'000	%
AMERICAS (continued)			
Travel and leisure	Ctrip.com International	1,727	0.5
Software and computer services	Advent Software	2,713	
	Aladdin Knowledge Systems	2,230	
	Descartes Systems Group	1,166	
	Epiq Systems	2,624	
	Falconstor Software	564	
	Fundtech	1,479	
	Ilinc Communications	720	
	Intraware	440	
	Keynote Systems	1,197	
	Liveperson	536	
	Macrovision	1,381	
	Mentor Graphics	812	
	Netease.com	381	
	NetScout Systems	2,247	
	PDF Solutions	430	
	Pegasystems	598	
	Retalix	882	
	¶Smart Online	985	
	Supportsoft	981	
	Websense	1,834	
	Website Pros	1,452	
		25,652	7.5
Technology hardware and equipment	Actel	2,005	
	Adaptec	425	
	*Adaptive Broadband	3	
	Alvarion	1,145	
	Anadigics	2,383	
	Arris Group	876	
	Asyst Technologies	309	
	Atmi	1,620	
	CAM Commerce Solutions	945	
	Emulex New	902	
	Exar	221	
	Extreme Networks	2,175	
	Finisar	485	
	Harris Stratex Net	461	
	Lantronix	382	
	Micros Systems	1,762	
	Mindspeed Techs	844	
	MIPS Technologies	743	
	Mobility Electronics	384	
	MRV Communications	1,439	
	NMS Communications	350	
	Power Integrations	346	
	Rackable Systems	251	
	Radware	214	
	Rimage	391	
	RIT Technologies	63	
	Silicon Image	159	
	Silicon Motion Technology	1,758	
	Sonicwall	2,396	
	STEC	1,317	
	Supertex	1,251	
	Virage Logic	838	
		28,843	8.4
	TOTAL AMERICAN EQUITIES	60,188	17.5

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2007

Classification	Name			Value £'000	%
ASIA PACIFIC					
Chemicals	Nepes	Korea		610	
	Techno Semichem	Korea		1,958	
				2,568	0.8
Electronic and electrical equipment	Dae Duck Electronics	Korea		380	
	Fine Dnc	Korea		659	
	Huan Hsin	Singapore		708	
	Innotek	Singapore		716	
	Simm Tech	Korea		839	
	¶Surface Mount Technology	Singapore		252	
	Tripod Technology	Taiwan		1,004	
	UJU Electronics	Korea		833	
	Unimicron Technology	Taiwan		1,126	
	Wooree ETI	Korea		655	
				7,172	2.1
Media	Star Publications	Malaysia		676	0.2
Software and computer services	BSE Holdings	Korea		628	
	Cyberlink	Korea		405	
	Reckon	Australia		1,571	
	Springsoft	Taiwan		956	
				3,560	1.0
Technology hardware and equipment	Ardentec	Taiwan		430	
	Core Logic	Korea		303	
	D-Link	Taiwan		1,992	
	EMW Antenna	Korea		383	
	Gemtek Technology	Taiwan		533	
	Global Testing	Singapore		576	
	Jadason Enterprises	Singapore		878	
	KH Vatec	Korea		1,146	
	King Yuan Electronics	Taiwan		335	
	Kinsus Interconnect Technology	Taiwan		688	
	Min Aik Technology	Taiwan		690	
	Mitac International	Taiwan		862	
	Phicom	Korea		701	
	Powertech Technology	Taiwan		1,989	
	STS Semiconductor and Telecommunications	Korea		348	
	ZyXEL Communications	Taiwan		753	
				12,607	3.7
	TOTAL ASIA PACIFIC EQUITIES			26,583	7.8
	Value of equity stocks		317,659		
	Convertible loan stocks having an element of equity		405		
	Warrants having an element of equity		1		
TOTAL EQUITY INVESTMENTS				318,065	92.6
FIXED INTEREST	Bundesrepublik Deutschland $5\frac{1}{4}$% 2010		7,545		
	US Treasury Note $4\frac{1}{2}$% 2010		5,223		
TOTAL FIXED INTEREST				12,768	3.7
NET LIQUID ASSETS				12,664	3.7
TOTAL ASSETS AT MARKET VALUE				343,497	100.0

(† denotes holding listed on AIM)
(* denotes unlisted security)
(‡ denotes holding wholly or partly in convertible loan stock)
(¶ denotes holding wholly or partly in warrants)

TEN YEAR RECORD

CAPITAL

At 31 December	Total assets £'000	Bank loans £'000	Equity shareholders' funds £'000	Net asset value per share p	Diluted net asset value per share* p	Share price p	Warrant price p	(Discount)/ premium† %
1997	147,424	–	147,424	177.84	171.80	136.00	60.50	(20.8)
1998	170,982	–	170,982	206.25	201.70	161.50	77.50	(19.9)
1999	432,620	(3,343)	429,277	517.44	494.22	511.00	411.00	3.4
2000	378,607	(3,233)	375,374	447.55	431.43	491.00	382.50	13.8
2001	275,624	(2,892)	272,732	322.94	314.53	306.00	212.50	(2.7)
2002	199,900	(22,310)	177,590	210.23	206.68	177.00	79.00	(14.4)
2003	350,209	(29,325)	320,884	365.44	365.44	325.25	–	(11.0)
§2004	356,874	(24,663)	332,211	379.43	379.43	322.75	–	(14.9)
2005	358,293	–	358,293	409.22	409.22	379.75	–	(7.2)
2006	401,228	(20,000)	381,228	435.41	435.41	383.50	–	(11.9)
2007	**343,497**	**–**	**343,497**	**394.96**	**394.96**	**312.00**	**–**	**(21.0)**

* The diluted net asset value per ordinary share figures have been calculated in accordance with FRS14.
† (Discount)/premium is the difference between Herald's quoted share price and its underlying diluted net asset value.
§ The figures prior to 2004 have not been restated for the changes in accounting policies implemented in 2005.

REVENUE / GEARING RATIOS

Period to 31 December	Gross revenue £'000	Available for ordinary shareholders £'000	Earnings per ordinary share net** p	Dividend per ordinary share net p	Expense ratio†† %	Actual gearing‡‡	Potential gearing§§
1997	3,185	1,118	1.35	0.85	1.29	92	100
1998	3,845	1,134	1.37	0.90	1.36	94	100
1999	3,658¶	717	0.86	0.85	0.95	93	101
2000	6,508	778	0.93	0.85	1.40	86	101
2001	4,728	1,145	1.36	0.85	1.07	84	101
2002	3,539	627	0.74	0.85	1.21	108	113
2003	3,882	276	0.32	0.30	1.20	103	109
2004	4,776	301	0.34	0.30	1.20	97	107
2005	5,368	556	0.64	0.60	1.16	97	100
2006	6,492	1,922	2.19	1.20	1.13	102	105
2007	**5,167**	**(1,370)**	**(1.57)**	**0.50**	**1.25**	**93**	**100**

** The calculation of earnings per ordinary share is based on the revenue from ordinary activities after taxation and the weighted average number of ordinary shares in issue (see note 8, page 42).
†† Ratio of total operating costs against average shareholders' funds.
‡‡ Total assets (including all debt used for investment purposes) less all cash and fixed interest securities (excluding convertibles) divided by shareholders' funds.
§§ Total assets (including all debt used for investment purposes) divided by shareholders' funds.
¶ Restated for the adoption of FRS16 ''Current Tax''.

CUMULATIVE PERFORMANCE (taking 1997 as 100)

At 31 December	Diluted net asset value per share†	Share price	Benchmark¶¶	Hoare Govett Smaller Cos & AIM Index	Russell 2000 Technology Index	Earnings per ordinary share	Dividend per ordinary share net	Retail price index
1997	100	100	100	100	100	100	100	100
1998	117	119	99	91	111	101	106	103
1999	288	376	169	141	234	64	100	105
2000	251	361	149	135	150	69	100	108
2001	183	225	125	111	120	101	100	108
2002	120	130	83	82	58	55	100	112
2003	213	239	117	114	86	24	35	115
2004	221	237	126	133	76	25	35	119
2005	238	279	151	163	83	47	71	121
2006	253	282	169	195	83	162	141	127
2007	**230**	**229**	**163**	**181**	**85**	**(116)**	**59**	**132**

Compound Annual Returns

5 year	13.8%	12.0%	14.5%	17.2%	7.8%	N/A	(10.1)%	3.4%
10 year	8.7%	8.7%	5.0%	6.1%	(1.7)%	N/A	(5.2)%	2.8%

Past performance is no guarantee of future performance.
The figures prior to 2004 have not been restated for the changes in accounting policies implemented in 2005.
¶¶From 1 January 2006 the benchmark was charged to $^2/_3$ Hoare Govett Smaller Companies Index plus AIM (capital gains on investment companies) and $^1/_3$ Russell 2000 (small cap) Technology Index (in sterling terms).

DIRECTORS' REPORT

The Directors present their report and accounts for the year ended 31 December 2007.

Business Review

Business and Status

The Company is an investment company within the meaning of Section 266 of the Companies Act 1985.

The Company carries on business as an investment trust. It was approved by HM Revenue & Customs as an investment trust under Section 842 of the Income and Corporation Taxes Act 1988 for the year ended 31 December 2006, subject to any matters that may arise from any subsequent enquiry by HM Revenue & Customs into the Company's tax returns. In the opinion of the Directors the Company has conducted its affairs so as to enable it to continue to obtain such approval and it will continue to seek approval under Section 842 of the Income and Corporation Taxes Act 1988 each year.

