

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**ANNUAL REPORT  
AND  
FINANCIAL STATEMENTS**

**FOR THE 11 MONTH PERIOD ENDED 31 DECEMBER 2009**

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **MANAGEMENT AND OTHER INFORMATION**

#### **Investment Manager**

Montanaro Asset Management Limited  
53 Threadneedle Street  
London EC2R 8AR  
United Kingdom

#### **Listing Sponsor**

NCB Stockbrokers Limited  
3 George's Dock  
International Financial Services Centre  
Dublin 1  
Ireland

#### **Administrator and Secretary**

State Street Fund Services (Ireland) Limited  
78 Sir John Rogerson's Quay  
Dublin 2  
Ireland  
(Formerly Northern Trust International Fund  
Administration Services (Ireland) Limited)

#### **Custodian**

State Street Custodial Services (Ireland) Limited  
78 Sir John Rogerson's Quay  
Dublin 2  
Ireland  
(Formerly Northern Trust Fiduciary Services  
(Ireland) Limited)

#### **Legal Advisers**

*As to Irish Law*  
Matheson Ormsby Prentice  
70 Sir John Rogerson's Quay  
Dublin 2  
Ireland  
(Formerly Mason Hayes & Curran)

#### **Legal Adviser**

*As to UK & US Law*  
Salans  
Millenium Bridge House  
2 Lambeth Hill  
London EC4V 4AJ  
United Kingdom.

#### **Independent Auditors**

Ernst & Young  
Chartered Accountants & Registered Auditors  
Harcourt Centre  
Harcourt Street  
Dublin 2  
Ireland

#### **Directors**

Paul McNaughton (Irish) (Chairman)  
Chris Jones (British)  
David O'Donnell (Irish)  
Rodney Barton (British)  
Simon O'Sullivan (Irish)

All Directors are independent non-executive  
Directors.

**Registered Number:** 330162

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### DIRECTORS' REPORT

The Directors present, herewith, their annual report for the 11 month period ended 31 December 2009.

#### Background

Montanaro European Smaller Companies plc (the "Company" or the "Fund") was incorporated in Ireland on 14 July 2000 under registered number 330162 as an umbrella-type open-ended investment company with variable capital and limited liability under the Companies Act 1963 to 2009. On 29 November 2000, it was authorised by the Irish Financial Services Regulatory Authority in accordance with the provisions of the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (as amended), as an undertaking for collective investment in transferable securities ("UCITS").

The Company is structured as an umbrella fund so that different series of shares (each allocated to a particular sub-fund) may be issued from time to time at the direction of the Directors with the approval of the Financial Regulator. The assets of each sub-fund will be separate from one another and will be invested separately in accordance with the investment objectives and policies of each sub-fund.

The first sub-fund, Montanaro European Smaller Companies Fund was listed on the Irish Stock Exchange on 11 December 2000. On 12 October 2006, two additional shares classes were launched, a euro share class and US dollar share class.

Additional sub-funds, Montanaro Absolute Return Fund and Montanaro European Equity Income Fund, were listed on the Irish Stock Exchange on 3 January 2007 and commenced trading on 5 January 2007. A revised prospectus was issued dated 15 November 2006 and subsequently updated on 25 September 2007 incorporating the issue of the two new sub-funds. The only change to the new prospectus issued on the 18 September 2008 stated that Simon O'Sullivan was appointed to the Board on 18 April 2008. A new prospectus was issued on 1 October 2009 incorporating the issue of the Euro Accumulation share class. The Montanaro Absolute Return Fund terminated on 3 July 2009.

The Fund was authorised by the Financial Regulator in Ireland on 29 November 2000 and was approved by the following competent authorities for sale in their relevant jurisdictions as follows: the Financial Services Authority (FSA) in the UK on 12 May 2005; the Autorité des Marchés Financiers (AMF) in France on 29 July 2005; by the Netherlands Authority for the Financial Markets on 15 February 2007; by the Finansinspektionen in Sweden on 6 September 2007; and the Swiss Federal Banking Commission on 29 October 2008.

At 31 December 2009, the net asset value of the Fund was €459,739,802 (31 January 2009: €210,616,479).

#### Results for the period ended 31 December 2009

The results for the period are set out in the Profit and Loss Account on page 14 and the Balance Sheet of the Company is set out on page 12.

#### Dividends and Distributions

The following interim distributions were paid during the financial year ending 31 December 2009:

Montanaro European Smaller Companies Fund: €4,158,373 (31 January 2009: €249,932);

Montanaro European Equity Income Fund: £153,676 (31 January 2009: £94,866);

Montanaro Absolute Return Fund (Terminated): €Nil (31 January 2009: €39,583).

The following distributions in respect of the financial period ending 31 December 2009 were approved by the Directors during the period for ex-date 20 January 2010:

<b>Fund</b>	<b>Share Class</b>	<b>Rate per Share December 2009</b>
Montanaro European Smaller Companies Fund	GBP	£ 0.018588
	EUR	€0.019276
	USD	\$ 0.00245
<b>Fund</b>	<b>Share Class</b>	<b>Rate per Share December 2009</b>
Montanaro European Equity Income Fund	GBP	£ 0.011361
	EUR	€0.007834

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### DIRECTORS' REPORT (Continued)

#### Dividends and Distributions (Continued)

The following distributions in respect of the financial period ending 31 March 2010 were approved by the Directors during the period for ex-date 9 April 2010:

Fund	Share Class	Rate per Share March 2010
Montanaro European Equity Income Fund	GBP	£ 0.007458
	EUR	€0.004993

#### Directors

The Directors of the Company as at 31 December 2009 are stated on page 1.

#### Directors' & Secretary's Interests

The Directors of the Company, the Secretary and their families had no interests in the shares of the Company at 31 December 2009 and 31 January 2009 apart from Paul McNaughton who held 161,253 shares in the Fund at the period end (31 January 2009: 147,679 shares). No other Director of the Company had at any time during the period a material interest in any contract of significance, subsisting during or at the end of the period, in relation to the business of the Company.

#### Directors' Remuneration

Each Director shall be entitled to such remuneration for his or her services as the Directors may determine provided that the aggregate emoluments of all Directors in respect of any twelve month period shall not exceed £80,000 plus out of pocket expenses, or such higher amount as may be approved by the Company in general meeting. From 1 September 2008 there was a change in the Directors' fees structure, the fee split from this date going forward was as follows, Mr O'Donnell, Mr O' Sullivan, Mr Barton and Mr Jones were entitled to fees of £15,000 per annum while Mr McNaughton was entitled to a fee of £20,000 per annum.

#### Cross Liability Risk

Other sub-funds may be introduced by the Company from time to time, with the prior approval of the Financial Regulator. Although a separate portfolio will be maintained for each sub-fund and each sub-fund will be treated as bearing its own liabilities, the Company as a whole will remain ultimately liable to third parties for the liabilities of all the sub-funds.

Where the assets of a sub-fund are insufficient to meet the liabilities of that sub-fund any liabilities, which remain undischarged, will attach to the Company as a whole and be allocated amongst the other sub-funds. If assets are so transferred, the Directors shall advise Shareholders of any such transfer in the next succeeding annual or half yearly reports to Shareholders. As at 31 December 2009, the Directors are not aware of any such existing or contingent liability (31 January 2009 – nil).

#### Books of Account

The Directors are responsible for ensuring that proper books of account, as outlined in Section 202 of the Companies Act 1990, are kept by the Company. To achieve this, the Directors have employed a service organisation, State Street Fund Services (Ireland) Limited (the "Administrator"). The books of account are maintained at the office of the Administrator at 78 Sir John Rogerson's Quay, Dublin 2, Ireland.

#### Risk Management, Objectives and Policies

The main risks arising from the Company's financial instruments are market price, liquidity, credit, interest rate and foreign currency risk.

A detailed explanation of the risks to which the Company is exposed is provided in Note 8 to the financial statements.

The investment objectives of the sub-funds are set out in Note 8 to the financial statements.

There can be no assurance that the Company will achieve its investment objective. The value of shares may rise or fall as the capital value of the securities in which the Company invests, may fluctuate.

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **DIRECTORS' REPORT (Continued)**

#### **Statement of Directors' Responsibilities**

The Directors are responsible for preparing the annual report and financial statements in accordance with applicable Irish Law and Generally Accepted Accounting Practice in Ireland.

Irish company law requires the Directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company and the profit or loss of the Company for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping proper books of account which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements are prepared in accordance with accounting standards generally accepted in Ireland and comply with Irish Statute comprising the Companies Acts, 1963 to 2009, the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003 (as amended) and the Listing Rules of the Irish Stock Exchange. 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.

In December the Board took the decision to seek to close the Absolute Return Fund during 2009. This was communicated to investors in December who were invited to switch into other Montanaro funds at no cost. Thus by the end of 2008 there were no remaining investors in the Fund. The last NAV per share was struck on 30/12/08 for Euro class and 31/12/08 for GBP class.

#### **Events During the Period**

On 31 January 2009, State Street Fund Services (Ireland) Limited was appointed as Administrator and Company Secretary to the Company. The Company's registered office changed on the same date to Block D, Iveagh Court, Harcourt Road, Dublin 2. On 31 January 2009, State Street Custodial Services (Ireland) Limited was appointed as Custodian to the Company. The new Administrator, Company Secretary and Custodian to the Company are located at 78 Sir John Rogerson's Quay, Dublin 2.

The Montanaro European Smaller Companies Fund - EUR Accumulation Class shares were launched on 2 October 2009.

#### **Events Since the Period End**

The distributions declared prior to the period end for ex-date 20 January 2010 were paid on 3 February 2010. The distributions declared post period end for ex-date 9 April 2010 will be paid on 23 April 2010.

The Company's registered office changed to 78 Sir John Rogerson's Quay on 5 March 2010.

#### **Independent Auditors**

The Auditors, Ernst & Young, will continue in office in accordance with Section 160 (2) of the Companies Act, 1963.

#### **On behalf of the Board of Directors:**

**Paul McNaughton**  
**Director**

**David O'Donnell**  
**Director**

**15 April 2010**

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **CUSTODIAN'S REPORT TO THE SHAREHOLDERS**

#### **Report of the Custodian to the Shareholders**

We have enquired into the conduct of the Montanaro European Smaller Companies Plc ('the Company') for the period ended 31 December 2009, in our capacity as Custodian to the Company.

This report including the opinion has been prepared for and solely for the unitholders in the Company as a body, in accordance with the Financial Regulator's UCITS Notice 4, and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown.

#### **Responsibilities of the Custodian**

Our duties and responsibilities are outlined in the Financial Regulator's UCITS Notice 4. One of those duties is to enquire into the conduct of the Company in each annual accounting period and report thereon to the shareholders.

Our report shall state whether, in our opinion, the Company has been managed in that period in accordance with the provisions of the Company's Memorandum and Articles of Association and the UCITS Regulations. It is the overall responsibility of the Company to comply with these provisions. If the Company has not so complied, we as Custodian must state why this is the case and outline the steps which we have taken to rectify the situation.

#### **Basis of Custodian Opinion**

The Custodian conducts such reviews as it, in its reasonable opinion, considers necessary in order to comply with its duties as outlined in UCITS Notice 4 and to ensure that, in all material respects, the Company has been managed (i) in accordance with the limitations imposed on its investment and borrowing powers by the provisions of its constitutional documentation and the appropriate regulations and (ii) otherwise in accordance with the Company's constitutional documentation and the appropriate regulations.

