HERALD INVESTMENT TRUST plc

ANNUAL REPORT & FINANCIAL STATEMENTS

31 December 2011

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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 2011

Total assets†	Shareholders' funds	Market capitalisation
£520m	**£449m**	**£363m**

†Before deduction of bank loans and derivative financial instruments

Policy and Objective	Herald's objective is to achieve capital appreciation through investments in smaller quoted companies, in the areas of telecommunications, multimedia 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 22
Comparative Index	The portfolio comparative index against which performance is measured is 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) Though we consider this comparative index to provide a reasonable base for measuring the Company'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 79,698,283 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 215,000 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 2010 shareholders voted in favour of the Company continuing to operate as an investment trust The next continuation vote is in 2013 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 2011	31 December 2010	% change
Total assets (before deduction of bank loans and derivative financial instruments)	£519 7m	£533 5m	
Bank loans	£50 0m	£50 0m	
Derivative financial instruments	£20 4m	£8 9m	
Shareholders' funds	£449 3m	£474 6m	
Net asset value per Ordinary share	563 7p	593 8p	(5 1)
Share price	455 0p	483 0p	(5 8)
FTSE 100	5,572 3	5,899 9	(5 6)
FTSE All-Share	2,857 9	3,062 9	(6 7)
FTSE Small Cap	2,748 8	3,228 6	(14 9)
Hoare Govett Smaller Companies Index plus AIM (capital gains ex investment companies)	3,101 6	3,650 8	(15 0)
Russell 2000 (small cap) Technology Index (in sterling terms)	880 9	957 3	(8 0)
Composite comparative index			(12 5)
Dividend per Ordinary share	1 00p	–	
Revenue earnings per Ordinary share	1 19p	0 05p	
Total expense ratio	1 10%	1 05%	
Discount	19 3%	18 7%	

Year to 31 December	2011	2011	2010	2010
Year's high and low	**High**	**Low**	**High**	**Low**
Share price	545 5p	419 0p	490 0p	328 0p
Net asset value	647 8p	516 7p	599 4p	420 2p
Discount	22 2%	13 1%	23 6%	14 7%

At 31 December	2011	2010
Net return per Ordinary share		
Revenue	1 19p	0 05p
Capital	(31 43p)	171 87p
Total	(30 24p)	171 92p

Source Thomson Reuters Datastream/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

Past performance is not a guide to 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 2011	Inception 16 February 1994	% change
Net asset value per Ordinary share	563 7p	98 7p	471 1
Share price	455 0p	90 9p	400 6
Hoare Govett Smaller Companies Index plus AIM (capital gains ex investment companies)	3,101 6	1,750 0	77 2
Russell 2000 (small cap) Technology Index (in sterling terms)†	880 9	688 7*	27 9
FTSE 100	5,572 3	3,417 7	63 0
FTSE All-Share	2,857 9	1,717 8	66 4
FTSE Small Cap	2,748 8	2,076 1	32 4

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

† The Russell 2000 (small cap) Technology Index was rebased during 2009 following some minor adjustments to its constituents The rebased index is used from 31 December 2008 onwards

Source Thomson Reuters Datastream/Baillie Gifford & Co

Source Thomson Reuters Datastream

Source Thomson Reuters 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 comparative index was changed to $^2/_3$ Hoare Govett Smaller Companies Index plus AIM (capital gains ex investment companies) and $^1/_3$ Russell 2000 (small cap) Technology Index (in sterling terms)

DIRECTORS, MANAGER AND ADVISERS

Directors

Julian Cazalet was appointed to the Board in 2008 and became Chairman in 2009 He was managing director – corporate finance at JPMorgan Cazenove until his retirement in December 2007 A Chartered Accountant he joined Cazenove in 1973 and was made a Partner in 1978 From 1989 he worked in Corporate Finance and advised investment trusts in addition to his work with industrial and commercial companies He is a director of the White Ensign Association Limited, Deltex Medical Group plc, Charles Taylor Consulting plc, Cothill Educational Trust and Greenham Common Community Trust

Clay Brendish, CBE was appointed to the Board in 2001 He has been non-executive chairman of Anite plc since 2005 and SThree plc since 2010 He is a trustee of the Economist Newspapers Limited Clay's other non-executive directorship is with The Test and Itchen Association Limited He is a member of the Administrative Board of Elster Group 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

Tim Curtis was appointed to the Board in 2004 He was chief executive of Zetex plc (formerly Telemetrix PLC), and is non-executive chairman of RaceCourse Technical Services Ltd Former non-executive directorships were with IBS OPENSystems plc between 2005 and 2008, TVS Entertainment plc, Dobson Park Industries plc and Pace Micro Technology plc Tim was previously a director of Unitech plc

Douglas McDougall, OBE was appointed to the Board in 2002 and is Chairman of the Audit Committee and 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, The European Investment Trust plc, The Independent Investment Trust PLC and The Scottish Investment Trust PLC and is a director of The Monks Investment Trust PLC and Pacific Horizon Investment Trust PLC He is a former chairman of IMRO, of the Association of Investment Companies and of the Fund Managers' Association

Stewart Newton was appointed to the Board on 6 January 2012 He is chairman and a founder director of The Real Return Group Limited and is non-executive director of Solon Ventures Limited He was the founder and executive chairman of Newton Investment Management from 1977–2002 He also sits on the Investment Advisory Committee of The Wellcome Trust and is a Council Member at Imperial College, where he is Chairman of the committee managing the College Fund

All Directors are members of the Audit Committee and of the Nomination Committee

Secretary

Baillie Gifford & Co
Calton Square
1 Greenside Row
Edinburgh EH1 3AN
Tel 0131 275 2000

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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Independent Auditors
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London SE1 2AF

Solicitors
Macfarlanes
20 Cursitor Street
London EC4A 1LT

Stockbrokers
JP Morgan Cazenove Ltd
10 Aldermanbury
London EC2V 7RF

Singer Capital Markets Limited
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London W1S 1YZ

Bankers
The Bank of New York Mellon
One Piccadilly Gardens
Manchester M1 1RN

Registrars
Capita Registrars
Northern House
Woodsome Park
Fenay Bridge
Huddersfield HD8 0LA
Tel 0871 664 0300
(calls cost 10p per minute plus network extras, lines are open 8 30 am to 5 30 pm Monday–Friday)
Website www capitaregistrars com
E-mail shareholder services@capitaregistrars com

CHAIRMAN'S STATEMENT

2011 was a year of macroeconomic uncertainty and volatile stock markets that saw widespread declines Against this background I am pleased to report that the majority of portfolio companies made sound progress, albeit the net assets per share showed a negative return of 5 1% The UK portion of our portfolio returned +1 5%, which is significantly ahead of the main UK and overseas indices, as well as the overseas returns in the portfolio, justifying the overweight position in this region The FTSE Small Cap Index returned -12 3%, the HGSC Index plus AIM (ex investment companies) returned -13 1% and the FTSE AIM Index returned -25 0% The Company's second heaviest weighting was in the US, where small technology companies had a poor year relative to large ones, and the Russell 2000 Technology Index returned -8 4% in $ (-7 9% in £) The Company's US portfolio returned -1 8% Unfortunately the overall return was dragged down by the smaller Asian and European portfolios and a widening loss on the mark to market valuation of the interest rate swap, which was taken out to hedge interest rate volatility on the loan

The dull returns reflect the difficult stock market environment, which has led to a virtually closed market for primary capital for the third year running in the UK, Europe and to a lesser extent in the US In contrast there has continued to be a steady pace of takeovers A total of fourteen investee companies were taken over during the year, where our stakes had an aggregate value of almost £42m This takes the cumulative total value of takeovers within the portfolio over the last five years to £171m, and compares to a net value of just over £66m of external capital raised in the history of the Trust Valuations and takeovers in the UK seem to be driven by a continued withdrawal of capital from equities by pension funds and insurance companies From the micro perspective of Herald, it seems bizarre that actuaries appear to have such an influence on asset allocation decisions, with views that are so divergent from any reasoned investment judgment over the medium and long term

The TMT sector, in which the Company's investments are focused, is never homogeneous, and as ever there have been parts of the universe structurally and cyclically challenged, while other parts have shown sparkling growth New technologies open up new markets, which can grow significantly whatever the economic backdrop The internet continues to have the most profound effect, both positively and negatively, and the mobile internet has again been a strong driver in 2011

The best way of illustrating what a good year 2011 has been for the Company, in spite of the decline in the net asset value, is to quantify a few metrics in the portfolio The share of revenues in portfolio companies exceeds £400m for the first time, the share of net income of profitable companies exceeds £30m for the first time, and the share of net cash continues to exceed £20m, against an equity value of £462m Furthermore, although the prime motive for the fund is capital growth, dividend income growth has been particularly robust in the UK (+44%), which is masked by flat overseas dividend income and a decline in bond income Some companies paying a dividend for the first time flatter the dividend growth rate These valuation metrics provide considerable confidence for the year ahead, and appears to offer value versus cash and bonds

Dividends have never been significant for the Company, reflecting the growth orientation of the portfolio, but 2010 was the first year in respect of which no dividend was paid by the Company In light of the robust dividend growth during the year the Directors have decided to recommend a dividend of 1 00p in respect of 2011

It is rational to be apprehensive about the coming year reflecting the excessive Government leverage in the world and European instability in particular Nevertheless, cash and bonds seem particularly unattractive, while there remains scope for growth in the technology sector, on very reasonable valuations, which appears attractive relative to appealing alternative investment opportunities

The Board

I am delighted to welcome Stewart Newton, who joined the Board in January Stewart has very broad experience in the investment world He is currently chairman and founder partner of an investment group focussed on real and absolute returns He is also closely involved in technology in both the academic world, as a Council Member of Imperial College, and in the charitable sector as a member of the Investment Committee of The Wellcome Trust We very much look forward to working with him

Clay Brendish will leave the Board at the conclusion of the AGM Clay's clear advice and wisdom over the past eleven years have been very much appreciated by both the Board and the Manager We thank him most sincerely for his contribution to Herald during his time as a Director and wish him well for the future

Julian Cazalet
Chairman

21 February 2012

INVESTMENT MANAGER'S REPORT

The 5 1% decline in NAV is disappointing, and at odds with what has seemed a very good year Throughout the year many days have started miserably with the deluge of grim political and economic news Earthquakes and floods have added to the woes Yet every day we have been cheered by meetings and results from companies with news flow that has been altogether more satisfactory It seems that the TMT (technology, media and telecommunications) sector in which we invest has operated on a different cycle, not economically, but temperamentally The sector's period of madness was in 2000, when excessive confidence led to insane valuations, over-exuberant growth plans, excessive investment, and unsound jargon became the order of the day land grab, multiples of sales, salary inflation, excessive IPOs, acquisitions using overrated paper etc The sector came down to earth with a bump in 2002 Since then, technology company managements are wiser, and sound business fundamentals have resumed with cash-generative, controlled growth the objective The madness of the financial and property sector bubbles followed that of the TMT bubble, eventually extending to the consumer I fear excessive leverage will take longer to repair than the TMT follies, but let us hope that there is a similarly effective grounding in other parts of the economy Meanwhile we can enjoy the progress in the sector in which we invest

UK

The UK declined marginally in capital terms, but yield raised the total return to 1 5% This is some 15% ahead of the HGSC Index plus AIM (capital gains ex investment companies), but this is a general index, so a flattering comparator on this occasion Nevertheless, since inception the internal rate of return of HIT's UK portfolio is nearly 15% in capital terms versus the HGSC Index rising just over 3% per annum, so 2011's outperformance is not so far ahead of the long-term average

Eleven holdings appreciated by more than £1m over the year, and 19 fell by more than £1m, so performance was mixed Phoenix IT and IQE proved the most expensive, each declining more than £5m, but neither are troubled businesses, and I remain confident about their potential In contrast, both Alterian and Patsystems genuinely disappointed expectations and in consequence were both defenceless when approached for a takeover Imagination, Telecom Plus and NCC were large holdings that performed well, offsetting the losers There were five other UK takeovers which, including Alterian and Patsystems, yielded £29m cash Collectively over time the stocks taken over increased the assets of the Company by £15 6m, of which Group NBT was the most significant In recent years I have been disappointed by some takeovers occurring at too low a price It has been frustrating to have invested pre-profits at a high risk stage to find the company is taken over at a much lower-risk stage, with profits potential remaining I have been less anguished by this year's takeovers, because a number had management issues As ever, the cash is helpful, and in particularly short supply when there are excellent opportunities arising from low, and sometimes anomalously low valuations associated with the perennial cash outflow from shrinking the UK equity market The Bank of England helpfully quantified this in a recent report Between 2003 and 2008, the average monthly net withdrawal (primary capital issues less take-over and buybacks) was £0 7bn There was a brief respite in 2009–10 reflecting rescue rights issues, but outflows have resumed at a similar rate in 2011 The TMT space should be an area prolific for IPOs, but when fund managers have negative cash flows the resources are not available, which I find disturbing as a UK taxpayer It is advantageous to be able to buy stocks inexpensively, but it is disappointing to have missed out on investable propositions, because there were insufficient other funds prepared to invest

US

The Trust's US return was marginally negative at -2 5%, which was 6 2% ahead of the most relevant index, the Russell 2000 Technology Index In contrast the large capitalisation index was virtually flat As in the UK, performance was mixed MIPS, Support com and Anadigics all fell by $4m, but were offset by the star performer for the year, Silicon Motion It increased by 341% ($14 3m) At the start of the year HIT was its largest institutional shareholder, but some quality names have built stakes this year It provides controllers for flash memory, which is being widely used in Android mobile phones Ceva and OCZ also contributed usefully, the first providing IP for the baseband in phones, and the second also in the flash memory market The long term returns for HIT in the US have been materially inferior to the UK and European returns, albeit better than the relevant US indices This may appear anomalous given the number of strong US companies, but reflects valuations that have often discounted too much growth at IPO However, these have come down, and technology stocks no longer have a premium valuation to the S&P in p/e terms in spite of the S&P p/e also being low by historic standards I am more tempted than at any stage to increase the US weighting because of improved relative valuations