Investment Policy

Herald's objective is to achieve capital appreciation through investments in smaller quoted companies, in the areas of telecommunications, multi-media and technology (TMT). Investments may be made across 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.

While the policy is global investment in the above target areas the approach is to construct a diversified portfolio through the identification of individual companies which offer long term growth potential, typically over a five year horizon or more. The portfolio is actively managed and does not seek to track any benchmark. With a remit to invest in smaller companies with market capitalisation generally below £1bn, there tends to be a correlation with the performance of smaller companies, as well as those of the technology sector. A degree of volatility relative to the overall market should be expected.

The risk associated with the illiquidity of smaller companies is reduced by generally restricting the stake in any one company to less than 10% of the shares in issue. A number of investments are in early stage companies, which have a higher stock specific risk but the potential for above average growth. Stock specific risk is reduced by having a diversified portfolio of over 200 holdings. In addition, to contain the risk of any one holding, the Manager generally takes profits when a holding reaches more than 5% of the portfolio. The Manager actively manages the exposure within the constraint that illiquid positions cannot be traded for short term movements.

The Company has a policy not to invest more than 15% of gross assets in other UK listed investment companies.

From time to time, fixed interest holdings, non equity or unlisted investments may be held on an opportunistic basis.

The current maximum gearing limit is 30% and the Board is proposing to seek shareholder approval at the Annual General Meeting to increase this maximum gearing limit to 50%. If this proposal is approved at the Annual General Meeting, it would enable utilisation of gearing at up to the 30% level with reduced risk of forced selling in the short term in an adverse market. Borrowings are invested primarily in equity markets but the Manager will be entitled to invest in other securities in the companies in the target areas when it is considered that the investment grounds merit the Company taking a geared position. The Board's intention is to gear the portfolio when appropriate with borrowings to around 30% of net assets. Gearing levels are monitored closely by the Manager and reviewed by Directors at each Board Meeting.

The Company may use derivatives which will be principally, but not exclusively, for the purpose of efficient portfolio management (i.e. for the purpose of reducing, transferring or eliminating investment risk in its investments, including protection against currency risk).

A detailed analysis of the Company's investment portfolio is set out on pages 15 to 19 and in the Investment Manager's Report.

Performance

At each Board meeting, the Directors consider a number of performance measures to assess the Company's success in achieving its objectives.

The key performance indicators (KPIs) used to measure the progress and performance of the Company over time are established industry measures and are as follows:

- the movement in net asset value per ordinary share compared to the benchmark;
- the movement in the share price;
- the discount; and
- the total expense ratio.

A historical record of these measures are shown on pages 2, 3 and 20.

In addition to the above, the Board considers peer group comparative performance.

A review of the year and the investment outlook is contained in the Chairman's Statement and the Investment Manager's Report on pages 5 to 10.

Principal Risks and Uncertainties

The principal risks facing the Company relate to the Company's investment activities. An explanation of these risks and how they are managed are contained in note 18 to the accounts on pages 45 to 49.

The Company operates as an investment trust company in accordance with Section 842 of the Income and Corporation Taxes Act 1988. As such, the Company is exempt from capital gains tax on the sale of its investments. The Manager monitors investment movements and the Secretaries monitor the level of forecast income and expenditure and the amount of proposed dividends to ensure the provisions of Section 842 are not breached. An explanation of market risk, (other price, interest rate and foreign currency), credit risk and liquidity risk and how they are managed are contained in note 18 to the accounts on pages 45 and 49.

Financials

The financial highlights for the year under review are as follows: the net asset value per share decreased by 9.3% during the year, compared to a decrease in the benchmark of 4.0%, the dividend decreased by 58.3% to 0.50p per share and the discount widened from 11.9% to 21.0%.

Results and Dividend

The net revenue loss after tax was £1,370,000 (2006 – net revenue return of £1,922,000) and the capital loss £32,947,000 (2006 – capital return of £21,538,000) giving a total loss of £34,317,000 (2006 – total return of £23,460,000) for the period.

The Directors recommend a dividend of 0.50p per Ordinary share for the year ended 31 December 2007, which, if approved at the Annual General Meeting, will be payable on 1 May 2008 to holders registered on 11 April 2008. The ex-dividend date is 9 April 2008.

The net asset value (NAV) of the Company at 31 December 2007 represented a value of 395.0p per Ordinary share. This represented a decrease of 9.3% during the year and a rise of 300.2% since the date of committal of funds (16 February 1994) after allowing for launch expenses of 1.3p per share.

The Board

The Directors at the year end, and their interests in the Company, all of which are beneficially owned, were as follows:

	Number of Ordinary Shares	
Name	**31 December 2007**	**31 December 2006**
Martin Boase	50,000	50,000
Clay Brendish	14,700	14,700
Timothy Curtis	2,000	2,000
Douglas McDougall	225,000	225,000

Mr C J Cazalet held 25,000 shares at the date of his appointment, 18 January 2008. There have been no changes intimated in the above Directors' interests up to 29 February 2008.

Mr T M Curtis and Mr D C P McDougall retire by rotation and, being eligible, offer themselves for re-election.

In accordance with the Combined Code on Corporate Governance Mr M Boase, who is 75 and who has served on the Board for more than nine years, retires and offers himself for re-election.

The Board has reviewed the performance of Messrs Boase, Curtis and McDougall. Their performance continues to be effective and each remains committed to the Company. Their contribution to the Board is valued highly and the Board recommends their re-election to shareholders.

Mr C J Cazalet was appointed to the Board on 18 January 2008. His appointment falls to be confirmed at the Annual General Meeting.

Management and Administration

For the entire year under review the management of the Company was contracted to Herald Investment Management Limited ('HIML'). HIML is authorised and regulated by the Financial Services Authority.

The management contract is subject to 12 months' notice by either party. The senior director of HIML with prime responsibility for the management of Herald Investment Trust is Katie Potts, who is also a substantial shareholder of HIML. HIML is remunerated at a monthly rate of 0.08333% of the Company's net asset value calculated using middle market prices. Compensation fees would only be payable in respect of this 12 month period if termination were to occur sooner.

At 31 December 2007 the Company was the beneficial owner of 13.86% of the Ordinary share capital of HIML Holdings.

Administration of the Company and its investments is contracted by HIML to Baillie Gifford & Co, who also act as Company Secretary.

Custody of investments is contracted to The Bank of New York Mellon.

The Board considers the Company's investment management and secretarial arrangements for the Company on an ongoing basis and a formal review is conducted annually. The Board considers, amongst others, the following topics in its review: investment performance in relation to the investment policy and strategy; the continuity of personnel managing the assets and reporting to the Board; the level of service provided in terms of the accuracy and timeliness of reports to the Board and the frequency and quality of both verbal and written communications with shareholders. Following the most recent review the Board is of the opinion that the continued appointment of Herald Investment Management Limited as investment manager, on the terms agreed, is in the interests of shareholders due to the experience of the Manager and the quality of information provided to the Board.

Significant Shareholdings

At 29 February 2008 the Directors have been notified of the following major shareholdings in the Company:

Name	Ordinary Shares	% of issue
Asset Value Investors Limited (Indirect)*	6,103,115	7.0
HBOS plc (Direct)	4,198,477	4.8
(Indirect)	1,535,227	1.8
Rathbone Brothers Plc (Indirect)	4,306,555	5.0
Legal & General Group Plc (Direct)	3,519,006	4.0

* Includes British Empire Securities & General Trust plc.

Payment of Suppliers

It is the Company's payment policy to obtain the best possible terms for all business. The Company negotiates with its suppliers the terms on which business will take place and abides by such terms.

The Company did not have any trade creditors at 31 December 2006 or 2007.

Disclosure of Information to Auditors

The Directors confirm that so far as each of the Directors is aware there is no relevant audit information of which the Company's auditors are unaware and the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Independent Auditors

The Auditors, Ernst & Young LLP, are willing to continue in office and in accordance with sections 385 and 390A of the Companies Act 1985 resolutions concerning their reappointment and remuneration will be submitted to the Annual General Meeting.

Share Capital

Capital Structure

At 31 December 2007 the Company's capital structure consisted of 86,971,010 Ordinary shares of 25p each (2006 – 87,556,010 Ordinary shares).

Dividends

The Ordinary shares carry a right to receive dividends which are declared from time to time by an ordinary resolution of the Company (up to the amount recommended by the Directors) and to receive any interim dividends which the Directors may resolve to pay.

Capital entitlement

On a winding up, after meeting the liabilities of the Company, the surplus assets will be paid to ordinary shareholders in proportion to their shareholdings.

Voting

On a show of hands, every ordinary shareholder present in person or by proxy has one vote and on a poll every ordinary shareholder present in person has one vote for every share he/she holds and a proxy has one vote for every share in respect of which he/she is appointed.

Information on the deadlines for proxy appointments can be found on page 51.

Annual General Meeting

At the Annual General Meeting of the Company to be held on 22 April 2008 the following resolutions will be proposed as special business.

Authority to Repurchase the Company's Ordinary Shares

At the Company's Annual General Meeting held on 25 April 2007 it was resolved that the Company be authorised to purchase in the market up to 13,058,689 Ordinary shares (14.99% of its Ordinary share capital in issue at that time). During the year to 31 December 2007 the Company bought back 585,000 Ordinary shares (nominal value £146,250 which comprised 0.67% of the issued share capital at 1 January 2007) on the London Stock Exchange for cancellation. Between 1 January 2008 and the date of this report, the Company bought back a further 884,487 Ordinary shares (nominal value £221,122 which comprised 1.02% of the issued share capital at 1 January 2008) on the London Stock Exchange for cancellation. The Board continues to believe, however, that the ability of the Company to purchase its own Ordinary shares in the market will potentially benefit all shareholders of the Company. The repurchase of Ordinary shares at a discount to the underlying net asset value ("NAV") should enhance the NAV per Ordinary share of the remaining shares and may also enable the Company to address more effectively any imbalance between supply and demand for the Company's Ordinary shares.