#### **Opinion**

In our opinion, the Company has been managed during the year, in all material respects:

(i) in accordance with the limitations imposed on the investment and borrowing powers of the Company by the Memorandum & Articles of Association and by the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003, as amended, ('the Regulations'); and

(ii) otherwise in accordance with the provisions of the Memorandum & Articles of Association and the Regulations.

**State Street Custodial Services (Ireland) Limited**

**78 Sir John Rogerson's Quay**

**Dublin 2**

**Ireland**

**15 April 2010**

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### PERFORMANCE SUMMARY

	Montanaro European Smaller Companies Fund				Montanaro European Equity Income Fund	
	EUR	EUR (Acc) <sup>(3)</sup>	GBP	USD	EUR	GBP
31/01/09 NAV per share	1.61		1.45	2.05	0.41	0.62
31/12/09 NAV per share	2.32	2.13	2.08	1.88	0.61	0.92
Dividends paid over the period	0.0325		0.0152	1.0669	0.0243	0.0376
11 month Fund NAV <sup>(1)</sup> return	46.3%	6.3%	45.1%	64.0%	57.8%	56.4%
11 month Benchmark <sup>(2)</sup> return	53.7%	5.7%	53.8%	71.8%	58.1%	58.2%

Based on dealing NAVs

(1) Source: Montanaro, Bloomberg. NAV to NAV, unrounded. Returns are calculated with dividends reinvested at ex date. NAVs prior to 01/10/09 priced at midday; since 2/10/09 priced at 4pm

(2) MSCI European Smaller Companies Index in the relevant currency (Source Bloomberg)

(3) Launched 02/10/09

### Commentary on Markets – 11 months February to December 2009

The turmoil in markets and in many financial institutions that had begun in 2007 persisted into 2009. By March 2009, equity markets were pricing in a severe recession if not an actual depression. However, finally, cumulative government policy announcements of support for the banks and massive fiscal expansion finally convinced investors that all was not lost and markets began to rally sharply in mid-March.

Companies in general had entered the sudden recession in late 2008 completely unprepared and fully exposed to the down turn, which had contributed to the market pessimism. Consumer confidence was low; political uncertainty was high; bankruptcies were rising; property prices were falling fast; and growth forecasts were being revised down aggressively.

By March 2009, many low quality companies were valued as though they were regarded as almost bankrupt and had become “penny stocks”. This was especially the case amongst smaller companies where investors worried they would not be able to roll over their financing or cover their losses. So, not surprisingly, as sentiment turned some companies’ share prices rose as much as tenfold during what came to be labeled as the “dash for trash” from March through September 2009. Equally unsurprisingly, the Montanaro quality approach to investing meant that the Fund’s portfolio underperformed the indices during this period.

High quality companies had not fallen so far and did not recover nearly so quickly nor as much. However, by mid-September, this sharp rally was largely complete and investors again began to look more rationally at businesses and their medium and long term prospects. High quality companies once again began to perform well and the Fund began to outperform the indices.

Thus, the Funds outperformed in February 2009, underperformed in March through September and then outperformed again in the fourth quarter of 2009. The Montanaro European Equity Income Fund underperformed by rather less during the “dash for trash” as a result of its focus on higher yielding stocks and the market appetite for secure income so that it also performed better for the period as a whole, performing broadly in line with its benchmark on a total return basis.

Both Funds produced excellent absolute returns for the 11 month period under review, with the NAV per share (with dividends reinvested) in Euro terms of MESCF rising by 46.3% and of MEEIF rising by 57.8%. These are the kind of returns offered by the SmallCap asset class after a severe bear market and, Montanaro believes, good evidence that the SmallCap Effect is alive and well.

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **PERFORMANCE SUMMARY (Continued)**

#### **2010 Outlook**

Throughout the period, Montanaro consistently maintained its longstanding investment approach that has been used since the launch of the Fund. Thus, Montanaro continued to focus on high quality companies and remains confident that this approach will continue to generate excellent longer term returns in the future, albeit possibly with occasional periods of underperformance. This lower risk approach based on thorough research means the volatility of the absolute returns to investors is often less than those from the market indices.

From October 2009 through February 2010, equity markets generally were correcting or pausing after the preceding six month rally. There were a series of further events globally which contributed to preventing markets rising, notably questions around the solvency of Greece. The Euro zone has been in some turmoil as commentators even questioned the survivability of the monetary union and investors came to understand the scale and duration of the likely domestic demand deflation necessary across Southern Europe in order to restore fiscal balance. Despite good numbers emerging on factory orders and continuing evidence of economic recovery in Northern Europe, the Euro weakened against the US dollar and may well remain under pressure for the balance of 2010.

In the UK, the economy managed only barely to escape recession in Q4 2009; the trade figures remain poor; ahead of the May general election political uncertainty remains high; and the fiscal deficits are bigger than might have been thought possible. This has led to Sterling weakness and concerns about an economic “double dip” when the inevitable fiscal tightening begins in 2011 (or possibly earlier).

However, Montanaro remains optimistic about the outlook for equities, and European SmallCap in particular, for the balance of the year. Emerging market economies are in good shape and many smaller companies are benefitting from the growth there. Euro and Sterling interest rates are likely to remain low for longer than many had previously expected. The strength in the US dollar will be helpful.

Investor sentiment is still generally cautious and many investors still hold significant amounts of cash, having missed out on the rally in 2009. In addition, takeover activity should pick up this year as better capitalized companies take advantage of attractive valuations.

Bad economic news may well persist but Montanaro believes that earnings will continue to exceed expectations for the rest of 2010. Both market analysts and companies themselves have been and probably remain too cautious about this earnings recovery. On top of this, markets - including SmallCap equities - are good value by long term historic standards.

Montanaro believes investors will continue to prefer well-managed high quality businesses with good prospects, even in an economic environment that may well remain moderate in both the UK and Continental Europe, for some time to come. 2010 should be an environment when stock pickers do well, especially those like Montanaro with one of the largest specialist SmallCap research teams anywhere in Europe doing its own careful research.

**Charles Montanaro**

Montanaro Asset Management Limited

March 2010

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **MONTANARO EUROPEAN SMALLER COMPANIES FUND (“The Fund”)**

#### **INVESTMENT MANAGER’S REVIEW**

##### **Investment Objective**

The investment objective of the Fund is to achieve capital growth by investing principally in European (including U.K. and Emerging European) quoted small companies and to outperform its Benchmark the MSCI Europe SmallCap Index .

The MSCI Europe SmallCap Index is calculated daily by Morgan Stanley Capital International. It is a sample of small capitalisation companies from constituent countries in Europe. The index represents the small cap segment in 16 developed equity markets in Europe: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

##### **Investment Policy**

The Fund shall invest at least two thirds of its total assets (after deduction of ancillary liquid assets) in equity securities of smaller companies having their registered office in Europe or companies having their registered office outside Europe but deriving predominant revenues or profits from the European region. Such Companies shall be quoted in the European Union, Iceland, Norway and Switzerland (but without restricting the Fund from investing in smaller companies quoted on other European stock exchanges or quoted on non European Stock exchanges). Smaller companies shall mean companies whose market capitalisation shall not exceed €3 billion.

Up to one third of the total assets of the Fund may be invested in aggregate in equity securities of companies over €3 billion in size. The Fund will invest at least 75% of its net assets in securities eligible for the Plan d’Epargne en Actions (“PEA” in France) and is therefore eligible to the PEA.

##### **Investment Strategy**

In accordance with the investment objectives of the Fund, the focus has been on quoted “smaller” companies falling within the Fund’s benchmark which includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom. Investment may also be made in the ten new countries which joined the EU in 2004: Czech, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

At 31 December 2009, investments were held in 14 countries. The portfolio is well diversified, consisting of over 70 holdings.

##### **Performance Review**

See Performance Summary on page 6.

##### **Charles Montanaro**

Montanaro Asset Management Limited  
March 2010

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **THE MONTANARO EUROPEAN EQUITY INCOME FUND (“Income Fund”)**

#### **INVESTMENT MANAGER’S REVIEW**

##### **Investment Objective**

The investment objective of the Fund is to provide investors with higher than market average dividend income and to outperform its Benchmark the MSCI Europe SmallCap (Total Return) Index.

##### **Investment Policy**

The Fund shall invest at least two thirds of its total assets (after deduction of ancillary liquid assets) in equity securities of smaller companies having their registered office in Europe or companies having their registered office outside Europe but deriving predominant revenues or profits from the European region. Such Companies shall be quoted in the European Union, Iceland, Norway and Switzerland (but without restricting the Fund from investing in smaller companies quoted on other European stock exchanges) or quoted on non European Stock exchanges. Smaller companies shall mean companies whose market capitalisation shall not exceed €3 billion.

Up to one third of the total assets of the Fund may be invested in aggregate in equity securities of companies over €3 billion in size. The Fund will invest at least 75% of its net assets in securities eligible for the Plan d’Epargne en Actions (“PEA” in France) and is therefore eligible to the PEA.

It is intended that the Fund will invest primarily in quoted smaller companies offering a dividend yield higher than the overall market or offering the potential for above average dividend growth in pursuit of its investment objectives.

Dividends are payable or may be re-invested quarterly.

##### **Performance Review**

See Performance Summary on page 6.

##### **Charles Montanaro**

Montanaro Asset Management Limited

March 2010

## **THE MONTANARO ABSOLUTE RETURN FUND**

The Absolute Return Fund ceased to take further subscriptions on 1 January 2009 following the decision by the Directors on 3 December 2008 to liquidate the Fund.

On 3 July 2009 the Irish Financial Services Regulatory Authority approved the termination of the Sub-Fund.

## **INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF THE MONTANARO EUROPEAN SMALLER COMPANIES PLC**

We have audited the financial statements of Montanaro European Smaller Companies plc for the period ended 31 December 2009, which comprise the Profit & Loss Account, Balance Sheet and Statement of changes in net assets attributable to redeemable participating shares and the related notes 1 to 18. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with Section 193 of the Companies Act, 1990. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The Directors are responsible for the preparation of the financial statements in accordance with applicable Irish law and Accounting Standards issued by the Accounting Standards Board and promulgated by the Institute of Chartered Accountants in Ireland ("Generally Accepted Accounting Practice in Ireland") as set out in the Statement of Directors' Responsibilities.

The Directors are also responsible for preparing the Schedule of Investments in accordance with the requirements of the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (as amended) Notices (the "UCITS Notices") issued by the Irish Financial Services Regulatory Authority (the "Financial Regulator").

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Acts, 1963 to 2009 and the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (as amended). We also report to you our opinion as to: whether proper books of account have been kept by the Company; and whether the information given in the Directors' Report is consistent with the financial statements. In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit and whether the financial statements are in agreement with the books of account.

We also report to you if, in our opinion, any information specified by law regarding directors' remuneration and other transactions is not disclosed and, where practicable, include such information in our report.

We review whether the Portfolio and Statement of Investments has been prepared in accordance with the requirements of the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (as amended) Notices (the "UCITS Notices") issued by the Irish Financial Services Regulatory Authority (the "Financial Regulator") and we report if it does not.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report, and the Investment Manager's Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

## **INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF THE MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **Basis of audit opinion**

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

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

### **Opinion**

In our opinion the financial statements give a true and fair view, in accordance with Generally Accepted Accounting Practice in Ireland, of the state of affairs of the company as at 31 December 2009 and of its losses for the period then ended and have been properly prepared in accordance with the provisions of the Companies Acts, 1963 to 2009, and the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (as amended).