Europe

Europe has had a dire year This was reflected in very limited exposure to Europe, and the decline of 21 8% would have been worse but for the takeovers of Norkom (Ireland) and Infovista (France) The European exposure of £9 3m at the year-end, and only £12 3m at the start of the year is minimal The trouble is that so much of Europe is so horribly uncommercial, with shareholders ranking low in the pecking order It seems things can only get worse in the short term We are privileged at Herald to have the chance to meet management around the globe More than ever the UK and the US appear safer homes than raw economic data might suggest

Far East

It has been a challenging year in Asia We have previously commented that the manufacturing nature of the Far East, often with little pricing power, makes companies vulnerable to reduced demand This has occurred this year, particularly in the second half The biggest exposure is to South Korea, which seems to be moving up the value chain, and performance positively returned 1 5%, but Taiwan was poor Overall the Far East declined 16 6%

Swap

The fund continues to have a facility of £50m Nearly four years ago interest rates seemed attractively low, and worth locking in at the available level Neither the Board nor I anticipated the degree to which yields have continued to fall The mark to market loss is now £20 4m, but need never be realised if we carry forward the position, as we currently plan to do

Sector Background

The TMT space has the luxury and challenge of supplying multiple market sectors It is wise to assume that consumer, Government and enterprise spending will be constrained in the coming year, so how will it affect the TMT sectors? By segment

1 Consumer

There are now over 2 billion connected consumers globally This century has seen universal consumer adoption of the internet Initially "narrow" band for e-mails, and search (Google), and progressively broadband, and the mobile internet This has led to the emergence of social media (Facebook, Twitter et al), internet TV (Netflix now accounts for >40% of internet traffic in the US), e-Readers, online shopping and more Can the indebted consumer in the Anglo-Saxon world, or the poor consumers in the emerging world afford to maintain, and even increase their expenditure? Increasingly the consumer cannot afford not to be "connected" Indeed for many users the cost of internet connection is actually negative, reflecting the sums saved on flights, holidays, insurance, on-line shopping etc The savings are being created by disintermediation of middlemen (insurance brokers, travel agents, book shops, specialist retailers etc), by reduced administration costs and by the enablement of pricing comparisons and therefore suppliers margin pressure In addition for many products there is a profound disruption in the retail channel There is evidently a diversion of consumer expenditure to fund internet access, the devices that enable it and the products and services available over it As networks are upgraded, and users learn the enhanced capabilities usage will grow, and the thirst for upgraded devices will continue Usage will have to become metred, and the days of unlimited access are numbered In the emerging world, while expenditure and therefore savings are less, the communications leap is greater, and more basic markets such as banking are being opened up There remains a strong following wind!

2 Government

With fiscal deficits everywhere there will be pressures However, large parts of Government are bureaucratic, and have been slow and inefficient about adopting cost-saving technology solutions Furthermore, Governments have huge installed bases of legacy systems with viciously high maintenance costs Some of the large legacy technology companies could well be challenged by an erosion of these lucrative maintenance charges when applications and databases are migrated to more efficient cloud architectures Essentially 'the cloud' is not an application, but it enables existing applications to be delivered more cheaply, and enables new applications such as social media to exist There has been a fashion for outsourcing services While this has further to run, in the UK and US many long term contracts are firmly in renewal territory These suppliers should be vulnerable to difficult headwinds

Traditional defence expenditure looks particularly vulnerable, but as military headcount and weapons expenditure reduce, there simply must be a corresponding diversion of resources to cyber security This has multiple facets (i) protecting data against criminals (internally as well as externally) (ii) protecting data and infrastructure against terrorists or hostile states (iii) it has become evident this year with the Arab Spring and riots in the UK, that social media poses new challenges that Governments will have to address

IT spending looks set to rise overall, but almost certainly there will be incumbent losers, and newcomers addressing the new issues

3. **Enterprise**

   Gartner is a leading IT research house which analyses the large enterprises' IT budgets They have published interesting statistics stating that the average IT spend per employee for their customer base was $12,700 in 2011 Of this, 41% was spent on IT staff and a further 21% outsourced 75% of total spend was operational expenditure versus 25% capital investment Internal IT departments are facing huge challenges Legacy systems are hugely expensive to maintain, and employees from 21 year old starters to the Chairman are increasingly IT literate, and expect consumer quality, which comes at a small fraction of the cost of business systems, whose development costs cannot be amortised over millions of units

   Enterprises have to address the requirement for mobile internet, and they are having to respond to the social media phenomena in marketing, advertising and more sophisticated business intelligence applications The majority of IT spend relates to legacy applications, and expenditure will be made to save costs It seems probable that internal operational expenditure will fall as legacy applications are gradually replaced by cloud architecture, which may well be outsourced This is akin to the food retailing chains' development of their buying power, which squeezed the food manufacturers As companies migrate IT resources to third party data centres, with large buying power, it seems probable that there will be a similar squeeze on suppliers

Again winners and losers are inevitable, but note that 75% of spend is virtually non-discretionary operational cost, which can only be reduced with investment

The big trend to come has been described as "the internet of everything" The internet began as a network of computers, then phones, and next devices A hyperconnected world is emerging where everything (physical and virtual) has its own URL (IP address) and can communicate information Machine-to-machine communication, RFID chips, QR codes, GPS, NFC, IP video are innovations that have already begun to emerge, but there will be more

Summary

The prospective p/e of the portfolio is c 12x on analysts' forecasts It seems that forecasts may in aggregate fall to a lower rate of growth, but a couple of warnings on US holdings left the share prices relatively unscathed I expect a more difficult year for profits growth, but a better year for share prices, because there is fundamental value A resolution of the structural issues in Europe could see a dramatic upside, and a lower chance of a worsening Currently the fund is fully invested reflecting confidence in the value in the portfolio, but it is reassuring to have the proceeds of the borrowing facility available if there is a material wobble, which could provide some outstanding opportunities

Performance Attribution (in sterling terms)

Equity markets	Comparative index allocation 01 01 11 %	Comparative index allocation 31 12 11 %	Herald asset allocation 01 01 11 %	Herald asset allocation 31 12 11 %	Performance* Herald %	Performance* Comparative index %	Contribution to relative return %	Contribution attributable to stock selection %	Contribution attributable to asset allocation† %
UK	66 7	66 7	65 4	68 6	1 5	(13 1)	11 2	11 4	(0 2)
Europe ex UK	–	–	2 6	2 1	(21 8)	–	(0 3)	–	(0 3)
USA	33 3	33 3	25 5	25 0	(1 8)	(8 0)	1 0	1 6	(0 6)
Asia Pacific ex Japan	–	–	6 3	6 9	(16 6)	–	(0 4)	–	(0 4)
Emerging Markets	–	–	0 4	0 4	5 1	–	0 1	–	0 1
Bonds	–	–	4 2	5 8	9 2	–	0 9	–	0 9
Cash	–	–	8 0	6 8	0 1	–	0 5	–	0 5
Swap	–	–	(1 9)	(4 5)	n/a	–	(3 3)	–	(3 3)
Loans	–	–	(10 5)	(11 1)	1 7	–	(1 5)	–	(1 5)
Total	100 0	100 0	100 0	100 0	(4 1)	(11 2)	8 0	13 2	(4 6)

Past performance is not a guide to 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 (4 1%) against a comparative index return of (11 2%) translates into a relative return of 8 0%, divide the portfolio return of 95 9 by the comparative index return of 88 8 and subtract one

† Asset allocation includes the contribution attributable to currency movements

Katie Potts

21 February 2012

Investment Changes (£'000)

	Valuation at 31 December 2010	Net acquisitions/ (disposals)	Appreciation/ (depreciation)	Valuation at 31 December 2011
Equities*				
UK	310,334	202	(2,691)	307,845
Continental Europe	12,296	(393)	(2,597)	9,306
USA	120,967	(6,053)	(2,544)	112,370
Asia Pacific	29,691	7,914	(6,661)	30,944
Emerging Markets	1,962	(76)	102	1,988
Total equities	475,250	1,594	(14,391)	462,453
Bonds				
UK bonds	20,151	(4,160)	454	16,445
Euro bonds	–	9,446	345	9,791
Total bonds	20,151	5,286	799	26,236
Total investments	495,401	6,880	(13,592)	488,689
Net liquid assets	38,098	(7,065)	(66)	30,967
Total assets	533,499	(185)	(13,658)	519,656

The total assets figure above comprises assets less current liabilities before deduction of bank loans and derivative financial instruments

* Equities includes convertibles and warrants

TOP TWENTY EQUITY HOLDINGS

AT 31 DECEMBER 2011

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

Imagination Technologies

Imagination Technologies is an international leader in the creation and licensing of semiconductor System-on-Chip Intellectual Property (SoC IP) Imagination creates market-leading embedded graphics, video and display acceleration, multi-threaded processing and multi-standard receiver technologies and licenses this IP (Intellectual Property) to global semiconductor and system companies These technologies are used in the following markets digital radio and audio, mobile phone multimedia, personal media player, car navigation and driver information, personal navigation mobile computing, digital TV and set-top box, and mobile TV 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 which is the number one supplier of radios in the UK The adoption of digital radio in other countries France and Germany in particular, is opening up a bigger international market and they have launched an internet radio range for the US market The group has a highly skilled workforce of around 900 people, of which over 80% are R&D engineers Apple and Intel are both investors in Imagination Technologies

Country		United Kingdom
% of total assets		5 3
	31/12/11	31/12/10
Valuation (£m)	27 73	21 00
Shares (m)	5 05	5 86

SDL

SDL is the leader in Global Information Management (GIM) solutions that help organisations to accelerate the delivery of high-quality multilingual content to global markets alongside their products and services SDL's best-of-breed Web Content Management eCommerce, Structured Content and Language Technologies, combined with its Language Services drive down the cost of content creation, management, translation and publishing SDL solutions increase conversion ratios and customer satisfaction through targeted information across all customer touch points Global industry leaders who rely on SDL include ABN-Amro, Bosch, Canon CNH FICO, GlaxoSmithKline Hewlett-Packard, KLM, Microsoft, NetApp, Philips, SAP and Sony SDL has over 1 500 enterprise customers, has deployed over 170,000 software licenses and provides access to on-demand portals for 10 million customers per month It has a global infrastructure of more than 60 offices in 35 countries SDL is in Gartner's leader quadrant for web content management

Country		United Kingdom
% of total assets		3 8
% of issued share capital held		3 8
	31/12/11	31/12/10
Valuation (£m)	19 70	21 55
Shares (m)	2 98	3 36

Telecom Plus

Telecom Plus which owns and operates the Utility Warehouse brand is the UK's only fully integrated provider of a wide range of competitively priced utility services spanning both the communications and energy markets Telecom Plus supplies fixed wire and mobile telecommunications services, gas and electricity to over 370,000 residential and small business customers in the United Kingdom with a unified bill and good value utilities Telecom Plus 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 individual users to negotiate bulk buying deals with major suppliers passing the benefit back to their customers Telecom Plus does not advertise and has no shops Instead, they rely on word of mouth recommendations from satisfied customers and from a network of Independent Distributors

Country		United Kingdom
% of total assets		2 8
	31/12/11	31/12/10
Valuation (£m)	14 52	12 07
Shares (m)	1 89	2 69

NCC Group

As a trusted adviser, NCC Group provides business critical IT assurance and protection to over 15 000 organisations worldwide, including 94 out of the FTSE 100 The Group operates two main complementary divisions Escrow and Assurance Escrow includes ensuring source code data or other business critical material is protected and accessible should anything happen to a key supplier Furthermore NCC confirm the material held is properly protected by verifying that it can be rebuilt from its source code components Assurance, incorporates expert led security testing covering forensics, vulnerability research and the development of expert software to aid organisations in their on-going battle with information security breaches

Country		United Kingdom
% of total assets		1 9
% of issued share capital held		3 5
	31/12/11	31/12/10
Valuation (£m)	10 05	6 66
Shares (m)	1 21	1 21

Silicon Motion Technology

Established in 1995 Silicon Motion Technology designs, is a fabless semiconductor company which develops and markets high performance low-power semiconductor solutions for multimedia consumer electronics applications such as smartphones, digital cameras notebook and tablet PCs, and personal navigation devices It has three product lines mobile storage, multimedia systems-on-a-chip (SoCs) for embedded graphics applications, and mobile communications Silicon Motion Technology is often at the forefront of microcontroller and NAND flash storage devices, with their products being used in many of the leading smartphone and mobile devices The Company's mobile communications product line consists of mobile television integrated circuit solutions and handset transceiver circuits Its embedded graphics processors are generally used to render text, or two-dimensional graphics and user interfaces

Country		USA
% of total assets		1 9
	31/12/11	31/12/10
Valuation (£m)	9 86	2 68
Shares (m)	0 75	1 00

TOP TWENTY EQUITY HOLDINGS *continued*

AT 31 DECEMBER 2011

OpSec Security

OpSec provides solutions to combat counterfeiting and the related problems of diversion, grey marketing online brand abuse and fraud It provides anti-counterfeiting technologies, services and software to over 300 global brands across industry sectors and over 50 governments worldwide The Group operates manufacturing facilities and laboratories in the USA and the UK, and has sales operations in the Americas, Europe and Asia OpSec supplies technologies and solutions into three core markets Banknote and High Security Documents Brand Protection and ID Solutions In addition OpSec owns 50% of 3dcd LLC, a joint venture which licenses technologies for the protection of optical discs (CDs and DVDs)

Country		United Kingdom
% of total assets		1 9
% of issued share capital held		23 3
	31/12/11	31/12/10
Valuation (£m)	9 71	1 53
Shares (m)	18 68	6 98

Phoenix IT Group

Phoenix IT was 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 as well as 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
% of total assets		1 7
% of issued share capital held		7 3
	31/12/11	31/12/10
Valuation (£m)	8 80	14 09
Shares (m)	5 58	5 35

Diploma

Diploma is 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
% of total assets		1 5
	31/12/11	31/12/10
Valuation (£m)	8 00	6 46
Shares (m)	2 35	2 35

