

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**ANNUAL REPORT  
AND  
AUDITED FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED 31 DECEMBER 2010**

An open-ended investment company with variable capital authorised by the Central Bank of Ireland under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (as amended).

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **MANAGEMENT AND OTHER INFORMATION**

#### **Directors**

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

#### **Listing Sponsor**

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

All Directors are independent non-executive Directors.

#### **Administrator and Secretary**

State Street Fund Services (Ireland) Limited  
78 Sir John Rogerson's Quay  
Dublin 2  
Ireland

#### **Custodian**

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

#### **Legal Advisers**

*As to Irish Law*  
Matheson Ormsby Prentice  
70 Sir John Rogerson's Quay  
Dublin 2  
Ireland

#### **Legal Adviser**

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

#### **Independent Auditors**

PricewaterhouseCoopers  
Chartered Accountants & Registered Auditors  
One Spencer Dock  
Dublin 1  
Ireland

#### **Investment Manager**

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

#### **Swiss Representative \***

First Independent Fund Services Ltd  
Klausstrasse 33  
CH-8008 Zurich  
Switzerland

#### **Swiss Paying Agent**

NPB New Private Bank Ltd  
Limmatquai 122  
P.O. Box  
CH – 8022  
Switzerland

**Registered Number:** 330162

\* The prospectus, the articles of association, the simplified prospectus, the annual and semi-annual report, as well as a list containing all purchases and sales which have been made during the reporting period, can be obtained free of charge at the Swiss Representative.

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### DIRECTORS' REPORT

The Directors present, herewith, their annual report for the year ended 31 December 2010.

#### 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 Central Bank of Ireland (the "Central Bank") 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 Central Bank. 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 listed, 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. 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 Central Bank 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; by the FINMA in Switzerland on 29 October 2008; by the Finanstilsynet in Norway on 3 May 2010; and by the Finanssivalvonta in Finland on 20 May 2010.

At 31 December 2010, the Net Asset Value (NAV) of the Fund was €845,121,281

#### Results for the year ended 31 December 2010

The results for the year are set out in the Profit and Loss Account on page 16 and the Balance Sheet of the Company is set out on page 14.

#### Dividends and Distributions

The following interim distributions were paid during the financial year ending 31 December 2010:

Montanaro European Smaller Companies Fund: €3,410,617 (31 December 2009: €4,158,373);

Montanaro European Equity Income Fund: £179,486 (31 December 2009: £153,676);

The following distributions in respect of the financial year ending 31 December 2010 were approved by the Directors for ex-date 25 March 2011:

<b>Fund</b>	<b>Share Class</b>	<b>Rate per Share December 2010</b>
Montanaro European Equity Income Fund	GBP	£0.005299
	EUR	€0.006898

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

#### **Directors**

The Directors of the Company as at 31 December 2010 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 2010 and 31 December 2009 apart from Paul McNaughton who held 161,253 shares in the Fund at the year end (31 December 2009: 161,253 shares). No other Director of the Company had at any time during the year a material interest in any contract of significance, subsisting during or at the end of the year, 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 year shall not exceed £80,000 plus out of pocket expenses, or such higher amount as may be approved by the Company in general meeting. Mr O'Donnell, Mr O' Sullivan, Mr Barton and Mr Jones are entitled to fees of £15,000 per annum while Mr McNaughton is 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 Central Bank of Ireland (the "Central Bank"). 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 2010, the Directors are not aware of any such existing or contingent liability (31 December 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 year 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 year. 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.

#### **Events During the Year**

The distributions declared for ex-date 20 January 2010 were paid on 3 February 2010. The distributions declared for ex-date 9 April 2010 were paid on 23 April 2010. The distributions declared for ex-date 9 July 2010 were paid on 23 July 2010. The distributions declared for ex-date 12 October 2010 were paid on 26 October 2010.

The functional currency of the Montanaro European Equity Income Fund was re-evaluated during the year as a result of reviews within the Company's structure. Due to the mixture of currencies in which financing is received and, coupled with the principal currency exposure arising from investment activities, Euro was selected as the functional currency which best reflects the underlying conditions that are more relevant to the Fund.

The Board of Directors resolved on 7 December 2010 that the functional currency of the Montanaro European Equity Income Fund be changed from Sterling to Euro.

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

#### **Events Since the Year End**

Effective from 27 January 2011, the Independent Auditors of the Company changed from Ernst & Young to PricewaterhouseCoopers, Chartered Accountants and Registered Auditors, One Spencer Dock, North Wall Quay, Dublin 1, Ireland.

#### **Independent Auditors**

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

#### **Corporate Governance Statement**

##### ***General Principles***

The Company is subject to compliance with the requirements of the Irish Companies Acts, 1963 to 2009 (the "Irish Companies Acts"), the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003, as amended (the "UCITS Regulations") and the Central Bank of Ireland (the "Central Bank") UCITS notices and guidance notes.

The European Communities (Directive 2006/46/EC) Regulations (S.I. 450 of 2009 and S.I. 83 of 2010) (the "Regulations") requires the inclusion of a corporate governance statement in the Directors' Report.

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### DIRECTORS' REPORT (Continued)

#### **Corporate Governance Statement (Continued)**

Although there is no specific statutory corporate governance code applicable to Irish collective investment schemes whose shares are admitted to trading on the Irish Stock Exchange, the Company is subject to corporate governance practices imposed by:

- (i) The Irish Companies Acts, 1963 to 2009 which are available for inspection at the registered office of the Company; and may also be obtained at <http://www.irishstatutebook.ie/home.html>;
- (ii) The Articles of Association of the Company which are available for inspection at the registered office of the Company at 78 Sir John Rogerson's Quay and at the Companies Registration Office in Ireland;
- (iii) The Central Bank of Ireland (the "Central Bank") in their UCITS Notices and Guidance Notes which can be obtained from the Central Bank's website at: <http://www.financialregulator.ie/industry-sectors/funds/Pages/default.aspx> and are available for inspection at the registered office of the Company; and
- (iv) The Irish Stock Exchange ("ISE") through the ISE Code of Listing Requirements and Procedures which can be obtained from the ISE's website at: <http://www.ise.ie/index.asp?locID=7&docID=-1>

The Board of Directors did not adopt any further corporate governance codes for the year ended 31 December 2010.

The Irish Funds Industry Association ("IFIA") has published a corporate governance code ("IFIA Code") that may be adopted on a voluntary basis by Irish authorized collective investment schemes. It should be noted that the IFIA Code reflects existing corporate governance practices imposed on Irish authorized collective investment schemes, as noted above. If the IFIA Code is adopted on a voluntary basis, it can be referred to in the disclosures made in the Directors' Report in compliance with the provisions of the European Communities (Directive 2006/46/EC) Regulations (i.e. S.I. 450 of 2009 and S.I. 83 of 2010).

On 7 December 2010 the Board of Directors (the Board") voluntarily adopted the Corporate Governance Code for Irish Domiciled Collective Investment Schemes as published by the Irish Funds Industry Association, as the Company's corporate governance code.

#### ***Internal Control and Risk Management Systems in Relation to Financial Reporting***

The Board is responsible for establishing and maintaining adequate internal control and risk management systems of the Company in relation to the financial reporting process. Such systems are designed to manage rather than eliminate the risk of error or fraud in achieving the Company's financial reporting objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board has procedures in place to ensure that all relevant books of account are properly maintained and are readily available, including production of annual (and half yearly) financial statements. The Board has appointed the Administrator to maintain the books and records of the Company. The Administrator is authorised and regulated by the Central Bank and must comply with the rules imposed by the Central Bank. From time to time, the Board of Directors examines and evaluates the Administrator's financial accounting and reporting routines. The annual financial statements of the Company are produced by the Administrator and reviewed by the Investment Manager. They are required to be approved by the Board and the annual (and half yearly) financial statements of the Company are required to be filed with the Central Bank and the Irish Stock Exchange ("ISE").