We have obtained all the information and explanations we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the Company. The financial statements are in agreement with the books of account.

In our opinion the information given in the Directors' Report is consistent with the financial statements.

Ernst & Young  
Chartered Accountants and Registered Auditors  
Dublin

15 April 2010

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**BALANCE SHEET**

*As at 31 December 2009*

	Notes	Montanaro European Smaller Companies Fund €	Montanaro European Equity Income Fund £	Total as at 31 December 2009 €
<b>Current Assets</b>				
Financial assets at fair value through profit or loss:				
-Transferable securities		454,718,906	3,695,939	458,878,785
-Collective investment schemes		791,153	-	791,153
Cash and cash equivalents	5	717,594	118,512	850,982
Dividends and interest receivable		584,447	17,903	604,597
Other receivables		381,036	3,881	385,404
<b>Total current assets</b>		<b>457,193,136</b>	<b>3,836,235</b>	<b>461,510,921</b>
<b>Current Liabilities</b>				
Investment management fees payable	7	(1,512,251)	-	(1,512,251)
Administrator fee payable		(105,034)	(1,075)	(106,244)
Trustee fee payable		(54,195)	(245)	(54,471)
Directors' fees payable	15	(72,966)	(700)	(73,754)
Other accrued expenses payable		(22,201)	(1,953)	(24,399)
<b>Total current liabilities</b>		<b>(1,766,647)</b>	<b>(3,973)</b>	<b>(1,771,119)</b>
<i>(excluding net assets attributable to holders of redeemable participating shares)</i>		<i>(1,766,647)</i>	<i>(3,973)</i>	<i>(1,771,119)</i>
<b>Net asset value attributable to holders of redeemable participating shares at bid market prices</b>		<b>455,426,489</b>	<b>3,832,262</b>	<b>459,739,802</b>

Please refer to Note 10 for Net Asset Value and NAV per share details.

*The accompanying notes form an integral part of these financial statements.*

**On behalf of the Board of Directors:**

**Paul McNaughton**  
Director

**David O'Donnell**  
Director

**15 April 2010**

# MONTANARO EUROPEAN SMALLER COMPANIES PLC

## BALANCE SHEET

As at 31 January 2009

Notes	Montanaro European Smaller Companies Fund €	Montanaro Absolute Return Fund €	Montanaro European Equity Income Fund £	Total as at 31 January 2009 €
<b>Current Assets</b>				
Financial assets at fair value through profit or loss:				
-Transferable securities	197,946,379	-	2,472,137	200,727,558
-Collective investment schemes	514,773	-	-	514,773
Cash and cash equivalents	9,814,990	19,813	133,617	9,985,123
Dividends and interest receivable	224,564	-	-	224,564
Other receivables	168,466	32,460	2,335	203,553
<b>Total current assets</b>	<b>208,669,172</b>	<b>52,273</b>	<b>2,608,089</b>	<b>211,655,571</b>
<b>Current Liabilities</b>				
Investment management fees payable	(870,366)	-	-	(870,366)
Administrator fee payable	(32,613)	-	(417)	(33,082)
Audit fee payable	(31,304)	-	-	(31,304)
Bank overdraft	-	(41,069)	-	(41,069)
Trustee fee payable	(12,021)	(1,815)	(261)	(14,130)
Directors' fees payable	(7,396)	-	-	(7,396)
Other accrued expenses payable	(32,356)	(9,389)	-	(41,745)
<b>Total current liabilities</b>				
<i>(excluding net assets attributable to holders of redeemable participating shares)</i>	(986,056)	(52,273)	(678)	(1,039,092)
<b>Net asset value attributable to holders of redeemable participating shares at bid market prices</b>	<b>207,683,116</b>	<b>-</b>	<b>2,607,411</b>	<b>210,616,479</b>

Please refer to Note 10 for Net Asset Value and NAV per share details.

*The accompanying notes form an integral part of these financial statements.*

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**PROFIT AND LOSS ACCOUNT**

*Period ended 31 December 2009*

		<b>Montanaro European Smaller Companies Fund</b>	<b>Montanaro European Equity Income Fund</b>	<b>Total 31 December 2009</b>
		€	£	€
<b>Income</b>				
Net realised loss on investments and foreign exchange		(46,782,239)	(336,014)	(47,158,794)
Net change in fair value of investments and foreign exchange		160,715,305	1,521,957	162,420,892
Dividend Income		9,553,607	197,910	9,775,396
Interest income		3,808	-	3,808
Less withholding taxes on dividends and other investment income		(814,176)	(15,556)	(831,609)
<b>Net investment income</b>		<u>122,676,305</u>	<u>1,368,297</u>	<u>124,209,693</u>
<b>Expenses</b>				
Investment management fee	7	(4,457,133)	-	(4,457,133)
Administrator's fees		(202,698)	(2,042)	(204,986)
Trustee fee		(177,630)	(2,740)	(180,701)
Other expenses		(135,367)	(1,530)	(137,081)
Legal fees		(161,226)	(2,369)	(163,881)
Directors' fees	15	(85,772)	-	(85,772)
Audit fee		(32,828)	(309)	(33,174)
<b>Total operating expenses</b>		<u>(5,252,654)</u>	<u>(8,990)</u>	<u>(5,262,728)</u>
<b>Net income from operations before finance costs</b>		<u>117,423,651</u>	<u>1,359,307</u>	<u>118,946,965</u>
<b>Finance costs</b>				
Income distribution	4	(4,158,373)	(153,676)	(4,330,591)
<b>Net increase in net assets attributable to holders of redeemable participating shares</b>		<u><u>113,265,278</u></u>	<u><u>1,205,631</u></u>	<u><u>114,616,374</u></u>

All amounts arose from continuing operations. There are no gains or losses other than those dealt with in the profit and loss account.

*The accompanying notes form an integral part of these financial statements.*

**On behalf of the Board of Directors:**

**Paul McNaughton**  
Director

**David O'Donnell**  
Director

**15 April 2010**

# MONTANARO EUROPEAN SMALLER COMPANIES PLC

## PROFIT AND LOSS ACCOUNT

Period ended 31 January 2009

	Notes	Montanaro European Smaller Companies Fund €	Montanaro Absolute Return Fund €	Montanaro European Equity Income Fund £	Total 31 January 2009 €
<b>Income</b>					
Net realised loss on investments and foreign exchange		(75,889,502)	(1,932,473)	(654,239)	(78,636,564)
Net change in fair value of investments and foreign exchange		(174,792,224)	540,533	(974,114)	(175,464,555)
Interest income		459,425	15,875	8,940	486,431
Dividend income		12,627,824	98,081	176,566	12,945,746
Less withholding taxes on dividends and other investment income		(1,420,853)	(10,309)	(22,382)	(1,459,030)
<b>Net investment expenditure</b>		<b>(239,015,330)</b>	<b>(1,288,293)</b>	<b>(1,465,229)</b>	<b>(242,127,972)</b>
<b>Expenses</b>					
Investment management fee	7	(5,976,710)	(4,799)	(7,544)	(5,990,902)
Trustee fee		(472,463)	(15,042)	(7,635)	(497,011)
Administrator's fees		(316,955)	(2,649)	(3,037)	(323,385)
Other expenses		(222,358)	(19,696)	(5,712)	(249,166)
Legal fees		(175,833)	-	(545)	(176,512)
Directors' fees	15	(70,066)	-	-	(70,066)
Audit fees		(31,304)	-	-	(31,304)
Performance fee	2	(30,007)	-	-	(30,007)
<b>Total operating expenses</b>		<b>(7,295,696)</b>	<b>(42,186)</b>	<b>(24,473)</b>	<b>(7,368,353)</b>
<b>Net loss from operations before finance costs</b>		<b>(246,311,026)</b>	<b>(1,330,479)</b>	<b>(1,489,702)</b>	<b>(249,496,325)</b>
<b>Finance costs</b>					
Income distribution	4	(249,932)	(39,583)	(94,866)	(407,632)
<b>Net decrease in net assets attributable to holders of redeemable participating shares</b>		<b>(246,560,958)</b>	<b>(1,370,062)</b>	<b>(1,584,568)</b>	<b>(249,903,957)</b>

All amounts arose from continuing operations. There are no gains or losses other than those dealt with in the profit and loss account.

The accompanying notes form an integral part of these financial statements.

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**STATEMENT OF CHANGES IN NET ASSETS ATTRIBUTABLE TO HOLDERS OF REDEEMABLE PARTICIPATING SHARES**

*Period ended 31 December 2009*

	<b>Montanaro European Smaller Companies Fund</b>	<b>Montanaro European Equity Income Fund</b>	<b>Total 31 December 2009</b>
	€	£	€
<b>Net assets attributable to holders of redeemable shares at start of period</b>	207,683,116	2,607,411	210,616,479
Net increase in net assets attributable to holders of redeemable participating shares	113,265,278	1,205,631	114,616,374
Proceeds from issuance of shares	222,292,676	109,035	222,414,866
Payments on redemptions of shares	(87,814,581)	(89,815)	(87,915,233)
Foreign exchange adjustments arising on combination	-	-	7,316
<b>Net assets attributable to holders of redeemable shares at end of period</b>	455,426,489	3,832,262	459,739,802

*The accompanying notes form an integral part of these financial statements.*

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**STATEMENT OF CHANGES IN NET ASSETS ATTRIBUTABLE TO HOLDERS OF REDEEMABLE PARTICIPATING SHARES**

*Period ended 31 January 2009*

	<b>Montanaro European Smaller Companies Fund</b>	<b>Montanaro Absolute Return Fund</b>	<b>Montanaro European Equity Income Fund</b>	<b>Total 31 January 2009</b>
	€	€	£	€
<b>Net assets attributable to holders of redeemable shares at start of the period</b>	559,061,302	4,179,890	4,343,763	569,155,269
Net decrease in net assets attributable to holders of redeemable participating shares	(246,560,958)	(1,370,062)	(1,584,568)	(249,903,957)
Proceeds from issuance of shares	62,780,483	1281	10,032	62,794,255
Payments on redemptions of shares	(167,597,711)	(2,811,109)	(161,816)	(170,610,296)
Foreign exchange adjustment arising on combination	-	-	-	(818,792)
<b>Net assets attributable to holders of redeemable shares at end of period</b>	<b>207,683,116</b>	<b>-</b>	<b>2,607,411</b>	<b>210,616,479</b>

*The accompanying notes form an integral part of these financial statements.*

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **STATEMENT OF ACCOUNTING POLICIES**

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

#### ***Basis of preparation***

The financial statements are prepared in accordance with accounting standards issued by the Accounting Standards Board (ASB) and promulgated by the Institute of Chartered Accountants in Ireland ("Generally Accepted Accounting Practice in Ireland") and the provisions of the Companies Acts, 1963 to 2009 and the European Communities (Undertakings for Collective Investments in Transferable Securities) Regulations 2003 as amended. The financial statements have been prepared on a historical cost basis, except for financial instruments classified at fair value through profit or loss that have been measured at fair value.

The format and certain wordings of the financial statements have been adapted from those contained in the Companies (Amendment) Act, 1986 so that, in the opinion of the Directors, they more appropriately reflect the Company's business as an investment fund.