ATMI

ATMI Inc is a supplier of materials materials packaging and materials delivery systems used globally in the manufacture of microelectronics devices The company s products consist of front-end semiconductor performance materials sub-atmospheric pressure gas delivery systems for safe handling and delivery of toxic and hazardous gases, and materials packaging and dispensing systems ATMI serves and provides applications and analytical support services to three markets integrated circuit IC fabrication, flat-panel displays and life sciences ATMI is devoted to constantly revolutionising microelectronic manufacturing technologies helping them drive these industries forward They are headquartered in Danbury, Connecticut and employ over 800 people

Country		USA
% of total assets		1 5
	31/12/11	31/12/10
Valuation (£m)	7 73	5 09
Shares (m)	0 60	0 40

Advent Software

Advent supplies investment management companies with integrated software products and services in portfolio administration including workflows within the managers and external portfolio reporting Each solution focuses on specific mission-critical functions of the front, middle and back offices and is designed to meet the needs of the particular client, as determined by size assets under management and complexity of the investment environment With more than 4 600 client firms, Advent has established itself as a leading provider of mission-critical applications to meet the demands of investment management operations around the world It has adopted a rental model

Country		USA
% of total assets		1 4
	31/12/11	31/12/10
Valuation (£m)	7 52	8 88
Shares (m)	0 48	0 24

IDOX

IDOX plc develops and markets information management products and services It services more than 90% of UK local authorities and has a high proportion of recurring revenue It provides document management, case management, workflow systems content and related Web-based portals IDOX has three main service lines data management software, mainly sold to the public sector consultancy services and recruitment systems for the management and distribution of personnel files and information It is actively moving its market focus to increasingly target the private sector

Country		United Kingdom
% of total assets		1 4
% of issued share capital held		8 8
	31/12/11	31/12/10
Valuation (£m)	7 28	4 17
Shares (m)	30 32	30 32

Allocate Software

Allocate Software plc is a global workforce and corporate governance software solutions provider for organisations with large multi-skilled workforces With a blue chip client base spanning the public and private sector, its key vertical markets include healthcare and defence At the core of the business is Allocate s workforce optimisation software which streamlines the whole workforce management of multi disciplinary groups, across diverse locations Allocate provides services and support to over 700 customers throughout the world with the majority of revenue coming from the healthcare industry It is headquartered in London

Country		United Kingdom
% of total assets		1 3
% of issued share capital held		13 6
	31/12/11	31/12/10
Valuation (£m)	6 58	4 56
Shares (m)	8 55	6 00

Euromoney Institutional Investor

Euromoney is a leading international business-to-business media group focused primarily on the international finance, metals and commodities sectors It publishes more than 70 magazines, newsletters and journals, including Euromoney Institutional Investor and Metal Bulletin It also runs an extensive portfolio of conferences seminars and training courses and is a leading provider of electronic information and data covering international finance metals and emerging markets Its main offices are in London, New York and Hong Kong and nearly half its revenues are derived from the United States

Country		United Kingdom
% of total assets		1 3
	31/12/11	31/12/10
Valuation (£m)	6 56	8 65
Shares (m)	1 05	1 25

Alternative Networks

Alternative Networks is a UK based independent telecommunications service provider targeted primarily at the corporate market It supplies a wide range of services, including managed network services non-geographic number services mobile phone and data services, and internet and broadband provision It also supplies, installs and maintains business telephone systems, and associated integrated communications applications and manages working group tariffs via partnerships with O2 Vodafone RIM, Nokia and HTC Founded in 1994, it employs over 500 members of staff, servicing over 5 000 customers

Country		United Kingdom
% of total assets		1 2
% of issued share capital held		4 4
	31/12/11	31/12/10
Valuation (£m)	6 33	4 07
Shares (m)	2 13	2 13

Ceva

CEVA is the world's leading licensor of DSP cores and platform solutions for the mobile, digital home and networking markets CEVA s IP portfolio includes comprehensive technologies for cellular baseband (2G / 3G / 4G) multimedia, HD video, HD audio voice over packet (VoP), Bluetooth, Serial Attached SCSI (SAS) and Serial ATA (SATA) Headquartered in Mountain View California, CEVA has 190 employees worldwide, with design centers in Israel and Ireland and sales and support offices located in Europe the U S and throughout Asia More than 2 5 billion CEVA-powered chips have been shipped worldwide The CEVA business model consists of three components, upfront license fees royalty revenue chips incorporating CEVA IP, and, revenues from related customer support development tools and maintenance

Country		USA
% of total assets		1 2
	31/12/11	31/12/10
Valuation (£m)	6 19	4 96
Shares (m)	0 32	0 38

M&C Saatchi

M&C Saatchi is a global marketing services business working for clients across a wide variety of industry sectors The Company was founded in 1995 Starting with a strong base in the UK and Australia, M&C Saatchi have added new agencies and disciplines in Asia USA and Europe, employing over 1,250 staff in 19 countries

Country		United Kingdom
% of total assets		1 1
% of issued share capital held		8 2
	31/12/11	31/12/10
Valuation (£m)	5 92	6 86
Shares (m)	5 15	5 40

StatPro Group

StatPro is a leading provider of portfolio analysis and asset valuation software and services for the global asset management industry The company s focus is on delivering a SaaS-based analytics and data platform on a rental basis to investment management companies allowing them to analyse portfolio performance, attribution risk and GIPS® compliance StatPro also provides market data and valuation feeds including a Complex Asset Pricing service StatPro has over 250 clients and generally experiences in excess of a 90% annual renewal rate

Country		United Kingdom
% of total assets		1 1
% of issued share capital held		11 3
	31/12/11	31/12/10
Valuation (£m)	5 92	7 71
Shares (m)	6 88	6 88

Fidessa Group

Fidessa supplies trading systems to the world's financial markets It is the leading supplier of multi-asset trading, portfolio analysis decision support, compliance market data and connectivity solutions Fidessa's products and services make it easier to buy sell and own financial assets of all types on a global basis and uniquely serves both the buy-side and sell-side communities globally Fidessa has developed its products over 28 years, investing heavily in their continual evolution Fidessa's products are used by over 85% of tier-one, global financial institutions Headquartered in London and with regional operations across Europe North America Asia and the Middle East Fidessa supports over 26 000 users across 900 clients serving a broad spectrum of customers from major investment banks and asset managers through to specialist niche brokers and hedge funds The product is supplied on a rental basis

Country		United Kingdom
% of total assets		1 1
	31/12/11	31/12/10
Valuation (£m)	5 88	6 00
Shares (m)	0 39	0 39

Mellanox Technologies

Mellanox Technologies is a leading supplier of end-to-end InfiniBand and Ethernet connectivity solutions and services for servers and storage Mellanox products optimise data center performance and deliver industry-leading bandwidth scalability, power conservation and cost-effectiveness whilst converging multiple legacy network technologies into one future-proof architecture The company offers innovative solutions that address a wide range of markets including High Performance Computing enterprise, mega warehouse data centers cloud computing Internet and Web 2 0 Founded in 1999, Mellanox Technologies is headquartered in Sunnyvale California and Yokneam, Israel

Country		USA
% of total assets		1 1
% of issued share capital held		6 8
	31/12/11	31/12/10
Valuation (£m)	5 77	4 62
Shares (m)	0 28	0 28

Andor Technology

Andor develops and manufactures high performance digital cameras for the scientific research & industrial communities The company has grown organically and is today the fastest growing company manufacturing high performance digital cameras Established in 1989 out of Queen's University in Belfast, Andor now employs more than 300 people in 16 offices worldwide and distributes its products to 10,000 customers in 55 countries Andor acquired Bitplane AG in 2009 Bitplane is the world s leading interactive microscopy image analysis software company specialising in Medical and Life Sciences In 2010 Andor acquired Photonic Instruments, USA which developed the revolutionary Mosaic and Micropoint products and are the market leaders in fluorescence imaging and laser ablation for confocal and widefield microscopy

Country		United Kingdom
% of total assets		1 1
% of issued share capital held		3 1
	31/12/11	31/12/10
Valuation (£m)	5 61	3 88
Shares (m)	0 95	0 95

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

CLASSIFICATION OF INVESTMENTS

Classification	UK %	Continental Europe %	USA %	Asia Pacific %	Emerging Markets %	2011 Total %	2010 Total %
EQUITIES. (including convertibles and warrants)							
OIL & GAS	**0.3**	–	–	–	–	**0.3**	**0.1**
Oil equipment services and distribution	0.3	–	–	–	–	0.3	0.1
BASIC MATERIALS	–	–	–	**0.7**	–	**0.7**	**0.6**
Chemicals	–	–	–	0.7	–	0.7	0.6
INDUSTRIALS	**9.7**	**0.2**	–	**1.7**	–	**11.6**	**9.2**
Aerospace and defence	0.3	–	–	–	–	0.3	0.2
Electronic and electrical equipment	2.6	–	–	1.6	–	4.2	3.1
Support services	6.8	0.2	–	0.1	–	7.1	5.9
CONSUMER GOODS	**0.1**	–	–	–	–	**0.1**	**0.2**
Household goods and home construction	0.1	–	–	–	–	0.1	0.2
HEALTH CARE	**0.8**	–	**0.3**	–	–	**1.1**	**0.5**
Health care equipment and services	0.4	–	0.3	–	–	0.7	0.5
Pharmaceuticals and biotechnology	0.4	–	–	–	–	0.4	–
CONSUMER SERVICES	**7.9**	**0.1**	–	**0.1**	–	**8.1**	**9.2**
Media	7.9	0.1	–	0.1	–	8.1	9.2
TELECOMMUNICATIONS	**4.1**	–	**0.9**	**0.1**	–	**5.1**	**3.9**
Fixed line telecommunications	4.0	–	0.9	–	–	4.9	3.6
Mobile telecommunications	0.1	–	–	0.1	–	0.2	0.3
FINANCIALS	**0.9**	–	–	–	–	**0.9**	**0.4**
Financial services	0.5	–	–	–	–	0.5	0.1
Equity investment instruments	0.4	–	–	–	–	0.4	0.3
TECHNOLOGY	**35.4**	**1.5**	**20.4**	**3.4**	**0.4**	**61.1**	**65.0**
Software and computer services	25.5	0.9	8.2	0.7	0.4	35.7	40.3
Technology hardware and equipment	9.9	0.6	12.2	2.7	–	25.4	24.7
TOTAL EQUITIES (including convertibles and warrants)	**59.2**	**1.8**	**21.6**	**6.0**	**0.4**	**89.0**	
Total equities – 2010 (including convertibles and warrants)	58.2	2.3	22.7	5.5	0.4		**89.1**
BONDS	**3.1**	**1.9**	–	–	–	**5.0**	**3.8**
NET LIQUID ASSETS	**5.6**	**0.1**	–	**0.3**	–	**6.0**	**7.1**
TOTAL ASSETS (before deduction of bank loans and derivative financial instruments)	**67.9**	**3.8**	**21.6**	**6.3**	**0.4**	**100.0**	
Total assets – 2010	68.7	2.3	22.7	5.9	0.4		**100.0**
BANK LOANS	**(9.6)**	–	–	–	–	**(9.6)**	**(9.4)**
DERIVATIVE FINANCIAL INSTRUMENTS	**(3.9)**	–	–	–	–	**(3.9)**	**(1.7)**
SHAREHOLDERS' FUNDS	**54.4**	**3.8**	**21.6**	**6.3**	**0.4**	**86.5**	
Shareholders' funds – 2010	57.6	2.3	22.7	5.9	0.4		**88.9**
Number of equity investments (including convertibles and warrants)	135	13	52	44	1	245	220

GEOGRAPHICAL SPREAD OF INVESTMENTS

31 December 2011 **31 December 2010**

DETAILED LIST OF INVESTMENTS

AT 31 DECEMBER 2011

Classification	Name	Value £'000	%
UNITED KINGDOM			
Oil equipment, services and distribution	* KBC Advanced Technologies	1,357	0.3
Aerospace and defence	* Cohort	1,352	0.3
Electronic and electrical equipment	* Andor Technology	5,605	
	e2v Technologies	2,332	
	* Gooch and Housego	722	
	Hiwave Technology	737	
	* Microsaic Systems	378	
	* RCG Holdings	48	
	Volex	1,290	
	Xaar	1,829	
	XP Power	757	
		13,698	2.6
Support services	Acal	2,163	
	AEA Technology	140	
	* Avisen	267	
	* Digital Barriers	4,856	
	Diploma	7,997	
	Electrocomponents	4,065	
	† Freshwater UK	–	
	Harvey Nash Group	481	
	* Maintel	2,014	
	* OpSec Security	9,713	
	* Planet Payment	1,591	
	* Sagentia	860	
	* Spectra Systems	216	
	St Ives	894	
	* Tangent Communications	292	
		35,549	6.8
Household goods and home construction	* PhotonStar LED Group	613	0.1
Health care equipment and services	* Deltex Medical	2,302	0.4
Pharmaceuticals and biotechnology	* Sphere Medical	2,108	0.4
Media	* Avesco	3,006	
	Bloomsbury Publishing	1,474	
	* Brainjuicer	2,051	
	Centaur Media	504	
	Chime Communications	2,096	
	* Dotdigital	610	
	* Ebiquity	2,323	
	Euromoney Institutional Investor	6,562	
	Future Network	639	
	* M&C Saatchi	5,923	
	* Media Corporation	258	
	* Next Fifteen Communications	4,499	
	* Parellel Media Group	448	
	* Pivot Entertainment Group	153	
	* Progressive Digital Media Group	509	
	Quarto Group	2,346	
	* Ten Alps	862	
	* The Mission Marketing Group	350	
	† Touch Group	–	
	Trinity Mirror	1,027	
	* UBC Media Group	143	
	* WFCA	54	
	* Weare 2020	160	
	* Yougov	887	
	Wilmington Group	4,205	
	* Woodburne Square	19	
		41,108	7.9
Fixed line telecommunications	* Alternative Networks	6,326	
	Telecom Plus	14,519	
		20,845	4.0