During the period of these financial statements, the Board was responsible for the review and approval of the annual financial statements as set out in the Statement of Directors' Responsibilities. The statutory financial statements are required to be audited by independent auditors who report annually to the Board on their findings. The Board monitors and evaluates the independent auditor's performance, qualifications and independence. As part of its review procedures, the Board receives presentations from relevant parties including consideration of Irish accounting standards and their impact on the annual financial statements, and presentations and reports on the audit process. The Board evaluates and discusses significant accounting and reporting issues as the need arises.

#### ***Dealings with Shareholders***

The convening and conduct of shareholders' meetings are governed by the Articles of Association of the Company and the Irish Companies Acts. Although the Directors may convene an extraordinary general meeting of the Company at any time, the Directors were required to convene the first annual general meeting of the Company within eighteen months of incorporation and fifteen months of the date of the previous annual general meeting thereafter, provided that an annual general meeting is held once in each year within six months of the end of each accounting period of the Company.

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

#### **Corporate Governance Statement (Continued)**

At least twenty-one clear days' notice of every annual general meeting and any meeting convened for the passing of a special resolution must be given to shareholders and fourteen days' notice must be given in the case of any other general meeting, unless the auditors of the Company and all the shareholders of the Company entitled to attend and vote agree to shorter notice. Two shareholders present either in person or by proxy constitutes a quorum at a general meeting. The share capital of the Company is divided into different classes of shares and the Irish Companies Acts and the Articles of Association provide that the quorum for a general meeting convened to consider any alteration to the rights attached to any class of shares, is two or more shareholders present in person or by proxy, holding or representing by proxy at least one third of the issued shares of the relevant class.

Every holder of participating shares or non-participating shares present, in person or by proxy who votes on a show of hands is entitled to one vote. On a poll, every holder of participating shares present, in person or by proxy, is entitled to one vote in respect of each share held by him, and every holder of non-participating shares is entitled to one vote in respect of all non-participating shares held by him. At any general meeting, a resolution put to the vote of the meeting is decided on a show of hands unless, before or upon the declaration of the result of the show of hands, a poll is demanded by the chairman of the general meeting, or by at least two members or shareholders present, in person or by proxy, having the right to vote at such meeting, or any holder or holders of participating shares present, in person or by proxy, representing at least one tenth of the shares in issue having the right to vote at such meeting

Shareholders may resolve to sanction an ordinary resolution or special resolution at a shareholders' meeting. Alternatively, a resolution in writing signed by all of the shareholders and holders of non-participating shares for the time being entitled to attend and vote on such resolution at a general meeting of the Company, will be valid and effective for all purposes as if the resolution had been passed at a general meeting of the Company duly convened and held. An ordinary resolution of the Company (or of the shareholders of a particular fund or class of shares) requires a simple majority of the votes cast by the shareholders voting, in person or by proxy, at the meeting at which the resolution is proposed. A special resolution of the Company (or of the shareholders of a particular fund or class of shares) requires a majority of not less than 75% of shareholders present, in person or by proxy, and voting in general meeting in order to pass a special resolution including a resolution to amend the Articles of Association.

#### ***Board composition and activities***

In accordance with the Irish Companies Acts and the Articles of Association, unless otherwise determined by an ordinary resolution of the Company in general meeting, the number of Directors may not be less than two. Currently the Board is comprised of five non-executive Directors, all of whom are independent. Details of the current Directors are set out on page 1, under the heading "Directors".

The business of the Company is managed by the Directors, who exercise all such powers of the Company as are not by the Companies Acts or by the Articles of Association of the Company required to be exercised by the Company in general meeting.

A Director may, and the Company Secretary on the requisition of a Director will, at any time summon a meeting of the Directors and ad hoc meetings, in addition to four regular Board meetings, are convened as required.

Questions arising at any meeting of the Directors are determined by the meeting Chairman. In the case of an equality of votes, the Chairman of the meeting at which the show of hands takes place or at which the poll is demanded shall be entitled to a second or casting vote. The quorum necessary for the transaction of business at a meeting of the Directors is two.

There is one sub-committee of the Board in operation, the Audit Committee. The members of the Audit Committee are David O'Donnell and Simon O'Sullivan.

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

**Director**

**Director**

**3 June 2011**

## **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 Montanaro European Smaller Companies Plc ('the Company') for the year ended 31 December 2010, 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 Central Bank of Ireland'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 Central Bank of Ireland's UCITS Notice 4. One of those duties is to enquire into the conduct of the Company in each annual accounting year and report thereon to the shareholders.

Our report shall state whether, in our opinion, the Company has been managed in that year 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**

**3 June 2011**

## 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
31/12/07 NAV per share	3.28		2.41	4.77	0.79	0.99
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
31/12/10 NAV per share	3.28	3.05	2.83	2.36	0.82	1.2
Dividends paid over the year ended 31/12/10	0.019276	-	0.0186	0.00245	0.0278	0.0406
13 month Fund NAV <sup>(1)</sup> return (fiscal year 2008)	-50.8%	-	-40.0%	-57.1%	-48.7%	-37.4%
11 month Fund NAV <sup>(1)</sup> return (fiscal year 2009)	43.7%	6.3%	43.7%	-8.3%	50.0%	48.5%
12 month Fund NAV <sup>(1)</sup> return (fiscal year 2010)	42.1%	43.3%	36.5%	25.9%	34.3%	29.8%
12 month Benchmark <sup>(2)</sup> return	27.7%	27.7%	23.4%	19.1%	30.9%	26.5%

<sup>(1)</sup> Source: Montanaro, Bloomberg. NAV to NAV, unrounded. NAVs prior to 01/10/09 priced at midday; since 2/10/09 priced at 4pm.

<sup>(2)</sup> MSCI European Smaller Companies Index in the relevant currency (Source Bloomberg).

<sup>(3)</sup> Launched 02/10/09.

#### Commentary on markets

2010 was an outstanding year for investors in European SmallCap which rose by 28% following a gain of 56% in 2009. Our Fund did even better appreciating in Euros by 42% last year. This is pleasing in light of the doom and gloom that prevailed in the media. Many warned of the risk of a global “double-dip” recession caused by the austerity measures forced on governments to cut public spending to reduce excessive deficits. The debt problems among the “PIIGS” (Portugal, Ireland, Italy, Greece and Spain) threatened the very existence of the Euro. North and South Korea embarked on increasingly loud sabre rattling. Investors who, as a result, sought the safety of large companies last year underperformed by 24% and have lost money over the past decade.

So what about 2011? Economists are more confident now about the outlook for the global economy expecting growth at or above 4% over the next two years. This comes from continued strength in the emerging world and ever more expansionary policies in the US. In Europe, the strength of central and northern countries will more than offset the deflationary forces at play within the PIIGS. Germany, which produces around a quarter of the output in Europe, is China’s fifth largest trade partner and can barely keep up with demand. In the UK, deficit reduction efforts are bearing fruit and the Olympic Games should give a boost to the economy.

Montanaro believe that we are less than half-way through a major equity Bull Market which started in April 2009 when we first turned positive again. After a severe Bear Market such as we saw in 2007-2008, Bull Markets historically have lasted on average 5 - 6 years and SmallCap outperformed by no less than 7% p.a.. Market valuations are attractive and below average (notably 10% cheaper than Emerging Market equities and US equities). European corporate earnings continue to surprise on the upside as Analysts have remained too sceptical and conservative since the credit crunch. In 2008, many small companies, which typically are more flexible and dynamic with more entrepreneurial management, were quick to cut costs in the face of difficult times. Leaner and meaner than ever today, they have recovered well and are generating record levels of cash and profits.

