ANNUAL FINANCIAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2017 (AUDITED)

This is the Annual Financial Report of Herald Investment Trust plc as required to be published under DTR 4 of the UKLA Listing Rules.

Results and dividend

The net asset value (NAV) of the Company at 31 December 2017 was 1374.9p per ordinary share (2016 – 1083.2p). This represented an increase of 26.9% during the year. The discount was 14.8% (2016: 18.5%) and the share price increased by 32.7% to 1171.0p.

The Company made a revenue profit of £486,000 (2016: £430,000) giving net earnings of 0.68p per share (2016: 0.58p) per share. The directors do not recommend a dividend (2016 – nil) for the year ended 31 December 2017.

The financial information set out in this Annual Financial Report does not constitute the Company's statutory accounts for 2016 or 2017. Statutory accounts for the years ended 31 December 2016 and 31 December 2017 have been reported on by the Independent Auditor. The Independent Auditor's Reports on the Annual Report and Financial Statements for 2016 and 2017 were unqualified, did not draw attention to any matters by way of emphasis, and did not contain a statement under 498(2) or 498(3) of the Companies Act 2006. The Company's statutory accounts for the year ended 31 December 2016 have been filed with the Registrar of Companies. The Company's statutory accounts for the year ended 31 December 2017 will be delivered to the Registrar in due course.

The financial information in this Annual Financial Report has been prepared using 'FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland' (FRS102), which forms part of Generally Accepted Accounting Practice ('UK GAAP') issued by the Financial Reporting Council. The financial statements have also been prepared in accordance with The Companies Act 2006 and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies and Venture Capital Trusts' issued by the Association of Investment Companies (AIC) in November 2014 as amended in January 2017.

STATISTICS AND PERFORMANCE – YEAR'S SUMMARY

		31 December 2017	31 December 2016	% change
Total assets (before deduction of bank loans)		£966.7m	£816.4m	
Bank loans		-	£25.0m	
Shareholders' funds		£966.7m	£791.4m	
Net asset value per share		1374.9p	1083.2p	26.9
Share price		1171.0p	882.5p	32.7
Numis Smaller Companies Index plus AIM (ex. investment companies)		6,001.8	5,049.8	18.9
Russell 2000 (small cap) Technology Index (in sterling terms)		2,480.2	2,311.0	7.3
Dividend per ordinary share		-	-	
Profit per ordinary share (revenue)		0.68p	0.58p	
Ongoing charges*		1.08%	1.09%	
Discount to NAV		14.8%	18.5%	

* Ongoing charges calculated in accordance with AIC guidelines: annualised charges, excluding interest, incurred by the Company, expressed as a percentage of the average net asset value.

LONG TERM PERFORMANCE SUMMARY

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

	31 December 2017	Inception 16 February 1994	% change
Net asset value per ordinary share (including current year income)	1374.88p	98.72p	1292.70
Net asset value per ordinary share (excluding current year income)	1374.20p	98.72p	1292.02
Share price	1171.00p	90.90p	1188.23
Numis Smaller Companies Index plus AIM (ex. investment companies)	6001.77	1750.00	242.96
Russell 2000 (small cap) Technology Index (in sterling terms)	2480.20	688.70	259.53

CHAIRMAN'S STATEMENT AND REVIEW OF 2017

I am delighted to report that Herald's net asset value per share appreciated 26.9% during 2017. This equates to a total return of £203m. During the year, £27.6m was spent on share buy-backs; this equates to 3.8% of the outstanding shares at the start of 2017.

The share price appreciated by 32.7%, more than the 26.9% appreciation in the net assets, reflecting a narrower discount to the net asset value per share. The discount was 14.8% at the year-end.

2017 was an exciting year for the technology sector with a new phase of internet disruption emerging, and concepts that had previously caused excitement now coming through in positive financial results. In particular, the quality of the internet network has improved sufficiently to enable a mass migration to centralised processing in the data centre. New demand has led to capacity shortages in hardware including ASICs as well as NAND and DRAM memory. This has satisfactorily benefited a number of small companies.

The UK portion of the portfolio performed strongly in 2017 with a 35.2% (IRR) total return compared with 21.9% in the Numis Smaller Companies Index (including AIM and ex investment companies). The smaller European portion performed even better, returning 52.1% (IRR, in sterling terms); while Asia appreciated by 24.3% (IRR, in sterling terms). The North American part of the portfolio lagged somewhat, appreciating only 18.2% (IRR, in sterling terms), although this significantly exceeded the sterling total return of the Russell 2000 Technology Index of 7.6%. There was a drag on the portfolio from net cash and cash equivalents held mainly in US dollars (including short dated US treasuries).

A significant proportion of the positive performance was derived from a small number of our holdings, 24 of which appreciated in value by more than 100%. Between them, they accounted for only 8.2% of the Company at the start of the year, but they contributed 63% of the aggregate return. IQE was the star performer by value, appreciating by nearly £30m. In previous years, we have commented on the high level of takeover activity. In 2017, takeovers and bid approaches have continued - 13 in total with an aggregate value of £52m, the largest of which was SQS (c.£18m). Six of these were in the UK, six in North America and one in Asia. But unlike previous years, 2017 has also seen a much healthier level of IPOs and secondary offerings. There have been a few US IPOs, but there have been more takeovers, so in the US the number of listed technology companies continues to shrink. The AIM market in the UK, on the other hand, has been relatively vibrant. The manager has participated in IPOs and follow-on fundraisings to an aggregate value of £55.6m. Out of a total of 67 of these fund raising events, six were IPOs, and 50 were in the UK. AIM has proved to be a healthy market for development capital, but when companies become cash generative they are often taken over by private equity houses or trade buyers.

The Company has again generated a small amount of net revenue, but we are not proposing to pay a dividend. While the board acknowledges that dividend income is welcome for some shareholders, our strategy and our strength has been to deliver capital appreciation. The Company repaid its £25 million sterling term loan on maturity at the end of December and now has no outstanding debt, although we have retained a £25 million multi-currency facility (currently undrawn, term expiring in December 2019) in case opportunities arise.

The board has decided to increase the target size limit of investee companies from below \$2bn to below \$3bn market capitalisation. It has always been the policy to make investments below the size limit, but the manager has continued to hold some positions that rise above the threshold. Following strong performances, 15 companies had a market capitalisation exceeding \$2m with an aggregate value of £79.5m, which is higher than previous years. This limit has not been changed for a number of years, and a higher limit offers more flexibility as the size of the Company grows. The board has also reviewed the performance comparator that we have used historically, which has been expressed as a blend of 2/3rd the Numis Smaller Companies Index plus AIM (ex. investment companies) and 1/3rd the Russell 2000 (small cap) Technology Index (in sterling terms). We believe that it is more meaningful to describe them as two comparative indices rather than an artificial blend benchmark and will do so in the future.