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2011

Classification	Name	Value £'000	%
UNITED KINGDOM (continued)			
Mobile telecommunications	* 2 Ergo Group	305	0 1
Financial services	* Imperial Innovations	1 567	
	IP Group	978	
		2 545	0 5
Equity investment instruments	† Herald Ventures II	1,709	
	† HIML Holdings Limited	207	
		1,916	0 4
Software and computer services	* @UK	532	
	* Active Risk Group	1,167	
	* Allocate Software	6,584	
	Alterian	4,201	
	* Artilium	494	
	* Atlantic Global	82	
	* Bango	3,179	
	* Brady	2,697	
	† Business Control Solutions	-	
	† Celoxica Holdings	-	
	* Coms	44	
	* Corero	1,389	
	* Craneware	3 136	
	† Dealogic	1 690	
	* Delcam	1,330	
	* Dillistone	1,237	
	* Earthport	739	
	* Eckoh Technologies	1,816	
	Electronic Data Processing	779	
	* Eservglobal	312	
	* Ffastfill	4,397	
	Fidessa Group	5,879	
	* First Derivatives	475	
	* GB Group	3,722	
	* Globo	321	
	Gresham Computing	2,162	
	* IDOX	7,276	
	Innovation	1,610	
	* Intercede	1,271	
	†*# Invu	269	
	* Iomart	1,698	
	* IS Solutions	237	
	* K3 Business Technology	2,066	
	Kewill Systems	1,679	
	Kofax	3,510	
	* Maxima Holdings	892	
	Microgen	3,461	
	NCC Group	10,055	
	* Netcall	462	
	* OMG	1,364	
	Parity	253	
	* Patsystems	1 722	
	Phoenix IT Group	8 799	
	* Scisys	1,200	
	SDL	19 703	
	†*# Servicepower Technologies	1,419	
	* Silanis International	806	
	†*# SocialGO	139	
	* SQS Software Quality Systems	2,972	
	* StatPro Group	5,918	
	* Tikit	395	
	* Timeweave	3,614	
	†*# Zoo Digital	1,215	
		132,369	25 5

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2011

Classification	Name		Value £'000	%
UNITED KINGDOM (continued)				
Technology hardware and equipment	* Amino Technologies		950	
	BATM Advanced Communications		1,692	
	CML Microsystems		2,092	
	* Concurrent Technology		351	
	CSR		820	
	Filtronic		286	
	Imagination Technologies		27,734	
	† Intechnology		1 286	
	* IQE		3 768	
	* MTI Wireless Edge Ltd		190	
	Northamber		1,646	
	Pace		1,086	
	* Sandvine		335	
	† Spectrum Interactive		–	
	* Telit Communications		2,475	
	* Toumaz		5,468	
	* Ubisense		528	
	Wolfson Microelectronics		1,071	
			51,778	9 9
	TOTAL UNITED KINGDOM EQUITIES		307,845	59 2
CONTINENTAL EUROPE				
Support services	Hologram Industries	France	1,052	0 2
Health care equipment and services	Mauna Kea Technologies	France	203	–
Media	High Co	France	259	
	Roularta Media Group	Belgium	312	
			571	0 1
Software and computer services	† Atex	Norway	–	
	Devoteam	France	374	
	Isra Vision Systems	Germany	706	
	Lbi International	Netherlands	722	
	Opera Software	Norway	1,255	
	Ordina	Netherlands	1,181	
	Sword Group	France	493	
			4,731	0 9
Technology hardware and equipment	BE Semiconductor	Netherlands	2,530	
	Soitec	France	219	
			2 749	0 6
	TOTAL CONTINENTAL EUROPEAN EQUITIES		9,306	1 8
USA				
Electronic and electrical equipment	RF Monolithics		129	-
Health care equipment and services	SonoSite		1,386	0 3
Media	Techtarget		46	–
Fixed line telecommunications	AboveNet		4,601	0 9
Software and computer services	Actuate		5,436	
	Advent Software		7,524	
	Descartes Systems Group		2,491	
	Epiq Systems		2,320	
	Falconstor Software		494	
	Keynote Systems		3,568	
	KEYW		474	
	Mentor Graphics		2,180	
	NetScout Systems		3,394	
	Pegasystems		3,494	
	Retalix Ltd		1,176	
	SPS Commerce		833	
	Support com		1,448	
	Vasco Data Security		838	
	Web com		1,842	
	Websense		5 363	
			42,875	8 2

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2011

Classification	Name		Value £'000	%
USA (continued)				
Technology hardware and equipment	Alliance Fiber Optic Product		929	
	Anadigics		1,201	
	ATMI		7,733	
	Aviat Networks		246	
	Cavium		1,371	
	Ceragon Networks		276	
	Ceva		6,189	
	Extreme Networks		2,295	
	† Green Plug		1,802	
	Integrated Device Technology		842	
	Lantronix		267	
	Mellanox Technologies		5,773	
	Micros Systems		2,997	
	Mindspeed Technologies		2,391	
	MIPS Technologies		1,148	
	MRV Communications		1,295	
	PLX Technology		917	
	Power Integrations		747	
	Radisys		343	
	Radware		3,760	
	Sandvine	Canada	357	
	Silicom		560	
	Silicon Image		211	
	Silicon Motion Technology		9,864	
	Spansion		646	
	Standard Microsystems		1,656	
	STEC		553	
	Supertex		1,579	
	Tessera Technologies		2,371	
	Trident Microsystems		46	
	Viasat		2,968	
	ATMI		63,333	12 2
	TOTAL USA EQUITIES		112,370	21 6
ASIA PACIFIC				
Chemicals	OCI Materials	Korea	298	
	Soulbrain	Korea	3,299	
			3,597	0 7
Electronic and electrical equipment	BSE Holdings	Korea	345	
	Dae Duck Electronics	Korea	2,187	
	Elk	Korea	224	
	Fine DNC	Korea	271	
	Fine Technix	Korea	646	
	Huan Hsin	Singapore	114	
	Innotek	Singapore	416	
	KH Vatec	Korea	246	
	Simm Tech	Korea	681	
	Surface Mount Technology	Singapore	27	
	Tripod Technology	Taiwan	1,017	
	UJU Electronics	Korea	1,290	
	Unimicron Technology	Taiwan	973	
			8,437	1 6
Support services	51 Job	China	537	0 1
Media	Hong Kong Economic Times	Hong Kong	562	0 1
Mobile telecommunications	CITIC Telecom International	Hong Kong	275	0 1
Software and computer services	Kingdee International Software	Hong Kong	259	
	Melbourne IT	Australia	401	
	Netqin Mobile	China	243	
	Reckon	Australia	1 640	
	Springsoft	Taiwan	808	
	Trunkbow	China	61	
			3,412	0 7

DETAILED LIST OF INVESTMENTS *continued*

AT 31 DECEMBER 2011

Classification	Name		Value £'000	%
ASIA PACIFIC (continued)				
Technology hardware and equipment	Advantech	Taiwan	1,050	
	Ardentec	Taiwan	534	
	Crucialtec	Korea	363	
	D-Link	Taiwan	905	
	Gemtek Technology	Taiwan	134	
	Global Testing	Singapore	258	
	Hana Micron	Korea	255	
	Hanmi Semiconductor	Korea	518	
	Innox	Korea	1,972	
	Jadason Enterprises	Singapore	456	
	King Yuan Electronics	Taiwan	309	
	Kinsus Interconnect Technology	Taiwan	1,560	
	Min Aik Technology	Taiwan	765	
	Nepes	Korea	1,605	
	Orise Technology	Taiwan	204	
	Powertech Technology	Taiwan	1 678	
	Protec	Korea	165	
	PSK	Korea	666	
	Silicon Works	Korea	321	
	Unizyx Holdings	Taiwan	406	
			14,124	2 7
	TOTAL ASIA PACIFIC EQUITIES		30,944	6 0
EMERGING MARKETS				
Software and computer services	Datatec	South Africa	1,988	0 4
	TOTAL EMERGING MARKETS EQUITIES		1,988	0 4
	Value of equity stocks	461,291		
	Convertible loan stocks having an element of equity	1,162		
TOTAL EQUITY INVESTMENTS			462,453	89 0
FIXED INTEREST	Daily Mail GT 5 75% 2018	1,715		
	Daily Mail GT 7 5% 2013	1,674		
	Norway 4 24% 2017	4,819		
	Norway 4 5% 2019	4,972		
	† Ten Alps Loan Note	1,700		
	UK Treasury 4% 2016	9,143		
	WPP Group 6% 2017	2,213		
TOTAL FIXED INTEREST			26 236	5 0
TOTAL INVESTMENTS			488,689	94 0
NET LIQUID ASSETS			30,967	6 0
TOTAL ASSETS AT MARKET VALUE			519,656	100 0

(Before deduction of bank loans and derivative financial instruments)

(* 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	Shareholders' funds £'000	Net asset value per share p	Diluted net asset value per share* p	Share price p	Warrant price p	(Discount)/ premium† %
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)
2008	275,789	(65 079)‡	210,710	252 63	252 63	184 00	-	(27 2)
2009	397 194	(56 298)‡	340 896	420 58	420 58	337 75	-	(19 7)
2010	533 499	(58,937)‡	474 562	593 85	593 85	483 00	-	(18 7)
2011	**519,656**	**(70,357)‡**	**449,299**	**563 75**	**563 75**	**455 0**	-	**(19 3)**

* The diluted net asset value per ordinary share figures have been calculated in accordance with FRS22
† (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
‡ Includes derivative financial instruments

Revenue

Gearing Ratios

Year to 31 December	Gross revenue £'000	Available for ordinary shareholders £'000	Earnings per ordinary share net¶ p	Dividend per ordinary share net p	Total expense ratio§ %	Actual gearing^	Potential gearing**
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
2008	7 629	4,742	5 59	1 55††	1 13	101	131
2009	6 077	324	0 39	0 30	1 12	105	117
2010	7 277	42	0 05	-	1 05	101	112
2011	**9,171**	**947**	**1 19**	**1 00**	**1 10**	**105**	**116**

¶ 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 43)
§ 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 and corporate bonds) divided by shareholders funds
** Total assets (including all debt used for investment purposes) divided by shareholders funds
†† The 2008 dividend excludes the special dividend of 3 45p

Cumulative Performance (taking 2001 as 100)

At 31 December	Diluted net asset value per share*	Share price p	Comparative index‡‡	Hoare Govett Smaller Cos & AIM Index	Russell 2000 Technology Index§§	Earnings per ordinary share	Dividend per ordinary share net	Retail price index
2001	100	100	100	100	100	100	100	100
2002	66	58	66	74	49	54	100	103
2003	116	106	93	102	71	24	35	106
^^2004	121	105	100	120	64	25	35	110
2005	130	124	120	147	70	47	71	112
2006	138	125	135	175	69	161	141	117
2007	126	102	130	162	71	(116)	59	122
2008	80	60	77	82	56	411	182	123
2009	134	110	118	129	81	29	35	126
2010	189	158	157	166	114	4	-	132
2011	**179**	**149**	**137**	**141**	**105**	**87**	**118**	**138**
Compound Annual Returns								
5 year	5 3%	3 5%	0 4%	(4 2%)	8 7%	(11 5%)	(3 6%)	3 4%
10 year	6 0%	4 0%	3 2%	3 5%	0 5%	(1 3%)	1 6%	3 3%

Past performance is not a guide to 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 comparative index was charged to ²/₃ Hoare Govett Smaller Companies Index plus AIM (capital gains ex investment companies) and ¹/₃ Russell 2000 (small cap) Technology Index (in sterling terms)
§§ The Russell 2000 (small cap) Technology Index was rebased during 2009 following some minor adjustments to its constituents The rebased index is used from 31 December 2008 onwards

DIRECTORS' REPORT

The Directors present their Report together with the financial statements of the Company for the year to 31 December 2011

Business Review

Business and Status

The Company is an investment company within the meaning of Section 833 of the Companies Act 2006

The Company carries on business as an investment trust It was approved by HM Revenue & Customs as an investment trust under Section 1158 of the Corporation Tax Act 2010 for the year ended 31 December 2010, subject to matters that may arise from any subsequent enquiry by HM Revenue & Customs into the Company's tax return In the opinion of the Directors the Company has subsequently conducted its affairs so as to enable it to continue to seek such approval

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

Investment Policy

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 comparative index 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 Company recognises the long term advantages of gearing and has a maximum gearing limit of 50% of net assets Borrowings are invested primarily in equity markets but the Manager is 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 16 to 20 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 comparative index,
- the movement in the share price,
- the discount, and
- the total expense ratio

DIRECTORS' REPORT *continued*

A historical record of these measures is shown on pages 2, 3 and 21

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

Borrowings

A £25 million tranche of the £50 million multi-currency variable rate loan facility with The Royal Bank of Scotland plc expired on 25 May 2011 and was replaced with a two year £25 million multi-currency variable rate loan facility with The Royal Bank of Scotland plc, expiring 30 May 2013

Results and Dividend

The net asset value (NAV) of the Company at 31 December 2011 was 563 75p per Ordinary share (2010 – 593 85p) This represented a decrease of 5 1% during the year, compared to a decrease in the comparative index of 12 5% The discount widened from 18 7% to 19 3%

The Directors recommend a dividend of 1 00p (2010 – Nil) per Ordinary share for the year ended 31 December 2011 If approved at the Annual General Meeting, the final dividend will be payable on 3 May 2012 to holders registered on 10 April 2012 The ex-dividend date is 4 April 2012

Review of the Year and Future Trends

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 11

Principal Risks and Uncertainties

The Company's assets consist mainly of listed securities and its principal risks are therefore market related and include market risk (comprising currency risk, interest rate risk and other price risk), liquidity risk and credit risk An explanation of those risks and how they are managed is contained in note 20 to the accounts on pages 47 to 54

Other risks faced by the Company include the following

Regulatory Risk – failure to comply with applicable legal and regulatory requirements could lead to suspension of the Company's Stock Exchange Listing, financial penalties or a qualified audit report Breach of Sections 1158 and 1159 of the Corporation Tax Act 2010 could lead to the Company being subject to tax on capital gains The Manager's Compliance Officer and Baillie Gifford's Heads of Business Risk & Internal Audit and Regulatory Risk provide regular reports to the Audit Committee on their monitoring programmes The Manager monitors investment movements and the Secretary monitors the level of forecast income and expenditure to ensure the provisions of Sections 1158 and 1159 are not breached