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

### **PERFORMANCE SUMMARY (continued)**

We expect a significant pick-up in take-overs in 2011 as cash-rich buyers look at external growth to accelerate recent earnings growth. At the peak of the last cycle in 2006, Montanaro lost 20 companies to acquisitions. SmallCap looks under-valued based on price / book measures. Private equity may well make a comeback and compete with trade buyers for targets, many of which will be small companies, bidding up prices. Whilst this should help sentiment, as always there are two sides to every story. We also expect an increase in profit warnings this year. Economic conditions remain challenging and it becomes ever harder to exceed expectations as the cycle matures. Companies on high valuations that disappoint will be severely punished. This is one reason why Montanaro invest in the highest quality companies at attractive valuations. In addition, a large number of companies will be floated on the Stock Market this year which will absorb some of the cash held by investors. We also see a trend of gradually rising inflation and interest rates. The challenges of the PIIGS have not been resolved and are likely to lead to further speculation about the future of the Euro. Such concerns are likely to lead to greater stock market volatility than recently.

2011 will be a year for stock pickers. European SmallCap offers a huge choice of over 6,000 often under researched companies which can grow faster due to their size and give investors higher returns. Typically they are niche businesses with high barriers to entry, pricing power and more motivated management often with large stakes in their own businesses. Currently, European SmallCap is under-owned (everyone has bought bonds and Emerging Markets) and unloved (who wants to buy Europe in the middle of a PIIGS crisis?). But it is the contrarian investor who makes the money. Montanaro expect European SmallCap to continue to outperform both MidCap and LargeCap this year. With a bit of luck and hard work, we hope to do better once again.

**Charles Montanaro**

Montanaro Asset Management Limited

March 2011

## **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 Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

##### **Performance Review**

See Performance Summary on page 8.

##### **Charles Montanaro**

Montanaro Asset Management Limited

March 2011

## **MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

#### **INVESTMENT MANAGER’S REVIEW**

##### **Investment Objective**

The investment objective of the Income 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 Income 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 Income 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 Income Fund may be invested in aggregate in equity securities of companies over €3 billion in size. The Income 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 Income 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 8.

##### **Charles Montanaro**

Montanaro Asset Management Limited

March 2011

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

We have audited the Company's financial statements for the year ended 31 December 2010 which comprise the Balance Sheet, the Profit and Loss Account, the Statement of Changes in Net Assets Attributable to Redeemable Participating Shareholders, the schedule of investments and the related notes. These financial statements have been prepared under the accounting policies set out therein.

### **Respective responsibilities of Directors and Auditors**

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable Irish law and the accounting standards issued by the Accounting Standards Board and published by the Institute of Chartered Accountants in Ireland (Generally Accepted Accounting Practice in Ireland) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 193 of the Companies Act, 1990 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 or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with Generally Accepted Accounting Practice in Ireland, and are properly prepared in accordance with Irish statute comprising the Companies Acts, 1963 to 2009 and the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003, as amended. We state whether we have obtained all the information and explanations we consider 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 our opinion as to:

- whether the Company has kept proper books of account; and
- whether the directors' report is consistent with the financial statements.

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

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

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. 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 the Company's affairs at 31 December 2010 and of its results for the year then ended; and
- have been properly prepared in accordance with the requirements of the Companies Acts, 1963 to 2009 and the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003, as amended.

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MONTANARO EUROPEAN SMALLER COMPANIES PLC (Continued)**

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 Company's 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.

**PricewaterhouseCoopers  
Chartered Accountants and Registered Auditors  
Dublin**

**3 June 2011**

# MONTANARO EUROPEAN SMALLER COMPANIES PLC

## BALANCE SHEET

As at 31 December 2010

	Notes	Montanaro European Smaller Companies Fund €	Montanaro European Equity Income Fund £	Total as at 31 December 2010 €
<b>Current Assets</b>				
Financial assets at fair value through profit or loss:				
-Transferable securities		822,022,007	7,483,886	830,756,039
-Collective investment schemes		1,107,604	-	-
Cash and cash equivalents	5	37,161,151	18,630	37,182,893
Dividends and interest receivable		628,055	8,589	638,079
Receivable for fund shares sold		1,573,034	-	1,573,034
Compensation receivable	19	742,912	-	742,912
Other receivables		9,809	2,335	12,534
<b>Total current assets</b>		<b>863,244,572</b>	<b>7,513,440</b>	<b>870,905,491</b>
<b>Current Liabilities</b>				
Payable for investments purchased		(11,857,009)	-	(11,857,009)
Payable for fund shares repurchased		(7,579)	-	(7,579)
Investment management fees payable	7	(2,628,681)	-	(2,628,681)
Performance fees payable	7	(14,967,773)	-	(14,967,773)
Administrator fee payable		(80,187)	(817)	(81,140)
Custody & trustee fee payable		(66,090)	(2,004)	(68,429)
Directors' fees payable	15	(4,303)	(27)	(4,335)
Professional fees payable		(28,090)	(212)	(28,337)
Other accrued expenses payable		(72,752)	(630)	(73,487)
<b>Total current liabilities</b>		<b>(29,712,464)</b>	<b>(3,690)</b>	<b>(29,716,770)</b>
<i>(excluding net assets attributable to holders of redeemable participating shares)</i>				
<b>Net asset value attributable to holders of redeemable participating shares at bid market value</b>		<b>833,532,108</b>	<b>7,509,750</b>	<b>841,188,721</b>
Adjustment from bid to last traded market value		3,886,451	39,509	3,932,560
<b>Net asset value attributable to holders of redeemable participating shares at last traded market value</b>		<b>837,418,559</b>	<b>7,549,259</b>	<b>845,121,281</b>

There has been a change in the Accounting Policy for Cross holdings. Please refer to page 22 for further details.

Please refer to Note 13 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:**

**Director**

**Director**

**3 June 2011**

# 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	-	-
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>460,719,768</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)
Custody & 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>				
<i>(excluding net assets attributable to holders of redeemable participating shares)</i>		(1,766,647)	(3,973)	(1,771,119)
<b>Net asset value attributable to holders of redeemable participating shares at bid market value</b>		<b>455,426,489</b>	<b>3,832,262</b>	<b>458,948,649</b>
Adjustment from bid to last traded market value		1,999,258	36,851	2,040,735
<b>Net asset value attributable to holders of redeemable participating shares at last traded market value</b>		<b>457,425,747</b>	<b>3,869,113</b>	<b>460,989,384</b>

There has been a change in the Accounting Policy for Cross holdings. Please refer to page 22 for further details.

Please refer to Note 13 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

Year ended 31 December 2010

		Montanaro European Smaller Companies Fund €	Montanaro European Equity Income Fund £	Total 31 December 2010 €
<b>Income</b>				
Net realised gain on investments and foreign exchange		4,772,393	467,985	5,308,662
Net change in fair value of investments and foreign exchange		223,355,140	960,758	224,176,318
Dividend income		14,321,076	213,068	14,565,233
Interest income		1,267	-	1,267
Compensation receivable	19	742,912	-	742,912
Other income		3,643	21	3,667
<b>Investment income</b>		<b>243,196,431</b>	<b>1,641,832</b>	<b>244,798,059</b>
<b>Expenses</b>				
Investment management fee	7	(8,737,216)	-	(8,737,216)
Performance fee		(14,967,773)	-	(14,967,773)
Administrator's fees		(341,177)	(2,990)	(344,603)
Custody & trustee fee		(383,783)	(6,448)	(391,172)
Other expenses		(194,113)	(1,414)	(195,733)
Legal fees		(89,823)	(715)	(90,642)
Directors' fees	15	(123,516)	(1,005)	(124,668)
Professional fees		(56,337)	(457)	(56,861)
<b>Total operating expenses</b>		<b>(24,893,738)</b>	<b>(13,029)</b>	<b>(24,908,668)</b>
<b>Net income from operations</b>		<b>218,302,693</b>	<b>1,628,803</b>	<b>219,889,391</b>
Withholding taxes		(1,218,540)	(19,422)	(1,240,796)
<b>Finance costs</b>				
Income distribution	4	(3,410,617)	(179,486)	(3,616,292)
<b>Profit for the year</b>		<b>213,673,536</b>	<b>1,429,895</b>	<b>215,032,303</b>
Movement in adjustment from bid to last traded market value		1,887,193	2,658	1,890,239
<b>Net increase in net assets attributable to holders of redeemable participating shares</b>		<b>215,560,729</b>	<b>1,432,553</b>	<b>216,922,542</b>

There has been a change in the Accounting Policy for Cross holdings. Please refer to page 22 for further details.