#### ***Income***

Income received and receivable from investments and deposits is credited to the Profit and Loss Account on an accruals basis. Dividend income is credited to the Profit and Loss Account on an ex-dividend basis. Income is shown gross of any non-recoverable withholding taxes, which is disclosed separately in the Profit and Loss account, and net of any tax credits.

#### ***Share capital***

The Company's subscriber shares are classified as equity in accordance with the Company's articles of association. These shares do not participate in the profits of the Company.

#### ***Fees and charges***

The investment manager's fee, custody fee, administrator's fee, directors' fees and other operating expenses are charged to the Profit and Loss Account on an accruals basis.

#### ***Redeemable Participating Shares***

All redeemable participating shares issued by the Company provide the investors with the right to require redemption for cash at the value proportionate to the investor's share in the Company's net assets at the redemption date. In accordance with FRS 25, such instruments give rise to a financial liability for the present value of the redemption amount. In accordance with the prospectus, the Company is contractually obliged to redeem shares at the Net Asset Value per Share on the valuation date. In accordance with FRS 26 the best measure of fair value of a financial asset is usually the current bid price, the redeemable participating shares need to be adjusted to the bid-market prices to reflect this pricing adjustment for financial reporting purposes only.

#### ***Distributions to holders of redeemable participating shares***

Distributions to holders of redeemable participating shares are recorded in the Profit and Loss Account and recorded as finance costs when paid by the members.

#### ***Financial Instruments***

##### **(i) Classification**

In accordance with FRS 26 the Company has classified its investments into the financial assets at fair value through profit or loss category.

The category of financial assets and financial liabilities at fair value through profit or loss comprises:

- Financial instruments held-for-trading. These comprise equities and funds. These instruments are acquired or incurred principally for the purpose of generating a profit from short-term fluctuation in price.

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **STATEMENT OF ACCOUNTING POLICIES (Continued)**

#### ***Financial Instruments (Continued)***

- Financial instruments designated at fair value through profit or loss upon initial recognition. These include financial assets that are not held for trading purposes, such as Collective Investment Schemes. These financial instruments are designated on the basis that their fair value can be reliably measured and their performance has been evaluated on a fair value basis in accordance with the risk management strategy as set out in the Company's offering memorandum.

#### **(ii) Initial Measurement**

Purchases and sales of financial instruments are recognised on the trade date, which is the date that the Company commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial instruments that require delivery of assets within the period generally established by regulation or convention in the market place. Realised gains and losses on disposal of financial instruments are calculated using the first in first out (FIFO) method.

Financial instruments categorised at fair value through profit or loss are recognised initially at fair value, with transaction costs for such instruments being recognised directly in the Profit and Loss Account.

#### **(iii) Subsequent Measurement**

After initial measurement, the Company measures financial instruments which are classified as at fair value through profit or loss, at their fair values. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The fair value of financial instruments is based on their quoted market prices on a recognised exchange or sourced from a reputable broker/counterparty in the case of non-exchange traded instruments, at the Balance Sheet date without any deduction for estimated future selling costs. Financial assets are priced at their current bid prices, while financial liabilities are priced at their current offer prices.

If a quoted market price is not available on a recognised stock exchange or from a broker/counterparty, the fair value of the financial instruments may be estimated by the directors using valuation techniques, including use of recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Subsequent changes in the fair value of financial instruments at fair value through profit or loss are recognised in the profit and loss account.

#### **(iv) Derecognition**

The Company derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the financial asset and the transfer qualifies for derecognition in accordance with FRS 26.

The Company derecognises a financial liability when the obligation specified in the contract is discharged, cancelled or expires.

#### **(v) Offsetting**

Financial assets and liabilities are offset and the net amount reported in the Balance Sheet when there is a legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis, or realise the assets and settle the liability simultaneously.

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **STATEMENT OF ACCOUNTING POLICIES (Continued)**

#### ***Foreign Currency***

##### **(a) Functional and Presentation Currency**

Items included in Montanaro European Smaller Companies Fund's financial statements are measured and presented using the currency of the primary economic environment in which it operates ('the functional currency'). This is the euro, which reflects Montanaro European Smaller Companies Fund and Montanaro Absolute Return Fund's primary activity of investing in European securities.

The Montanaro European Equity Income Fund has adopted British Pounds sterling as its presentation currency ('the presentation currency'), as the Company's main investors are based in the United Kingdom. The Company's results and financial position are translated from its functional currency to its presentation currency, as follows:

- (i) assets and liabilities, including net assets attributable to holders of redeemable participating shares, are translated at the closing rate at each Balance Sheet date;
- (ii) proceeds from subscriptions and amounts paid on redemption of redeemable participating shares are translated at monthly average rates, which approximate the rates prevailing at the dates of the transactions. Translation differences on non-monetary items, such as equities, held at fair value through profit or loss are reported as part of the fair value gain or loss; and
- (iii) income and expenses are translated at the monthly average exchange rates (unless the average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rates prevailing on the dates of the transactions).

##### **(b) Foreign currency transactions**

Monetary assets and liabilities denominated in currencies other than the euro are translated into euro at the closing rates of exchange at each period end. Transactions during the period, including purchases and sales of securities, income and expenses, are translated at the rate of exchange prevailing on the date of the transaction. Foreign currency transaction gains and losses are included in the Profit and Loss Account.

##### **(c) Basis of combination**

The Sterling portfolios have been converted to Euro for financial statements purposes by using the Exchange rate at the Balance Sheet date (Note 11). The opening value of the Combined Company has been converted at the Exchange rates ruling at 31 January 2009. A gain of €7,316 (31 January 2009: loss of €818,792) arises from the conversion of this balance to the exchange rates ruling at 31 December 2009, which is included in the Statement of Changes in Net Assets Attributable to Holders of Redeemable Participating Shares. The loss only affects Combined Company position and has no impact on the Net Asset Value Attributable to Holders of Redeemable Participating Shares of the Portfolios.

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### NOTES FORMING PART OF THE FINANCIAL STATEMENTS

*Period ended 31 December 2009*

#### 1. Background

Montanaro European Smaller Companies Plc (the “Company”) was incorporated on 14 July 2000 under the laws of Ireland as an investment Company with variable capital under the laws of the Republic of Ireland and was listed on the Irish Stock Exchange on 11 December 2000.

The Company has two sub-funds (the “Funds”, each a “Fund”), Montanaro European Smaller Companies Fund and Montanaro European Equity Fund. Montanaro European Smaller Companies Fund and Montanaro European Equity Fund were in existence at the period end. Montanaro European Smaller Companies Fund has three classes of shares, a sterling class, a euro class and a dollar class. Montanaro European Equity Income Fund has two classes of shares, a euro class and a sterling class. All share classes are listed on the Irish Stock Exchange.

#### 2. Fees

##### *Investment Management Fee*

Each of the Funds will pay the Investment Manager a basic management fee of 1.5% per annum (plus VAT, if any). The management fee will accrue daily and will be calculated monthly on the basis of the NAV of the Fund on the last Dealing Day of each month and will be payable quarterly in arrears. There was a waiver in respect of management fees in the case of the Montanaro European Equity Income Fund by the Investment Manager. The Investment Management fee was €1,457,133 for the period (13 months ended January 2009: €5,990,902) of which €1,512,251 (31 January 2009: €870,366) was payable at the period end.

##### *Performance Fee*

##### *Montanaro European Smaller Companies Fund*

The Investment Manager may also be entitled to receive an annual performance-related fee based on the out-performance per Share over the return on the Morgan Stanley Europe Small Companies Index (the “Benchmark”).

The performance fee payable will be 20% of the amount by which the increase in the NAV per Share having adjusted for (i) the impact of any accruing performance fee, (ii) any dividends paid or payable by reference to the year in question and (iii) the hurdles set out at (a) and (b) below exceeds the return on the Benchmark plus 3 percentage points over the relevant accounting period. It will be calculated based on the time weighted average number of Shares in issue during the relevant period. Subject to the aforementioned provisions, a performance fee will only be payable in respect of any period if, and to the extent that, the closing NAV per Share exceeds the higher of (a) the opening NAV per Share for the relevant period; and (b) the NAV per Share on the last accounting period end by reference to which a performance fee was paid (if any).

Calculation periods of the performance fee will correspond to the accounting period of the Company. The performance fee shall be payable annually in arrears.

The performance fee will accrue and be taken into account in the calculation of the NAV per Share on each Dealing Day. If a Shareholder redeems Shares prior to the end of a calendar year, any accrued performance fee in respect of such Shares will remain in the Fund to the benefit of the remaining Shareholders if a performance fee is not payable in respect of that year.

Calculation periods of the performance fee corresponded to the accounting period of the Company. The performance fee was payable annually in arrears.

The performance fee, if any, accrued and was taken into account in the calculation of the NAV per Share on each Dealing Day. If a Shareholder redeemed Shares prior to the end of a calendar year, any accrued performance fee in respect of such Shares remained in the Fund to the benefit of the remaining Shareholders if a performance fee was not payable in respect of that year.

##### *Montanaro European Equity Income Fund*

The Investment Manager is not entitled to a performance fee on the Montanaro European Equity Income Fund.

# MONTANARO EUROPEAN SMALLER COMPANIES PLC

## NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)

Period ended 31 December 2009

### 2. Fees (Continued)

*Performance fees incurred:*

	Montanaro European Smaller Companies Fund	Montanaro European Income Fund	Total
	€	£	€
31 December 2009	-	-	-
31 January 2009	30,007	-	30,007

#### *Administration Fee*

The administration fee will accrue daily and be paid monthly in arrears at a rate of 0.075% of the Net Asset Value of each Sub-Fund, subject to an aggregate annual minimum Administration and Custody fee of €150,000 pro-rated across the Sub-Funds based upon each of the Sub-Fund's respective monthly Net Asset Value. The Administration fee was €204,986 for the period (13 months ended January 2009: €323,385) of which €106,244 (31 January 2009: €33,082) was payable at the period end.

#### *Custody Fee*

The Custodian will be paid an annual fee from the Company of 0.025% of the Net Asset Value of each Sub-Fund accruing daily and paid monthly in arrears, subject to an aggregate annual minimum Administration and Custody fee of €150,000 pro-rated across the Sub-Funds based upon each of the Sub-Fund's respective monthly Net Asset Value. In addition the Custodian is entitled to a transaction fee of €35 for each transaction conducted pursuant to the Custodian Agreement, such fee has been waived since 1 January 2007. The Custody fee was €180,701 for the period (13 months ended January 2009: €497,011) of which €54,471 (31 January 2009: €14,130) was payable at the period end.

#### *Directors' Fees*

Each Director shall be entitled to such remuneration for his or her services as the Directors may determine provided that the aggregate emoluments of all Directors in respect of any twelve month period shall not exceed £80,000 plus out of pocket expenses, or such higher amount as may be approved by the Company in general meeting. From 1 September 2008 there was a change in the Directors' fees structure, the fee split from this date going forward was as follows, Mr O'Donnell, Mr O' Sullivan, Mr Barton and Mr Jones were entitled to fees of £15,000 per annum while Mr McNaughton was entitled to a fee of £20,000 per annum. The Directors' fees were €85,772 for the period (13 months ended January 2009: €70,066) of which €72,966 (31 January 2009: €7,396) was payable at the period end.