Major regulatory change could impose unnecessary compliance burdens on the Company or threaten the viability of the investment company structure In such circumstances representation is made to ensure that special circumstances of investment trusts are recognised

Operational/Financial Risk – failure of the Secretary's accounting systems or those of other third party service providers could lead to an inability to provide accurate reporting and monitoring or a misappropriation of assets The Secretary has a comprehensive business continuity plan which facilitates continued operation of the business in the event of a service disruption or major disruption The Audit Committee reviews the Secretary's Report on Internal Controls and the reports by other key third party providers are reviewed by the Secretary on behalf of the Audit Committee

Discount Volatility – the discount at which the Company's shares trade can widen The Board monitors the level of discount and the Company has authority to buy back its own shares

Gearing Risk – the Company may borrow money for investment purposes If the investments fall in value, any borrowings will magnify the extent of this loss If borrowing facilities are not renewed, the Company may have to sell investments to repay borrowings

All borrowings require the prior approval of the Board and gearing levels are discussed by the Board and Managers at every meeting The majority of the Company's investments are in quoted securities

Employees

The Company has no employees

Social and Community Issues

As an investment trust, the Company has no direct social or community responsibilities However, the Company believes that it is in the shareholders' interests to consider environmental, social and governance factors when selecting and retaining investments Details of the Company's policy on socially responsible investment are set out on page 27

Corporate Governance

Compliance

The Board is committed to achieving and demonstrating high standards of Corporate Governance This statement outlines how the principles of the June 2010 UK Corporate Governance Code (the "Code"), which can be found at www frc org uk, were applied throughout the financial year The Board confirms that the Company has complied throughout the year under review with the relevant provisions of the Code, except that Mr J Cazalet, Chairman of the Board, is a member of the Audit Comittee The Board believes that it is appropriate for Mr Cazalet to be a member of the Audit Committee as he is considered to be independent and there are no conflicts of interest

The Association of Investment Companies has published its own Code of Corporate Governance which provides a framework of best practice for investment companies which can be found at www theaic co uk The Board is of the opinion that the Company has complied with the recommendations of the AIC Code

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 financial statements, investment transactions, revenue budgets and performance Full and timely information is provided to the Board to enable it to function effectively and to allow Directors to discharge their responsibilities

Following the appointment of Mr SW Newton on 6 January 2012, the Board comprises five Directors, all of whom are non-executive The Chairman is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda 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 comprising entirely non-executive Directors, there is no chief executive officer Mr DCP 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

Terms of Appointment

The terms and conditions of Directors' appointments are set out in formal letters of appointment which 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 The Board has agreed that all Directors will retire annually and if appropriate, offer themselves for re-election

Independence of Directors

All the Directors 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

Mr CM Brendish and Mr DCP McDougall have served on the Board for more than nine years Mr Brendish is not offering himself for re-election at the Annual General Meeting The Directors recognise the importance of succession planning for company boards and review the Board composition annually However, 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 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 has concluded that Mr Brendish and Mr McDougall continue to be independent in character and judgement and their skills and experience have been a benefit to the Board

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, revenue budgets, dividend policy and communication with shareholders The Board considers that it meets sufficiently regularly to discharge its duties effectively The table on page 25 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	**5**	**2**	**1**
Julian Cazalet	5	2	1
Clay Brendish	5	2	1
Timothy Curtis	5	2	1
Douglas McDougall	5	2	1

Mr SW Newton was appointed after the year end on 6 January 2012

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 Committee is responsible for considering Directors' potential conflicts of interest and for making recommendations to the Board on whether or not the potential conflicts should be authorised The terms of reference are available on request and on the Manager's website **http://www.heralduk.com**

During the year, the Nomination Committee initiated the search for an additional Director The Committee identified the skills and experience that would strengthen the Board, having due regard for the benefits of diversity on the Board The overriding priority in appointing new Directors to the Board is to identify the candidate with the best range of skills and experience to complement existing Directors The Committee considered several high quality candidates and identified Mr Stewart Newton as the preferred candidate due to his extensive investment experience Mr Newton was appointed to the Board on 6 January 2012 Given the quality of the candidates identified, it was not necessary either to appoint external search consultants or use open advertising

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 DCP McDougall The appraisals and evaluations considered, amongst other criteria, the balance of skills of the Board, training and development requirements, 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

The Board currently considers that the use of external consultants to facilitate this evaluation is unlikely to be a significant benefit to the process, though the option to do so is kept under review

A review of the Chairman's and other Director's commitments was carried out and the Nomination Committee is satisfied that they are capable of devoting sufficient time to the Company There were no significant changes to the Chairman's other commitments during the year

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 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 31 and 32

Internal Controls and Risk Management

The Directors acknowledge their responsibility for the Company's risk management and internal controls systems and for reviewing their effectiveness The systems are designed to manage rather than eliminate the risk of failure to achieve business objectives 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 Company's risk management and internal control systems and they have procedures in place to review their effectiveness on a regular basis No significant weaknesses were identified in the year under review

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 The Board acknowledges its responsibilities to supervise and control the discharge by the Manager and Secretary of their obligations

The practical measures in relation to the design, implementation and maintenance of control policies and procedures to safeguard the assets of the Company and to manage its affairs properly, including the maintenance of effective operational and compliance controls and risk management have also been delegated to HIML

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 its monitoring procedures on a regular basis The Baillie Gifford & Co Heads of Business Risk & Internal Audit and Regulatory Risk also provide the Board with regular reports on Baillie Gifford & Co's monitoring programmes as they relate to the secretarial and administrative function In addition, Baillie Gifford & Co conducts an annual review of its own system of internal controls which is documented within an internal controls report which has been designed to comply with Technical Release AAF 01/06 – Assurance Reports on Internal Controls of Service Organisations made available to Third Parties This report is independently reviewed by Baillie Gifford & Co's auditors A copy of the internal controls report is submitted to the Board

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 custodian prepares a report on its internal controls which is independently reviewed by KPMG Audit PLC

A detailed risk map is prepared which identifies the significant risks faced by the Company and the key controls employed to manage these risks

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 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 Manager and Company Secretary 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 Company, 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 33 to 35

Going Concern

In accordance with The Financial Reporting Council's guidance on going concern and liquidity risk, the Directors have undertaken a rigorous review of the Company's ability to continue as a going concern The Company's principal risks are market related and include market risk, liquidity risk and credit risk An explanation of these risks and how they are managed is contained in Note 20 to the financial statements The Company's assets, the majority of which are investments in quoted securities, exceed its liabilities significantly All borrowings require the prior approval of the Board Gearing levels and compliance with loan convenants are reviewed by the Board on a regular basis The loan facilities currently drawn down expire in May 2013 In accordance with the Company's Articles of Association, shareholders have the right to vote on the continuation of the Company every three years with the next vote being in April 2013

After making enquiries and notwithstanding the above, the financial statements 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

Audit Committee

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 **http://www.heralduk.com** Mr DCP McDougall is Chairman of the Audit Committee The Board believes it is appropriate for Mr Cazalet to be a member of the Audit Committee as he is considered to be independent and there are no conflicts of interest 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 any formal announcements relating to the Company's financial performance,
- reviewing the adequacy and effectiveness of internal control and risk management systems,
- making recommendations to the Board in relation to the appointment of the external auditor and approving the remuneration and terms of their engagement,
- developing and implementing policy on the engagement of the external auditor to supply non-audit services (there were no non-audit services during the year),
- reviewing and monitoring the independence, objectivity and effectiveness of the external auditor,
- 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

Ernst & Young LLP have been the Company's Auditor since 1994 Having considered the experience and tenure of the audit director and staff and level of service provided, the Committee remains satisfied with the auditor's effectiveness The auditor responsible for the audit is rotated every five years and the current lead audit director has been in place for one year There are no contractual obligations restricting the Company's choice of external auditor The Committee receives confirmation from the Auditor that they have complied with the relevant UK professional and regulatory requirements on independence The Committee does not believe that there has been any impairment to the Auditor's independence

Relations with Shareholders

The Board places great importance on communication with shareholders The Company's Manager meets regularly with larger 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, **http://www.heralduk.com**, 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

Corporate Governance and Stewardship

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 (ESG) 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 ESG issues but adopts a positive engagement approach whereby matters are discussed with management with the aim of improving the relevant policies and management systems and enabling the Manager to consider how ESG factors could impact long term investment returns The Manager's Statement of Compliance with the UK Stewardship Code can be found on the Manager's website at **http://www.heralduk.com** The Manager's policy has been reviewed and endorsed by the Board

Conflicts of Interest

Each Director submits a list of potential conflicts of interest to the Nomination Committee on an annual basis The Committee considers these carefully, taking into account the circumstances surrounding them, and makes a recommendation to the Board on whether or not the potential conflicts should be authorised Board authorisation is given for a period of one year Having considered the lists of potential conflicts there were no situations which gave rise to a direct or indirect interest of a Director which conflicted with the interests of the Company

Bribery Act 2010

The Bribery Act came into force on 1 July 2011 The Company has a zero tolerance policy towards bribery and is committed to carrying out business fairly, honestly and openly The Manager and Company Secretary also adopt a zero tolerance approach and have policies and procedures in place to prevent bribery

Directors

The Directors at the year end and their interests in the Company were

Name	Nature of Interest	Number of Ordinary Shares at 31 December 2011	Number of Ordinary Shares at 1 January 2011
Julian Cazalet	Beneficial	100,000	100,000
	Non-beneficial	50,000	50,000
Clay Brendish	Beneficial	14,700	14,700
Timothy Curtis	Beneficial	10,000	10,000
Douglas McDougall	Beneficial	242,000	233,500

Mr SW Newton purchased 25,000 shares on 3 February 2012 There have been no changes intimated in the above Directors' interests up to 20 February 2012

Mr SW Newton was appointed on 6 January 2012 and is required to seek election by shareholders at the Annual General Meeting The Directors believe that the Board will benefit from his skills and experience and recommend his election to shareholders

All Directors will retire at the Annual General Meeting and with the exception of Mr Brendish, all Directors will offer themselves for re-election

The Board has reviewed the performance of Mr CJ Cazalet, Mr TM Curtis and Mr DCP McDougall Their performance continues to be effective and they remain committed to the Company Their contribution to the Board is valued highly and the Board recommends their re-election to shareholders

Director Indemnification and Insurance

The Company has entered into deeds of indemnity in favour of each of the Directors The deeds cover any liabilities that may arise to a third party, other than the Company, for negligence, default or breach of trust or duty The Directors are not indemnified in respect of liabilities to the Company, any regulatory or criminal fines, any costs incurred in connection with criminal proceedings in which the Director is convicted or civil proceedings brought by the Company in which judgement is given against him In addition, the indemnity does not apply to any liability to the extent that it is recovered from another person

The Company maintains Directors' and Officers' liability insurance

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 plc 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 Careful consideration has been given by the Board as to the basis on which the management fee is charged The Board considers that maintaining a relatively low total expense ratio is in the best interest of all shareholders The Board is also of the view that calculating the fee with reference to performance would be unlikely to exert a positive influence over the long term performance At 31 December 2011, Katie Potts held 305,841 Ordinary shares of Herald Investment Trust plc

At 31 December 2011, the Company was the beneficial owner of 14 29% of the Ordinary share capital of HIML Holdings Limited, the parent company of HIML

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

The Board considers the 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 HIML 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

Major Interests in the Company's Shares

Name	Ordinary Shares	% of issue*
1607 Capital Partners (Indirect)	4,008,510	5 0
Rathbone Brothers Plc (Indirect)	4,103,909	5 1
Jupiter Asset Management Limited (Indirect)	3,640,845	4 6
Rensburg Sheppards Investment Management Limited (Indirect)	3,202,229	4 0
Legal & General Group Plc (Direct)	3,162,493	4 0

There have been no changes to the major interests in the Company's shares intimated up to 20 February 2012

* Based on issued share capital at 31 December 2011 of 79 698,283 Ordinary shares

Share Capital

Capital Structure

At 31 December 2011 the Company's capital structure consisted of 79,698,283 Ordinary shares of 25p each (2010 – 79,913,283 Ordinary shares) During the year 215,000 (2010 – 1,140,000) shares were bought back and cancelled There are no restrictions concerning the holding or transfer of the Company's Ordinary shares and there are no special rights attached to any of the shares

Dividends

The Ordinary shares carry a right to receive dividends Interim dividends are determined by the Directors and final dividends are subject to shareholder approval

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

Each Ordinary shareholder present in person or by proxy is entitled to one vote on a show of hands and, on a poll, to one vote for every share held

Information on the deadlines for proxy appointments can be found on page 56

Annual General Meeting

At the Annual General Meeting of the Company to be held on 17 April 2012 the following resolution will be proposed as special business

Authority to Purchase the Company's Ordinary Shares

At the Company's Annual General Meeting held on 19 April 2011 the Company was authorised to purchase up to 11,979,001 of the Company's Ordinary shares (14 99% of its Ordinary share capital in issue at that time) During the year to 31 December 2011 the Company bought back 215,000 Ordinary shares (nominal value £53,750 which comprised 0 3% of the issued share capital at 1 January 2011) on the London Stock Exchange for cancellation Between 1 January 2012 and the date of this report, no further shares have been bought back The Board continues to believe 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 2013 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) 5% above the average closing price (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 bid on the London Stock Exchange The full text of the authority being sought can be found in Resolution 10 in the Notice of Annual General Meeting 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

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 (excluding non-working days) before the time of the Annual General Meeting

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 2010 or 2011

Disclosure of Information to the Auditor

The Directors confirm that so far as each of the Directors is aware there is no relevant audit information of which the Company's auditor is 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 auditor is aware of that information

Independent Auditors

The Auditors, Ernst & Young LLP, are willing to continue in office and in accordance with sections 489 and 491(1) of the Companies Act 2006 resolutions concerning their reappointment and remuneration will be submitted to the Annual General Meeting