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:**

**Director**

**Director**

**3 June 2011**

# MONTANARO EUROPEAN SMALLER COMPANIES PLC

## PROFIT AND LOSS ACCOUNT

Period ended 31 December 2009\*

		Montanaro European Smaller Companies Fund €	Montanaro European Equity Income Fund £	Total 31 December 2009 €
<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	162,149,537
Dividend Income		9,553,607	197,910	9,775,396
Interest income		3,808	-	3,808
<b>Investment income</b>		<b>123,490,481</b>	<b>1,383,853</b>	<b>124,769,947</b>
<b>Expenses</b>				
Investment management fee	7	(4,457,133)	-	(4,457,133)
Administrator's fees		(202,698)	(2,042)	(204,986)
Custody & trustee fee		(177,630)	(2,740)	(180,701)
Other expenses		(135,367)	(1,530)	(137,082)
Legal fees		(161,226)	(2,369)	(163,881)
Directors' fees	15	(85,772)	-	(85,772)
Professional fees		(32,828)	(309)	(33,174)
<b>Total operating expenses</b>		<b>(5,252,654)</b>	<b>(8,990)</b>	<b>(5,262,729)</b>
<b>Net income from operations</b>		<b>118,237,827</b>	<b>1,374,863</b>	<b>119,507,218</b>
Withholding taxes		(814,176)	(15,556)	(831,609)
<b>Finance costs</b>				
Income distribution	4	(4,158,373)	(153,676)	(4,330,591)
<b>Profit for the year</b>		<b>113,265,278</b>	<b>1,205,631</b>	<b>114,345,018</b>
Movement in adjustment from bid to last traded market value		725,342	40,126	770,309
<b>Net increase in net assets attributable to holders of redeemable participating shares</b>		<b>113,990,620</b>	<b>1,245,757</b>	<b>115,115,327</b>

There has been a change in the Accounting Policy for Cross holdings. Please refer to page 22 for further details.

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

\* Period from 1 February 2009 to 31 December 2009.

*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**

*Year ended 31 December 2010*

	<b>Montanaro European Smaller Companies Fund</b>	<b>Montanaro European Equity Income Fund</b>	<b>Total 31 December 2010</b>
	€	£	€
<b>Net assets attributable to holders of redeemable shares at start of year</b>	457,425,747	3,869,113	460,989,384
Net increase in net assets attributable to holders of redeemable participating shares	215,560,729	1,432,553	216,922,542
Proceeds from issuance of shares	433,134,384	2,385,280	435,831,032
Payments on redemptions of shares	(268,702,301)	(137,687)	(268,860,078)
Foreign currency translation adjustment*	-	-	238,401
<b>Net assets attributable to holders of redeemable shares at end of year</b>	<b>837,418,559</b>	<b>7,549,259</b>	<b>845,121,281</b>

There has been a change in the Accounting Policy for Cross holdings. Please refer to page 22 for further details.

\* See accounting policy (iii) for foreign currency on page 31.

*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 year</b>	208,957,032	2,604,136	211,348,012
Net increase in net assets attributable to holders of redeemable participating shares	113,990,620	1,245,757	115,115,327
Proceeds from issuance of shares	222,292,676	109,035	222,405,548
Payments on redemptions of shares	(87,814,581)	(89,815)	(87,915,233)
Foreign currency translation adjustment*	-	-	35,730
<b>Net assets attributable to holders of redeemable shares at end of year</b>	<b>457,425,747</b>	<b>3,869,113</b>	<b>460,989,384</b>

There has been a change in the Accounting Policy for Cross holdings. Please refer to page 22 for further details.

\* See accounting policy (iii) for foreign currency on page 31.

\*\* Period from 1 February 2009 to 31 December 2009.

*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 Investment 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.

#### ***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.

#### ***Subscriber shares***

These shares do not participate in the profits of the Company.

#### ***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 NAV 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 the Fund incurs a legal or constructive obligation to pay such a dividend.

#### ***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. 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 value. 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***

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

Items included in the Company's financial statements are measured and presented using the currency of the primary economic environment in which it operates (the "functional currency"). This is Euro, which reflects the sub-funds' primary activity of investing in European securities.

The Montanaro European Smaller Companies Fund uses Euro as the presentation currency, in line with the functional currency.

The Montanaro European Equity Income Fund changed functional currency during the year under review from Sterling to Euro, following a review of the investment and capital activity of the sub-fund. The sub-fund has retained Sterling as the presentation currency in the current financial statements for operational reasons. The results and financial position of the sub-fund are translated to Sterling for presentation in these financial statements 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, which approximate the rates prevailing on the dates of the transactions.

##### **(ii) 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 year end. Transactions during the year, 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.

##### **(iii) Foreign currency translation adjustment**

The assets and liabilities of Montanaro European Equity Income Fund 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 December 2010, and the values of activities during the year have been converted using the average exchange rates for the year. A gain of €238,401 (31 December 2009: gain of €35,730) arises from the conversion of these amounts to the exchange rates ruling at 31 December 2010, which is included in the Statement of Changes in Net Assets Attributable to Holders of Redeemable Participating Shares. This notional gain only affects the combined Company position and has no impact on the NAV Attributable to Holders of Redeemable Participating Shares of either Fund.

#### ***Cross holdings – change in accounting policy***

All cross holdings and intra-Company transactions are eliminated in the presentation of the total Profit and Loss Account, Balance Sheet and Statement of Changes in Net Assets Attributable to Holders of Redeemable Participating Shares for the Company. This is a change in accounting policy from the presentation used previously, which did not eliminate cross holdings and intra-Company transactions. This change has been applied retrospectively.

This change is a prior year adjustment and the impact of this adjustment is a reduction in the combined Company value as at 31 December 2009 of €791,153, being the value of the investment in Montanaro European Equity Income Fund by Montanaro European Smaller Companies Fund which is eliminated on combination. The elimination only effects the combined Company position and has no impact on the NAV Attributable to Holders of Redeemable Participating Shares of either Fund.

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

### NOTES FORMING PART OF THE FINANCIAL STATEMENTS

*Year ended 31 December 2010*

#### 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 Income Fund. Montanaro European Smaller Companies Fund and Montanaro European Equity Income Fund were both in existence at the year end. Montanaro European Smaller Companies Fund has four classes of shares, a sterling class, a euro class, a dollar class and a euro accumulation 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 €8,737,216 for the year (period ended 31 December 2009: €4,457,133) of which €2,628,681 (31 December 2009: €1,512,251) was payable at the year 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 year. It will be calculated based on the time weighted average number of Shares in issue during the relevant year. Subject to the aforementioned provisions, a performance fee will only be payable in respect of any year if, and to the extent that, the closing NAV per Share exceeds the higher of (a) the opening NAV per Share for the relevant year; and (b) the NAV per Share on the last accounting year end by reference to which a performance fee was paid (if any).