The Company is an Alternative Investment Fund. Its manager, HIML, has to comply with MIFID II rules governing access to research. The manager has been concerned about the ramifications of this fundamental legislation for our remit focused on smaller companies globally. The manager is paying for research out of the management fee, and is paying significantly more than has ever been paid by the Company in commissions. Over 70 brokers have been signed up, which accounts for a significant proportion of research historically consumed. However, although the coverage from global players is a little improved, there is likely to be access to far fewer brokers, who cover small companies, than has been available in the past. The challenge is that in the small company world our competition is largely from investors local to the companies, who are in turn dealing with numerous smaller regional brokers. The second concern is that commission levels seem to have been cut to uneconomically low levels for transactions in smaller companies where orders may take days or weeks to execute, and often require active endeavours by brokers to generate the other side of the bargain. This may further diminish liquidity. I hope the market will adjust in the medium to long term, but the short-term uncertainty this has caused is extremely unwelcome.

2017 proved a remarkably good year for the Company. While the TMT market continues to be exciting, the financial markets are in less rude health. We are optimistic that this may prove a time for more market inefficiencies, and hence an opportunity for profitable investing.

Julian Cazalet
Chairman

INVESTMENT MANAGER'S REPORT

There have been positive returns in all regions of the portfolio in 2017. The UK market continued to be quite robust throughout 2017 with a healthy supply of new issues and secondary offerings. There have been a handful of companies that have been anomalously strong, but on the whole, in spite of the returns of recent years, it is not a frothy irrational market. Europe has been even stronger, and some new issues remind me of the Neuer Markt in 2000. The US market has been more measured, but there have been some new issues in the second half. The Asian market has continued to grow.

For the first time we have included the book cost of our top 20 holdings. We focus on investing, and MIFID II has focused our minds on the fact that our mandate and the way we operate is unusual. Few professional investors invest in microcaps for the long term. It is what we do. The book cost of the top 20 holdings is £63.5m and the market value is £299.9m so the average return is 370%, which demonstrates the value of our long-term approach. In addition we have realised gains of £58.9m from these 20 holdings. We are grateful to the efforts of the management teams that have delivered such good returns, and we aspire to be supportive long-term shareholders.

Less positively, the scale of withdrawal of institutional money from quoted markets in the UK and North America, which has led to takeovers persistently outnumbering new issues, is of concern. These takeovers have often been by private equity investors backed by large institutions. The scale of the issue is illustrated in the following table, which also shows how many investment opportunities there are for the Company's defined remit. The number of North American quoted TMT stocks (in certain ICB sectors) has fallen by 18% over five years, in the UK by 9%, and Europe by 10%. Only in Asia has the number grown (by 18%). (The list is not the entire remit, but the core sectors are useful for illustrative purposes.)

Number of quoted companies in target TMT remit

Region of listing	2012	2013	2014	2015	2016	**2017**	1 year % change	5 year % change
All								
North America	2,499	2,428	2,351	2,281	2,115	**2,038**	-4%	-18%
UK	295	290	293	282	271	**267**	-1%	-9%
Europe	1,450	1,419	1,394	1,319	1,298	**1,303**	0%	-10%
Asia	4,131	4,157	4,295	4,499	4,644	**4,864**	5%	18%
World	8,631	8,538	8,595	8,601	8,541	**8,689**	2%	1%
>$20m and <$3bn market cap								
North America	791	820	812	753	698	**677**	-3%	-14%
UK	164	179	187	170	164	**172**	5%	5%
Europe	569	593	563	556	562	**598**	6%	5%
Asia	2,910	3,016	3,148	3,220	3,394	**3,697**	9%	27%
World	4,548	4,731	4,846	4,805	4,916	**5,244**	7%	15%

Sectors include: Consumer Electronics, Media, Electronic and Electrical Equipment, Technology but exclude Telecommunications.
Source: Bloomberg/FTSE Russell Industry Classification Benchmark.

It is not clear whether this is a cyclical, or a structural change. Regulation has a heavy cost in quoted markets. In the US, Sarbanes Oxley has virtually killed the market for smaller companies, and Europe is catching up. I have, however, been suspicious that there is the potential for a great deal of value to be lost in the so called "Unicorns", which are private companies with a value in excess of $1bn. Companies such as Uber suggest no regulation could be worse than too much, but Softbank has funded Uber for now. A perceived negative for public markets is managements' frustration that investors expect steady growth in profits, and make it difficult to invest for the long term. We have first-hand experience of many management teams who saw their venture capital /private equity owners as far from utopia as well. Institutions used to be patient long-term public market investors, but they have reallocated capital. Will this reverse? Will institutional investors return to valuing the liquidity of public markets? One of the challenges to public markets, and tailwinds to private equity, has been balance sheet structures. There has been a significant financial incentive to own companies with debt, because interest is tax deductible and dividends are not. For pension funds in the UK this was only relevant from 1997 when they could no longer recover tax paid on dividends, which significantly changed allocations from public markets to private equity. This disadvantage is being reduced by lowering corporation tax rates in the UK; and the recently announced US tax changes including lower corporation tax and limiting the tax deductibility of interest to 30% of profits is very significant. For economic stability, it has to be a sound measure to encourage ownership of corporations through equity rather than debt. Common sense says that this measure will be followed elsewhere while interest rates are so low. Private equity has further leveraged returns with cheap bank debt, albeit with higher risk. This US tax change may mark a significant turning point for asset allocation between public and private equity, with the attractions of leveraged buyouts diminishing. Whilst this could reduce the number of takeovers, it should also be healthier for public markets in the long run.

Regional allocation changes (£'000)

	Valuation at 31 December 2016	Net acquisitions/ (disposals)	Appreciation/ (depreciation)	**Valuation at 31 December 2017**
Equities*				
UK	454,512	(19,850)	147,970	**582,632**
EMEA	34,481	2,573	18,562	**55,616**
North America	177,350	(1,647)	31,772	**207,475**
Asia Pacific	38,585	3,395	8,393	**50,373**
Total equities	704,928	(15,529)	206,697	**896,096**
Government bonds	8,041	22,966	(1,562)	**29,445**
Total investments	712,969	7,437	205,135	**925,541**
Net liquid assets	103,445	(59,164)	(3,172)	**41,109**
Total assets	816,414	(51,727)	201,963	**966,650**

* Equities includes convertibles and warrants
The total assets figure comprises assets less current liabilities before deduction of bank loan.

The bottom line is not complicated. Companies will be funded by those that pay the highest price. For now, private equity and venture capitalists in North America have the money. There is allegedly a trillion dollars in uninvested cash in private equity hands, so a reversal will take time. I prefer investing in the cheaper asset class, and unsurprisingly performance in the quoted world has been better in the shrinking markets.

The UK has not shrunk at the small end by number of companies. In practice larger companies have gone and smaller companies emerged, so it has shrunk by value. AIM is vibrant. There is a surprising level of entrepreneurialism in the UK relative to other countries, as well as skills. In a world awash with cash the area of conspicuous value is small companies that need cash, because debt funding is not available. That is part of the reason why the UK continues to be a surprisingly large element of this global fund.

Against the gloom of fiscal deficits, trade deficits and politics, there is one area of the economy conspicuously growing. The technology sector has been strong globally in 2017, and it has been remarkable how much growth there has been in London. In part this reflects a bubble in San Francisco and Silicon Valley, which has led to the big internet companies expanding elsewhere, and London has emerged as a hub that has attracted leading-edge talent, and in consequence companies. Google, for example, has received planning permission for a new 1m square foot office at Kings Cross following a submission in June 2017, and Facebook is allegedly negotiating to take a further 400,000 square foot nearby. These have followed announcements from Apple, who are building a new 500,000 square foot UK HQ in Battersea, and Amazon who have taken 514,000 square feet in Shoreditch. In addition London has become an important technical centre for the traditional financial sector, and is a hub for start-ups. A concern that we have had for a number of years is that the evaporation of larger technology companies in the UK would leave the UK with a diminishing skill base. I am therefore excited by the scale of investment into the UK by these vast US technology companies who are training people in leading edge skills.