Accordingly, the Directors are now recommending in Resolution 10 that this authority to purchase the Company's own Ordinary shares should be renewed and should now expire at the Company's Annual General Meeting to be held in 2009. Authority will be sought to purchase up to 14.99% of the Company's Ordinary shares in issue at the date of the passing of the resolution (the maximum permitted under the Listing Rules of the UK Listing Authority) at a price that is not less than 25p per share (the nominal value of each share) and must not exceed the higher of (a) 105% of the average of the middle market quotation (as derived from the Daily Official List of the London Stock Exchange) for the five business days immediately preceding the day of purchase and (b) the higher of the last independent trade and the highest current independent trade on the London Stock Exchange. The authority being sought, the full text of which can be found in Resolution 10 in the Notice of Annual General Meeting, will last until the date of the Annual General Meeting in 2009. The decision as to whether the Company repurchases any shares will be at the absolute discretion of the Board and will only be considered when it is in the interests of the Company and its shareholders as a whole. It is the intention that purchases will only be made at a discount to net asset value.

Changes to the Articles of Association

Conflicts of interest

The Directors are asking shareholders to approve Resolution 11 which contains some amendments to the Articles of Association to reflect the provisions of section 175 of the Companies Act 2006, which relates to conflicts of interest.

The Companies Act 2006 sets out directors' general duties which largely codify the existing law but with some changes. Under the Companies Act, from 1 October 2008 a director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict with the Company's interests. The requirement is very broad and could apply, for example, if a director becomes a director of another company or a trustee of another organisation. The Companies Act 2006 allows directors of public companies to authorise conflicts and potential conflicts, where appropriate, where the Articles of Association contain a provision to this effect. The Companies Act 2006 also allows the Articles of Association to contain other provisions for dealing with directors' conflicts of interest to avoid a breach of duty. This change to the Articles of Association, to take effect from 1 October 2008, would give the Directors authority to approve such situations and to include other provisions to allow conflicts of interest to be dealt with in a similar way to the current position.

There are safeguards which will apply when Directors decide whether to authorise a conflict or potential conflict. First, only Directors who have no interest in the matter being considered will be able to take the relevant decision, and secondly, in taking the decision the Directors must act in a way they consider, in good faith, will be most likely to promote the Company's success. The Directors will be able to impose limits or conditions when giving authorisation if they think this is appropriate.

It is also proposed that the Articles of Association should contain provisions relating to confidential information, attendance at board meetings and availability of board papers to protect a Director being in breach of duty if a conflict of interest or potential conflict of interest arises. These provisions will only apply where the position giving rise to the potential conflict has previously been authorised by the Directors and will take effect from 1 October 2008.

Increase in maximum level of gearing

An amendment to the Company's Articles of Association is being proposed in Resolution 12 in the Notice of Annual General Meeting to provide greater flexibility in the Company's gearing strategy. The proposed amendment is to increase the maximum level of gearing from the current level of 30% to 50% of shareholders' funds.

Recommendation

The Directors unanimously recommend all holders to vote in favour of all the resolutions to be proposed at the Annual General Meeting by completing and returning the enclosed form of proxy. The proxy form should be returned to the Company's Registrar as soon as possible but in any event so as to arrive no later than 48 hours before the time of the Annual General Meeting.

By order of the Board
Baillie Gifford & Co
Secretaries

3 March 2008

DIRECTORS' REMUNERATION REPORT

Directors' Remuneration Report

The Board has prepared this report, in accordance with the requirements of Schedule 7A to the Companies Act 1985. An ordinary resolution for the approval of this report will be put to the members at the forthcoming Annual General Meeting.

The law requires the Company's auditors to audit certain of the disclosures provided. Where disclosures have been audited, they are indicated as such. The Auditors' opinion is included in their report on pages 33 and 34.

Remuneration Committee

The Company currently comprises five Directors, including Mr C J Cazalet who was appointed to the Board on 18 January 2008, all of whom are non-executive (see page 4). There is no separate remuneration committee and the Board as a whole considers changes to Directors' fees from time to time. The Company Secretary, Baillie Gifford & Co, provides advice when the Board considers the level of Directors' fees.

Policy on Directors' Fees

The Board's policy is that the remuneration of Directors should be set at a reasonable level that is commensurate with the duties and responsibilities of the role and consistent with the requirement to attract and retain Directors of the appropriate quality and experience. It should also reflect the experience of the Board as a whole, be fair and comparable to that of other investment trusts that are similar in size. It is intended that this policy will continue for the year ending 31 December 2008 and subsequent years.

The fees for the non-executive Directors are determined within the limits set out in the Company's Articles of Association. Shareholders' approved an increase of the aggregate limit to £100,000 at the Annual General Meeting held on 14 April 2004. Non-executive Directors are not eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits.

The Board carried out a review of the level of Directors' fees during the year and concluded that the fees should remain unchanged at £22,500 for the Chairman and £15,000 for each Director.

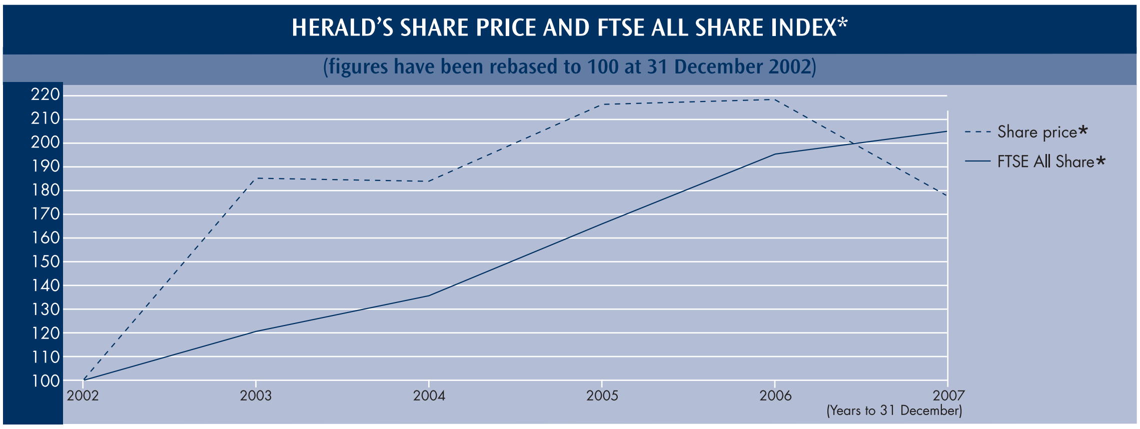
Directors' Service Contracts

It is the Board's policy that none of the Directors has a service contract. All of the Directors have been provided with appointment letters. The terms of their appointment provide that a Director shall retire and be subject to re-election at the first Annual General Meeting after their appointment. Directors are thereafter obliged to retire by rotation, and, if they wish, to offer themselves for re-election, at least every three years after that. There is no notice period and no provision for compensation upon early termination of appointment.

	Date of appointment	Due date for election/ re-election
Martin Boase	11 January 1994	AGM 2008
Clay Brendish	23 July 2001	AGM 2009
Timothy Curtis	22 July 2004	AGM 2008
Douglas McDougall	13 February 2002	AGM 2008
Julian Cazalet	18 January 2008	AGM 2008

Company Performance

The graph below compares, for the five financial years ended 31 December 2007, the total return (assuming all dividends are reinvested) to ordinary shareholders compared to the total shareholder return on a notional investment made up of shares in the component parts of the FTSE All-Share Index. This index was chosen for comparison purposes, as it is the best measure of performance for UK listed companies.



Source: Thomson Financial Datastream

*Total return (assuming all dividends are reinvested).

Past performance is no guarantee of future performance.

Directors' Emoluments for the Year (audited)

The Directors who served in the year received the following emoluments in the form of fees:

	Fees 2007 £	Fees 2006 £
Directors who served during the year:		
Martin Boase (Chairman)	22,500	22,500
Clay Brendish	15,000	15,000
Timothy Curtis	15,000	15,000
Douglas McDougall	15,000	15,000
	67,500	67,500

Sums Paid to Third Parties (audited)

The Directors' fees payable to Mr C M Brendish for the year to 31 December 2006, were paid to Technology Management Services. The payment was for making his services available as a Director of the Company.

Approval

The Directors' Remuneration Report on pages 26 and 27 was approved by the Board of Directors on 19 February 2008 and signed on its behalf by

Martin Boase
Chairman

CORPORATE GOVERNANCE

Compliance

The Board is committed to achieving and demonstrating high standards of Corporate Governance. This statement outlines how the principles of The Combined Code on Corporate Governance, published in June 2006 (the ''Combined Code'') were applied throughout the financial year.

The Board believes that the Company has complied throughout the year with the provisions of the Combined Code, except that no limit has been imposed on the overall length of service of Directors.

The Directors recognise the importance of succession planning for company boards and the Board composition is reviewed annually. The Board is of the view that length of service will not necessarily compromise the independence or contribution of Directors of an investment trust company where continuity and experience can be a benefit to the Board. Consequently, no limit has been imposed on the overall length of service. All Directors are, however, required to retire and, if appropriate seek re-election at least every three years. Directors who have more than nine years' service submit themselves for re-election annually.