Calculation years of the performance fee will correspond to the accounting year 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.

The performance fee was €14,967,773 for the year (period ended 31 December 2009: nil) of which €14,967,773 (31 December 2009: nil) was payable at the year end as follows:

Euro Class:	€8,921,410 (2009: nil)
Euro Accumulation Class:	€3,442,009 (2009: nil)
Sterling Class:	£ 2,231,671 (2009: nil)
US Dollar Class:	\$ nil (2009: nil)

##### *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)

Year ended 31 December 2010

### 2. Fees (Continued)

*Performance fees incurred:*

	Montanaro European Smaller Companies Fund	Montanaro European Income Fund	Total
	€	£	€
31 December 2010	14,967,773	-	14,967,773
31 December 2009	-	-	-

#### *Administration Fee*

The administration fee will accrue daily and be paid monthly in arrears at a rate of 0.07% of the NAV on the first £250 million, 0.06% on the next £250 million and 0.05% on the excess for each Sub-Fund. The Administration fee was €344,603 for the year (period ended 31 December 2009: €204,986) of which €81,140 (31 December 2009: €106,244) was payable at the year end.

#### *Custody & Trustee Fee*

The Custodian will be paid an annual fee from the Company of 0.02% of the NAV of each Sub-Fund accruing daily and paid monthly in arrears. 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 €391,172 for the year (period ended 31 December 2009: €180,701) of which €68,429 (31 December 2009: €54,471) was payable at the year 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 €24,668 for the year (period ended 31 December 2009: €85,772) of which €4,335 (31 December 2009: €73,754) was payable at the year end.

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

As at 31 December 2010 and 31 December 2009, financial assets held at fair value through profit or loss 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 year ended 31 December 2010:

Montanaro European Smaller Companies Fund: €3,410,617 (period ended 31 December 2009: €4,158,373)  
Montanaro European Equity Income Fund: £179,486 (period ended 31 December 2009: £153,676)

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 year from 1 January 2010 to 31 December 2010.

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

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

*Year ended 31 December 2010*

#### 5. Cash and Cash Equivalents

All uninvested cash is held on deposit with State Street Bank and Trust Company, London. At the year end, the Company had a cash balance of €37,182,893 (31 December 2009: €850,982) 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 year 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 €8,737,216 for the year (period ended 31 December 2009: €4,457,133) of which €2,628,681 (31 December 2009: €1,512,251) was payable at the year end.

Montanaro Asset Management Limited, as Investment Manager, earned a Performance fee of €4,967,773 for the year (period ended 31 December 2009: €Nil), all of which is included as a liability in the Balance Sheet at the year end.

There is compensation payable to the Fund of €742,912 (see Note 19) a proportion of which will be payable by Montanaro Asset Management Limited, as Investment Manager. The exact amount payable by the Investment Manager is still under review and discussion between the Investment Manager and the Administrator.

Paul McNaughton, the Company Chairman held 161,253 shares in the Company at the year end (31 December 2009: 161,253 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.

# MONTANARO EUROPEAN SMALLER COMPANIES PLC

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

Year ended 31 December 2010

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

#### 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.

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.

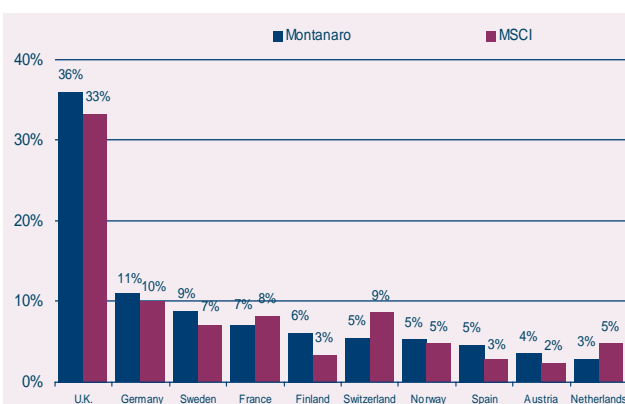
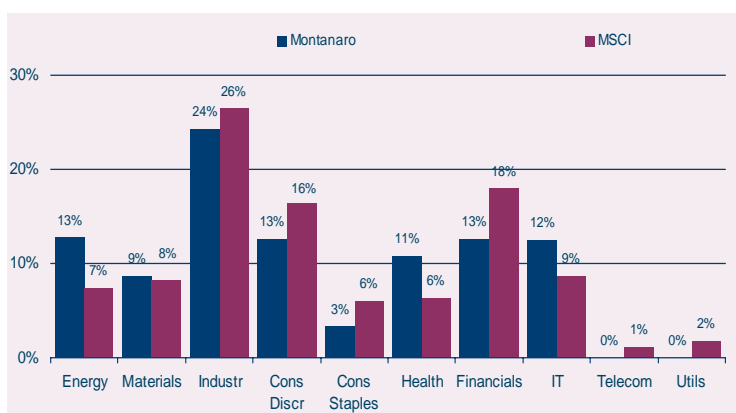
The Company's equity instruments are susceptible to market price risk arising from uncertainties about future prices of the instruments. The Company's market price risk is managed through diversification of the investment portfolios. In the case of each of the funds more than 95% of the funds' invested assets are invested in securities listed on recognised European exchanges. At 31 December 2010 the overall market exposures were as follows:

	31 December 2010		31 December 2009	
	Fair value	% of NAV	Fair value	% of NAV
<b>Securities held for trading</b>				
Montanaro European Smaller Companies Fund	€822,022,007	98.72	€454,718,906	99.85
Montanaro European Equity Income Fund	£7,483,886	99.65	£3,695,939	96.44

If the Company's underlying benchmarks at 31 December 2010 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 €41m and £374k respectively (31 December 2009: €23m and £185k respectively).

The sector and country distribution of the Company's investments at 31 December 2010 and 31 December 2009 is illustrated in the below tables, versus the MSCI Europe SmallCap Index:

#### 31 December 2010



# MONTANARO EUROPEAN SMALLER COMPANIES PLC

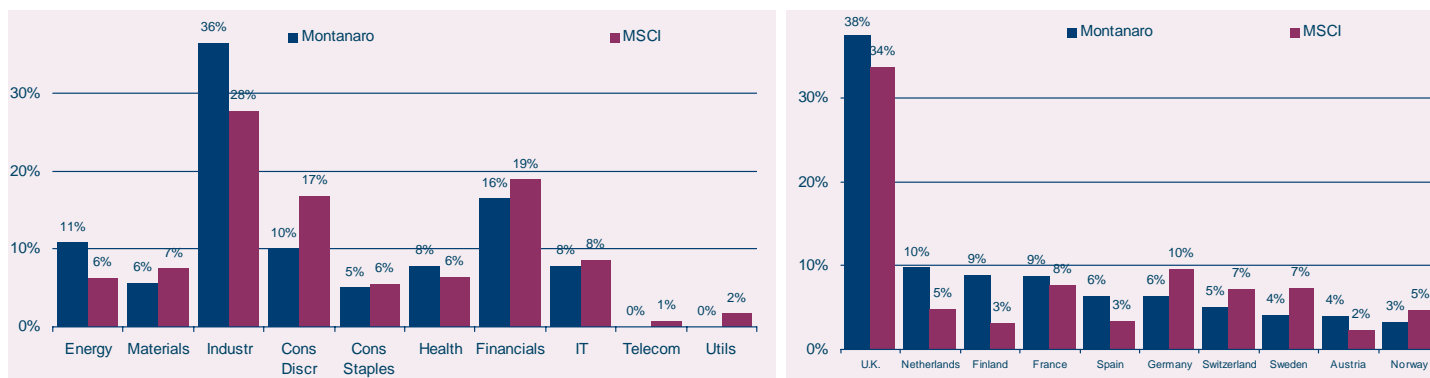
## NOTES FORMING PART OF THE FINANCIAL STATEMENTS (Continued)

Year ended 31 December 2010

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

#### Market Price Risk (Continued)

31 December 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. Cash balances of the Company are not subject to significant interest rate risk.