MIFID II

HIML is now having to pay directly for research. Through portals, it has historically received research from hundreds of brokers, and received research on at least one of our holdings from amongst our 125 brokers. However, HIML has received research from only one broker (or none at all) on 62 of our holdings. This reflects how fragmented the smaller companies market is. It is tempting to be dismissive and say we do not need research, but I see it as irresponsible not to seek as much information as reasonably possible. Research is also needed to encourage a healthy secondary market in stocks. We are still finding our way under the new regime, but have currently agreed deals with over 70 brokers to receive various levels of research services. We now have access to research from most of the global players. Although we have hardly dealt with them historically, we did receive written research from most of them and they accounted for a high proportion of the research we actually read. Much of this might be industry background rather than company specific. It was perhaps anomalous that we did not pay for this input, and the charges we have now agreed seem relatively reasonable. The problem is that the brokers providing the research do not make markets in smaller companies and do not provide liquidity in them - it is smaller brokers that do that. I sincerely hope that the multitude of smaller brokers will have a viable business model going forward. This exercise has focused our minds on how few investors attempt to invest globally in small companies as we do. In overseas markets, we are often the only foreign investor to visit individual companies. One outcome of the changes that I had not fully thought through is that salesmen and even sales traders can be considered part of research. Nobody would entertain paying a retainer to a car salesman for educating them as to whether they might at some stage want to buy a car, and in the smaller company world it seems that that is what we are being expected to do. We are eager to see how the marketplace evolves over the next year or two. Experience says that if stocks get overlooked by the market they will get taken over, which provides reassurance, but in the long run the primary capital raising market will disappear if the secondary market falters.

Sector Performance (Sterling Millions)

	Market value equity portfolio 31 Dec 2017	% of equity portfolio 31 Dec 2017	**Total return equity portfolio 31 Dec 2017**	Total return equity portfolio 2016
Software	220.0	24.6	**45.2**	39.6
Semiconductors	130.8	14.6	**56.9**	41.1
Computer Services	117.3	13.1	**38.8**	11.3
Media Agencies	85.8	9.6	**20.3**	8.4
Internet	66.9	7.5	**24.2**	3.0
Telecommunications Equipment	38.7	4.3	**-0.4**	7.4
Publishing	34.9	3.9	**3.7**	5.3
Electrical Components & Equipment	28.8	3.2	**4.5**	2.6
Fixed Line Telecommunications	18.5	2.1	**0.7**	0.1
Business Support Services	17.1	1.9	**-4.1**	-1.1
Computer Hardware	15.4	1.7	**0.3**	1.2
Other	121.9	13.6	**27.1**	24.0
Total	**896.1**	**100%**	**217.3**	**143.0**

UK

In the UK performance has been sparkling this year with a total return of 35.2% (IRR). 17 UK holdings have returned more than 100%, as shown in the table below. Collectively these companies delivered a total return of £104m, and only one, IQE, was a top 20 holding at the start of the year. Arguably the performance of the smaller holdings reflects the fact that we are in the later stages of the bull market.

Industry pioneer eg Solutions was acquired by a NASDAQ listed company. Although a small company it had an interesting customer in Facebook. AIM listed stocks in aggregate delivered a total return of £123.9m.

IQE's HQ is in South Wales, but they have operations in North America and Asia, and are now the market leader globally for manufacturing compound semiconductor wafers. Historically, the largest market has been the RF component from power amplifiers in mobile phones with Skyworks the biggest customer, but this year Lumentum and others have emerged as customers for VCSELs, which are semiconductor based laser diodes. These are being used in the latest mobile phones for 3D sensing, and for connectors in datacentres as well as other applications. In percentage terms, Zoo Digital appreciated the most (by 550%). The patient support that we gave to the company during a technical transition has been rewarded. In the darkest period, only Zoo's chief executive and Herald supported the company with cash to enable the company to survive. Although still a small company, based in Sheffield, it has an impressive customer list with Netflix adding to long standing customers such as Disney and Warner. Other significant contributors to performance were Bango, BE Semiconductor Industries, Frontier Developments, Microgen, Isra Vision, Blue Prism, Loop-up and Versarien.

UK companies returning more than 100%	2017 total return (%)
Zoo Digital	550
Versarien	442
Frontier Developments	342
Bango	286
IQE	261
Spectra Systems	246
LoopUp	195
Wandisco	186
Blue Prism	183
eg Solutions	177
Taptica	173
Microgen	157
XLMedia	123
Sophos	119
Cloudcall	115
Frontier Smart Technologies	107
XP Power	103

Imagination Technologies has been taken over. It is a rather sad end for a highly innovative company because the loss of the Apple contract led to a sale from a position of weakness. Nevertheless, over the history of Herald, Imagination is one of the most profitable holdings with realised profits of £32.9m, and marginally exceeded only by IQE and Diploma. Imagination provided graphics and video technology to the iPhone and iPad, but is being designed out. I have enormous respect for Hossein Yossaie, who led the business for many years, and would like to thank him very much for his efforts, and I know how highly he was regarded on the West coast. Unfortunately I do not think that the Imagination board optimised the outcome, and were not helped by frustrated shareholders. I am interested to hear that the chief technology officer now runs R&D for Apple in the UK. The other significant takeover is SQS. We first owned the shares buying 425,000 at IPO in 2005, and have increased the holding with 17 subsequent purchases to hold 2.19m shares now. On completion the value will be c.£18m. While I am disappointed to see it go, it was a worthwhile takeover premium.

North America

The US portfolio returned 18.2% (IRR, in sterling terms), which was usefully ahead of the Russell 2000 Technology Index which rose 7.6% (in sterling terms). However returns were mixed. The gains of £45.7m were offset by losses of £13.5m. The best performer was Boingo Wireless, which supplies internet to the US military, and its Distributed Antenna Service (DAS) offers Wi-Fi handoff to mobile phone carriers in populated areas like airports and stadiums. Five9 (VOIP call centres), Hortonworks (Hadoop database) and Mellanox (InfiniBand and Ethernet connectivity) also contributed usefully. In addition Adesto (low power non-volatile memory), Hydrogenics (electricity to hydrogen), RingCentral (VOIP telephony) and Pixelworks (system on a chip display solutions) all appreciated more than 100%. Partially offsetting these gains, fibre companies, Inphi and Fabrinet, ceded some of 2016's gains, and Radisys and Amber Road have disappointed. The price earnings ratio (p/e) of 33 on the North American portfolio is 45% higher than the UK, but the US has traditionally been more highly rated.

EMEA

The EMEA return of 52.1% (IRR, in sterling terms) reflected outstanding returns from BE Semiconductor (+138%), which supplies leading semiconductor packaging equipment, and Isra Vision (+120%). We acquired Isra in 2004 at €13, and it has recently caught the robotics craze, and ended the year at €212.6.