The Board is also adhering to the principles of the AIC Code in all material respects.

The Board

The Board has overall responsibility for the Company's affairs. It has a number of matters reserved for its approval including strategy, approval of the financial statements, investment policy, borrowings, gearing, treasury matters, dividend and corporate governance policy. The Board also reviews the investment transactions, revenue budgets and performance. Full and timely information is provided to the Board to enable the Board to function effectively and to allow directors to discharge their responsibilities.

The Board currently comprises five Directors, including Mr C J Cazalet who was appointed to the Board on 18 January 2008, all of whom are non-executive. The executive responsibilities for investment management and administration have been delegated to Herald Investment Management Limited ('HIML') and Baillie Gifford & Co respectively, and in the context of a Board comprised entirely of non-executive Directors, there is no chief executive officer. Mr D C P McDougall is the senior independent director.

The Directors believe that the Board has a balance of skills and experience which enable it to provide effective leadership and proper governance of the Company. Information about the Directors, including their relevant experience, can be found on page 4.

There is an agreed procedure for Directors to seek independent professional advice if necessary at the Company's expense. The Company also maintains Directors' and Officers' Liability insurance.

Independence of Directors

All the Directors, with the exception of Mr C J Cazalet, are considered by the Board to be independent of the Manager and free of any business or other relationship which could interfere with the exercise of their independent judgement.

The Chairman, Martin Boase, was independent at the date of his appointment and, notwithstanding that Mr Boase holds 6.03% of the ordinary share capital of the investment management company, the Board has concluded that he continues to be independent. The Board believes that Mr Boase's shareholding has not, in the past, given rise to a conflict of interest or affected his independent judgement, nor is it expected to do so in the future. As Mr Boase has been a Director for more than nine years and is over 70 years of age, he has agreed to offer himself for re-election annually. The Board subscribes to the view expressed in the AIC Code that long-serving directors should not be prevented from being considered as independent. Following a formal performance evaluation, the Board is of the view that Mr Boase continues to be independent. The Board considers that none of Mr Boase's other commitments interfere with the discharge of his responsibilities to the Company and is satisfied that he makes sufficient time available to serve the Company effectively. There has been no significant change to the Chairman's other commitments during the year.

Meetings

There is an annual cycle of Board meetings which is designed to address in a systematic way overall strategy, review of investment policy, investment performance, marketing, revenue budgets, dividend policy and communication with shareholders. The Board considers that it meets sufficiently regularly to discharge its duties effectively. The table below shows the attendance record for the Board and Committee meetings held during the year. All the Directors attended the Annual General Meeting.

	Board	Audit Committee	Nomination Committee
Number of meetings	**4**	**2**	**1**
Martin Boase	4	2	1
Clay Brendish	3	2	1
Timothy Curtis	4	2	1
Douglas McDougall	4	2	1

Nomination Committee

The Nomination Committee consists of all the Directors and the Chairman of the Board is Chairman of the Committee. The Committee meets on an annual basis and at such other times as may be required. The Committee has written terms of reference which include reviewing the Board, identifying and nominating new candidates for appointment to the Board, Board appraisal, succession planning and training. The Committee also considers whether Directors should be recommended for re-election by shareholders. The terms of reference are available on request and on the Manager's website: **www.heralduk.com**.

The Nomination Committee reviewed the Directors' balance of skills, knowledge and experience during the year and concluded that the Board would be strengthened by the appointment of an additional Director. Mr C J Cazalet was identified as the preferred candidate due to his experience in corporate finance and his extensive knowledge of investment trusts. Following an initial meeting with the Chairman, he was interviewed by the other members of the Nomination Committee. At the conclusion of this process he was appointed to the Board with effect from 18 January 2008.

Given the quality of the candidate identified, it was unnecessary to either appoint external search consultants or use open advertising on this occasion.

Performance Evaluation

The Nomination Committee met to assess the performance of the Chairman, each Director, the Board as a whole and its committees, after inviting each Director and the Chairman to consider and respond to a set of questions. The appraisal of the Chairman was led by Mr D C P McDougall. The appraisals and evaluations considered amongst other criteria, the balance of skills of the Board, the contribution of individual Directors and the overall effectiveness of the Board and its Committees. Following this process it was concluded that the performance of each Director, the Chairman, the Board and its Committees continues to be effective and each Director and the Chairman remain committed to the Company.

Terms of Appointment and Re-election

Letters which specify the terms of appointment, are issued to Directors. The letters of appointment are available for inspection on request.

Under the provisions of the Company's Articles of Association, a Director appointed during the year is required to retire and seek election by shareholders at the next Annual General Meeting. Directors are required to submit themselves for re-election at least once every three years. Directors who have served for more than nine years offer themselves for re-election annually.

The names of the Directors retiring and offering themselves for re-election together with the reasons why the Board supports the re-elections are set out on pages 22 and 23.

Induction and Training

Training for new Directors is tailored to the particular circumstances of the individual appointee. Regular briefings are provided on changes in regulatory requirements that could affect the Company and the Directors. Directors receive other relevant training as necessary.

Remuneration

As all the Directors are non-executive, the provisions of the Combined Code in respect of Directors' remuneration are not relevant to the Company except to the extent that they relate specifically to non-executive directors. Consequently there is no requirement for a separate remuneration committee. Directors' fees are considered by the Board as a whole within the limits approved by shareholders. The Company's policy on remuneration is set out in the Directors' Remuneration Report on pages 26 and 27.

Internal Controls and Risk Management

The Directors acknowledge their responsibility for the Company's system of internal controls and for reviewing its effectiveness. The system of internal controls is designed to manage rather than eliminate risk and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Company, in accordance with the guidance ''Internal Controls: Revised Guidance for Directors on the Combined Code.''

The Directors confirm that they have reviewed the effectiveness of the system and they have procedures in place to review its effectiveness on a regular basis.

The practical measures to ensure compliance with regulation and company law, and to provide effective and efficient operations and investment management, have been delegated to HIML and Baillie Gifford & Co, as detailed in the Directors' Report. The Board acknowledges its responsibilities to supervise and control the discharge by the Manager and Secretaries of their obligations.

The Manager has been delegated responsibility for the design, implementation and maintenance of control policies and procedures to safeguard the assets of the Company and to manage its affairs properly. This responsibility also extends to maintaining effective operational and compliance controls and risk management.

The Company's investments are segregated from the investment and administration functions through the appointment of The Bank of New York Mellon as independent custodian of the Company's investments.

The Manager has a compliance function in accordance with the Financial Services Authority regulations. The Manager's compliance function provides the Board with a report on monitoring procedures on a regular basis. In addition, Baillie Gifford & Co conducts an annual review of its own system of internal controls which is documented within an internal controls report. This report is independently reviewed by Baillie Gifford & Co's auditors. A copy of the internal controls report is submitted to the Board. The Baillie Gifford & Co heads of business risk & internal audit and regulatory risk provide the Board with regular reports on Baillie Gifford & Co's monitoring programmes as they relate to the secretarial and administrative function.

A detailed risk map is prepared which identifies the significant risks faced by the Company and the key controls to manage these risks are confirmed as in place and operating effectively.

These procedures ensure that consideration is given regularly to the nature and extent of the risks facing the Company and that they are being actively monitored. Where changes in risk have been identified during the year they also provide a mechanism to assess whether further action is required to manage the risks identified. The Board confirms that these procedures have been in place throughout the Company's financial year, are operating effectively and continue to be in place up to the date of approval of this Report.

Internal Audit

The Audit Committee carries out an annual review of the need for an internal audit function. The Committee continues to believe that the compliance and internal control systems and the internal audit function in place within the Investment Manager and Company Secretaries provide sufficient assurance that a sound system of internal control, which safeguards shareholders' investment and the Company's assets, is maintained. An internal audit function, specific to the trust, is therefore considered unnecessary.

Accountability and Audit

The respective responsibilities of the Directors and the auditors in connection with the Financial Statements are set out on pages 32 to 34.

The accounts have been prepared on the going concern basis as it is the Directors' opinion that the Company will continue in operational existence for the foreseeable future.

An Audit Committee has been established consisting of all the independent non-executive Directors. Its authority and duties are clearly defined within its written terms of reference which are available on request from the Company and on the Manager's website: **www.heralduk.com**. The Chairman of the Board is Chairman of the Audit Committee. The Committee's responsibilities, which were discharged during the year, include:

- monitoring and reviewing the integrity of the half-yearly and annual financial statements and the internal financial controls;
- making recommendations to the Board in relation to the appointment of the external auditors and approving the remuneration and terms of their engagement;
- developing and implementing policy on the engagement of the external auditors to supply non-audit services (there were no non-audit services provided in the period);
- reviewing and monitoring the independence, objectivity and effectiveness of the external auditors;
- reviewing the arrangements in place within HIML whereby their staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters insofar as they may affect the Company;
- reviewing the terms of the Investment Management Agreement; and
- considering annually whether there is a need for the Company to have its own internal audit function.

The Committee considers the experience and tenure of the audit partner and staff and the nature and level of services provided. The Committee receives confirmation from the auditors that they have complied with the relevant UK professional and regulatory requirements on independence.

Relations with Shareholders

The Board places great importance on communication with shareholders. The Company's Manager meets regularly with institutional shareholders and reports to the Board. The Chairman is available to meet with shareholders as appropriate. Shareholders wishing to communicate with the Chairman or any other Director may do so by writing to him at the registered office of the Company which is shown on page 4.