By order of the Board

Julian Cazalet

Julian Cazalet
Chairman

21 February 2012

DIRECTORS' REMUNERATION REPORT

The Board has prepared this report in accordance with the requirements of the Companies Act 2006 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 Auditor's opinion is included in their report on pages 34 and 35

Remuneration Committee

The Company has five Directors 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 and comparative information 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 and 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 2012 and subsequent years

The fees for the non-executive Directors are determined within an aggregate limit set out in the Company's Articles of Association which currently stands at £100,000 Non-executive Directors are not eligible for bonuses, pension benefits, share options, long term incentive schemes or other benefits

The Board reviewed Directors' fees during the year and concluded that the fees should remain unchanged at £25,500 for the Chairman and £17,000 for each Director In addition, it was agreed the Chairman of the Audit Committee would receive an additional £2,000 per annum with effect from 1 July 2011

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 election at the first Annual General Meeting after their appointment Under the provisions of the UK Corporate Governance Code, all Directors are required to retire at each Annual General Meeting and offer themselves for re-election There is no notice period and no provision for compensation upon early termination of appointment

Name	Date of appointment	Due date for election/re-election
Julian Cazalet	18 January 2008	AGM 2012
Timothy Curtis	22 July 2004	AGM 2012
Douglas McDougall	13 February 2002	AGM 2012
Stewart Newton	6 January 2012	AGM 2012

Company Performance

The graph below compares, for the five financial years ended 31 December 2011, 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 Reuters Datastream

* Total return (assuming all dividends are reinvested)

Past performance is not a guide to future performance

Directors' Remuneration for the Year (audited)

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

	Fees 2011 £	Fees 2010 £
Directors who served during the year		
Julian Cazalet	25,500	25,500
Clay Brendish	17,000	17,000
Timothy Curtis	17,000	17,000
Douglas McDougall	18,000	17,000
	77,500	76,500

Approval

The Directors' Remuneration Report on pages 31 and 32 was approved by the Board of Directors on 21 February 2012 and signed on its behalf by

Julian Cazalet Julian Cazalet.
Chairman

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration 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 Under that law the Directors have elected to prepare the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period In preparing these financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent, and
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements

The Directors are responsible for the keeping of adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 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

The Directors have delegated responsibility to the Manager for the maintenance and integrity of the Company's page of the Manager's website Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

The work carried out by the Auditor does not involve any consideration of these matters and, accordingly, the Auditor accepts no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website

Each of the Directors, whose names and functions are listed within the Directors, Manager and Advisers section confirm that, to the best of their knowledge

- the financial statements, which have been prepared in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), give a true and fair view of the assets, liabilities, financial position and net return of the Company, and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces

By order of the Board

Julian Cazalet

Julian Cazalet

21 February 2012

INDEPENDENT AUDITOR'S 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 2011 which comprise the Income Statement, the Balance Sheet, the Reconciliation of Movements in Shareholders' Funds, the Cash Flow Statement and the related notes 1 to 20 The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 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 auditor's 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 Auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 33, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

Scope of the Audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on Financial Statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of its net return for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matters prescribed by the Companies Act 2006

In our opinion

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006, and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following

Under the Companies Act 2006 we are required to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Under the Listing Rules we are required to review

- the Directors' Statement, set out on page 26, in relation to going concern,
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review, and
- certain elements of the report to the shareholders by the Board on Directors' remuneration

Ernst & Young LLP

Caroline Gulliver, Senior Statutory Auditor
for and on behalf of Ernst & Young LLP
Statutory Auditor
London

21 February 2012

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER

	Notes	2011 Revenue £'000	2011 Capital £'000	2011 Total £'000	2010 Revenue £'000	2010 Capital £'000	2010 Total £'000
(Losses)/gains on investments	14	–	(25,012)	(25,012)	–	137,953	137,953
Currency (losses)/gains	14	–	(66)	(66)	–	347	347
Income	2	9,171	–	9,171	7,277	–	7,277
Investment management fee	3	(4,752)	–	(4,752)	(3,966)	–	(3,966)
Other administrative expenses	4	(350)	–	(350)	(299)	–	(299)
Net return before finance costs and taxation		4,069	(25,078)	(21,009)	3,012	138,300	141,312
Finance costs of borrowings	5	(2,978)	–	(2,978)	(2,816)	–	(2,816)
Net return on ordinary activities before taxation		1,091	(25,078)	(23,987)	196	138,300	138,496
Tax on ordinary activities	6	(144)	–	(144)	(154)	–	(154)
Net return on ordinary activities after taxation		947	(25,078)	(24,131)	42	138,300	138,342
Net return per Ordinary share	8	1 19p	(31 43p)	(30 24p)	0 05p	171 87p	171 92p

A final dividend for the year of 1 00p (2010 – Nil) per Ordinary share is proposed More information on dividend distributions can be found in Note 7 on page 43

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 No operations were acquired or discontinued during the year

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 40 to 54 are an integral part of the financial statements

BALANCE SHEET

AT 31 DECEMBER

	Notes	2011 £'000	2011 £'000	2010 £'000	2010 £'000
Fixed assets					
Investments held at fair value through profit or loss	9		488,689		495,401
Current assets					
Debtors	10	1,947		1,316	
Cash and short term deposits	17	30,021		39,497	
		31,968		40,813	
Creditors.					
Amounts falling due within one year	11	(51,001)		(52,715)	
Derivative financial instruments	12	(20,357)		(8,937)	
		(71,358)		(61,652)	
Net current liabilities			(39,390)		(20,839)
TOTAL NET ASSETS			449,299		474,562
Capital and reserves					
Called up share capital	13		19,924		19,978
Share premium	14		73,738		73,738
Capital redemption reserve	14		2,028		1,974
Capital reserve	14		350,721		376,931
Revenue reserve	14		2,888		1,941
SHAREHOLDERS' FUNDS			449,299		474,562
NET ASSET VALUE PER ORDINARY SHARE (including current year income)	15		563 75p		593 85p
NET ASSET VALUE PER ORDINARY SHARE (excluding current year income)			562 56p		593 80p

The financial statements of Herald Investment Trust plc (Company Registration No 2879728) were approved by the Board of Directors and authorised for issue on 21 February 2012 and signed on its behalf by

Julian Cazalet
Chairman

Julian Cazalet

The accompanying notes on pages 40 to 54 are an integral part of the financial statements

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

FOR THE YEAR ENDED 31 DECEMBER 2011

	Notes	Called up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Share-holders' funds £'000
Shareholders' funds at 1 January 2011		19,978	73,738	1,974	376,931	1,941	474,562
Net return on ordinary activities after taxation		–	–	–	(25,078)	947	(24,131)
Shares bought back	13	(54)	–	54	(1,132)	–	(1,132)
Shareholders' funds at 31 December 2011		19,924	73,738	2,028	350,721	2,888	449,299

FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	Called up share capital £'000	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Share-holders' funds £'000
Shareholders' funds at 1 January 2010		20,263	73,738	1,689	243,064	2,142	340,896
Net return on ordinary activities after taxation		–	–	–	138,300	42	138,342
Shares bought back	13	(285)	–	285	(4,433)	–	(4,433)
Dividends paid during the year	7	–	–	–	–	(243)	(243)
Shareholders' funds at 31 December 2010		19,978	73,738	1,974	376,931	1,941	474,562

The accompanying notes on pages 40 to 54 are an integral part of the financial statements

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER

	Notes	2011 £'000	2011 £'000	2010 £'000	2010 £'000
Net cash inflow from operating activities	16		3,547		3,580
Servicing of finance					
Loan and derivative interest		(2,935)		(2,823)	
Net cash outflow from servicing of finance			(2,935)		(2,823)
Financial investment					
Purchase of investments		(89,449)		(77,590)	
Sale of investments		80,493		102,455	
Net cash (outflow)/inflow from financial investment			(8,956)		24,865
Equity dividend paid	7		–		(243)
Net cash (outflow)/inflow before financing			(8,344)		25,379
Financing					
Bank loans drawn down	11	25,000		-	
Bank loans repaid	11	(25,000)		–	
Shares repurchased	13	(1,132)		(4,433)	
Net cash outflow from financing			(1,132)		(4,433)
(Decrease)/increase in cash	17		(9,476)		20,946
Reconciliation of net cash flow to movement in net debt	17				
(Decrease)/increase in cash for period			(9,476)		20,946
Movement in net (debt)/funds in period			(9,476)		20,946
Net debt at 1 January			(10,503)		(31,449)
Net debt at 31 December			(19,979)		(10,503)

The accompanying notes on pages 40 to 54 are an integral part of the financial statements

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting policies

The financial statements for the year to 31 December 2011 have been prepared on the basis of the accounting policies set out below, which are consistent with those in the Company's Annual Report and Financial Statements at 31 December 2010

(a) Accounting convention

The financial statements 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 financial statements have been prepared in accordance with The Companies Act 2006, applicable UK accounting standards and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies and Venture Capital Trusts' (issued January 2009)

In order to better reflect the activities of the Company 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 at fair value through profit or loss upon initial recognition and are measured at subsequent reporting dates at fair value 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 Interest from fixed interest securities is recognised on an effective yield basis 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) Financial instruments

The Company uses interest rate swaps to hedge the cash flow risk arising from interest rate fluctuations The swap is marked to fair value The fair value is estimated based on the swap provider's valuation and is compared to an external model and external prices Gains or losses arising on the fair value of the interest rate swap during the year are taken to the income statement as a capital item

In accordance with FRS 26 'Financial Instruments Measurement', derivative instruments are valued at fair value and are included in current assets or current liabilities in the balance sheet

(g) 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

NOTES TO THE FINANCIAL STATEMENTS *continued*

1. Accounting policies (continued)

(h) 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

(i) Capital reserve

The Company is precluded by its Articles from making any distribution of capital profits by way of dividend

Gains and losses on disposal of investments, changes in investment holding gains/(losses), realised exchange differences of a capital nature and purchases of the Company's own shares for cancellation are dealt with in this reserve

(j) Use of estimates

The preparation of financial statements requires the Company to make judgements, estimates and assumptions that affect amounts reported for assets and liabilities as at the balance sheet date and the amounts reported for revenues and expenses during the year However, the nature of estimation means that the actual outcomes could differ from those estimates, possibly significantly The judgements relate to the investments where there is no appropriate market price i e the unlisted investments and the interest rate swap

2. Income

	2011 £'000	2010 £'000
Income from investments		
Franked dividends from listed investments	4,024	2,919
Franked dividends from unlisted investments (inc AIM)	2,532	1,574
Unfranked income from unlisted (inc AIM) UK convertible bonds	74	43
UK unfranked investment income	221	217
Overseas dividend income	1,214	1,135
UK interest	846	1,036
Overseas interest	180	177
	9,091	7,101
Other income		
Deposit interest	80	142
Underwriting commission	–	34
	80	176
Total income	9,171	7,277
Total income comprises		
Dividends from equity securities designated at fair value through profit or loss	7,991	5,845
Interest from financial assets designated at fair value through profit or loss	1,100	1,256
Deposit interest	80	142
Underwriting commission	–	34
	9,171	7,277

3. Investment management fee

	2011 £'000	2010 £'000
Investment management fee	4,752	3,966

Herald Investment Management Limited is appointed investment manager 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

	2011 £'000	2010 £'000
Custodian's fees	38	33
Registrars' fees	41	27
Directors' fees	78	77
Auditor's fees – statutory audit	18	17
Miscellaneous expenses	175	145
	350	299

5. Finance costs of borrowings

	2011 £'000	2010 £'000
Bank loans repayable within one year	947	707
Interest on swap	2,031	2,109
	2,978	2,816

6. Tax on ordinary activities

	2011 £'000	2010 £'000
Analysis of charge in year		
Overseas taxation	144	154

Factors affecting tax charge for year

The tax charge for the year is lower than the standard rate of corporation tax in the UK of 26 5% (2010 – 28%)

The differences are explained below

	2011	2010
Net return on ordinary activities before taxation	(23,987)	138,496
Net return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 26 5% (2010 – 28%)	(6,356)	38,779
Capital returns not taxable	6,645	(38,724)
Dividends not subject to UK tax	(2,117)	(1,637)
Overseas withholding tax	144	154
Movement in excess management expenses	1,828	1,582
Current tax charge for the year	144	154

As an Investment Trust, the Company's capital gains are not taxable

There is no UK corporation tax charge at 31 December 2011 or 31 December 2010 as the Company has unrelieved management expenses which are available to be carried forward The tax charge for 31 December 2011 and 2010 comprises overseas withholding taxes written off

At 31 December 2011 the Company had surplus management expenses of £35 million (2010 – £28 million) 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 dividends

	2011	2010	2011 £'000	2010 £'000
Amounts recognised as distributions in the period:				
Previous year's final	–	0 30p	–	243

Set out below are the total dividends payable in respect of the financial year, which is the basis on which the requirements of Section 1158 of the Corporation Tax Act 2010 are considered The revenue available for distribution by way of dividend for the year ended 31 December 2011 is £947,000 (2010 – £42,000)

	2011	2010	2011 £'000	2010 £'000
Amounts paid and proposed in respect of the period:				
Proposed final dividend per Ordinary share	1 00p	–	797	–

The current year's proposed dividend will be paid on 3 May 2012 to all shareholders on the register at the close of business on 10 April 2012 The ex-dividend date is 4 April 2012

8. Net return per Ordinary share

2011 Revenue	2011 Capital	2011 Total	2010 Revenue	2010 Capital	2010 Total
1 19p	(31 43p)	(30 24p)	0 05p	171 87p	171 92p

Revenue return per Ordinary share is based on the net revenue return on ordinary activities after taxation of £947,000 (2010 – £42,000) and on 79,799,598 Ordinary shares (2010 – 80,465,858) 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 £25,078,000 (2010 – net capital gain of £138,300,000) and on 79,799,598 Ordinary shares (2010 – 80,465,858) 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