Asia

The Asian portfolio returned 24.3% (IRR, in sterling terms). In comparison, the Kosdaq IT index in South Korea returned 24.3% and the TWSE Electronics index in Taiwan rose 23.3%.

Nine Asian holdings rose more than 50% in the year, with these investments spread across a range of countries and sectors. The semiconductor industry had a cyclically strong year and a couple of semiconductor capital equipment suppliers in South Korea performed particularly well, for example; Hanmi Semiconductor was up 101% and PSK was up 95%. Two Chinese internet businesses also contributed usefully: 51Jobs addresses the HR and recruitment sector and BitAuto is a leading automotive website. The worst performer in Asia was PChome, which fell 47.8%. This was due to an aggressive price competitor called Shopee raising money at the group level via the IPO of SEA in the United States – the funds raised are financing a price war in Taiwan to the detriment of PChome. The forecast p/e of the Asian portfolio is around 15, lower than some other areas of the portfolio, a discount that reflects additional risks of investing in the region and the relative scarcity of recurring revenue cash generative business models.

Outlook

The UK continued to benefit in 2017 from sterling weakness in 2016, and there is likely to be a relative headwind this year. Nevertheless the p/e of the portfolio at 23 does not seem expensive relative to bonds and other sectors with lower growth prospects. The sector remains exciting.

Katie Potts

TOP TWENTY EQUITY HOLDINGS
AT 31 DECEMBER 2017

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

IQE		
IQE is the leading global supplier of advanced compound semiconductor wafers. These wafers are atomically engineered to provide IQE's customers with the materials from which they produce high performance wireless, photonic and electronic devices or "chips." It is IQE's epitaxial layer processes that enable chips to operate at the high frequencies (radio frequencies or RF) that are used for all forms of wireless communications. IQE's "epi" processes also manufacture materials that enable the conversion of energy to light or light to energy for sensing, lighting and power generation technologies. IQE's products cover a diverse range of applications, supported by an innovative outsourced foundry services portfolio that allows the group to meet the wafer manufacturing needs of the world's leading semiconductor manufacturers.		£26.1m Valuation 2.7% Of total assets 2.5% Of issued share capital held £6.1m Book cost

GB Group		
GB Group is a global specialist in Identity Data Intelligence. This is the data that reveals who a person really is. GBG helps organisations realise the full value of their customer base by recognising and verifying all elements of a consumer's identity at every interaction. GBG combines trillions of data records, relating to the identities of over 4.4 billion people, from over 200 data providers all over the world. This intelligence helps GBG's clients make the right decisions about the customers they serve and the people they employ. GBG protects, predicts and provides information that is used to maximise customer value for some of the largest companies in the UK. The		£26.0m Valuation 2.7% Of total assets 3.9% Of issued share capital held £1.7m Book cost

company provides an integrated and comprehensive range of data services to clients allowing them to interact effectively with their customers, improve long term profitability and reduce fraud. Headquartered in Chester (UK), GBG provides solutions to many of the world's biggest organisations, including established brands like Nike, Ford and HSBC.		

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.		£23.1m Valuation 2.4% Of total assets 1.6% Of issued share capital held £1.3m Book cost

Bango		
Founded in 1999 Bango's vision is to make a frictionless payment experience available to every mobile device user in the world. The Bango Platform is deployed with the world's leading mobile app stores. Global leaders plugging into Bango include Amazon, Google, Samsung and Microsoft. Reaching a larger share of people than ever, Bango has an addressable base of over 1.7bn mobile phone customers. As more customers and partners adopt the Bango Platform and as more transactions are analyzed by Bango technology, the platform becomes increasingly powerful, providing unique insights that drive revenue growth. This in turn drives more customers to use the Bango Platform, fuelling a virtuous circle of success for the Bango Platform and the internet industry.		£20.7m Valuation 2.1% Of total assets 12.1% Of issued share capital held £6.8m Book cost

BE Semiconductor Industries		
Besi is a leading supplier of semiconductor assembly equipment for the global semiconductor and electronics industries offering high levels of accuracy, productivity and reliability at a low cost of ownership. Besi develops leading edge assembly processes and equipment for leadframe, substrate and wafer level packaging applications in a wide range of end-user markets including electronics, mobile internet, computer, automotive, industrial, LED and solar energy. Customers are primarily leading semiconductor manufacturers, assembly subcontractors and electronics and industrial companies.		£18.7m Valuation 1.9% Of total assets 0.8% Of issued share capital held £1.5m Book cost

Next Fifteen Communications		
Next 15 aims to become the world's largest and most respected specialist communications group. To do this, the group continues to build a portfolio of businesses that cater to the subtly different needs of the various market sectors and geographies in which it operates. Next 15 employs over 1,610 people across 39 offices in 14 countries. The group incorporates 18 subsidiary agencies, spanning digital content, marketing, PR, consumer, technology, marketing software, market research, public affairs and policy communications.		£18.2m Valuation 1.9% Of total assets 5.5% Of issued share capital held £2.6m Book cost

SQS Software Quality Systems		
SQS is the leading global provider of quality assurance services for digital business processes. This position stems from over 30 years of successful consultancy operations. SQS consultants provide solutions for all aspects of quality throughout the whole software product lifecycle driven by a standardised methodology, industrialised automation processes and deep domain knowledge in various industries. Headquartered in Cologne, Germany, the company now employs approximately 4,400 staff. With over 10,000 completed projects under its belt, SQS has a strong client base, including half of the DAX 30, nearly a third of the EURO STOXX 50 and 20% of the FTSE 100 companies.		£17.7m Valuation 1.8% Of total assets 6.8% Of issued share capital held £5.5m Book cost

On 15 December 2017, it was announced that SQS would be taken over by Assystem Technologies.

Silicon Motion		
Silicon Motion Technology Corporation is a global leader and pioneer in developing NAND flash controller ICs for solid-state storage devices and specialty RF ICs for mobile devices. Silicon Motion has a broad portfolio of controller technologies and solutions and has shipped over five billion NAND controllers, more than any other company in the world. Key products are controllers used in embedded storage products such as SSDs and eMMCs, as well as in expandable storage products such as memory cards and USB flash drives. Products are widely used in consumer devices and for industrial, enterprise, commercial and other applications. Customers include most of the NAND flash makers, leading technology OEMs, and the majority of storage device module makers. More NAND flash products - especially next-generation flash - produced by Intel, Micron, Samsung, SanDisk, SK Hynix and Toshiba are supported by Silicon Motion controllers than any other company.		£15.0m Valuation 1.6% Of total assets 1.1% Of issued share capital held £1.8m Book cost

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.		£14.3m Valuation 1.5% Of total assets 4.8% Of issued share capital held £3.6m Book cost

Dotdigital		
Dotdigital is the leading provider of intuitive software as a service ("SaaS") and managed services to digital marketing professionals, through the 'dotmailer' platform. dotmailer is a marketing automation platform with email at its core. Since 1999 Dotdigital has been empowering global marketers with the tools and services that make it easy to get outstanding results from marketing campaigns.		£11.3m Valuation 1.2% Of total assets 3.7% Of issued share capital held £1.7m Book cost

IDOX		
Idox is the leading applications provider to UK local government for core functions relating to land, people and property, such as its market leading planning systems and election management software. Over 90% of UK local authorities are now customers. Idox provides public sector organisations with tools to manage information and knowledge, documents, content, business processes and workflow as well as connecting directly with the citizen via the web, and providing election management solutions. Idox delivers engineering document control, project collaboration and facility management applications to many leading companies in industries such as oil & gas, and construction.		£11.3m Valuation 1.2% Of total assets 7.5% Of issued share capital held £4.9m Book cost

Microgen		
Listed on the London Stock Exchange since 1974, Microgen is a financially strong group providing innovative software solutions. Microgen is the owner of two leading software businesses, Aptitude Software and Microgen Financial Systems. Aptitude Software serves enterprise CFOs in a range of industries, helping them to streamline finance operations, address regulatory requirements and deliver strategic insights to their business leaders. Microgen Financial Systems offers a range of financial services technology		£11.3m Valuation 1.2% Of total assets 4.0% Of issued share capital held £2.9m Book cost

systems focused on the global wealth management sector and the UK payments market, and also provides application management services.		