### 3. Financial instruments at fair value through profit or loss

As at 31 December 2009 and 31 January 2009, financial assets held for trading are listed securities fixed at closing bid prices for long positions, apart from collective investment schemes which are priced at the latest available net asset value, calculated by the Administrator of the Underlying Fund.

### 4. Distribution Policy

The Company made the following distributions to redeemable participating shareholders during the period ended 31 December 2009:

Montanaro European Smaller Companies Fund: €4,158,373 (13 months ended January 2009: €249,932)  
Montanaro European Equity Income Fund: £153,676 (13 months ended January 2009: £94,866)  
Montanaro Absolute Return Fund (Terminated): €Nil (13 months ended January 2009: €39,583)

Distributions may be paid out of the net investment income of the Company. Otherwise all income and gains of the Company will be accumulated within the Company. It is the intention of the Directors to apply for UK Distributor Status certification for the period from 1 February 2009 to 31 December 2009.

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)

*Period ended 31 December 2009*

#### 5. Cash and Cash Equivalents

All uninvested cash is held on deposit with State Street Bank and Trust Company, London. At the period end, the Company had a cash balance of €50,982 (31 January 2009: €9,985,123) and a bank overdraft of €Nil (31 January 2009: €1,069) with State Street Bank and Trust Company, London.

#### 6. Cash Flow Statement

The Fund has availed of the exemption available to open-ended investment funds under FRS 1 (Revised) not to prepare a cash flow statement.

#### 7. Related Parties

The following transactions were entered into during the period by the Company in the ordinary course of business and on normal commercial terms:

Montanaro Asset Management Limited, as Investment Manager, earned a Management Fee of €1,457,133 for the period (13 months ended January 2009: €5,990,902) of which €1,512,251 (31 January 2009: €870,366) was payable at the period end.

Montanaro Asset Management Limited, as Investment Manager, earned a Performance fee of €Nil for the period (13 months ended January 2009: €30,007) of which €Nil (31 January 2009: €nil) was payable at the period end.

Paul McNaughton, the Company Chairman held 161,253 shares in the Company at the period end (31 January 2009: 147,679 shares).

#### 8. Risks Associated with Financial Instruments

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Fund's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance. Further, the Company has investment guidelines that set out its overall business strategies, its tolerance for risk and its general risk management philosophy and has established processes to monitor and control economic hedging transactions in a timely and accurate manner.

The Company's assets and liabilities comprise financial instruments which mainly include

- Investments in equity shares, preferred stock and collective investment schemes. These are held in accordance with the Company's investment objectives and policies
- Cash, liquid resources and short-term debtors and creditors that arise directly from its investment activities.

The investment objectives of the Funds are as follows:

##### *Montanaro European Smaller Companies Fund*

The investment objective of the Fund is to achieve capital growth by investing principally in European (including U.K. and Emerging European) quoted small companies and to outperform its Benchmark (The MSCI Europe SmallCap Index).

##### *Montanaro European Equity Income Fund*

The investment objective of the Fund is to provide investors with higher than market average dividend income by investing principally in European (including U.K. and Emerging European) quoted small companies and to outperform its Benchmark the MSCI Europe SmallCap (Total Return) Index.

##### **Market Price Risk**

The Company trades in financial instruments, taking positions in traded instruments to take advantage of short-term market movements in the equity markets.

# MONTANARO EUROPEAN SMALLER COMPANIES PLC

## NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)

Period ended 31 December 2009

### 8. Risks Associated with Financial Instruments (Continued)

#### Market Price Risk (Continued)

All securities investments present a risk of loss of capital. The Investment Manager moderates this risk through a careful selection of securities and other financial instruments within specified limits. The maximum risk resulting from financial instruments is determined by the fair value of the financial instruments. The Fund's overall market positions are monitored on a daily basis by the Fund's Investment Manager and are reviewed on a monthly basis by the Directors upon receipt of the monthly Investment Manager's report. The monthly Investment Manager's report includes details of the fund's performance, relative performance, a fund analysis, a list of the top ten holdings and a sector and country distribution analysis.

The positions held by the Company at the year end are disclosed in the Schedule of Investments.

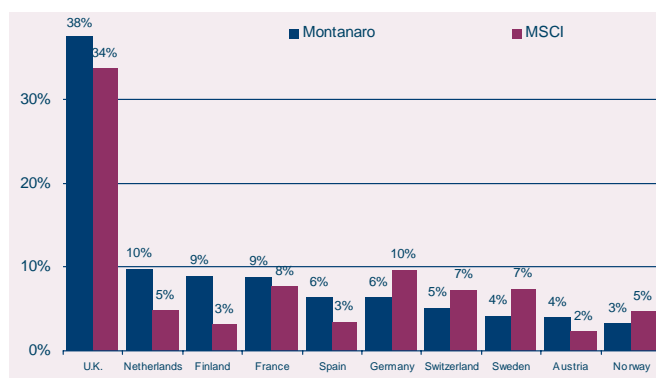
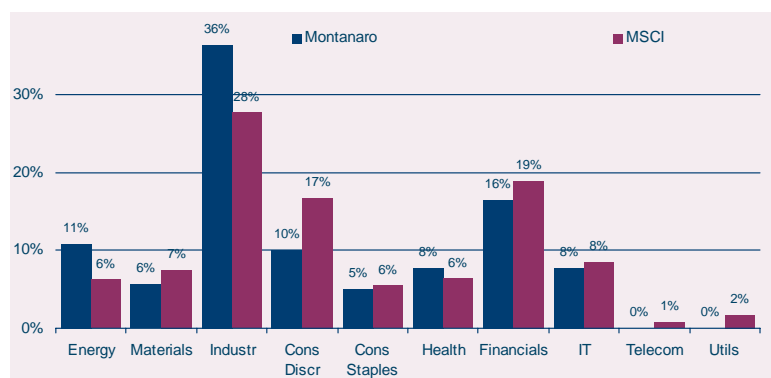
The Company's equity instruments are susceptible to market price risk arising from uncertainties about future prices of the instruments. The Company's market price risk is managed through diversification of the investment portfolios. In the case of each of the funds more than 95% of the funds' invested assets are invested in securities listed on recognised European exchanges. At 31 December 2009 the overall market exposures were as follows:

	31 December 2009		31 January 2009	
	Fair value	% of NAV	Fair value	% of NAV
<b>Securities held for trading</b>				
Montanaro European Smaller Companies Fund	€454,718,906	99.85	€198,461,152	95.56
Montanaro European Equity Income Fund	£3,695,939	96.44	£2,472,137	94.81

If the Company's underlying benchmarks at 31 December 2009 had increased or decreased by 5% with all other variables held constant, this would have increased or reduced net assets attributable to holders of redeemable shares of the European Small Companies Fund and the European Equity Income Fund by approximately €23m and £185k respectively (31 January 2009: €10m and £124k respectively).

The sector and country distribution of the Company's investments at 31 December 2009 and 31 January 2009 is illustrated in the below tables, versus the MSCI Europe SmallCap Index:

#### 31 December 2009



**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

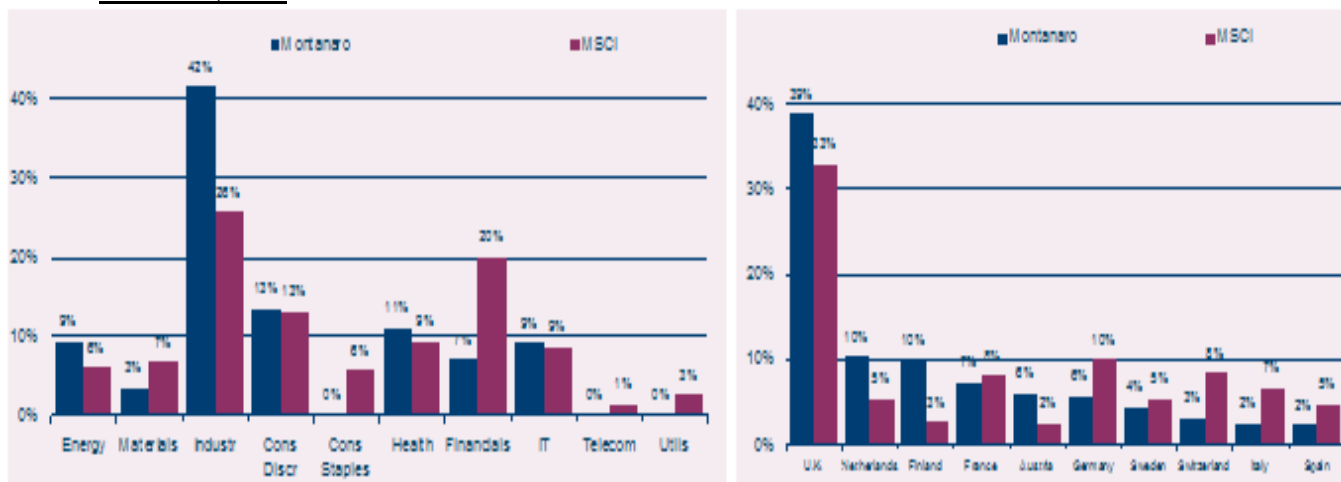
**NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)**

*Period ended 31 December 2009*

**8. Risks Associated with Financial Instruments (Continued)**

*Market Price Risk (Continued)*

31 January 2009



**Interest Rate Risk**

The majority of the Company's financial assets are equity shares and other instruments which neither pay interest nor have a maturity date. As a result, the Company is not subject to significant amounts of risk due to fluctuations in the prevailing levels of market interest rates.

**Foreign Currency Risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. In accordance with the Company's policy, the Investment Manager monitors the Company's currency position on a daily basis, and the Directors review it on a monthly basis by reviewing the monthly Administration report and the monthly Investment Manager's report.

The Company holds assets denominated in currencies other than the euro, the functional currency. It is therefore exposed to currency risk, as the value of the securities denominated in other currencies will fluctuate due to changes in exchange rates. The Company's policy is not to enter into any currency hedging. The table below indicates the currencies to which the Company had significant exposure at 31 December 2009:

	<b>Montanaro European Smaller Companies Fund</b>		<b>Montanaro European Equity Income Fund</b>	
	<b>31 Dec 09</b>	<b>31 Jan 09</b>	<b>31 Dec 09</b>	<b>31 Jan 09</b>
	<b>€'000</b>	<b>€'000</b>	<b>£'000</b>	<b>£'000</b>
CHF	22,887	6,448	158	87
GBP	179,669	91,690	1,796	411
EUR	218,846	97,710	1,595	1,750
NOK	15,182	3,118	-	-
SEK	18,843	9,309	283	359
USD	-	1	-	-
	<b>455,427</b>	<b>208,276</b>	<b>3,832</b>	<b>2,607</b>

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)

*Period ended 31 December 2009*

#### 8. Risks Associated with Financial Instruments (Continued)

##### *Foreign Currency Risk (continued)*

At 31 December 2009, had the exchange rate between the euro and other currencies to which the Company is exposed increased or decreased by 5% with all other variables held constant, the increase or decrease respectively in net assets attributable to holders of redeemable preference shares of the European Smaller Companies Fund, and European Equity Income Fund would amount to approximately €11.3m and £97k respectively (31 January 2009: €5.5m and £110k respectively).

##### *Credit/Counterparty Risk*

Credit risk is the risk that an issuer or counterparty will be unable to meet a commitment that it has entered into with the Company.