	2011 £'000	2010 £'000
Financial assets designated at fair value through profit or loss on initial recognition		
Listed UK – equity investments – London Stock Exchange	153,854	158,864
– AIM	146,237	148,592
– debt investments	16,445	20,151
Listed Overseas – equity investments	152,806	163,894
– debt investments	9,791	-
Unquoted*	9,556	3,900
Total investments in financial assets at fair value through profit or loss	488,689	495,401

9. Fixed assets – investments (continued)

	Listed in UK £'000	Listed overseas £'000	AIM £'000	Unquoted * £'000	Total £'000
Cost of investments at 1 January 2011	107,368	120,490	135,195	12,919	375,972
Investment holding gains/(losses) at 1 January 2011	71,647	43,404	13,397	(9,019)	119,429
Fair value of investments at 1 January 2011	179,015	163,894	148,592	3,900	495,401
Movements in the year					
Purchases at cost	14,539	39,475	30,127	3,558	87,699
Sales – proceeds	(24,241)	(29,451)	(26,449)	(703)	(80,844)
– gains/(losses) on sales	12,479	9,844	12,377	(1,088)	33,612
Amortisation of fixed income book cost	140	(115)	–	–	25
Changes in investment holding gains/(losses)	(11,633)	(21,050)	(15,941)	1,420	(47,204)
Change in listing	–	–	(2,469)	2,469	–
Fair value of investments at 31 December 2011	170,299	162,597	146,237	9,556	488,689
Cost of investments at 31 December 2011	110,285	140,243	148,781	17,155	416,464
Investment holding gains/(losses) at 31 December 2011	60,014	22,354	(2,544)	(7,599)	72,225
Fair value of investments at 31 December 2011	170,299	162,597	146,237	9,556	488,689

	2011 £'000	2010 £'000
Gains/(losses) on investments designated at fair value through profit or loss on initial recognition		
Realised gains/(losses) on sales	33,612	35,970
Changes in investment holding (losses)/gains	(47,204)	104,622
	(13,592)	140,592

*The unquoted balance comprises Business Control Solutions at Nil, Celoxica Holdings at Nil, Dealogic at £1,690,000, Freshwater UK at Nil, HIML Holdings Limited at £207,000, Herald Ventures II at £1,709,000, Intechnology at £1,286,000, Invu Convertible loan notes at £240,000, Servicepower Technologies Convertible loan stock at £358,000, Social Go Warrants at Nil, Spectrum Interactive at Nil, Ten Alps Loan Note at £1,700,000, Touch Group at Nil, Zoo Digital at £564,000, Atex at Nil and Green Plug at £1,802,000

The investments in the equity and fixed interest stocks of unlisted companies that the Company holds are not traded and as such the prices are more uncertain than those of more widely traded securities 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 as described in note 1(b) The fair value of unlisted investments at 31 December 2011 was £9,556,000 (2010 £3,900,000)

At 31 December 2011 the Company was the beneficial owner of 14 29% (2010 – 14 29%) of the Ordinary share capital of HIML Holdings Limited HIML Holdings Limited is incorporated in the United Kingdom

	2011 £'000	2010 £'000
Transaction costs		
The following transaction costs were incurred during the period		
Purchases	424	422
Sales	198	368
	622	790

10. Debtors

	2011 £'000	2010 £'000
Due within one year·		
Income accrued	1,576	1,270
Sales for subsequent settlement	351	–
Taxation recoverable	6	9
Other debtors and prepayments	14	37
	1,947	1,316

None of the above debtors are financial assets designated at fair value through profit or loss The carrying amount of debtors is a reasonable approximation of fair value

11. Creditors

	2011 £'000	2010 £'000
Amounts falling due within one year:		
Purchases for subsequent settlement	–	1,750
Bank loans	50,000	50,000
Swap interest	359	382
Other creditors and accruals	642	583
	51,001	52,715

None of the above creditors are financial liabilities designated at fair value through profit or loss Included in other creditors and accruals is £375,000 (2010 – £399,000) in respect of the investment management fee

The Company has a £50 million multi-currency variable rate loan facility with The Royal Bank of Scotland plc, which comprises two £25 million tranches expiring in May 2013 On 31 May 2011, a £25 million tranche expired and was replaced with a two year £25 million multi-currency variable rate loan facility with The Royal Bank of Scotland plc expiring 30 May 2013 The arrangement fee on this replacement facility was £62,500 which has been written off through finance costs of borrowings

At 31 December 2011, there were outstanding drawings of £50 million (2010 – £50 million) Interest on the loans is payable in quarterly instalments in January, April, July and October The estimated repayment value of the loan at 31 December 2011 was £50 million The indicative costs of repaying the loan as at 31 December 2011 were not material in the context of the above figures

The interest on the £50 million facility has been fixed for the long term through a 30 year interest rate swap but may vary on periodic renewals of the debt facility to the extent that the mark up over LIBOR charged by a lending bank varies The fair value of the interest rate swap contract at 31 December 2011 was an estimated liability of £20 4 million (2010 – £8 9 million) which was based on the swap provider's valuation

The loan has been disclosed as due within one year as the Company has an unconditional and irrevocable right to prepay the advance under the terms and conditions of the loan agreement The duration of the advance is 1, 3 or 6 months and the decision to rollover the loan is made at quarterly board meetings based on circumstances prevailing at the time The decision to continue with the swap arrangement is reviewed at the same time as the loan agreement

The main covenants relating to the loan are

1 Total borrowings shall not exceed 25% of the Company's Gross Assets adjusted by deducting
   (i) the market value of any unlisted investments (excluding AIM),
   (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 35% of gross assets
2 The ratio of quoted assets to total borrowings shall not be less than 3 1

12. Derivative financial instruments

	2011 Notional contract amount £'000	2011 Fair value assets £'000	2011 Fair value liablities £'000	2011 Fair value balance £'000	2010 Notional contract amount £'000	2010 Fair value assets £'000	2010 Fair value liablities £'000	2010 Fair value balance £'000
Total derivative assets/(liabilities) held for trading	50,000	27,551	(47,908)	(20,357)	50,000	49,370	(58,307)	(8,937)

The fair value is estimated based on the swap provider's valuation and is compared to an external model and external prices The swap provider does not disclose the basis of its valuation methodology or assumptions and may change these at any time at its sole discretion The swap valuation gives an indication of fair value, but the price at which the swap can be unwound or realised may diverge materially from this valuation depending on market conditions and liquidity The fair value of the swap at 31 December 2011 was £20,357,000 (2010 – £8,937,000)

13. Called up share capital

	2011 Number	2011 £'000	2010 Number	2010 £'000
Allotted, called up and fully paid				
Ordinary shares of 25p	79,698,283	19,924	79,913,283	19,978

At the Annual General Meeting in April 2011, Shareholders granted the Company authority to purchase shares in the market up to 11,979,001 Ordinary shares (equivalent to 14 99% of its issued share capital at that date) In the year to 31 December 2011, a total of 215,000 (2010 – 1,140,000) Ordinary shares with a nominal value of £53,750 (2010 – £285,000) were bought back at a total cost of £1,132,000 (2010 – £4,433,000) At 31 December 2011 the Company had authority to buy back a further 11,764,001 Ordinary shares Under the provisions of the Company's Articles share buy-backs are funded from the capital reserve

14. Capital and reserves

	Share premium £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000
At 1 January 2011	73,738	1,974	376,931	1,941
Shares purchased for cancellation	–	54	(1,132)	–
Gains on sales	–	–	33,612	–
Changes in investment holding gains	–	–	(47,204)	–
Movement in fair value of interest rate swap	–	–	(11,420)	–
Other exchange differences	–	–	(66)	–
Revenue return on ordinary activities after taxation	–	–	–	947
Balance at 31 December 2011	73,738	2,028	350,721	2,888

The capital reserve includes investment holding gains of £72,225,000 (2010 – £119,429,000) as disclosed in note 9

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

15. 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

	2011	2010	2011 £'000	2010 £'000
Ordinary shares	563 75p	593 85p	449,299	474,562

Net asset value per Ordinary share is based on net assets as shown above and on 79,698,283 (2010 – 79,913,283) Ordinary shares, being the number of Ordinary shares in issue at each date

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

	2011 £'000	2010 £'000
Net return on ordinary activities before finance costs and taxation	(21,009)	141,312
Losses/(gains) on investments	25,012	(137,953)
Currency losses/(gains)	66	(347)
(Increase)/decrease in accrued income	(307)	279
Decrease/(increase)in other debtors	23	(2)
(Decrease)/increase in creditors	(7)	117
Amortisation of fixed income book cost	(25)	(19)
Income tax repaid	4	-
Overseas tax suffered	(144)	(154)
Realised currency (loss)/profit	(66)	347
Net cash inflow from operating activities	3,547	3,580

17. Analysis of changes in net debt

	At 1 January 2011 £'000	Cash flows £'000	At 31 December 2011 £'000
Cash at bank and in hand	39,497	(9,476)	30,021
Loans due within one year	(50,000)	-	(50,000)
	(10,503)	(9,476)	(19,979)

18. Contingent liabilities, guarantees and financial commitments

At 31 December 2011 and 31 December 2010 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 The first tranche was drawn down in October 2004, with a total of £2,700,000 being drawn down at 31 December 2010 with a further £300,000 in the year to 31 December 2011 The commitment was fully drawn down in May 2011

19. Capital management

The Company does not have any externally imposed capital requirements The capital of the Company is the Ordinary share capital and reserves as detailed in notes 13 and 14 It is managed in accordance with its investment policy in pursuit of its investment objective, both of which are detailed on page 22, and shares may be repurchased as explained on pages 29 and 30

20. 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 and has an interest rate swap, the purpose of which is to hedge the variability in cash flows arising from interest rate fluctuations on bank loans 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

20. Financial instruments (continued)

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 22

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 pages 43 and 44

A full list of the Company's investments is given on pages 16 to 20 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 12 to 15

Other Price Risk Sensitivity

33 6% of the Company's equity investments at 31 December 2011 (2010 – 33 4%) were listed on the main list of the London Stock Exchange and a further 31 6% (2010 – 31 2%) on AIM The NASDAQ Stock Exchange accounts for 24 2% (2010 – 25 3%) and other stock exchanges 9 2% (2010 – 9 4%) A 10% increase in stock prices at 31 December 2011 would have increased total net assets and net return on ordinary activities after taxation by £46,200,000 (2010 – £47,500,000) A decrease of 10% would have had an equal but opposite effect The portfolio does not target any exchange as a comparative index, 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 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 borrowings of £50 million (2010 – £50 million) Under the terms of an interest rate swap, the interest payable on the bank loans has been fixed

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

Financial Assets

	2011 Fair value £'000	2011 Weighted average interest rate/ interest rate	2011 Weighted average period until maturity/ maturity date	2010 Fair value £'000	2010 Weighted average interest rate/ interest rate	2010 Weighted average period until maturity/ maturity date
Fixed rate						
UK bonds	16,445	4 9%	5 years	20,151	4 7%	4 years
EUR bonds	9,791	4 4%	6 years	–	–	–
UK convertible bonds	1,162	7 5%	3 years	843	6 9%	3 years
Cash						
Other overseas currencies	1,762			2,278		
Sterling	28,259	0 3%		37,219	0 2%	
	30,021			39,497		

20. Financial instruments (continued)

(ii) Interest Rate Risk (continued)

The cash deposits generally comprise call or short term money market deposits with original maturities of less than 3 months which are repayable on demand The benchmark rate which determines the interest payments received on cash balances is the bank base rate

Financial Liabilities

	2011 £'000	2011 Net interest rate paid	2011 Loan facility expired/ expires	2010 £'000	2010 Net interest rate paid	2010 Loan facility expired/ expires
Bank Loan	25,000	1 3%	May 2011	25,000	1 3%	May 2011
	25,000	1 6%	May 2013	25,000	1 4%	May 2013
	25,000	2 4%	May 2013	–	–	–
		1 9%			1 4%	
Swap	50,000	4 1%		50,000	4 2%	
Total		6 0%			5 6%	

The effective fixed rate of interest on the loans of 6 0% (2010 – 5 6%) reflects a weighted average variable interest rate paid of 1 9% (2010 – 1 4%), with a further weighted average of 4 1% paid on the swap (2010 – 4 2%) The Company's facilities are rolling on a quarterly basis with the facilities expiring in May 2013 While the 30 year swap remains in place, the net interest payable will effectively be fixed for the duration of the term of the loan facilities

	2011 Notional contract amount £'000	2011 Fair value assets £'000	2011 Fair value liablities £'000	2011 Fair value balance £'000	2010 Notional contract amount £'000	2010 Fair value assets £'000	2010 Fair value liablities £'000	2010 Fair value balance £'000
Total derivative assets/(liabilities) held for trading	50,000	27,551	(47,908)	(20,357)	50,000	49,370	(58,307)	(8,937)

Interest rate risk sensitivity

(a) Cash

An increase of 100 basis points in interest rates as at 31 December 2011 would have a direct effect on net assets Based on the position at 31 December 2011, over a full year, an increase of 100 basis points would have increased the net return on ordinary activities after taxation by £300,000 (2010 – £395,000) and would have increased the net asset value per share by 0 38p (2010 –0 49p) 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

(b) Fixed rate bonds

An increase of 100 basis points in bond yields as at 31 December 2011 would have decreased total net assets and total return on ordinary activities by £817,000 (2010 – £678,000) and would have decreased the net asset value per share by 1 02p (2010 – 0 85p) A decrease in bond yields would have had an equal and opposite effect The Convertible loan stocks having an element of equity are not included in this analysis as given the nature of the businesses and the risk profile of the balance sheets they are considered to have more equity like characteristics

(c) Bank loans

The effect of an increase or decrease of 100 basis points in 3 month LIBOR interest rates as at 31 December 2011 on the interest cost of the bank loans and the net income return has been eliminated through a 30 year floating interest rate to fixed interest rate swap The swap generates payments or charges that offset changes in the 3 month LIBOR interest rate, so that the interest payable on the bank loans is effectively converted to a fixed rate loan at 4 8975% (2010 – 4 8975%) plus margin cost The initial term of the swap on commencement at 30 years did not match the term of the loans, therefore, hedge accounting is not used and changes in the fair value of the swap are captured in the net return on ordinary activities as set out in (d) below