#### 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 2010:

	Montanaro European Smaller Companies Fund		Montanaro European Equity Income Fund	
	31 Dec 10 €000	31 Dec 09 €000	31 Dec 10 £'000	31 Dec 09 £'000
CHF	44,974	22,887	556	158
DKK	16,779	-	131	-
GBP	310,208	179,669	3,176	1,796
EUR	340,894	218,846	2,776	1,595
NOK	44,981	15,182	-	-
SEK	74,903	18,843	871	283
	<u>832,739</u>	<u>455,427</u>	<u>7,510</u>	<u>3,832</u>

## MONTANARO EUROPEAN SMALLER COMPANIES PLC

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

*Year ended 31 December 2010*

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

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

At 31 December 2010, 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 €23.4m and £206k respectively (31 December 2009: €1.3m and £97k 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 2010 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 2010 of €37,182,893 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.

The Company's securities are maintained within the Custodian's custodial network in segregated accounts. The Custodian will ensure that any agent it appoints to assist in safekeeping the assets of the Company will segregate the assets of the Company. Thus in the event of insolvency or bankruptcy of the Custodian, the Company's assets are segregated and protected and this further reduces counterparty risk. The Company will, however, be exposed to the risk of the Custodian or certain depositories used by the Custodian, in relation to the Company's cash held by the Custodian. In event of the insolvency or bankruptcy of the Custodian, the Company will be treated as a general creditor of the Custodian in relation to cash holdings of the Company and as such the amount that the Company will recover is dependent on the amount of cash available to the liquidator to distribute.

##### *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 2010 no such borrowings existed (31 December 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. All of the liabilities of the Company are payable in less than three months.

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

*Year ended 31 December 2010*

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

***Fair Value Estimation***

FRS 29 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.

***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 2010 and 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>
<b>31 December 2010</b>	<b>€</b>	<b>€</b>	<b>€</b>	<b>€</b>
Financial assets at fair value through profit or loss:				
-Transferable securities	822,022,007	-	-	822,022,007
-Collective investment schemes	-	1,107,604	-	1,107,604
<b>Total assets</b>	<b>822,022,007</b>	<b>1,107,604</b>	<b>-</b>	<b>823,129,611</b>

<b>Montanaro European Equity Income Fund</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>31 December 2010</b>	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
Financial assets at fair value through profit or loss:				
-Transferable securities	7,483,886	-	-	7,483,886
<b>Total assets</b>	<b>7,483,886</b>	<b>-</b>	<b>-</b>	<b>7,483,886</b>

<b>Montanaro European Smaller Companies Fund</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>31 December 2009</b>	<b>€</b>	<b>€</b>	<b>€</b>	<b>€</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>455,510,059</b>

<b>Montanaro European Equity Income Fund</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>31 December 2009</b>	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</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>

*Year ended 31 December 2010*

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

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 year ended 31 December 2010 and period ended 31 December 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**

The Company has authorised Share Capital of €38,100 (divided into 38,100 Subscriber Shares of one Euro each). At 31 December 2010 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.

**Redemption of Shares**

Shareholders may redeem their Shares on and with effect from any Dealing Day at the NAV 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 NAV 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 Central Bank, 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.

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

*Year ended 31 December 2010*

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

**Year ended 31 December 2010**

<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 year	51,580,649	119,811,922	334,056	27,616,945
Subscriptions	13,864,518	54,035,579	19,868,386	83,275,703
Redemptions	(23,646,398)	(56,672,448)	(19,826,960)	(8,560,108)
Compensation units to be issued	123,247	415,088		
Units in Issue at end of year	<u>41,922,016</u>	<u>117,590,141</u>	<u>375,482</u>	<u>102,332,540</u>

**Montanaro European Equity Income Fund**

	<b>GBP Class</b>	<b>EUR Class</b>
Units in Issue at beginning of year	2,511,516	2,853,339
Subscriptions	2,170,867	128,840
Redemptions	(126,911)	(10,555)
Units in Issue at end of year	<u>4,555,472</u>	<u>2,971,624</u>

**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>

**Montanaro European Equity Income Fund**

	<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>

**11. Exchange Rates**

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

	<b>31 December 2010</b>	<b>31 December 2009</b>
British Sterling Pound	0.8569	0.8887
Danish Kroner	7.4521	-
Norwegian Kroner	7.7978	8.2883
Swedish Kroner	9.0190	10.2443
Swiss Franc	1.2505	1.4832
US Dollar	1.3416	1.4347

**12. Taxation**

Under current law and practice the Company qualifies as an investment undertaking as defined in Section 739B of the Taxes Consolidation Act, 1997, as amended. On that basis, it is not chargeable to Irish tax on its income or gains. However, Irish tax may arise on the happening of a "chargeable event". A chargeable event includes any distribution payments to shareholders, any encashment, redemption, cancellation or transfer of shares and the holding of shares at the end of each eight year period beginning with the acquisition of such shares.

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

*Year ended 31 December 2010*

**12. Taxation (Continued)**

No Irish tax will arise on the Fund in respect of chargeable events in respect of:

(a) a shareholder who is neither Irish resident nor ordinarily resident in Ireland for tax purposes, at the time of the chargeable event, provided appropriate valid declarations in accordance with the provisions of the Taxes Consolidation Act, 1997, as amended, are held by the Fund; and

(b) certain exempted Irish tax resident shareholders who have provided the Fund with the necessary signed statutory declarations.

Dividends, interest and capital gains (if any) received on investments made by the Fund may be subject to withholding taxes imposed by the country from which the investment income/gains are received and such taxes may not be recoverable by the Fund or its shareholders.

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

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

	<b>GBP Class</b>	<b>EUR Class</b>	<b>USD Class</b>	<b>EUR Acc. Class</b>
<b>As at 31 December 2010</b>				
<b>Montanaro European Smaller Companies Fund</b>				
Dealing NAV	£118,722,792	€385,642,059	US\$886,833	€311,767,495
Shares in Issue	41,922,016	117,590,141	375,482	102,332,540
Dealing NAV per share	£2.83	€3.28	US\$2.36	€3.05
<b>Montanaro European Equity Income Fund</b>				
Dealing NAV	£5,457,913	€2,440,695		
Shares in Issue	4,555,472	2,971,624		
Dealing NAV per share	£1.20	€0.82		
<b>As at 31 December 2009</b>				
<b>Montanaro European Smaller Companies Fund</b>				
Dealing NAV	£107,357,942	€277,432,267	US\$626,753	€58,722,375
Shares in Issue	51,580,649	119,811,922	334,056	27,616,945
Dealing NAV per share	£2.08	€2.32	US\$1.88	€2.13
<b>Montanaro European Equity Income Fund</b>				
Dealing NAV	£2,319,007	€1,744,685		
Shares in Issue	£2,511,516	€2,853,339		
Dealing NAV per share	£0.92	€0.61		
<b>As at 31 January 2009</b>				
<b>Montanaro European Smaller Companies Fund</b>				
Dealing NAV	£41,154,476	€63,005,579	US\$29,668	
Shares in Issue	28,415,324	101,137,468	14,469	
Dealing NAV per share	£1.45	€1.61	US\$2.05	
<b>Montanaro European Equity Income Fund</b>				
Dealing NAV	£1,585,561	€1,148,591		
Shares in Issue	2,557,357	2,777,778		
NAV per share	£0.62	€0.41		

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

*Year ended 31 December 2010*

**14. Comparatives**

The comparative financial statements relate to the eleven month period ended 31 December 2009.