The Company's Annual General Meeting provides a forum for communication with all shareholders. The level of proxies lodged for each resolution is announced at the meeting and is published on the Manager's website subsequent to the meeting. The notice period for the Annual General Meeting is at least twenty working days. Shareholders and potential investors may obtain up-to-date information on the Company from the Manager's website: **www.heralduk.com**.

Voting Policy and Socially Responsible Investment

The Company has given discretionary voting powers to the investment manager, HIML. The Manager votes against resolutions it considers may damage shareholders' rights or economic interests. The Company believes that it is in the shareholders' interests to consider environmental, social and governance factors when selecting and retaining investments and has asked the Manager to take these issues into account as long as the investment objectives are not compromised. The Manager does not exclude companies from its investment universe purely on the grounds of environmental, social and governance issues but adopts a positive engagement approach whereby matters are discussed with management with the aim of improving the relevant policies and management systems. The Manager's policy has been reviewed and endorsed by the Board.

On behalf of the Board

Martin Boase
Chairman

3 March 2008

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RELATION TO THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the year and of the net return for the year. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates which are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with that law and those regulations.

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF HERALD INVESTMENT TRUST plc

We have audited the financial statements of Herald Investment Trust plc for the year ended 31 December 2007 which comprise the Income Statement, Balance Sheet, Reconciliation of Movements in Shareholders' Funds, Cash Flow Statement, and the related notes 1 to 19. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Director's Report is consistent with the financial statements.

In addition, we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if the information specified by law regarding the Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2006 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risks and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. Other information comprises only the Company Summary, Year's Summary, Long Term Performance Summary, Directors, Manager and Advisers, Chairman's Statement, Investment Manager's Report, Top Twenty Holdings, Classification of Investments, Geographical Spread of Investments, Detailed List of Investments, Ten Year Record, Directors' Report, unaudited part of the Directors' Remuneration Report, Corporate Governance Statement, Notice of Annual General Meeting and Further Shareholder Information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of Audit Opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2007 and of its net loss for the year then ended;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

ERNST & YOUNG LLP
Registered Auditor
Edinburgh

3 March 2008

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2007

	Notes	2007 Revenue £'000	2007 Capital £'000	2007 Total £'000	2006 Revenue £'000	2006 Capital £'000	2006 Total £'000
(Losses)/gains on investments	9	–	(32,898)	(32,898)	–	21,779	21,779
Currency losses	13	–	(49)	(49)	–	(241)	(241)
Income	2	5,167	–	5,167	6,492	–	6,492
Investment management fee	3	(4,252)	–	(4,252)	(3,927)	–	(3,927)
Other administrative expenses	4	(268)	–	(268)	(262)	–	(262)
Net return before finance costs and taxation		647	(32,947)	(32,300)	2,303	21,538	23,841
Finance costs of borrowings	5	(1,883)	–	(1,883)	(284)	–	(284)
Net return on ordinary activities before taxation		(1,236)	(32,947)	(34,183)	2,019	21,538	23,557
Tax on ordinary activities	6	(134)	–	(134)	(97)	–	(97)
Net return on ordinary activities after taxation		(1,370)	(32,947)	(34,317)	1,922	21,538	23,460
Net return per Ordinary share	8	(1.57)p	(37.82)p	(39.39)p	2.19p	24.60p	26.79p

The Board proposed on 19 February 2008 a dividend of 0.50p per Ordinary Share (31 December 2006 – 1.20p).

The total column of this statement is the profit and loss account of the Company.

All revenue and capital items in the above 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.

The accompanying notes on pages 39 to 49 are an integral part of this statement.

BALANCE SHEET
AT 31 DECEMBER 2007

	Notes	2007 £'000	2007 £'000	2006 £'000	2006 £'000
Fixed assets					
Investments held at fair value through profit or loss	9		330,833		387,345
Current assets					
Debtors	10	839		2,776	
Cash at bank and in hand	18	12,155		11,778	
		12,994		14,554	
Creditors: Amounts falling due within one year	11	(330)		(20,671)	
Net current assets/(liabilities)			12,664		(6,117)
TOTAL NET ASSETS			343,497		381,228
Capital and reserves					
Called-up share capital	12		21,743		21,889
Share premium	13		73,738		73,738
Capital redemption reserve	13		209		63
Capital reserve	13		246,171		281,486
Revenue reserve	13		1,636		4,052
EQUITY SHAREHOLDERS' FUNDS			343,497		381,228
NET ASSET VALUE PER ORDINARY SHARE	14		394.96p		435.41p

The accounts were approved by the Board of Directors and authorised for issue on 3 March 2008 and signed on their behalf by

Martin Boase
Chairman

The accompanying notes on pages 39 to 49 are an integral part of this statement.

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

FOR THE YEAR ENDED 31 DECEMBER 2007

	Notes	Called-up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Total share-holders' funds £'000
Shareholders' funds at 1 January 2007		21,889	73,738	63	281,486	4,052	381,228
Net return on ordinary activities after taxation	13	–	–	–	(32,947)	(1,370)	(34,317)
Shares bought back	12	(146)	–	146	(2,368)	–	(2,368)
Dividends paid during the year	7	–	–	–	–	(1,046)	(1,046)
Shareholders' funds at 31 December 2007		21,743	73,738	209	246,171	1,636	343,497

FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	Called-up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Total share-holders' funds £'000
Shareholders' funds at 1 January 2006		21,889	73,738	63	259,948	2,655	358,293
Net return on ordinary activities after taxation		–	–	–	21,538	1,922	23,460
Dividends paid during the year	7	–	–	–	–	(525)	(525)
Shareholders' funds at 31 December 2006		21,889	73,738	63	281,486	4,052	381,228

The accompanying notes on pages 39 to 49 are an integral part of this statement.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2007

	Notes	2007 £'000	2007 £'000	2006 £'000	2006 £'000
Net cash inflow from operating activities	15		187		2,107
Servicing of Finance					
Loan interest		(2,156)		(10)	
Net cash outflow from servicing of finance			(2,156)		(10)
Financial investment					
Purchase of investments		(82,697)		(115,977)	
Sale of investments		108,457		97,094	
Net cash inflow/(outflow) from financial investment			25,760		(18,883)
Equity dividend paid	7		(1,046)		(525)
Net cash inflow/(outflow) before financing			22,745		(17,311)
Financing					
Shares repurchased	12	(2,368)		–	
Loans drawn down		60,000		20,000	
Loans repaid		(80,000)		–	
Net cash (outflow)/inflow from financing			(22,368)		20,000
INCREASE IN CASH	16		377		2,689
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS/(DEBT)	16				
Increase in cash in period			377		2,689
Decrease/(increase) in bank loans			20,000		(20,000)
MOVEMENT IN NET FUNDS/(DEBT) IN PERIOD			20,377		(17,311)
NET (DEBT)/FUNDS AT 1 JANUARY			(8,222)		9,089
NET FUNDS/(DEBT) AT 31 DECEMBER			12,155		(8,222)

The accompanying notes on pages 39 to 49 are an integral part of this statement.

NOTES TO THE ACCOUNTS

1. Accounting policies

The Financial Statements for the year to 31 December 2007 have been prepared on the basis of the accounting policies set out below, which are consistent with those in the Company's Annual Financial Statements at 31 December 2006.

(a) Accounting convention

The accounts are prepared on the assumption that approval as an investment trust will continue to be granted by HM Revenue & Customs.

The Directors consider the Company's functional currency to be sterling as the Company's shareholders are predominantly based in the UK and the Company is subject to the UK's regulatory environment.

The accounts have been prepared in accordance with The Companies Act 1985, applicable UK accounting standards and the AIC's revised Statement of Recommended Practice "Financial Statements of Investment Trust Companies" issued in 2003, revised 2005.

In order to better reflect the activities of the trust and in accordance with guidance issued by the AIC, supplementary information which analyses the profit and loss account between items of a revenue and capital nature has been presented in the Income Statement.

Financial assets and financial liabilities are recognised in the Company's balance sheet when it becomes a party to the contractual provisions of the instrument.

(b) Investments

Purchases and sales of investments are accounted for on a trade date basis.

All investments are designated as fair value through profit or loss upon initial recognition. The fair value of listed security investments is bid value, or in the case of FTSE 100 constituents, at last traded prices issued by the London Stock Exchange. Investments on the Alternative Investment Market are included at their bid value. The fair value of unlisted investments uses valuation techniques determined by the Directors on the basis of latest information in line with the relevant principles of the International Private Equity and Venture Capital Valuation Guidelines.

Gains and losses arising from changes in the fair value of investments are taken to capital reserve.

(c) Income

Dividend income is accounted for when the entitlement to the income is established (normally on the ex-dividend date). Franked income is stated net of tax credits. Unfranked investment income includes the taxes deducted at source. Underwriting commission and interest receivable on deposits are recognised on an accruals basis.

(d) Expenses

All expenses are accounted for on an accruals basis and are charged through the revenue column of the income statement except where they relate directly to the acquisition or disposal of an investment (transaction costs) and, are taken to the income statement as a capital item.

(e) Finance costs

Finance costs are accounted for on an accruals basis and are charged through the revenue column of the income statement.

(f) Deferred taxation

Deferred taxation is provided on all timing differences which have originated but not reversed at the balance sheet date, calculated on an undiscounted basis, and based on enacted tax rates relevant to the benefit or liability. Deferred tax assets are recognised only to the extent that it is more likely than not that there will be taxable profits from which underlying timing differences can be deducted.

(g) Foreign currency

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and loans denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. Exchange differences of a revenue nature are taken to the revenue account. Those of a capital nature are taken to capital reserve.