The Company's maximum exposure to credit risk (not taking into account the value of any collateral or other security held) in the event that counterparties fail to perform their obligations as of 31 December 2009 in relation to each class of recognised financial assets, is the carrying amount of those assets as indicated in the Balance Sheet.

All transactions in listed securities are settled/paid for upon delivery using approved brokers. The risk of default is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker. The trade will fail if either party fails to meet its obligation.

In accordance with the Company's policy, the Investment Manager monitors the Company's credit position on a daily basis, and the Board of Directors reviews it on a monthly basis by reviewing the Administrator's monthly report which includes details of failed/failing trades.

In particular there is cash holding at 31 December 2009 of €50,982 with State Street Bank and Trust Company, London, which has a credit rating of AA-, rated by Standard & Poor's. The investments are held by the Custodian, State Street Custodial Services (Ireland) Limited, which has a credit rating of AA-, rated by Standard & Poor's.

##### *Significant concentrations of credit risk*

Concentrations of credit risk exist when changes in economic, industry or geographic factors affect counterparties whose aggregate credit exposure is significant in relation to the Company's total credit exposure. The Company's portfolio of financial instruments is broadly diversified along industry, product and geographic lines, and transactions are entered into with diverse creditworthy counterparties, thereby mitigating any significant concentration of credit risk.

##### *Liquidity Risk*

The Company is exposed to daily cash redemptions of redeemable shares. It therefore invests the majority of its assets in investments that are traded in an active market and can be readily disposed of.

The Company's listed securities are considered readily realisable, as they are listed on recognised European stock exchanges. The Company has the ability to borrow in the short term to ensure settlement. At 31 December 2009 no such borrowings existed (31 January 2009: Nil).

In accordance with the Company's policy, the Investment Manager monitors the Fund on a daily basis, and the Board of Directors reviews it on a monthly basis by reviewing the monthly Administrator's report and the monthly Investment Manager's report.

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)**

*Period ended 31 December 2009*

**8. Strategy in using financial instruments (Continued)**

*Liquidity Risk (continued)*

The tables below analyse the Company's financial liabilities into relevant maturity groupings based on the remaining period to maturity at the Balance Sheet date to the contractual maturity date. Redeemable Shares are classified as maturing in less than one month as they are redeemable on demand.

<b>31 December 2009</b>	<b>&lt;1 Month</b>	<b>1-3 Months</b>	<b>3 Months to 1 Year</b>	<b>No stated maturity</b>	<b>Total</b>
	€	€	€	€	€
Financial assets at fair value through profit or loss	459,669,938	-	-	-	459,669,938
Cash and cash equivalents	850,982	-	-	-	850,982
Other receivables	990,001	-	-	-	990,001
<b>Total Assets</b>	<b>461,510,921</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>461,510,921</b>
Trade and other payables	-	(1,771,119)	-	-	(1,771,119)
Redeemable Shares	(459,739,802)	-	-	-	(459,739,802)
<b>Total Liabilities</b>	<b>(459,739,802)</b>	<b>(1,771,119)</b>	<b>-</b>	<b>-</b>	<b>(461,510,921)</b>
<b>Liquidity Gap</b>	<b>1,771,119</b>	<b>(1,771,119)</b>	<b>-</b>	<b>-</b>	<b>-</b>

<b>31 January 2009</b>	<b>&lt;1 Month</b>	<b>1-3 Months</b>	<b>3 Months to 1 Year</b>	<b>No stated maturity</b>	<b>Total</b>
	€	€	€	€	€
Financial assets at fair value through profit or loss	201,242,331	-	-	-	201,242,331
Cash and cash equivalents	9,985,123	-	-	-	9,985,123
Other receivables	428,117	-	-	-	428,117
<b>Total Assets</b>	<b>211,655,571</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>211,655,571</b>
Bank overdraft	(41,069)	-	-	-	(41,069)
Trade and other payables	(717,579)	(280,444)	-	-	(998,023)
Redeemable Shares	(210,616,479)	-	-	-	(210,616,479)
<b>Total Liabilities</b>	<b>(211,375,127)</b>	<b>(280,444)</b>	<b>-</b>	<b>-</b>	<b>(211,655,571)</b>
<b>Liquidity Gap</b>	<b>280,444</b>	<b>(280,444)</b>	<b>-</b>	<b>-</b>	<b>-</b>

***Fair Value Estimation***

The Company adopted the amendment to FRS 29, effective 1 January 2009. This requires the Company to classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 - Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)

Period ended 31 December 2009

#### 8. Strategy in using financial instruments (Continued)

##### *Fair Value Estimation (continued)*

The determination of what constitutes 'observable' requires significant judgement by the Company. The Company 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 following tables analyse within the fair value hierarchy the Company's financial assets measured at fair value at 31 December 2009. There are no financial liabilities measured at fair value.

<b>Montanaro European Smaller Companies Fund</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	€	€	€	€
Financial assets at fair value through profit or loss:				
-Transferable securities	454,718,906	-	-	454,718,906
-Collective investment schemes	-	791,153	-	791,153
<b>Total assets</b>	<b>454,718,906</b>	<b>791,153</b>	<b>-</b>	<b>791,153</b>

<b>Montanaro European Equity Income Fund</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	£	£	£	£
Financial assets at fair value through profit or loss:				
-Transferable securities	3,695,939	-	-	3,695,939
<b>Total assets</b>	<b>3,695,939</b>	<b>-</b>	<b>-</b>	<b>3,695,939</b>

Investments whose values are based on quoted market prices in active markets and therefore classified in level 1 include active listed equities. Investments whose values are based on prices other than quoted market prices in active markets and therefore classified in level 2 include collective investment schemes which are not traded on an exchange but for which prices are publically available.

There were no transfers between levels during the year. The Company does not hold any investments classified within Level 3.

#### 9. Soft Commission Arrangements

During the periods ended 31 December 2009 and 31 January 2009 there were no soft commission arrangements.

#### 10. Share Capital and Redeemable Participating Shares

##### **Redeemable Participating Shares – non equity**

The authorised share capital of the company is 1,000,000,000 redeemable participating Shares of no par value. The redeemable participating shares issued by the Company are freely transferable and are entitled to participate equally in the profits and dividends of the relevant Fund and its assets upon liquidation. The redeemable participating Shares, which are of no par value and which must be fully paid up on issue, carry no preferential or pre-emptive rights. Holders of redeemable participating Shares are entitled to one vote at General Meetings of the Company in respect of each redeemable participating Share held.

##### **Subscriber Shares – equity**

The Company has authorised Share Capital of €38,100 (divided into 38,100 Subscriber Shares of one Euro each). At 31 December 2009 there were 7 Subscriber Shares of €1 each in issue (being the minimum share capital of the Company) held by the Investment Manager. Subscriber Shares do not entitle the holders to any dividend and on a winding-up entitle the holder to receive the amount paid thereon but not otherwise to participate in the assets of the Company. The Subscriber shares do not form part of redeemable participating Shareholders' Funds. They are thus disclosed by way of this note only. In the opinion of the Directors, this disclosure reflects the nature of the Company's business as an investment fund.

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)**

*Period ended 31 December 2009*

**10. Share Capital and Redeemable Participating Shares (Continued)**

**Redemption of Shares**

Shareholders may redeem their Shares on and with effect from any Dealing Day at the Net Asset Value per Share calculated on or with respect to the relevant Dealing Day in accordance with the procedures specified in the relevant Supplement (save during any period when the calculation of Net Asset Value is suspended). If the redemption of part only of a Shareholder's shareholding would leave the Shareholder holding less than the Minimum Holding for the relevant Fund, the Directors or their delegates may, if they think fit, redeem the whole of that Shareholder's holding.

**Share Classes**

Shares will be issued to investors as Shares of a Class in the Funds. The Directors may, whether on the establishment of each Fund or from time to time, with prior notification to, and clearance by the Financial Regulator, create more than one Class of Shares in each of the Funds. The Directors may in their absolute discretion differentiate between Classes of Shares, without limitation, as to currency denomination of a particular Class, dividend policy, hedging strategies if any applied to the designated currency of particular Classes, fees and expenses or the Minimum Subscription of Minimum Holding applicable.

**Period ended 31 December 2009**

<b>Montanaro European Smaller Companies Fund</b>	<b>GBP Class</b>	<b>EUR Class</b>	<b>USD Class</b>	<b>EUR Acc. Class</b>
Units in Issue at beginning of period	28,415,324	101,137,468	14,469	-
Subscriptions	27,118,095	57,714,763	319,587	27,616,945
Redemptions	(3,952,770)	(39,040,309)	-	-
Units in Issue at end of period	<u>51,580,649</u>	<u>119,811,922</u>	<u>334,056</u>	<u>27,616,945</u>

<b>Montanaro European Equity Income Fund</b>	<b>GBP Class</b>	<b>EUR Class</b>
Units in Issue at beginning of period	2,557,357	2,777,778
Subscriptions	89,659	75,561
Redemptions	(135,500)	-
Units in Issue at end of period	<u>2,511,516</u>	<u>2,853,339</u>

**Period ended 31 January 2009**

<b>Montanaro European Smaller Companies Fund</b>	<b>GBP Class</b>	<b>EUR Class</b>	<b>USD Class</b>
Units in Issue at beginning of period	32,647,037	137,129,275	772,340
Subscriptions	1,853,382	22,154,205	-
Redemptions	(6,085,095)	(58,146,012)	(757,871)
Units in Issue at end of period	<u>28,415,324</u>	<u>101,137,468</u>	<u>14,469</u>

<b>Montanaro Absolute Return Fund</b>	<b>GBP Class</b>	<b>EUR Class</b>
Units in Issue at beginning of period	1,383,155	2,984,734
Subscriptions	1,128	-
Redemptions	(1,384,283)	(2,984,734)
Units in Issue at end of period	<u>-</u>	<u>-</u>

<b>Montanaro European Equity Income Fund</b>	<b>GBP Class</b>	<b>EUR Class</b>
Units in Issue at beginning of period	2,742,340	2,777,778
Subscriptions	15,875	-
Redemptions	(200,858)	-
Units in Issue at end of period	<u>2,557,357</u>	<u>2,777,778</u>

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)**

*Period ended 31 December 2009*

**11. Exchange Rates**

The exchange rates to Euro (€) at the period end were:

	<b>31 December 2009</b>	<b>31 January 2009</b>
Czech Koruna	-	28.0165
British Sterling Pound	0.8887	0.8962
Iceland Krona	-	146.0718
Danish Kroner	-	7.4546
Norwegian Kroner	8.2883	8.8569
Polish Zloty	-	4.4571
Swedish Kroner	10.2443	10.6302
Swiss Franc	1.4832	1.4874
US Dollar	1.4347	1.2815

**12. Taxation**

Under current law and Irish practice, the Company qualifies as an investment undertaking under Section 739B of the Taxes Consolidation Act 1997 and is not therefore chargeable to Irish tax on its relevant income or relevant gains. No stamp, transfer or registration tax is payable in Ireland on the issue, redemption or transfer of shares in the Company. Distributions and interest on securities issued in countries other than Ireland may be subject to taxes including withholding taxes imposed by such countries. The Company may not be able to benefit from a reduction in the rate of withholding tax by virtue of the double taxation agreement in operation between Ireland and the other countries. The Company may not therefore be able to reclaim withholding tax suffered by it in particular countries.