**15. Directors' Remuneration**

Directors' fees charged during the year amounted to €24,668 (period ended 31 December 2009: €85,772), of which €4,335 (31 December 2009: €73,754) was payable at the year end.

**16. Cross Holdings**

Montanaro European Smaller Companies Fund held 1,350,738 shares in Montanaro European Equity Income Fund as at 31 December 2010 (31 December 2009: 1,296,972 shares), and received €36,668 in distributions from the Montanaro European Equity Income Fund during the year (period ended 31 December 2009: €9,318).

All cross holdings and intra-Company transactions are eliminated in the presentation of the total Profit and Loss Account, Balance Sheet and Statement of Changes in Net Assets Attributable to Holders of Redeemable Participating Shares for the Company.

**Year from 1 January 2010 to 31 December 2010**

	<b>Montanaro European Equity Fund No. of shares</b>	<b>Total as at 31 December 2010 No. of shares</b>
Holding at beginning of year	1,296,972	1,296,972
Shares purchased	53,766	53,766
Holding at end of year	<u>1,350,738</u>	<u>1,350,738</u>
	<b>€</b>	<b>€</b>
Net realised gain on investment	<u>-</u>	<u>-</u>
Cost	(1,301,539)	(1,301,539)
Fair value	<u>1,107,605</u>	<u>1,107,605</u>
Unrealised gain/(loss) on investment	<u>(193,934)</u>	<u>(193,934)</u>

**Period from 1 February 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>

# MONTANARO EUROPEAN SMALLER COMPANIES PLC

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

*Year ended 31 December 2010*

### 17. Audit Fees

Fees paid to the Independent Auditors in respect of the year/period ended 31 December (exclusive of VAT) were:

	<b>Statutory audit</b>	<b>Other assurance services</b>	<b>Tax advisory services</b>	<b>Other non-audit services</b>
	€	€	€	€
31 December 2010	22,000	4,800	-	-

### 18. Post Balance Sheet Events

Effective from 27 January 2011, the Independent Auditors of the Company changed from Ernst & Young to PricewaterhouseCoopers, Chartered Accountants and Registered Auditors, One Spencer Dock, North Wall Quay, Dublin 1, Ireland.

The following distributions in respect of the financial year ending 31 December 2010 were approved by the Directors for ex-date 25 March 2011:

<b>Fund</b>	<b>Share Class</b>	<b>Rate per Share December 2010</b>
Montanaro European Equity Income Fund	GBP	£0.005299
	EUR	€0.006898

### 19. Net Asset Reconciliation

Net Asset Value per Financial Statements	€841,188,721
Adjustment for performance fees*	(€50,203)
Adjustment for compensation due to fund**	(€742,912)
Adjustment from Bid to last traded market value	€3,932,560
Net Asset Value per dealing NAV	<u>€844,328,166</u>

\*Following a review of performance fees by the Custodian, the performance fees on the Fund have been re-calculated and the revised fee of €14,967,773 is reflected in these financial statements.

\*\*As the timing and value of the performance fees calculated during the year were revised following a review by the Custodian, this has resulted in compensation payable to the fund of €742,912 in respect of redemptions made at an incorrect NAV.

Also, additional shares should have been issued in respect of subscriptions made at an incorrect NAV during the year. The additional shares of Euro Class 415,088 and Sterling Class 123,247 have been reflected in these financial statements.

### 20. Approval of Financial Statements

These financial statements were approved by the Directors of the Company on 3 June 2011.

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

*As at 31 December 2010*

<b>Financial assets at fair value through profit or loss</b>	<b>Shares/Par</b>	<b>Fair Value €</b>	<b>% of Net Assets</b>
<b>Common Stock (December 2009: 99.85%)</b>			
<b>Austria (December 2009: 4.04%)</b>			
Kapsch TrafficCom	180,000	12,659,400	1.51
Schoeller Bleckmann	275,000	17,776,000	2.12
		<b>30,435,400</b>	<b>3.63</b>
<b>Belgium (December 2009: 0.67%)</b>			
Van de Velde	104,087	4,029,208	0.48
		<b>4,029,208</b>	<b>0.48</b>
<b>Bermuda (December 2009: 2.63%)</b>			
Aquarius Platinum	2,000,000	8,171,653	0.98
Ocean Wilsons Holdings	857,500	13,710,159	1.64
Seawell Ltd/Bermuda	1,000,000	4,783,422	0.57
		<b>26,665,234</b>	<b>3.19</b>
<b>Denmark (December 2009: nil)</b>			
Christian Hansen Holding	1,100,000	16,768,398	2.00
		<b>16,768,398</b>	<b>2.00</b>
<b>Finland (December 2009: 8.98%)</b>			
Konecranes International	375,000	11,516,250	1.38
Nokian Renkaat	445,000	12,210,800	1.46
Outotec	325,000	15,024,750	1.79
Vacon	340,000	13,198,800	1.58
		<b>51,950,600</b>	<b>6.21</b>
<b>France (December 2009: 8.85%)</b>			
Euler Hermes	220,000	15,400,000	1.84
SILIC	115,000	10,609,900	1.27
Stallergenes	170,000	10,006,200	1.19
Virbac	180,386	23,269,794	2.78
		<b>59,285,894</b>	<b>7.08</b>
<b>Germany (December 2009: 6.35%)</b>			
Aixtron SE	200,000	5,488,000	0.66
CTS Eventim	179,247	8,245,362	0.98
ElringKlinger	395,000	10,303,575	1.23
Fuchs Petrolub	140,000	15,428,000	1.84
GFK	500,000	18,635,000	2.23
Pfeiffer Vacuum Technology	104,390	9,096,545	1.09
Rational	87,092	14,117,613	1.69
Wincor Nixdorf	200,000	12,134,000	1.45
		<b>93,448,095</b>	<b>11.17</b>
<b>Greece (December 2009: 2.17%)</b>			
Frigoglass	1,312,843	13,141,558	1.57
		<b>13,141,558</b>	<b>1.57</b>
<b>Italy (December 2009: 2.30%)</b>			
DiaSorin	550,000	17,512,000	2.09
		<b>17,512,000</b>	<b>2.09</b>
<b>Luxembourg (December 2009: nil)</b>			
Acergy	1,000,000	18,274,470	2.18
		<b>18,274,470</b>	<b>2.18</b>
<b>Netherlands (December 2009: 8.24%)</b>			
Arcadis	444,000	7,705,620	0.92