Pega		
Pegasystems' adaptive, cloud-architected software – built on the unified Pegasystems Platform – empowers people to rapidly deploy, and easily extend applications to meet strategic business needs. Over its 30-year history, Pegasystems has delivered award-winning capabilities in CRM and BPM, powered by advanced artificial intelligence and robotic automation, to help the world's leading brands optimise customer experience and automate operations. Globally over 3000 customers rely on Pegasystems' dynamic solutions and strategic applications to drive excellence in their sales, marketing, customer service, and operations.		£11.1m Valuation 1.1% Of total assets 0.4% Of issued share capital held £1.6m Book cost

Boingo Wireless		
Boingo Wireless' footprint of distributed antenna systems (DAS), Wi-Fi and small cells reaches more than a billion people annually, making Boingo one of the largest providers of indoor wireless networks. Boingo connects people at airports, stadiums, military bases, convention centers, and commercial properties.		£11.0m Valuation 1.1% Of total assets 1.6% Of issued share capital held £3.2m Book cost

First Derivatives		
Incorporated in 1996, First Derivatives is a leading provider of products and consulting services to some of the world's largest finance, technology and energy institutions. FD is the developer of the world-leading database technology kdb+. Focused on financial institutions that work cross-asset, often with multi-system and/or high volume trading activities the Company's software is also used in a range of industries including telecoms, digital marketing, pharma and utilities to help organisations solve their most demanding data management and analytics challenges. The Company is headquartered in Newry, Northern Ireland where it has established its research and development centre. FD now employs over 2,000 people worldwide.		£11.0m Valuation 1.1% Of total assets 1.0% Of issued share capital held £1.4m Book cost

Euromoney Institutional Investor		
Euromoney magazine was founded in 1969. Euromoney Institutional Investor has since developed into an international business-to-business information and events group. Euromoney's primary sectors include asset management, banking and capital markets, specialist finance, metals, mining, energy and commodities. On 10 January 2018 Euromoney sold its Institutional Investor journals to Pageant Media. The transaction is in line with Euromoney's strategy to recycle capital towards ever-higher-quality businesses. Euromoney is now mostly what they describe as a 2.0 information business, focused on customer-centric, digital, subscription businesses and networking events. These types of business will continue to be important but Euromoney are also looking to invest in B2B 3.0 businesses which are defined as operating at the centre of a customer's industry, offering products deeply embedded in its customers' workflow and helping customers to become more efficient and to find solutions to opportunities and threats they face.		£11.0m Valuation 1.1% Of total assets 0.8% Of issued share capital held £1.6m Book cost
CEVA		
CEVA is the leading licensor of digital signal processing platforms and artificial intelligence processors which enable a smarter, connected world. CEVA partners with semiconductor companies and OEMs worldwide to create power-efficient, intelligent and connected devices for a range of end markets, including mobile, consumer, automotive, industrial and IoT. CEVA's		£10.9m Valuation 1.1% Of total assets 1.4% Of issued share capital held £2.0m Book cost

ultra-low-power IPs for vision, audio, communications and connectivity include comprehensive DSP-based platforms. For artificial intelligence, CEVA offers a family of AI processors capable of handling the complete gamut of neural network workloads, on-device. For connectivity, CEVA offers the industry's most widely adopted IPs for Bluetooth (low energy and dual mode) and Wi-Fi (802.11 a/b/g/n/ac up to 4x4). To date, more than 8 billion CEVA-powered chips have been shipped worldwide, for a wide range of diverse end markets.		
Statpro Group		
Statpro is a global provider of award winning portfolio analytics solutions for the investment community. The group's cloud-based platform provides vital analysis of portfolio performance, attribution, risk and compliance. This multi-asset class analytics platform helps Statpro's clients increase assets under management, improve client service, meet tough regulations and reduce costs. The group's integrated and global data coverage includes over 3.2 million securities such as equities, bonds, mutual funds, FX rates, futures, options, OTCs, sector classifications and much else besides. The group has operations in Europe, North America, South Africa, Asia and Australia, with hundreds of clients in 39 countries around the world. StatPro has grown its annualised recurring revenue from less than £1 million in 1999 to around £53 million at end September 2017. Over 75% of recurring revenues are generated outside the UK.		£10.6m Valuation 1.1% Of total assets 11.5% Of issued share capital held £5.9m Book cost

Radware		
Radware is a global leader of application delivery and cyber security solutions for virtual, cloud and software defined data centres. Its award-winning solutions portfolio delivers service level assurance for business-critical applications, while maximizing IT efficiency. Radware's solutions empower more than 10,000 enterprise and carrier customers worldwide to adapt to market challenges quickly, maintain business continuity and achieve maximum productivity while keeping costs down.		£10.3m Valuation 1.1% Of total assets 1.6% Of issued share capital held £4.5m Book cost
YouGov		
YouGov is an international data and analytics group. The core offering of opinion data is derived from a participative panel of 5 million people worldwide. This continuous stream of data is combined with deep research expertise and broad industry experience into a systematic research and marketing platform. The suite of syndicated, proprietary data products includes YouGov BrandIndex, the daily brand perception tracker, and YouGov Profiles, a planning and segmentation tool. YouGov Omnibus provides a fast and cost-effective service for obtaining answers to research questions from both national and selected samples. With 30 offices in 20 countries and panel members in 38 countries, YouGov has one of the world's top ten international market research networks.		£10.3m Valuation 1.1% Of total assets 3.2% Of issued share capital held £2.9m Book cost