20. Financial instruments (continued)

Interest rate risk sensitivity (continued)

(d) Floating interest rate to fixed interest rate swap

A decrease of 100 basis points on 30 year interest rates as at 31 December 2011 would have a direct effect on the fair value of the swap and net assets Based on the position as at 31 December 2011, over a full year, a decrease of 100 basis points would have decreased the gains on investments and net return on ordinary activities after taxation by £12,020,000 (2010 – £9,617,000) and would have decreased the net asset value per share by 15 08p (2010 – 12 03p) An increase of 100 basis points would have had an equal but opposite effect

(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 16 to 20 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 2011

	Investments £'000	Cash and deposits £'000	Loans £'000	Other debtors and creditors* £'000	Net exposure £'000
US dollar	113,211	1	–	3	113,215
Korean won	15,351	–	–	5	15,356
Norwegian krone	11,046	–	–	232	11,278
Taiwan dollar	10,343	1,761	–	–	12,104
Euro	8,051	–	–	(19)	8,032
Other overseas currencies	6,397	–	–	–	6,397
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	164,399	1,762	–	221	166,382
Sterling	324,290	28,259	(50,000)	(19,632)	282,917
	488,689	30,021	(50,000)	(19,411)	449,299

*Includes net non-monetary assets of £32,000

20. Financial instruments (continued)

(iii) Foreign Currency Risk (continued)

At 31 December 2010

	Investments £'000	Cash and deposits £'000	Loans £'000	Other debtors and creditors* £'000	Net exposure £'000
US dollar	120,967	-	–	3	120,970
Taiwan dollar	14,435	2,245	–	–	16,680
Korean won	9,952	33	–	-	9,985
Euro	8,994	–	–	(14)	8,980
Other overseas currencies	10,568	–	–	–	10,568
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	164,916	2,278	-	(11)	167,183
Sterling	330,485	37,219	(50,000)	(10,325)	307,379
	495,401	39,497	(50,000)	(10,336)	474,562

*Includes net non-monetary assets of £49,000

Foreign currency risk sensitivity

At 31 December 2011, had sterling strengthened by 10% (2010 –10%) 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 10% (2010 – 10%) 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 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

	2011 £'000	2010 £'000
US dollar	11,321	12,097
Korean won	1,536	998
Norwegian krone	1,128	-
Taiwan dollar	1,210	1,668
Euro	803	898
Other overseas currencies	640	1,057
	16,638	16,718

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 UK and Norwegian Government securities and UK corporate bonds

20. Financial instruments (continued)

B Credit Risk (continued)

Credit Risk Exposure

The exposure to credit risk at 31 December was

	2011 £'000	2010 £'000
Fixed interest investments	26,236	20,151
Cash and short term deposits	30,021	39,497
Debtors and prepayments	1,947	1,316
	58,204	60,964

The maximum exposure in fixed interest investments was £30,587,000 (2010 – £27,331,000) and the minimum £20,059,000 (2010 – £20,041,000) The maximum exposure in cash was £42,208,000 (2010 – £45,239,000) and the minimum £12,009,000 (2010 – £ 13,213,000)

None of the Company's financial assets are past due or impaired

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

(a) Equity Securities

The Company's unlisted investments are not readily realisable, but these only amount to 1 8% of the Company's total assets at 31 December 2011 (2010 – 0 7%)

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 34% (£168 million) (2010 – 32% (£160 million)) of the portfolio is invested in listed 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 6 9% (2010 – 6 4%)

(b) Floating interest rate to fixed interest rate swap

The fair value of the swap is estimated by RBS the provider of the swap and is compared to an external model and external prices

Previously, the primary valuation method has been to use an external model with external prices (source Bloomberg), which is then compared to the swap provider's valuation Historically the difference has been within an acceptable tolerance, however there was a divergence at 31 December 2011 between the RBS valuation and the external model The RBS capital valuation was (£20,357,842) in comparison to the external model of (£19,850,744) As the RBS valuation was lower this figure has been used as the appropriate fair value

However RBS have acknowledged that they have changed their valuation methodology and assumptions during the year, but have not disclosed the details, and furthermore may change these at any time as the following RBS disclaimer highlights

"RBS has produced this valuation as of a particular time and date on the basis of, inter alia, its proprietary valuation models or those of third party providers, the assumptions made therein, relevant market data (including data from third party sources) and its assessment (in its sole discretion) of the factors relevant to the valuation and may be changed at any time at RBS' sole discretion without notice to you Provision of this valuation does not constitute either a bid or an offer for securities, or a bid or an offer to unwind a transaction If RBS agrees to quote a live price to unwind a transaction or to trade a security, such live price is likely to differ from the most recent valuation for such transaction or security, as the case may be, and may be more unfavourable to you Valuations and quotations may differ materially between dealers "

The swap valuation gives an indication of fair value, but the price at which the swap can be unwound or realised may diverge materially from this valuation depending on market conditions and liquidity

20. Financial instruments (continued)

C. Liquidity Risk (continued)

Liquidity Risk Exposure

Contractual maturities of the financial liabilities at the year end, based on the earliest date on which payment can be required are as follows

	2011 One year or less £'000	2010 One year or less £'000
Bank loans	51,727	51,591
Derivative financial instruments	25,725	12,935
Other creditors	444	2,201
	77,896	66,727

Fair Value of Financial Instruments

Fair values are measured using the following fair value hierarchy

Level 1 reflects financial instruments quoted in an active market

Level 2 reflects financial instruments whose fair value is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables includes only data from observable markets

Level 3 reflects financial instruments whose fair value is determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable market transactions in the same instrument and not based on available observable market data

The valuation techniques used by the Company are explained in the accounting policies on pages 40 and 41

The tables below set out the fair value measurements using the fair value hierarchy

At 31 December 2011

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets				
Equity investments	454,597	–	7,856	462,453
Government debt securities	18,934	–	–	18,934
Other debt securities	5,602	–	1,700	7,302
Current assets	31,968	–	–	31,968
Total assets	511,101	–	9,556	520,657
Financial liabilities				
Bank loans	50,000	–	–	50,000
Derivatives	–	20,357	–	20,357
Current liabilities (excluding bank loans)	1,001	–	–	1,001
Total liabilities	51,001	20,357	–	71,358
Total net assets	460,100	(20,357)	9,556	449,299

20. Financial instruments (continued)

A reconciliation of fair value measurements in Level 3 is set out below

At 31 December 2011

	Equity Investments £'000
Opening balance at 1 January 2011	3,900
Purchases	3,558
Sales	(703)
Transfers into Level 3	2,469
Total gains or losses	
– on assets sold during the year	(1,088)
– on assets held at 31 December 2011	1,420
Closing balance at 31 December 2011	9,556

Transfers into Level 3 relate to investments for which listing has been suspended during the year

At 31 December 2010

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets				
Equity investments	471,350	–	3,900	475,250
Government debt securities	14,669	–	–	14,669
Other debt securities	5,482	–	–	5,482
Current assets	40,813	–	–	40,813
Total assets	532,314	–	3,900	536,214
Financial liabilities				
Bank loans	50,000	–	–	50,000
Derivatives	–	8,937	–	8,937
Current liabilities (excluding bank loans)	2,715	–	–	2,715
Total liabilities	52,715	8,937	–	61,652
Total net assets	479,599	(8,937)	3,900	474,562

A reconciliation of fair value measurements in Level 3 is set out below

At 31 December 2010

	Equity Investments £'000
Opening balance at 1 January 2010	2,949
Purchases	1,639
Sales	–
Transfers into Level 3	1,578
Total gains or losses	
– on assets sold during the year	–
– on assets held at 31 December 2010	(2,266)
Closing balance at 31 December 2010	3,900

Transfers into Level 3 relate to investments for which listing has been suspended during the year

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 Tuesday 17 April 2012 at 11.30 am for the following purposes

To consider and, if thought fit, approve resolutions 1 to 9 as ordinary resolutions and resolution 10 as a special resolution

Ordinary Business

1 To receive and adopt the Directors' Report, the Financial Statements and the Auditor's Report in respect of the year ended 31 December 2011

2 To approve the Directors' Remuneration Report for the year ended 31 December 2011

3 To declare a dividend of 1.00p per Ordinary share in respect of the year ended 31 December 2011

4 To re-elect Mr CJ Cazalet as a Director of the Company

5 To re-elect Mr TM Curtis as a Director of the Company

6 To re-elect Mr DCP McDougall as a Director of the Company

7 To elect Mr SW Newton as a Director of the Company

8 To reappoint Ernst & Young LLP as Independent Auditor of the Company to hold office until the conclusion of the next Annual General Meeting at which financial statements are laid before the Company

9 To authorise the Directors to determine the remuneration of the Independent Auditor

Special Business

10 That, the Company be generally and subject as hereinafter appears unconditionally authorised in accordance with Section 701 of the Companies Act 2006 (the 'Act') to make market purchases (within the meaning of Section 693(4) of the Act) of its issued shares of 25p each in the capital of the Company in substitution for any existing authority under section 701 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) 5% above the average closing price (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 bid 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 2013, 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

By order of the Board

Baillie Gifford & Co
Secretary

Baillie Gifford & Co.

Registered Office
10–11 Charterhouse Square
London EC1M 6EE

8 March 2012

NOTICE OF ANNUAL GENERAL MEETING *continued*

NOTES

1 As a member you are entitled to appoint a proxy or proxies to exercise all or any of your rights to attend, speak and vote at the AGM A proxy need not be a member of the Company but must attend the AGM to represent you You may appoint more than one proxy provided each proxy is appointed to exercise rights attached to different shares You can only appoint a proxy using the procedure set out in these notes and the notes to the proxy form You may not use any electronic address provided either in this notice or any related documents (including the circular and proxy form) to communicate with the Company for any purpose other than those expressly stated

2 To be valid any proxy form or other instrument appointing a proxy, together with any power of attorney or other authority under which it is signed or a certified copy thereof, must be received by post or (during normal business hours only) by hand at the Registrars of the Company at Capita Registrars, PXS, 34 Beckenham Road Beckenham, BR3 4TU no later than 48 hours (excluding non-working days) before the time of the meeting or any adjourned meeting

3 Shareholders may also use the online proxy voting service offered by Capita Registrars at **www capitashareportal com** to vote or appoint a proxy online Votes must be received no later than 48 hours (excluding non-working days) before the time of the meeting or any adjourned meeting To vote online, the unique personal identification Investor code printed on the proxy form will be required

4 CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual and/or by logging on to the website **www euroclear com/CREST** CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf

5 In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction) must be properly authenticated in accordance with Euroclear UK & Ireland Limited s specifications and must contain the information required for such instruction as described in the CREST Manual The message regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy must in order to be valid be transmitted so as to be received by the Company's registrar (ID RA10) no later than 48 hours (excluding non-working days) before the time of the meeting or any adjournment For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Application Host) from which the Company's registrar is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means

6 CREST members and, where applicable their CREST sponsors, or voting service providers should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular message Normal system timings and limitations will therefore, apply in relation to the input of CREST Proxy Instructions It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member, or sponsored member or has appointed a voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time In this connection CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular to those sections of the CREST Manual concerning practical limitations of the CREST system and timings

7 The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001

8 The return of a completed proxy form or other instrument of proxy will not prevent you attending the AGM and voting in person if you wish

9 Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001 and Section 311 of the Companies Act 2006 the Company specifies that to be entitled to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast), shareholders must be registered in the Register of Members of the Company no later than 48 hours (excluding non-working days) prior to the commencement of the AGM or any adjourned meeting Changes to the Register of Members after the relevant deadline shall be disregarded in determining the rights of any person to attend and vote at the meeting

10 Any person to whom this notice is sent who is a person nominated under Section 146 of the Companies Act 2006 to enjoy information rights (a Nominated Person) may under an agreement between him/her and the shareholder by whom he/she was nominated have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting If a Nominated Person has no such proxy appointment right or does not wish to exercise it he/she may under any such agreement have a right to give instructions to the shareholder as to the exercise of voting rights

11 The statement of the rights of shareholders in relation to the appointment of proxies in Notes 1 and 2 above does not apply to Nominated Persons The rights described in those Notes can only be exercised by shareholders of the Company

12 The members of the Company may require the Company to publish on its website, (without payment) a statement (which is also passed to the auditors) setting out any matter relating to the audit of the Company's accounts, including the auditors' report and the conduct of the audit The Company will be required to do so once it has received such requests from either members representing at least 5% of the total voting rights of the Company or at least 100 members who have a relevant right to vote and hold shares in the Company on which there has been paid up an average sum per member of at least £100 Such requests must be made in writing and must state your full name and address and be sent to the Company at 10-11 Charterhouse Square, London, ECIM 6EE

13 Information regarding the Annual General Meeting, including information required by Section 311A of the Companies Act 2006 is available from the Company's page of the Manager s website at www heralduk com

14 Members have the right to ask questions at the meeting in accordance with Section 319A of the Companies Act 2006

15 As at 20 February 2012 (being the last practicable date prior to the publication of this notice) the Company's issued share capital consisted of 79 698 283 Ordinary shares, carrying one vote each Therefore, the total voting rights in the Company as at 20 February 2012 were 79 698 283 votes

16 Any person holding 3% or more of the total voting rights of the Company who appoints a person other than the Chairman of the meeting as his proxy will need to ensure that both he and his proxy complies with their respective disclosure obligations under the UK Disclosure and Transparency Rules

17 No Director has a contract of service with the Company

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 Company** 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) Any shareholder uncertain of his or her position is recommended to seek expert advice
- **ISAs** The Ordinary shares of the Company are qualifying investments for individual saving accounts
- **Electronic Proxy Voting** If you hold stock in your own name you can choose to vote by returning proxies electronically at **www capitashareportal com** If you have any questions about this service please contact Capita Registrars on 0871 664 0300 (calls cost 10p per minute plus network extras, lines are open 8 30 am to 5 30 pm Monday-Friday)

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