To the extent that a chargeable event arises in respect of a Shareholder, the Company may be required to deduct in connection with that chargeable event and pay the tax to the Irish Revenue Commissioners. A chargeable event can include dividend payments to Shareholders, appropriation, cancellation, redemption, repurchase or transfer of shares, or a deemed disposal of Shares every eight periods beginning from the date of acquisition of those Shares. Certain exemptions can apply. To the extent that Shareholders have appropriate tax declarations in place with the Company there may be no requirement to deduct tax.

**13. Net Asset Value per Redeemable Participating Share**

All figures are in the currency of the respective share class.

<b>As at 31 December 2009</b>	<b>GBP Class</b>	<b>EUR Class</b>	<b>USD Class</b>	<b>EUR Acc. Class</b>
<b>Montanaro European Smaller Companies Fund</b>				
Dealing Net Asset Value	£107,357,942	€77,432,267	US\$626,753	€8,722,375
Bid/Ask adjustment per FRS 26	(469,226)	(1,212,565)	(2,739)	(256,656)
Financial Statements Net Asset Value	£106,888,715	€76,219,702	US\$624,014	€8,465,719
Shares in Issue	51,580,649	119,811,922	334,056	27,616,945
Dealing Net Asset Value per share	£2.08	€2.32	US\$1.88	€2.13
Financial Statements Net Asset Value per share	£2.08	€2.31	US\$1.88	€2.13
<b>Montanaro European Equity Income Fund</b>				
Dealing Net Asset Value	£2,319,007	€1,744,685	-	-
Bid/Ask adjustment per FRS 26	(22,087)	(16,617)	-	-
Financial Statements Net Asset Value	£2,296,920	€1,728,068	-	-
Shares in Issue	2,511,516	2,853,339	-	-
Dealing Net Asset Value per share	£0.92	€0.61	-	-
Financial Statements Net Asset Value per share	£0.91	€0.61	-	-

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)

Period ended 31 December 2009

#### 13. Net Asset Value per Redeemable Participating Share (Continued)

As at 31 January 2009	GBP Class	EUR Class	USD Class
<b>Montanaro European Smaller Companies Fund</b>			
Dealing Net Asset Value	£41,154,476	€63,005,579	US\$29,668
Bid/Ask adjustment per FRS 26	(247,954)	(990,111)	(180)
Financial Statements Net Asset Value	£40,906,522	€62,015,468	US\$29,488
Shares in Issue	28,415,324	101,137,468	14,469
Dealing Net Asset Value per share	£1.45	€1.61	US\$2.05
Financial Statements Net Asset Value per share	£1.44	€1.60	US\$2.04
<b>Montanaro European Equity Income Fund</b>			
Dealing Net Asset Value	£1,585,561	€1,149,591	-
Shares in Issue	2,557,357	2,777,778	-
Dealing Net Asset Value per share	£0.62	€0.41	-
<b>As at 31 December 2007</b>			
<b>Montanaro European Smaller Companies Fund</b>			
Net Asset Value	£78,679,358	€49,784,021	US\$3,684,062
Shares in Issue	32,647,037	137,129,275	772,340
Net Asset Value per share	£2.41	€0.28	US\$4.77
<b>Montanaro Absolute Return Fund</b>			
Net Asset Value	£1,231,008	€2,507,176	-
Shares in Issue	1,383,155	2,984,734	-
Net Asset Value per share	£0.89	€0.84	-
<b>Montanaro European Equity Income Fund</b>			
Net Asset Value	£2,714,917	€2,914,444	-
Shares in Issue	2,742,340	2,777,778	-
Net Asset Value per share	£0.99	€0.79	-

#### 14. Comparatives

The comparative financial statements relate to the thirteen month period ended 31 January 2009.

The Montanaro Absolute Return Fund terminated during the thirteen month period ended 31 January 2009 and is included in these financial statements for comparative information purposes only.

#### 15. Directors' Remuneration

Directors' fees charged during the period amounted to €85,772 (13 months ended January 2009: €70,066), of which €72,966 (31 January 2009: €7,396) was payable at the period end.

#### 16. Cross Holdings

Montanaro European Smaller Companies Fund held 1,296,972 shares in Montanaro European Equity Income Fund as at 31 December 2009 (31 January 2009: 1,262,626 shares), and received €318 in distributions from the Montanaro European Equity Income Fund during the period (period ended 31 January 2009: €6,181).

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)**

*Period ended 31 December 2009*

**16. Cross Holdings (Continued)**

**Period from 31 January 2009 to 31 December 2009**

	<b>Montanaro European Equity Fund No. of shares</b>	<b>Total as at 31 December 2009 No. of shares</b>
Holding at beginning of period	1,262,626	1,262,626
Shares purchased	34,346	34,346
Holding at end of period	<u>1,296,972</u>	<u>1,296,972</u>
	<b>€</b>	<b>€</b>
Net realised gain on investment	<u>-</u>	<u>-</u>
Cost	(1,264,851)	(1,264,851)
Fair value	<u>791,153</u>	<u>791,153</u>
Unrealised gain/(loss) on investment	<u>(473,698)</u>	<u>(473,698)</u>

**Period from 1 January 2008 to 31 January 2009**

	<b>Montanaro Absolute Return Fund No. of shares</b>	<b>Montanaro European Equity Fund No. of shares</b>	<b>Total as at 31 January 2009 No. of shares</b>
Holding at beginning of period	1,059,392	1,262,626	2,322,018
Shares redeemed	(1,059,392)	-	(1,059,392)
Holding at end of period	<u>-</u>	<u>1,262,626</u>	<u>1,262,626</u>
	<b>€</b>	<b>€</b>	<b>€</b>
Net realised gain on investment	<u>(478,520)</u>		<u>(478,520)</u>
Cost	-	(1,259,826)	(1,259,826)
Fair value	<u>-</u>	<u>514,773</u>	<u>514,773</u>
Unrealised gain/(loss) on investment	<u>-</u>	<u>(745,053)</u>	<u>(745,053)</u>

**17. Post Balance Sheet Events**

The following distributions in respect of the financial period ending 31 December 2009 were paid on 3 February 2010:

<b>Fund</b>	<b>Share Class</b>	<b>Rate per Share December 2009</b>
Montanaro European Smaller Companies Fund	GBP	£ 0.018588
	EUR	€0.019276
	USD	\$ 0.00245

<b>Fund</b>	<b>Share Class</b>	<b>Rate per Share December 2009</b>
Montanaro European Equity Income Fund	GBP	£ 0.011361
	EUR	€0.007834

The following distributions in respect of the financial period ending 31 March 2010 were approved by the Directors during the period for ex-date 9 April 2010:

<b>Fund</b>	<b>Share Class</b>	<b>Rate per Share March 2010</b>
Montanaro European Equity Income Fund	GBP	£ 0.007458
	EUR	€0.004993

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)**

*Period ended 31 December 2009*

**17. Post Balance Sheet Events (Continued)**

The Company's registered office changed to 78 Sir John Rogerson's Quay on 5 March 2010.

**18. Approval of Financial Statements**

These financial statements were approved by the Directors of the Company on 15 April 2010.

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**SCHEDULE OF INVESTMENTS  
MONTANARO EUROPEAN SMALLER COMPANIES FUND**

*As at 31 December 2009*

<b>Financial assets at fair value through profit or loss: Held for trading</b>	<b>Shares/Par</b>	<b>Fair Value €</b>	<b>% of Net Assets</b>
<b>Common Stock (January 2009: 95.31%)</b>			
<b>Austria (January 2009: 6.15%)</b>			
Andritz	260,500	10,448,655	2.30
Schoeller Bleckmann	235,350	7,931,295	1.74
		<b>18,379,950</b>	<b>4.04</b>
<b>Belgium (January 2009: 1.09%)</b>			
Van de Velde	104,087	3,054,953	0.67
		<b>3,054,953</b>	<b>0.67</b>
<b>Bermuda (January 2009: Nil)</b>			
Aquarius Platinum	1,100,000	5,038,986	1.11
Ocean Wilsons Holdings	720,000	6,888,226	1.52
		<b>11,927,212</b>	<b>2.63</b>
<b>Finland (January 2009: 9.93%)</b>			
Konecranes International	430,000	8,191,500	1.80
Nokian Renkaat	500,000	8,480,000	1.86
Outotec	175,315	4,337,293	0.95
Poyry	750,000	8,377,500	1.84
Vacon	299,647	7,760,858	1.71
Vaisala 'A' Shares	150,000	3,751,500	0.82
		<b>40,898,651</b>	<b>8.98</b>
<b>France (January 2009: 7.32%)</b>			
Bureau Veritas	100,000	3,619,000	0.80
Euler Hermes	85,000	4,444,650	0.98
Guerbet	45,000	4,369,500	0.96
Neopost	160,000	9,219,200	2.02
SILIC	60,000	5,098,800	1.12
Vilmorin & Cie	34,412	2,976,638	0.65
Virbac	146,135	10,581,635	2.32
		<b>40,309,423</b>	<b>8.85</b>
<b>Germany (January 2009: 5.69%)</b>			
Fuchs Petrolub	163,458	10,631,308	2.33
GFK	290,562	6,895,036	1.51
Rational	52,272	6,216,709	1.37
Wincor Nixdorf	109,500	5,185,920	1.14
		<b>28,928,973</b>	<b>6.35</b>
<b>Greece (January 2009: 1.76%)</b>			
Frigoglass	1,114,000	7,686,600	1.69
Hellenic Exchange Holdings	299,984	2,195,883	0.48
		<b>9,882,483</b>	<b>2.17</b>
<b>Ireland (January 2009: 0.41%)</b>			
		-	-
<b>Italy (January 2009: 2.44%)</b>			
Azimut Holdings	1,125,000	10,490,625	2.30
		<b>10,490,625</b>	<b>2.30</b>
<b>Netherlands (January 2009: 8.88%)</b>			
Arcadis	600,000	9,480,000	2.08
Fugro	250,000	10,060,000	2.21
Imtech	300,000	5,649,000	1.24
Koninklijke Vopak	125,000	6,922,500	1.52
Smit International	90,000	5,422,500	1.19
		<b>37,534,000</b>	<b>8.24</b>