(h) Capital reserve

The Company is precluded by its Articles from making any distribution of capital profits by way of dividend. Gains and losses on realisation of investments, changes in fair value of investments and exchange differences of a capital nature are dealt with in the capital reserve.

2. Income

	2007 £'000	2006 £'000
Income from investments		
Franked dividends from listed investments*	2,334	4,508
Franked dividends from unlisted investments (inc AIM)	846	318
Unfranked income from unlisted (inc AIM) UK convertible bonds	24	5
Overseas dividend income	1,014	1,032
Overseas interest	58	5
	4,276	5,868
Other income		
Deposit interest	891	619
Underwriting commission	–	5
	891	624
Total income	5,167	6,492
Total income comprises:		
Dividends from equity securities designated at fair value through profit or loss	4,194	5,858
Interest from financial assets designated at fair value through profit or loss	82	10
Deposit interest from financial assets not at fair value through profit or loss	891	619
Other income not from financial assets	–	5
	5,167	6,492

*2006 includes a special dividend of £1,889,000 from Amstrad.

3. Investment management fee

	2007 £'000	2006 £'000
Investment management fee	3,866	3,578
Unrecovered VAT thereon (see note 19)	386	349
	4,252	3,927

Herald Investment Management Limited are appointed investment managers under a management agreement which is terminable on twelve months notice. Their fee is calculated on a monthly rate of 0.08333% of the Company's net asset value based on middle market prices. The management fee is levied on all assets except the holding in Herald Ventures II Limited Partnership managed by Herald Investment Management Limited.

4. Other administrative expenses

	2007 £'000	2006 £'000
Custodian's fees	58	61
Registrars' fees	16	17
Directors' fees	68	68
Auditors' fees – audit work	14	13
Miscellaneous expenses	112	103
	268	262

5. Finance costs of borrowings

	2007 £'000	2006 £'000
Bank loans repayable within one year	1,883	284

6. Taxation

Analysis of charge in year	2007 £'000	2006 £'000
Overseas taxation	134	97

Factors affecting tax charge for year

The tax charge for the year is lower than the standard rate of corporation tax in the UK (30%).

The differences are explained below:

	2007 £'000	2006 £'000
Revenue return on ordinary activities before taxation	(1,236)	2,019
Revenue return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2006 – 30%)	(371)	606
Income not taxable	(954)	(1,448)
Overseas withholding tax claimed as a deduction	(40)	(29)
Overseas withholding tax	134	97
Excess expenses in period not provided for as an asset	1,365	871
Current tax charge for the year	134	97

Capital returns are not included in the above analysis; as an Investment Trust, the Company's capital gains are not taxable.

There is no UK corporation tax charge at 31 December 2007 or 31 December 2006 as the Company has unrelieved management expenses which are available to be carried forward. The tax charge for 31 December 2007 and 2006 comprises overseas withholding taxes written off.

At 31 December 2007 the Company had surplus management expenses of £20m (2006 – £15m) which have not been recognised as a deferred tax asset. This is because the Company is not expected to generate taxable income in a future period in excess of the deductible expenses of that future period and, accordingly, it is unlikely that the Company will be able to reduce future tax liabilities through the use of existing surplus expenses.

7. Ordinary dividend

	2007	2006	2007 £'000	2006 £'000
Amounts recognised as distributions in the period:				
Previous year's final (paid 3 May 2007)	1.20p	0.60p	1,046	525

We also set out below the total dividends payable in respect of the financial year, which is the basis on which the requirements of Section 842 of the Income and Corporation Taxes Act 1988 are considered. The revenue available for distribution by way of dividend for the year is £Nil (2006 – £1,922,000).

	2007	2006	2007 £'000	2006 £'000
Dividends paid and proposed in the period:				
Proposed final dividend per Ordinary share	0.50p	1.20p	435	1,051
Adjustment to provision for 2006 final dividend re shares bought back			–	(5)
			435	1,046

The current year's proposed dividend will be paid on 1 May 2008 to all shareholders on the register at the close of business on 11 April 2008. The ex-dividend date is 9 April 2008.

8. Net return per Ordinary share

	2007			2006	
Revenue	Capital	Total	Revenue	Capital	Total
(1.57)p	(37.82)p	(39.39)p	2.19p	24.60p	26.79p

Revenue return per Ordinary share is based on the net revenue loss on ordinary activities after taxation of £1,370,000 (2006 – revenue profit of £1,922,000) and on 87,114,983 Ordinary shares (2006 – 87,556,010) being the weighted average number of Ordinary shares in issue during the year.

Capital return per Ordinary share is based on the net capital loss for the financial year of £32,947,000 (2006 – net capital gain of £21,538,000) and on 87,114,983 Ordinary shares (2006 – 87,556,010) being the weighted average number of Ordinary shares in issue during the year.

There are no dilutive or potentially dilutive shares in issue.

9. Fixed assets – investments

Financial assets designated at fair value through profit or loss

	2007 £'000	2006 £'000
Listed UK equity investments – London Stock Exchange	116,549	168,829
– AIM	95,254	94,401
Listed Overseas – equity investments	104,045	122,416
– debt investments	12,768	–
Unquoted*	2,217	1,699
Total investments in financial assets at fair value through profit or loss	330,833	387,345

	Listed in UK £'000	Listed overseas £'000	AIM £'000	Unquoted £'000	Total £'000
Fair value of investments at 1 January 2007	168,829	122,416	94,401	1,699	387,345
Movements in the year:					
Purchases at cost	16,825	32,701	32,721	450	82,697
Sales – proceeds	(59,202)	(32,631)	(14,057)	(421)	(106,311)
– realised profit/(loss)	19,413	4,247	(6,146)	(669)	16,845
Movement in fair value	(25,870)	(9,920)	(11,296)	(2,657)	(49,743)
Change in listing	(3,446)	–	(369)	3,815	–
Fair value of investments at 31 December 2007	116,549	116,813	95,254	2,217	330,833

(Losses)/gains on investments designated at fair value through profit or loss	2007 £'000	2006 £'000
Realised gains on sales	16,845	23,963
Movement in fair value	(49,743)	(2,184)
	(32,898)	21,779

*The unquoted balance comprises Culver Holdings at £36,000, Herald Investment Management Limited, Herald Ventures 2 and HIML Jersey Ltd included at their aggregated cost of £1,466,000, Harrier Group at £343,000, UbiNetics at zero, Zoo Digital at £369,000, Adaptive Broadband at £3,000 and Atex at zero.

At 31 December 2007 the Company was the beneficial owner of 13.86% (2006 – 13.86%) of the Ordinary share capital of both HIML Holdings and HIML Jersey Ltd. HIML Holdings is incorporated in the United Kingdom whereas HIML Jersey Ltd is incorporated in Jersey.

9. Fixed assets – investments (continued)

Transaction costs	2007 £'000	2006 £'000
The following transaction costs were incurred during the period		
Purchases	387	687
Sales	354	376
	741	1,063

10. Debtors

	2007	2006
Due within one year:	£'000	£'000
Income accrued	763	502
Sales for subsequent settlement	9	2,155
Taxation recoverable	4	14
Other debtors and prepayments	63	105
	839	2,776

11. Creditors

	2007	2006
Amounts falling due within one year:	£'000	£'000
Bank loans	–	20,000
Other creditors and accruals	330	671
	330	20,671

Included in other creditors and accruals is £288,000 (2006 – £317,000) in respect of the investment management fee.

The Company has a 364 day £50 million multi-currency loan facility with The Royal Bank of Scotland which expires on 21 September 2008. At 31 December 2007 there were no outstanding drawings (2006 – £20,000,000 at a rate of 5.811%).

Interest on the multi-currency loan was payable in half yearly instalments in April and October. The loan was repaid in November 2007. The estimated repayment value of the loan at 31 December 2006 was £20,000,000. The indicative costs of repaying the loan as at 31 December 2006 were not material in the context of the above figures.

The main covenant relating to the loan is:

Total borrowings shall not exceed 25% of the Company's Gross Assets adjusted by deducting:

(i) the market value of any unlisted investments;

(ii) the amount by which the market value of any single investment represents more than 7.5% of the Company's gross assets; and

(iii) the amount by which the aggregate market value of the ten largest investments exceeds 45% of gross assets.

12. Called-up share capital

		2007	2006
Authorised:			
Ordinary shares of 25p:	Number	109,000,000	109,000,000
	£'000	27,250	27,250
Allotted, issued and fully paid:			
Ordinary shares of 25p:	Number	86,971,010	87,556,010
	£'000	21,743	21,889

At the Annual General Meeting in April 2007, Shareholders granted the Company authority to purchase shares in the market up to 13,058,689 Ordinary shares (equivalent to 14.99% of its issued share capital at that date). In the year to 31 December 2007, a total of 585,000 (2006 – Nil) Ordinary shares with a nominal value of £146,250 (2006 – Nil) were bought back at a total cost of £2,368,000 (2006 – Nil). At 31 December 2007 the Company had authority to buy back a further 12,913,689 Ordinary shares. Under the provisions of the Company's Articles share buy-backs are funded from the capital reserve. The Company does not have any externally imposed capital requirements.

13. Capital and Reserves

	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000
At 1 January 2007	73,738	63	281,486	4,052
Shares purchased for cancellation	–	146	(2,368)	–
Net gain on realisation of investments	–	–	16,845	–
Movement in fair value	–	–	(49,743)	–
Other exchange differences	–	–	(49)	–
Dividends appropriated during the year	–	–	–	(1,046)
Net revenue deficit for the year	–	–	–	(1,370)
Balance at 31 December 2007	73,738	209	246,171	1,636

The revenue reserve represents the only reserve from which dividends can be funded.