CLASSIFICATION OF INVESTMENTS

Classification *	UK %	EMEA %	North America %	Japan & Asia Pacific %	2017 Total %	2016 Total %
OIL & GAS	**0.7**	**-**	**0.5**	**-**	**1.2**	**0.9**
Alternative Energy	0.7	-	0.5	-	**1.2**	0.9
BASIC MATERIALS	**0.8**	**-**	**-**	**0.3**	**1.1**	**0.5**
Chemicals	0.8	-	-	0.3	**1.1**	0.5
INDUSTRIALS	**7.3**	**0.1**	**1.7**	**1.0**	**10.1**	**10.8**
Construction & Materials	0.1	-	-	-	**0.1**	0.1
Aerospace & Defence	0.6	-	-	-	**0.6**	0.7
Electronic & Electrical Equipment	2.5	0.1	1.2	0.3	**4.1**	3.3
Industrial Engineering	-	-	-	0.1	**0.1**	0.1
Support Services	4.1	-	0.5	0.6	**5.2**	6.6
CONSUMER GOODS	**1.2**	**0.2**	**0.3**	**-**	**1.7**	**1.1**
Household Goods & Home Construction	-	0.2	-	-	**0.2**	0.2
Leisure Goods	1.2	-	0.3	-	**1.5**	0.9
HEALTH CARE	**0.9**	**0.1**	**-**	**-**	**1.0**	**1.1**
Health Care Equipment & Services	0.7	0.1	-	-	**0.8**	1.1
Pharmaceuticals & Biotechnology	0.2	-	-	-	**0.2**	-
CONSUMER SERVICES	**12.6**	**-**	**0.3**	**0.7**	**13.6**	**13.0**
General Retailers	0.1	-	-	0.3	**0.4**	0.4
Media	12.3	-	0.3	0.2	**12.8**	12.6
Travel & Leisure	0.2	-	-	0.2	**0.4**	-
TELECOMMUNICATIONS	**2.0**	**0.1**	**0.2**	**-**	**2.3**	**2.7**
Fixed Line Telecommunications	1.9	-	-	-	**1.9**	2.6
Mobile Telecommunications	0.1	0.1	0.2	-	**0.4**	0.1
FINANCIALS	**0.8**	**-**	**0.1**	**-**	**0.9**	**0.9**
Financial Services	0.2	-	0.1	-	**0.3**	0.2
Equity Investment Instruments	0.5	-	-	-	**0.5**	0.6
Nonequity Investment Instruments	0.1	-	-	-	**0.1**	0.1
TECHNOLOGY	**34.0**	**5.2**	**18.4**	**3.2**	**60.8**	**55.3**
Software & Computer Services	27.2	2.5	11.1	0.9	**41.7**	36.4
Technology Hardware & Equipment	6.8	2.7	7.3	2.3	**19.1**	18.9
TOTAL EQUITIES (including convertibles and warrants)	**60.3**	**5.7**	**21.5**	**5.2**	**92.7**	**-**
Total equities – 2016	55.7	4.2	21.7	4.7	-	86.3
(including convertibles and warrants)						
BONDS	**-**	**-**	**3.0**	**-**	**3.0**	**1.0**
					-	
NET LIQUID ASSETS**	**1.5**	**0.5**	**2.2**	**0.1**	**4.3**	**12.7**
TOTAL ASSETS (before deduction of	**61.8**	**6.2**	**26.7**	**5.3**	**100.0**	**–**

bank loans)						
Total assets – 2016	68.4	5.2	21.7	4.7	–	100.0
BANK LOANS	**-**	**–**	**–**	**–**	**–**	**(3.1)**
SHAREHOLDERS' FUNDS	**61.8**	**6.2**	**26.7**	**5.3**	**100.0**	**–**
Shareholders' Funds – 2016	65.3	5.2	21.7	4.7	–	**96.9**
Number of equity investments (including convertibles and warrants)	148	18	65	40	**271**	252

*FTSE Russell Industry Benchmark Classification.
**Cash, current assets and liabilities, excluding bank loans.

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER

	2017 Revenue £'000	2017 Capital £'000	2017 Total £'000		2016 Revenue £'000	2016 Capital £'000	2016 Total £'000
Gains on investments	–	**205,508**	**205,508**		–	134,969	134,969
Currency (losses)/gains	–	**(3,172)**	**(3,172)**		–	7,951	7,951
Gains on derivative instruments	–	–	–		–	464	464
Income	**10,799**	–	**10,799**		9,541	–	9,541
Investment management fee	**(8,962)**	–	**(8,962)**		(7,133)	–	(7,133)
Other administrative expenses	**(578)**	**(5)**	**(583)**		(545)	(6)	(551)
Profit before finance costs and taxation	**1,259**	**202,331**	**203,590**		1,863	143,378	145,241
Finance costs of borrowings	**(514)**	–	**(514)**		(1,187)	–	(1,187)
Profit before taxation	**745**	**202,331**	**203,076**		676	143,378	144,054
Tax	**(259)**	–	**(259)**		(246)	–	(246)

Profit after taxation	486	202,331	202,817		430	143,378	143,808
Profit per ordinary share (basic and diluted)	0.68p	283.44p	284.12p		0.58p	191.75p	192.33p

There is no final dividend proposed (2016 – nil).

The total column of this statement is the profit and loss account of the Company, prepared in accordance with UK Accounting Standards.

The profit after taxation is the total comprehensive income and therefore no additional statement of comprehensive income is presented. The supplementary revenue and capital columns are presented for information purposes in accordance with the Statement of Recommended Practice issued by the Association of Investment Companies. All items in the above statement derive from continuing operations and the Company. No operations were acquired or discontinued in the year.

BALANCE SHEET
AT 31 DECEMBER

	2017 £'000	2017 £'000	2016 £'000	2016 £'000
Fixed assets				
Investments held at fair value through profit or loss		**925,541**		712,969
Current assets				
Cash and cash equivalents	**41,870**		82,448	
Other receivables	**1,682**		23,529	
	43,552		105,977	
Current liabilities				
Other payables	**(2,443)**		(27,532)	
	(2,443)		(27,532)	
Net current assets		**41,409**		78,445
TOTAL NET ASSETS		**966,650**		791,414
Capital and reserves				
Called up share capital		**17,577**		18,266
Share premium		**73,738**		73,738
Capital redemption reserve		**4,375**		3,686
Capital reserve		**869,799**		695,049
Revenue reserve		**1,161**		675
SHAREHOLDERS' FUNDS		**966,650**		791,414
NET ASSET VALUE PER ORDINARY SHARE (including current year revenue)		**1374.88p**		1083.21p
NET ASSET VALUE PER ORDINARY SHARE (excluding current year revenue)		**1374.20p**		1082.63p

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2017

	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 2017	**18,266**	**73,738**	**3,686**	**695,049**	**675**	**791,414**
Profit after taxation	**–**	**–**	**–**	**202,331**	**486**	**202,817**
Shares purchased for cancellation	**(689)**	**–**	**689**	**(27,581)**	**–**	**(27,581)**
Shareholders' funds at 31 December 2017	**17,577**	**73,738**	**4,375**	**869,799**	**1,161**	**966,650**

FOR THE YEAR ENDED 31 DECEMBER 2016

	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 2016	19,028	73,738	2,924	575,202	245	671,137
Profit after taxation	–	–	–	143,378	430	143,808
Shares purchased for cancellation	(762)	–	762	(23,531)	–	(23,531)
Shareholders' funds at 31 December 2016	18,266	73,738	3,686	695,049	675	791,414

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER

	2017 £'000	2017 £'000	2016 £'000	2016 £'000
Profit before finance costs and taxation	205,390		145,241	
Adjustments for gains on investments	(205,508)		(134,969)	
Realised gains on interest rate swap	-		(464)	
Decrease in accrued income	8		242	
Purchase of investments	(156,421)		(66,449)	
Sale of investments	171,125		107,087	
Increase in other receivables	(38)		(39)	
Increase in other payables	119		120	
Amortisation of fixed income book cost	(22)		1	
Effect of foreign exchange rate changes	3,172		(7,951)	
Overseas tax suffered	(259)		(246)	
Net cash inflow from operating activities		**15,766**		42,573
Finance activities				
Loan repayment	(25,000)		-	
Interest paid on loan and derivatives	(582)		(1,394)	
Swap repayment	-		(12,538)	
Shares repurchased	(27,590)		(23,504)	
Net cash outflow from financing activities		**(53,172)**		(37,436)
(Decrease)/increase in cash and cash equivalents		**(37,406)**		5,137
Cash and cash equivalents at the start of the year		**82,448**		69,360
Effect of foreign exchange rate changes		**(3,172)**		7,951
Cash and cash equivalents at the end of the year		**41,870**		82,448
Comprised of:				
Cash and cash equivalents		**41,870**		82,448

Cashflow from operating activities includes interest received of £518,000 (2016:£140,000) and dividends received of £9,674,000 (2016: £9,360,000).