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**SCHEDULE OF INVESTMENTS**

**MONTANARO EUROPEAN SMALLER COMPANIES FUND (Continued)**

*As at 31 December 2009*

<b>Financial assets at fair value through profit or loss: Held for trading (Continued)</b>	<b>Shares/Par</b>	<b>Fair Value €</b>	<b>% of Net Assets</b>
<b>Common Stock (January 2009: 95.31%) (Continued)</b>			
<b>Norway (January 2009: 1.50%)</b>			
DnB NOR ASA	794,444	6,014,697	1.32
TGS Nopec Geophysical	725,000	9,167,185	2.01
		<b>15,181,882</b>	<b>3.33</b>
<b>Spain (January 2009: 2.33%)</b>			
Grifols	500,000	6,102,500	1.34
Indra Sistemas	200,000	3,292,000	0.72
Prosegur Cia de Seguridad	300,000	10,266,000	2.25
Viscofan	550,000	9,768,000	2.15
		<b>29,428,500</b>	<b>6.46</b>
<b>Sweden (January 2009: 4.48%)</b>			
AF	275,000	5,248,065	1.15
Hufvudstaden Series A	706,479	3,741,267	0.82
RaySearch Laboratories Series B	1,265,220	3,581,655	0.79
SkiStar Series B	500,000	6,271,810	1.38
		<b>18,842,797</b>	<b>4.14</b>
<b>Switzerland (January 2009: 3.10%)</b>			
Aryzta	175,000	4,542,630	1.00
Banque Cantonale Vaudoise	12,500	3,463,860	0.76
Belimo Holdings	7,273	5,492,122	1.21
GAM Holding	575,000	4,873,171	1.07
Julius Baer Group	185,000	4,515,323	0.99
		<b>22,887,106</b>	<b>5.03</b>
<b>United Kingdom (January 2009: 40.23%)</b>			
Albemarle & Bond	1,178,750	3,475,993	0.76
Ashmore Group	3,450,000	10,530,881	2.31
Booker Group	10,873,500	5,629,672	1.24
Chemring Group	242,370	8,011,960	1.76
Chloride Group	5,291,455	10,720,216	2.35
Consort Medical	768,689	3,374,203	0.74
Dana Petroleum	500,000	6,618,099	1.45
Dignity	1,527,867	10,429,711	2.29
Domino's Pizza	2,656,000	8,908,412	1.96
Fisher & Sons	1,715,000	8,589,741	1.89
Genus	929,897	7,054,247	1.55
Hargreaves Lansdown	782,000	2,595,598	0.57
Latchways	464,712	3,399,799	0.75
NCC Group	1,508,337	6,536,045	1.43
Phoenix IT Group	1,390,000	4,145,879	0.91
Premier Oil	600,000	7,462,245	1.64
Primary Health Properties	1,018,128	3,311,739	0.73
Rensburg Sheppards	605,000	4,017,569	0.88
Ricardo	1,753,235	5,071,416	1.11
Rotork	225,000	3,003,469	0.66
RPS Group	3,206,250	7,816,490	1.72
Scott Wilson Group	2,138,227	2,184,019	0.48
Severfield Rowen	1,793,246	3,491,740	0.77
Shaftesbury	1,250,000	5,537,593	1.21

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**SCHEDULE OF INVESTMENTS**

**MONTANARO EUROPEAN SMALLER COMPANIES FUND (Continued)**

*As at 31 December 2009*

<b>Financial assets at fair value through profit or loss: Held for trading (Continued)</b>	<b>Shares/Par</b>	<b>Fair Value €</b>	<b>% of Net Assets</b>
<b>Common Stock (January 2009: 95.31%) (Continued)</b>			
<b>United Kingdom (January 2009: 40.23%) (Continued)</b>			
Ultra Electronics Holdings	473,972	7,335,189	1.61
Victrex	1,097,584	9,932,298	2.18
Wilmington Group	2,280,065	2,976,879	0.65
WSP Group	1,554,423	4,811,249	1.06
		<b>166,972,351</b>	<b>36.66</b>
<b>Total Common Stock (31 January 2009: 95.31%)</b>		<b>454,718,906</b>	<b>99.85</b>
<b>Financial assets at fair value through profit or loss: Designated at fair value through profit and loss</b>			
<b>UCITS Collective Investment Schemes (January 2009: 0.25%)</b>			
Montanaro European Equity Income Fund	1,296,972	791,153	0.17
<b>Total UCITS Collective Investment Schemes (January 2009: 0.25%)</b>		<b>791,153</b>	<b>0.17</b>
<b>Total financial assets at fair value through profit and loss</b>		<b>455,510,059</b>	<b>100.02</b>
Cash at bank (January 2009: 4.73%)		717,594	0.16
Other net liabilities (January 2009: (0.29)%)		(801,164)	(0.18)
<b>Total net assets attributable to holders of redeemable participating shares at bid market prices</b>		<b>455,426,489</b>	<b>100.00</b>

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**SCHEDULE OF INVESTMENTS  
MONTANARO EUROPEAN EQUITY INCOME FUND**

*As at 31 December 2009*

<b>Financial assets at fair value through profit or loss: Held for trading</b>	<b>Shares/Par</b>	<b>Fair Value £</b>	<b>% of Net Assets</b>
<b>Common Stock (January 2009: 94.81%)</b>			
<b>Austria (January 2009: 5.32%)</b>		-	-
<b>Finland (January 2009: 20.46%)</b>			
Outotec	6,000	131,885	3.44
		<b>131,885</b>	<b>3.44</b>
<b>France (January 2009: 9.58%)</b>			
Neopost	3,450	176,619	4.61
SILIC	1,900	143,455	3.74
		<b>320,074</b>	<b>8.35</b>
<b>Germany (January 2009: 6.79%)</b>			
Fielmann	3,000	136,096	3.55
Pfeiffer Vacuum Technology	3,400	176,717	4.61
Wincor Nixdorf	3,250	136,754	3.57
		<b>449,567</b>	<b>11.73</b>
<b>Greece (January 2009: 0.55%)</b>		-	-
<b>Italy (January 2009: 2.11%)</b>		-	-
<b>Isle of Man (January 2009: 0.00%)</b>			
Hansard Global	100,432	158,180	4.13
		<b>158,180</b>	<b>4.13</b>
<b>Netherlands (January 2009: 18.20%)</b>			
Corio	3,500	147,056	3.84
Exact Holding	10,000	163,390	4.26
Fugro	4,100	146,584	3.83
		<b>457,030</b>	<b>11.93</b>
<b>Spain (January 2009: 0.00%)</b>			
Prosegur Cia de Seguridad	5,700	173,300	4.52
		<b>173,300</b>	<b>4.52</b>
<b>Sweden (January 2009: 13.77%)</b>			
AF	10,000	169,555	4.42
Sweco	25,000	113,832	2.97
		<b>283,387</b>	<b>7.39</b>
<b>Switzerland (January 2009: 3.35%)</b>			
Banque Cantonale Vaudoise	640	157,570	4.11
		<b>157,570</b>	<b>4.11</b>
<b>United Kingdom (January 2009: 14.68%)</b>			
A & J Mucklow Group	50,000	151,625	3.96
City of London Investment Group	45,000	132,750	3.46
Domino Printing Sciences	28,300	93,192	2.43
Holidaybreak	57,555	127,628	3.33
James Halstead	34,000	193,800	5.06
Latchways	15,000	97,500	2.55
London Capital Group Holdings	65,000	83,200	2.17
Senior	250,000	185,000	4.83
Severfield Rowen	55,000	95,150	2.48
VP	84,119	145,526	3.80
Wilmington Group	99,438	115,348	3.01
WSP Group	52,446	144,227	3.76
		<b>1,564,946</b>	<b>40.84</b>

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**SCHEDULE OF INVESTMENTS**

**MONTANARO EUROPEAN EQUITY INCOME FUND (continued)**

*As at 31 December 2009*

	<b>Fair Value £</b>	<b>% of Net Assets</b>
<b>Total financial assets at fair value through profit and loss</b>	<b>3,695,939</b>	<b>96.44</b>
Cash at bank (January 2009: 5.13%)	118,512	3.09
Other net assets (January 2009: 0.06%)	17,811	0.47
<b>Total net assets attributable to holders of redeemable participating shares at bid market prices</b>	<b>3,832,262</b>	<b>100.00</b>

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**  
**MONTANARO EUROPEAN SMALLER COMPANIES FUND**

**PORTFOLIO CHANGES – LARGEST 20 ACQUISITIONS**

*For the period ended 31 December 2009*

	Nominal	Costs €
Ashmore Group	2,450,000	10,048,786
Viscofan Sa	550,000	8,334,468
Ultra Electronic	387,972	7,266,707
Virbac	115,000	7,219,576
Nexity Eur5	225,000	6,314,737
Grifola Sa	300,000	5,988,056
Booker Group Plc	10,873,500	5,624,104
Dignity	404,383	5,338,567
Dnb Nor Asa	650,000	5,274,193
Vopak (Kon)	77,500	5,002,278
Premier Oil	329,777	4,717,630
Euler Hermes	85,000	4,641,011
Victrex	522,584	4,638,116
Prosegur Seguridad	135,000	4,565,440
Wincor Nixdorf Ag	39,500	4,403,892
Julius Baer Hldgs	120,000	4,325,615
Fisher(J)+ Sons	757,741	4,293,020
Konecranes Oyj	155,000	4,274,478
Neopost	50,000	4,239,055
Shaftesbury	960,000	4,210,861

**PORTFOLIO CHANGES – LARGEST 20 DISPOSALS**

*For the period ended 31 December 2009*

	Nominal	Proceeds €
Bpp Hldgs	806,025	5,800,564
Nexity Eur5	225,000	5,688,303
Bnp Paribas	75,730	4,134,426
Cegedim	70,000	4,007,888
Tullow Oil	275,000	3,939,625
Palfinger Ag Ord	350,000	3,740,657
Unibail Rodamco Se	25,000	3,722,707
Lassila + Tikanoja	342,485	3,610,677
Premier Oil	249,221	3,335,386
Chemring Group	121,000	3,239,537
Acino Hldgs Ag	20,000	2,257,346
Andritz Ag	79,500	2,205,291
Vopak (Kon)	45,000	2,000,879
Kenmare Resources Plc	5,985,000	1,945,074
Tgs Nopec Geoph Co	200,000	1,941,774
Saes Getters	35,000	1,832,673
Imtech Nv	50,000	1,601,600
Fugro Nv	40,000	1,532,936
Virbac	18,865	1,181,090
Imtech Nv	50,000	1,011,505

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**  
**MONTANARO EUROPEAN EQUITY INCOME FUND**

**PORTFOLIO CHANGES – LARGEST 20 ACQUISITIONS**

*For the period ended 31 December 2009*

	Nominal	Costs £
James Halstead	40,000	168,704
Bqe Cant Vaudoise	640	156,097
Hansard Global Plc	100,432	151,288
Pfeiffer Vac Tech	3,400	150,858
Fugro Nv	5,100	146,700
Corio Nv	3,500	138,546
Fielmann Ag	3,000	137,352
Silic	2,500	135,867
Wsp Group	63,000	129,963
London Capital Grp	65,000	129,766
Vp Plc	84,119	128,302
Prosegur Seguridad Senior	5,700	127,397
Senior	330,000	116,870
Mucklow(A+J)Group	50,000	109,009
City Of Lon Inv Gp	45,000	106,945
Wincor Nixdorf Ag	3,250	106,839
Outotec Oyj	6,000	99,916
Latchways	15,000	98,742
Holidaybreak	44,000	90,211
Severfield Rowen	55,000	87,071

**PORTFOLIO CHANGES – LARGEST 20 DISPOSALS**

*For the period ended 31 December 2009*

	Nominal	Proceeds £
Bpp Hldgs	41,000	239,035
Imtech Nv	10,000	160,011
Arcadis Nv	5,000	152,924
Brewin Dolphin	100,000	138,996
Silic	2,350	138,263
Konecranes Oyj	7,500	136,686
Skistar Ab	20,000	134,425
Orion Corporation	12,500	126,739
Saes Getters	14,000	124,526
Poyry Oyj	7,500	123,259
Fuchs Petro Ag Oel	3,400	122,822
Andritz Ag	2,000	107,364
Belimo Holding Ag	200	104,862
Vacon	6,000	103,649
Wincor Nixdorf Ag	3,500	101,674
Rational Ag	1,700	93,344
Nordic Aluminum	7,500	77,042
Wsp Group	24,000	76,367
Schoeller Bleckman	3,000	68,061
Severfield Rowen	38,000	57,351