14. Net asset value per Ordinary share

The net asset value per Ordinary share and the net assets attributable to the Ordinary shareholders at the year end calculated in accordance with the Articles of Association were as follows:

	2007	2006	2007 £'000	2006 £'000
Ordinary shares	394.96p	435.41p	343,497	381,228

Net asset value per Ordinary share is based on net assets as shown above and on 86,971,010 (2006 – 87,556,010) Ordinary shares, being the number of Ordinary shares in issue at each date.

15. Reconciliation of net return before finance costs and taxation to net cash inflow from operating activities

	2007 £'000	2006 £'000
Net return on ordinary activities before finance costs and taxation	(32,300)	23,841
(Losses)/gains on investments	32,898	(21,779)
Currency losses	49	241
(Increase)/decrease in accrued income	(258)	121
Decrease/(increase) in debtors	42	(20)
(Decrease)/increase in creditors	(67)	41
Income tax repaid	6	–
Overseas tax suffered	(134)	(97)
Realised currency loss	(49)	(241)
Net cash inflow from operating activities	187	2,107

16. Analysis of changes in net (debt)/funds

	At 1 January 2007 £'000	Cash flows £'000	At 31 December 2007 £'000
Cash at bank and in hand	11,778	377	12,155
Loans due within one year	(20,000)	20,000	–
	(8,222)	20,377	12,155

17. Contingent Liabilities, Guarantees and Financial Commitments

At 31 December 2007 and 31 December 2006 the Company had a commitment to participate in Herald Ventures II Limited Partnership. The Company's commitment is limited to £3 million, drawn down in tranches, over a 5 year period. The first tranch was drawn down in October 2004, with a total of £1,200,000 being drawn down at 31 December 2006 with a further £450,000 in the year to 31 December 2007.

18. Financial Instruments

In accordance with the corporate objective of maximising capital appreciation the Company invests in securities on a worldwide basis. The Company makes use of gearing to achieve improved performance in rising markets. The Company's other financial instruments consist of cash, short term debtors and creditors.

The main risks arising from the Company's financial instruments are:

A. Market Risk

(i) Other price risk, being the risk that the value of investment holdings will fluctuate as a result of changes in market prices caused by factors other than interest rate or currency rate movement.

(ii) Interest rate risk, being the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates; and

(iii) Foreign currency risk, being the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

B. Credit Risk, being the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

C. Liquidity Risk, being the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

These risks and the policy for managing them have been applied throughout the year and are summarised below. Further detail is contained in the Business Review – Investment Policy section on page 21.

A. Market Risk

(i) Other Price Risk

The Company's investment portfolio is exposed to market price fluctuations which are monitored by the Manager in pursuance of the corporate objective. Securities held by the Company are valued at bid prices, whereas material unlisted investments are valued by the Directors on the basis of the latest information in line with the relevant principles of the International Private Equity and Venture Capital Valuation Guidelines (Accounting Policy (b)). These valuations also represent the fair value of the investments, see note 9 on page 42.

A full list of the Company's investments is given on pages 15 to 19. In addition, a geographical analysis of the portfolio, an analysis of the investment portfolio by broad industrial or commercial sector and a review of the 20 largest equity investments by their aggregate market value, are shown on pages 11 to 14.

18. Financial Instruments (continued)

Other Price Risk Sensitivity

36.6% of the Company's equity investments at 31 December 2007 were listed on the main list of the London Stock Exchange and a further 29.9% on AIM. The NASDAQ Stock Exchange accounts for 18.0% and other stock exchanges 14.7%. A 10% increase in stock prices at 31 December 2007 would have increased total net assets and net return on ordinary activities after taxation by £32,000,000 (2006 – £39,000,000). A decrease of 10% would have had an equal but opposite effect. The portfolio does not target any exchange as a benchmark, and the performance of the portfolio has a low correlation to generally used indices.

The shares of Herald Investment Trust plc have an underlying NAV per share. The NAV per share of Herald Investment Trust plc fluctuates on a daily basis. In addition, there is volatility in the discount/premium the share price has to NAV.

(ii) Interest Rate Risk

The majority of the Company's assets are equity shares and other investments which neither pay interest nor have a maturity date. However, the Company does hold Convertible Bonds and Government Securities, the interest rate and maturity dates of which are detailed below. Interest is accrued on sterling cash balances at a rate linked to the UK base rate.

The Company has borrowings, from time to time. The aim of the use of gearing is to enhance long term returns to shareholders by investing borrowed funds in equities and other assets. Gearing is actively managed. How and where borrowings are invested is reviewed by the Board in consultation with the Manager at every Board meeting. In light of the decisions made, appropriate adjustments to the gearing position are then made by the Manager.

At the year end the Company had no borrowings (2006 – £20 million which was repaid in November 2007). However, the Company has a bank debt facility of £50 million of which £Nil was utilised at 31 December 2007. The interest rate on amounts utilised is variable at 0.6% over LIBOR and a non-utilisation fee of 0.3% is payable from 1 January 2008.

The interest rate risk profile of the financial assets and financial liabilities at 31 December was:

Financial Assets

	2007			2006		
	Fair value £'000	Weighted average interest rate/ interest rate	Weighted average period until maturity/ maturity date	Fair value £'000	Weighted average interest rate/ interest rate	Weighted average period until maturity/ maturity date
Fixed rate:						
European bonds	7,545	$5\frac{1}{4}$%	2 years	–	–	–
US bonds	5,223	$4\frac{1}{2}$%	2 years	–	–	–
UK convertible bonds	405	7%	4 years	405	7%	5 years
US convertible bond	–	–	–	63	7%	2 years
Cash:						
Other overseas currencies	340	–		895	–	
Sterling	11,815	5.6%		10,883	5.1%	
	12,155			11,778		

The cash deposits generally comprise call or short term money market deposits of less than one month which are repayable on demand. The benchmark rate which determines the interest payments received on cash balances is the bank base rate.

18. Financial Instruments (continued)

(ii) Interest Rate Risk (continued)

Financial Liabilities

	2007			2006		
	£'000	Interest rate	Period until maturity	£'000	Interest rate	Period until maturity
Bank loans	–	–	–	20,000	5.811%	3 months

Interest rate risk sensitivity

An increase of 100 basis points in interest rates as at 31 December 2007 would have a direct effect on net assets. Based on the position at 31 December 2007, over a full year, an increase of 100 basis points would have increased the net return on ordinary activities after taxation by £122,000 (2006 – decreased net return on ordinary activities after taxation by £82,000) and would have increased the net asset value per share by 0.14p (2006 - decreased the net asset value per share by 0.09p). A decrease of 100 basis points would have had an equal but opposite effect. The calculations are based on the cash balances as at the respective balance sheet dates and are not representative of the year as a whole.

Although the Company currently has zero financial gearing, and on average the underlying investments have net cash, in practice rising interest rates should be expected to affect economic growth and therefore operating results in investee companies adversely.

(iii) Foreign Currency Risk

The Company's reporting currency is sterling, but investments are made in overseas markets as well as the United Kingdom and the asset value can be affected by movements in foreign currency exchange rates.

Furthermore many companies trade internationally both through foreign subsidiaries, and through exports. The greatest foreign currency risk occurs when companies have a divergence in currencies for costs and revenues. A much less risky exposure to currency is straight translation of sales and profits. The List of Investments on pages 15 to 19 breaks down the portfolio by geographic listing. However the location of the stock market quote only has a limited correlation to the costs, revenues and even activities of those companies, and so this note should not be regarded as a reliable guide to the sensitivity of the portfolio to currency movements. For example, the holdings in the portfolio that have suffered most from US$ weakness are UK companies with dollar revenues and sterling costs.

The Company does not hedge the sterling value of investments that are priced in other currencies. Overseas income is subject to currency fluctuations. The Company does not hedge these currency fluctuations because it is impossible to quantify the effect for the reasons stated above. However, from time to time the Manager takes a view by holding financial assets or liabilities in overseas currencies.

Exposure to currency risk through asset allocation by currency of listing is indicated below:

At 31 December 2007	Investments £'000	Cash and Deposits £'000	Loans £'000	Other debtors and creditors* £'000	Net exposure £'000
US dollar	66,094	–	–	228	66,322
Euro	17,810	–	–	9	17,819
Other overseas currencies	32,912	340	–	3	33,255
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	116,816	340	–	240	117,396
Sterling	214,017	11,815	–	269	226,101
	330,833	12,155	–	509	343,497

*Includes net non-monetary liabilities of £277,000.

18. Financial Instruments (continued)

(iii) Foreign Currency Risk (continued)

At 31 December 2006

	Investments £'000	Cash and Deposits £'000	Loans £'000	Other debtors and creditors* £'000	Net exposure £'000
US dollar	66,631	–	–	2	66,633
Euro	14,915	–	–	7	14,922
Other overseas currencies	40,872	895	–	29	41,796
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	122,418	895	–	38	123,351
Sterling	264,927	10,883	(20,000)	2,067	257,877
	387,345	11,778	(20,000)	2,105	381,228

*Includes net non-monetary liabilities of £296,000.