Income

	2017 £'000	2016 £'000
Income from investments		
Total income	10,799	9,541
Total income comprises:		
Dividends from equity securities at fair value through profit or loss	9,998	9,155
Interest from financial assets designated at fair value through profit or loss	440	360
Other income	371	26
	10,799	9,541

Business model 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 2016, 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

The Company'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 – strategy

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 $3bn, 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 250 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. 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).

Share capital

At 31 December 2017 the Company's capital structure consisted of 70,307,785 ordinary shares of 25p each (2016 – 73,061,801 ordinary shares). During the year 2,754,016 (2016 – 3,049,745) 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. On a winding up, after meeting the liabilities of the Company, the surplus assets would be paid to ordinary shareholders in proportion to their shareholdings.

Investment management agreement

The management of the Company and the implementation of its investment strategy is contracted to Herald Investment Management Limited ('HIML'). HIML is authorised and regulated by the Financial Conduct 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 the Company's portfolio is Katie Potts, who is also a substantial shareholder of HIML Holdings Limited, the parent company of HIML. HIML is remunerated at an annual rate of 1.0% of the Company's net asset value (excluding current year income) 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 an appropriate level of ongoing charges for a specialist trust 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.

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.

Acquisition of own shares

At the Company's AGM held in April 2017 the Company was authorised to purchase up to 14.99% of the Company's ordinary shares. During the year to 31 December 2017 the Company bought back 2,754,016 ordinary shares on the London Stock Exchange for cancellation. 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.

Significant financial issues relating to the 2017 financial statements

The UK Corporate Governance Code requires us to describe any significant issues considered in relation to the financial statements and how those issues were addressed. While there were no significant issues, two matters of risk of particular focus at the balance sheet date were the risk that investments might not have been correctly valued or beneficially owned. No issues were discovered.

Borrowings

The Company has a multi-currency revolving loan facility with RBS up to £25m, maturing in December 2019, under which no drawdowns have been made to date. The Company had a sterling term loan facility with RBS of £25m which was drawn down in full for much of the year but repaid at the expiry of its term on 29 December 2017.

Principal risks and uncertainties

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 fair value or 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.

The Company is exposed to counterparty credit risk from the parties with which it trades and will bear the risk of settlement default. Counterparty credit risk to the Company arises from transactions to purchase or sell investments and through interest rate swap transactions held within the portfolio.

There were no past or impaired assets as of 31 December 2017 (31 December 2016: nil).

The counterparties engaged with the Company are well recognised and regulated entities.

C. Liquidity Risk

Being the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

These risks and the policies for managing them have been applied throughout the year and are summarised below.

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. Listed securities held by the Company are valued at bid prices, whereas material unlisted investments are valued using valuation techniques selected 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. These valuations also represent the fair value of the investments.

Other Price Risk Sensitivity

16.7% of the Company's equity investments at 31 December 2017 (2016 – 20.6%) were listed on the main list of the London Stock Exchange and a further 47.8% (2016 – 42.2%) on AIM. The NASDAQ Stock Exchange accounts for 20.9% (2016 – 19.3%), New York Stock Exchange for 3.2% (2016 – 5.0%) and other stock exchanges 11.4% (2016 – 12.9%). A 10% increase in stock prices at 31 December 2017 would have increased total net assets and profit & loss after taxation by £89,610,000 (2016 – £70,493,000). 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.

(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 and Government bonds, 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 Bank of England base rate.

At 31 December 2017, the company had an undrawn £25 million multi-currency credit facility (2016: multi currency loan: £nil; sterling loan: £25 million). 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.

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

Financial Assets

	2017 Fair value £'000		2017 Weighted average interest rate/ interest		2017 Weighted average period until maturity/		2016 Fair value £'000		2016 Weighted average interest rate/ interest		2016 Weighted average period until maturity/

			rate		maturity date				rate		maturity date
Fixed rate:											
US bonds	29,445		1.0%		0.8 Years		8,041		2.6%		2.3 Years
UK convertible bonds	3,238		9.8%		3.4 Years		2,782		11.2%		1.6 Years
Cash:											
Other overseas currencies	26,363		0.2%				52,675		0.0%		
Sterling	15,507		0.0%				29,773		0.3%		
	41,870						82,448				

The benchmark rate which determines the interest payments received on cash balances is the Bank of England base rate.

Financial Liabilities

	2017 £'000		2017 Net interest rate paid		2017 Loan facility expired		2016 £'000		2016 Net interest rate paid		2016 Loan facility expires
Bank Loan	-		-		-		25,000		1.6%		Dec 2017
Total	-		-				-		1.6%		

At 31 December 2017, the Company had a committed revolving credit facility of £25 million (2016: multicurrency £25 million and sterling £25 million), maturing on 31 December 2019 with a cost associated rate of 0.63% for unutilised amounts.

The effective fixed rate of interest on the sterling loan for the period 1 January to 29 December 2017 was 1.5% (2016 – 1.5%).

Interest rate risk sensitivity

a) **Cash**
An increase of 100 basis points in interest rates as at 31 December 2017 would have a direct effect on net assets. Based on the position at 31 December 2017, over a full year, an increase of 100 basis points would have increased the profit & loss after taxation by £419,000 (2016 – £824,000) and would have increased the net asset value per share by 0.60p (2016 – 1.13p). 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 2017 would have decreased total net assets and profit & loss after taxation by £294,000 (2015 – £80,000) and would have decreased the net asset value per share by 0.42p (2015 – 0.11p). 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**
At 31 December 2017, the Comapny had no loan drawn down (2016 - an increase of 100 basis points in 3 month LIBOR interest rates as at 31 December 2016 on the interest cost of the bank loans would have decreased total net assets and profit & loss after taxation by £250,000 and would have decreased the net asset value per share by 0.34p. A decrease of 100 basis points in 3 month LIBOR interest rates would have the exact 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. 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 2017

	Investments £'000	Cash and deposits £'000	Loans £'000	Other receivables and payables £'000	Net exposure £'000
US dollar	243,248	20,655	-	103	264,006
Norwegian krone	9,264	4,510	-	-	13,774
Korean won	14,505	-	-	110	14,615
Taiwan dollar	17,175	1,143	-	-	18,318
Euro	44,852	52	-	611	45,515
Other overseas currencies	14,098	3	-	15	14,116
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	343,142	26,363	-	839	370,344
Sterling	582,399	15,507	-	(1,600)	596,306
	925,541	41,870	-	(761)	966,650