Foreign currency risk sensitivity

At 31 December 2007, had sterling strengthened by 5% in relation to all currencies, with all other variables held constant, total net assets and net return on ordinary activities after taxation would have decreased by the amounts shown below based solely on translation of securities quoted in currencies overseas. A 5% weakening of sterling against all currencies, with all other variables held constant, would have had an equal but opposite effect on the financial statement amounts. The analysis is performed on the same basis for 2006. However companies whose cost base diverges in currency terms from its sales will in the longer term have a significantly greater effect on valuation than simple translation. In the short term investee companies generally cover their currency exposure to varying degrees. There is insufficient publicly disclosed information to quantify this, but in the long term this effect is expected to dwarf simple translation of foreign listings in terms of both risk and reward, because many investee companies trade globally. Furthermore the country of listing is not necessarily an indication of the geography of some or even any operational activities for investee companies. The Manager does not use financial instruments to protect against currency movements. From time to time financial leverage has been made using debt in overseas currencies.

	2007	2006
US dollar	3,316	3,332
Euro	891	746
Other overseas currencies	1,663	2,090
	5,870	6,168

B. Credit Risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment which it has entered into with the Company. The Manager monitors counterparty risk on an ongoing basis.

The Company has investments in convertible loan stocks that have an element of equity, these securities are viewed as having a risk profile similar to the equity holdings. This is because the convertibles held are in nascent technology companies that may be loss making and may have weak balance sheets. For this reason these stocks are categorised as equity holdings.

The fixed interest securities held are German and US Government securities.

18. Financial Instruments (continued)

C. Liquidity Risk

The Company's policy with regard to liquidity is to provide a degree of flexibility so that the portfolio can be repositioned when appropriate and that most of the assets can be realised without an excessive discount to the market price. The Company's unlisted investments are not readily realisable, but these only amount to 0.6% of the Company's total assets at 31 December 2007.

In practice, liquidity in investee companies is imperfect, particularly those with a market value of less than £100 million. To reduce this liquidity risk it is the policy to diversify the holdings and generally to restrict the holding in any one company to less than 10% of the share capital of that company. Furthermore the guideline is for no single investment to account for more than 5% of the assets of the Company.

The market valuation of each underlying security gives an indication of value, but the price at which an investment can be made or realised can diverge materially from the bid or offer price depending on market conditions generally and particularly to each investment. 36% (£119m) of the portfolio is invested in stocks with a market capitalisation below £100 million, where liquidity is expected to be more limited. If these stocks had on average a realisable value 20% below the bid price the value of the total fund would be adversely affected by 7.5%.

Fair Value of Financial Assets and Liabilities

The Directors are of the opinion that the financial assets and liabilities of the Company are stated at fair value in the balance sheet.

19. Contingent Asset

In June 2007 the European Court of Justice ruled that investment trust management fees should be exempt from VAT and this decision has now been accepted in principle by HM Revenue & Customs. The result of this decision is that future management fees will not be subject to VAT and the Company will be able to recover some of the VAT suffered on past management fees. A number of legal and procedural matters remain to be resolved however before certainty is reached in respect of the amount of VAT that will be repaid. Consequently, no amounts have been recognised as an asset within these Accounts. The amount recoverable however will not be material and the amount is not expected to be more than 0.5% of shareholders' funds.

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Herald Investment Trust plc will be held at 10–11 Charterhouse Square, London EC1M 6EE on 22 April 2008 at 11.30 am for the following purposes:

Ordinary Business

1. To receive and adopt the Directors' report, the annual accounts and the Auditors' report in respect of the year ended 31 December 2007.
2. To approve the Directors' Remuneration Report for the year ended 31 December 2007.
3. To declare a final dividend of 0.50p per share in respect of the year ended 31 December 2007.

To consider resolution No. 4, special notice having been received of the intention to propose the resolution as an ordinary resolution (see note 4).

4. To re-elect Mr M Boase, who is aged 75, as a Director of the Company.
5. To re-elect Mr T M Curtis as a Director of the Company.
6. To re-elect Mr D C P McDougall as a Director of the Company.
7. To elect Mr C J Cazalet as a Director of the Company.
8. To reappoint Ernst & Young LLP as Independent Auditors to the Company to hold office until the conclusion of the next Annual General Meeting at which accounts are laid before the Company.
9. To authorise the Directors to determine the remuneration of the Independent Auditors.

Special Business

To consider and, if thought fit, pass the following resolutions as Special Resolutions:

10. That, the Company be generally and subject as hereinafter appears unconditionally authorised in accordance with Section 166 of the Companies Act 1985 (the "Act") to make market purchases (within the meaning of Section 163 of the Act) of its issued shares of 25p each in the capital of the Company in substitution for any existing authority under section 166 of the Act but without prejudice to any exercise of any such authority prior to the date hereof.

    PROVIDED ALWAYS THAT

    (i) the maximum number of shares hereby authorised to be purchased shall be 14.99% of the issued share capital on the date on which this resolution is passed;

    (ii) the minimum price which may be paid for a share shall be 25p;

    (iii) the maximum price (exclusive of expenses) which may be paid for a share shall not be more than the higher of (a) 105% of the average of the middle market quotations (as derived from the Daily Official List of the London Stock Exchange) for the shares for the five business days immediately preceding the date of purchase and (b) the higher of the last independent trade and the highest current independent trade on the London Stock Exchange;

    (iv) any purchase of shares will be made in the market for cash at prices below the prevailing net asset value per share (as determined by the Directors);

    (v) unless previously varied, revoked or renewed, the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2009; and

    (vi) the Company may make a contract to purchase shares under the authority hereby conferred prior to the expiry of such authority and may make a purchase of shares pursuant to any such contract notwithstanding such expiry.

11. That, with effect from 1 October 2008, the Articles of Association be amended by making the alterations marked on the print of the Articles of Association produced to the meeting marked ''A'' and initialled by the Chairman of the meeting for the purpose of identification.

12. That, the Articles of Association of the Company be and are hereby amended by deleting the words ''30 per cent'' contained in Article 97(B) thereto and substituting therefore the words ''50 per cent''.

By order of the Board

Baillie Gifford & Co
Secretaries

Registered Office:
10–11 Charterhouse Square
London EC1M 6EE

13 March 2008

NOTES

1. A shareholder entitled to attend, speak and vote at the meeting is entitled to appoint one or more proxies to attend, speak and, on a poll, to vote in his stead. Such proxy need not be a member of the Company.
2. A form of proxy is enclosed and to be valid must be lodged with the Registrars of the Company not later than forty-eight hours before the time fixed for the meeting.
3. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that only those shareholders entered on the Register of Members of the Company as at 6.00 pm on 18 April 2008 or, in the event that the meeting is adjourned, on the Register of Members 48 hours before the time of any adjourned meeting, shall be entitled to attend or vote at the meeting in respect of the number of ordinary shares registered in their name at that time. Changes to the entries on the Register of Members after 6.00 pm on 18 April 2008 or, in the event that the meeting is adjourned, in the Register of Members 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend or vote at this meeting, notwithstanding any provisions in any enactment, the Articles of Association of the Company or other instrument to the contrary.
4. In accordance with section 293 of the Companies Act 1985 special notice has been given to the Company of the resolution to reappoint a Director who is over the age of 70.
5. No Director has a contract of service with the Company.
6. Copies of the existing Articles of Association of the Company and the proposed revised Articles of Association will be available for inspection during normal business hours on any day (Saturdays, Sundays and public holidays excepted) until the close of the Annual General Meeting at the registered office of the Company and at the offices of Baillie Gifford & Co. Copies of the proposed revised Articles of Association will also be available for inspection at the place of the Annual General Meeting for 15 minutes before and during the meeting.
7. As at 5 March 2008, the latest practicable date prior to publication of this document, the Company had 86,086,523 ordinary shares in issue with a total of 86,086,523 voting rights.
8. Any person holding 3% of the total voting rights in the Company who appoints a person other than the Chairman as his proxy will need to ensure that both he and such third party complies with their respective disclosure obligations under the Disclosure and Transparency Rules.

FURTHER SHAREHOLDER INFORMATION

- **How to Invest** The Company's shares are traded on the London Stock Exchange. They can be bought by placing an order with a stockbroker or by asking a professional adviser to do so.

- **Sources of Further Information on the Trust** The price of shares is quoted daily in the *Financial Times*, *The Daily Telegraph* and *The Times*. The NAV per share is calculated and released daily to the London Stock Exchange and monthly to the Association of Investment Companies.

- **Key Dates** Ordinary shareholders normally receive a dividend in respect of each financial year which is normally paid late April/early May. The AGM is normally held in April.

- **Taxation** The price of the Ordinary shares (adjusted for the price of attributable warrants) on 21 February 1994, which was the first day of trading, was 90.9p. The amount attributable to the warrants for the purpose of capital gains tax is 9.1p per share issued (1994 Annual Report). Up to 5 April 1998 the basis for calculating non-trading gains or losses was the difference between that price, or any subsequent purchase price, and the sale price, using the indexation allowance for inflation. However, this indexation allowance was frozen at 5 April 1998, and replaced by a taper relief. Taper relief, however, cannot create or increase a loss. Any shareholder uncertain of his or her position is recommended to seek expert advice.

- **ISAs/PEPs** The Ordinary shares of the Company are qualifying investments for individual saving accounts and personal equity plans. PEPs ceased to be available for further investment from 5 April 1999. Any individual contemplating investment should consult his or her own adviser.

Herald is an investment trust. Investment trusts offer investors the following:

- Participation in a diversified portfolio of shares.
- Constant supervision by experienced professional managers.
- The Company is free from capital gains tax on capital profits realised within the portfolio.
- The opportunity to achieve improved performance for shareholders' funds in rising markets by the borrowing of additional money.

Summerhall Corporate 39962