At 31 December 2016

	Investments £'000	Cash and deposits £'000	Loans £'000	Other receivables and payables £'000	Net exposure £'000
US dollar	190,106	42,034	–	44	232,184
Norwegian krone	5,692	4,698	–	–	10,390
Korean won	11,669	–	–	119	11,788
Taiwan dollar	11,586	5,920	–	–	17,506
Euro	25,369	21	–	117	25,507
Other overseas currencies	14,035	2	–	13	14,050
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	258,457	52,675	–	293	311,425
Sterling	454,512	29,773	(25,000)	20,704	479,989
	712,969	82,448	(25,000)	20,997	791,414

Foreign currency risk sensitivity

At 31 December 2017, had sterling strengthened by 10% (2016 –10%) in relation to all currencies, with all other variables held constant, total net assets and profit & loss after taxation would have decreased by the amounts shown below based solely on translation of securities quoted in currencies overseas. A 10% (2016 – 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.

	2017 £'000	2016 £'000
US dollar	26,401	23,218
Norwegian krone	1,377	1,039
Korean won	1,461	1,179
Taiwan dollar	1,832	1,751
Euro	4,551	2,551
Other overseas currencies	1,412	1,405
	37,034	31,143

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 and for risk management purposes excluded from the credit risk analysis.

Credit Risk Exposure

The exposure to credit risk at 31 December was:

	2017 £'000	2016 £'000
Fixed interest investments	29,445	8,041
Cash and cash equivalents	41,870	82,448
Other receivables	1,682	23,529
	72,997	114,018

During the year the maximum exposure in fixed interest investments was £30,825,000 (2016 – £8,041,000) and the minimum £7,520,000 (2016 – £nil). The maximum exposure in cash was £101,245,000 (2016 – £82,448,000) and the minimum £41,870,000 (2016 – £60,243,000).

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.

Equity securities

The Company’s unlisted investments are not readily realisable, but these only amount to 1.3% of the Company’s total assets at 31 December 2017 (2016 – 1.4%).

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. 20.1% (£178 million) (2016 – 22.8% (£158 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 3.7% (2016 – 4.0%).

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:

	2017 One year or less £’000		2016 One year or less £’000
Bank loans	-		25,101
Other payables	2,443		2,532
	2,443		27,633

Fair Value of Financial Instruments

The Company’s investments, as disclosed in the Company’s balance sheet, are valued at fair value. Nearly all of the Company’s portfolio of investments are disclosed in the Level 1 category as defined in FRS102. Classification is based on the lowest level input that is significant to the fair value measure in its entirety.

The three levels set out in FRS102 follow:

Level 1 The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

Level 2 Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.

Level 3 Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

The investment manager considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

The analysis of the valuation basis for the financial instruments based on the hierarchy as at 31 December is as follows:

At 31 December 2017

	Level 1 £’000	Level 2 £’000	Level 3 £’000	Total £’000
Financial assets				
Equity investments	883,217	–	8,349	891,566
Government debt securities	29,445	–	-	29,445
Other debt securities	-	–	4,530	4,530

Current assets	43,552	–	-	43,552
Total assets	956,214	–	12,879	969,093
Financial liabilities				
Current liabilities	2,443	–	-	2,443
Total liabilities	2,443	–	-	2,443
Total net assets	**953,771**	**–**	**12,879**	**966,650**

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

At 31 December 2017

	£'000
Opening balance at 1 January 2017	11,730
Purchases	1,423
Sales	(998)
Total (losses) or gains:	
– on assets sold during the year	(329)
– on assets held at 31 December 2017	921
Assets transferred during the year	461
Return of capital	(329)
Closing balance at 31 December 2017	**12,879**

At 31 December 2016

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets				
Equity investments	693,198	–	7,656	700,854
Government debt securities	8,041	–	–	8,041
Other debt securities	–	–	4,074	4,074
Current assets	105,977	–	–	105,977
Total assets	807,216	–	11,730	818,946
Financial liabilities				
Bank loans	25,000	–	–	25,000
Current liabilities	2,532	–	–	2,532
Total liabilities	27,532	–	–	27,532
Total net assets	779,684	–	11,730	791,414

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

At 31 December 2016

	£'000
Opening balance at 1 January 2016	12,438
Purchases	2,115
Sales	(1,028)
Total losses:	
– on assets sold during the year	(1,412)
– on assets held at 31 December 2016	(383)
Closing balance at 31 December 2016	11,730

Other risks

Other risks to the Company's model, future performance, solvency or liquidity 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, depositary and administrator provide regular reports to the audit committee on their monitoring programmes. The manager monitors investment positions and the manager and company secretary monitor the level of forecast income and expenditure to ensure the provisions of Sections 1158 and 1159 are not breached.

Major regulatory change could impose disproportionate compliance burdens on the Company. In such circumstances representation would be made to seek to ensure that special circumstances of investment trusts are recognised.

Operational/financial/custody risk – failure of the administrator'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 manager, administrator and company secretary each have comprehensive business continuity plans which facilitate continued operation of the business in the event of a service disruption or major disruption. The audit committee receives the administrator's report on internal controls and the reports by other key third party providers are reviewed by the manager and company 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 manager at every meeting. The majority of the Company's investments are in quoted securities.

Viability statement

The UK Corporate Governance Code and Listing Rules require that the Company should publish a longer-term statement on the viability of the Company. The directors consider that three years is an appropriate forward looking time period. This recognises the Company's current position, the investment strategy, which includes investment in smaller companies and start-ups where a three year horizon is a meaningful period over which to judge prospects, the board's assessment of the main risks that threaten the business model and the relatively fast moving nature of the sectors in which the Company invests.

The directors confirm that, based on reviews conducted as part of the detailed internal controls and risk management processes, they have a reasonable expectation that the Company will continue to maintain its status as an investment trust, to implement its investment strategy and to operate and be able to meet its liabilities as they fall due for at least the next three financial years. Their consideration also takes into account the Company's gearing and financing arrangements and its projected income and expenditure.

There are no current plans to amend the investment strategy, which has delivered good investment performance for shareholders over many years and, the directors believe, should continue to do so. The investment strategy and its associated risks are kept under constant review by the board.

By definition, investment in smaller and start-up companies carries higher risks, both in terms of stock liquidity and longer-term business viability and this risk is accepted by the board. In addition, it should be noted that under the Company's articles of association, shareholders are required to vote triennially on whether the Company should continue as an investment trust, so the longer-term viability statement is contingent upon shareholders voting to support any continuation vote falling within the relevant three year period. The next continuation vote will be at the AGM in 2019.

Directors' responsibility statement pursuant to DTR4

The directors confirm that to the best of their knowledge:

- The financial statements have been prepared in accordance with United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including 'FRS 102 The Financial Reporting Standard applicable to the UK and Republic of Ireland' and give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and

- The management 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.

Copies of the Company's annual report and financial statements will be available from the Company's registered office or at www.heralduk.com once published on 12 March 2018.

By order of the board
Law Debenture Corporate Services Limited
Secretary
20 February 2018