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**SCHEDULE OF INVESTMENTS**

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

*As at 31 December 2010*

<b>Financial assets at fair value through profit or loss</b>	<b>Shares/Par</b>	<b>Fair Value €</b>	<b>% of Net Assets</b>
<b>Common Stock (December 2009: 99.85%) (Continued)</b>			
<b>Netherlands (December 2009: 8.24%) (Continued)</b>			
Fugro	275,000	16,912,500	2.02
		<b>24,618,120</b>	<b>2.94</b>
<b>Norway (December 2009: 3.33%)</b>			
TGS Nopec Geophysical	1,300,000	21,922,952	2.62
		<b>21,922,952</b>	<b>2.62</b>
<b>Spain (December 2009: 6.46%)</b>			
Indra Sistemas	500,000	6,392,500	0.76
Prosegur Cia de Seguridad	335,000	13,982,900	1.67
Viscofan	675,000	19,136,250	2.29
		<b>39,511,650</b>	<b>4.72</b>
<b>Sweden (December 2009: 4.14%)</b>			
AF	840,000	12,969,223	1.55
Avanza Bank Holding	334,237	8,653,282	1.03
Elekta	650,000	18,651,643	2.23
Hufvudstaden Series A	1,250,000	10,879,755	1.30
JM	650,000	11,350,981	1.36
RaySearch Laboratories Series B	1,265,220	5,274,646	0.63
SkiStar Series B	498,042	7,123,528	0.85
		<b>74,903,058</b>	<b>8.95</b>
<b>Switzerland (December 2009: 5.03%)</b>			
Belimo Holdings	11,000	14,866,535	1.78
Julius Baer Holding	1,250,000	15,444,323	1.84
LEM Holding	32,000	14,663,410	1.75
		<b>44,974,268</b>	<b>5.37</b>
<b>United Kingdom (December 2009: 36.66%)</b>			
Aberdeen Asset Management	1,500,000	3,546,651	0.42
Albemarle & Bond	1,151,864	4,221,032	0.50
Ashmore Group	3,720,000	14,548,063	1.74
Aveva Group	353,500	6,625,563	0.79
Booker Group	12,000,000	8,402,728	1.00
Chemring Group	287,370	9,662,122	1.15
Consort Medical	1,120,689	6,343,291	0.76
Croda International	535,000	10,058,591	1.20
Dignity	1,530,000	12,766,895	1.52
Domino Printing Sciences	2,963,978	22,484,133	2.68
Domino's Pizza	2,850,000	18,343,330	2.19
Fisher & Sons	2,000,000	11,658,785	1.39
Genus	1,000,000	10,013,251	1.20
Hargreaves Lansdown	1,210,046	8,275,368	0.99
Latchways	587,483	7,130,442	0.85
NCC Group	1,850,000	11,874,689	1.42
Phoenix IT Group	1,459,459	4,483,819	0.54
Premier Oil	750,000	16,989,266	2.03
Ricardo	2,000,000	6,652,160	0.79
Rotork	475,000	10,127,913	1.21
RPS Group	3,750,000	10,083,274	1.20
SDL	1,226,790	9,170,165	1.10

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**SCHEDULE OF INVESTMENTS**

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

*As at 31 December 2010*

<b>Financial assets at fair value through profit or loss</b>	<b>Shares/Par</b>	<b>Fair Value €</b>	<b>% of Net Assets</b>
<b>Common Stock (December 2009: 99.85%) (Continued)</b>			
<b>United Kingdom (December 2009: 36.66%) (Continued)</b>			
Severfield Rowen	1,787,000	6,386,876	0.76
Shaftesbury	2,100,000	10,923,196	1.30
Ultra Electronics Holdings	513,500	10,163,753	1.21
Victrex	1,330,000	22,987,646	2.75
Wilmington Group	2,292,065	4,092,665	0.49
WSP Group	1,584,701	6,565,435	0.78
		<b>284,581,102</b>	<b>33.96</b>
<b>Total Common Stock (December 2009: 99.85%)</b>		<b>822,022,007</b>	<b>98.16</b>
<b>UCITS Collective Investment Schemes (December 2009: 0.17%)</b>			
Montanaro European Equity Income Fund	1,350,738	1,107,604	0.13
<b>Total UCITS Collective Investment Schemes (December 2009: 0.17%)</b>		<b>1,107,604</b>	<b>0.13</b>
<b>Total financial assets at fair value through profit and loss</b>		<b>823,129,611</b>	<b>98.29</b>
Cash at bank (December 2009: 0.16%)		37,161,151	4.44
Other net liabilities (December 2009: (0.18)%)		(26,758,654)	(3.19)
<b>Total net assets attributable to holders of redeemable participating shares (at bid prices)</b>		<b>833,532,108</b>	<b>99.54</b>
Adjustment from bid prices to last traded prices		3,886,451	0.46
<b>Total net assets attributable to holders of redeemable participating shares (at last traded prices)</b>		<b>837,418,559</b>	<b>100.00</b>
<b>Analysis of Total Gross Assets (unaudited)</b>			<b>% of Total Gross Assets</b>
Transferable securities and money market instruments admitted to an official stock exchange listing or traded in a regulated market			95.22
Collective Investment Schemes			0.13
Other current assets			4.65
<b>Total</b>			<b>100.00</b>

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

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

*As at 31 December 2010*

<b>Financial assets at fair value through profit or loss</b>	<b>Shares/Par</b>	<b>Fair Value £</b>	<b>% of Net Assets</b>
<b>Common Stock (December 2009: 96.44%)</b>			
<b>Belgium (December 2009: nil)</b>			
Van de Velde	3,000	99,508	1.32
		<b>99,508</b>	<b>1.32</b>
<b>Denmark (December 2009: nil)</b>			
Christian Hansen Holding	10,000	130,620	1.73
		<b>130,620</b>	<b>1.73</b>
<b>Finland (December 2009: 3.44%)</b>			
Konecranes International	7,700	202,620	2.68
		<b>202,620</b>	<b>2.68</b>
<b>France (December 2009: 8.35%)</b>			
Euler Hermes	3,250	194,937	2.58
Neopost	2,050	114,441	1.52
SILIC	2,500	197,636	2.62
		<b>507,014</b>	<b>6.72</b>
<b>Germany (December 2009: 11.73%)</b>			
CTS Eventim	4,100	161,605	2.14
Fielmann	1,800	109,230	1.45
Rational	1,320	183,345	2.43
Wincor Nixdorf	3,050	158,557	2.10
		<b>612,737</b>	<b>8.12</b>
<b>Isle Of Man (December 2009: 4.13%)</b>			
Hansard Global	80,000	132,798	1.76
		<b>132,798</b>	<b>1.76</b>
<b>Netherlands (December 2009: 11.93%)</b>			
Beter Bed Holding	7,000	127,459	1.69
Exact Holding	8,800	154,955	2.05
Fugro	4,100	216,058	2.86
Koninklijke Boskalis Westminster	7,000	213,051	2.82
		<b>711,523</b>	<b>9.42</b>
<b>Spain (December 2009: 4.52%)</b>			
Indra Sistemas	12,500	136,938	1.81
Prosegur Cia de Seguridad	2,700	96,567	1.28
Tecnicas Reunidas	5,000	203,998	2.70
Viscofan	8,000	194,337	2.57
		<b>631,840</b>	<b>8.36</b>
<b>Sweden (December 2009: 7.39%)</b>			
AF	16,000	211,674	2.80
Avanza Bank Holding	8,500	188,563	2.50
JM	10,000	149,635	1.98
SkiStar Series B	15,000	183,837	2.44
Sweco	25,000	137,759	1.82
		<b>871,468</b>	<b>11.54</b>
<b>Switzerland (December 2009: 4.11%)</b>			
Banque Cantonale Vaudoise	625	210,283	2.79
Julius Baer Holding	15,000	158,804	2.10
LEM Holding	475	186,505	2.47
		<b>555,592</b>	<b>7.36</b>
<b>United Kingdom (December 2009: 40.84%)</b>			
A & J Mucklow Group	34,420	99,560	1.32

**MONTANARO EUROPEAN SMALLER COMPANIES PLC**

**SCHEDULE OF INVESTMENTS**

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

*As at 31 December 2010*

<b>Financial assets at fair value through profit or loss</b>	<b>Shares/Par</b>	<b>Fair Value £</b>	<b>% of Net Assets</b>
<b>Common Stock (December 2009: 96.44%) (Continued)</b>			
<b>United Kingdom (December 2009: 40.84%) (Continued)</b>			
Ashmore Group	40,000	134,040	1.78
Aveva Group	4,500	72,270	0.96
Cineworld Group	85,000	182,750	2.42
City of London Investment Group	45,000	202,725	2.69
Consort Medical	40,000	194,000	2.57
Croda International	10,000	161,100	2.13
Devro	75,000	188,025	2.49
Dignity	12,857	91,928	1.22
Domino Printing Sciences	30,000	195,000	2.58
Hargreaves Lansdown	35,000	205,100	2.72
James Halstead	25,400	186,690	2.47
Latchways	15,000	156,000	2.07
Mothercare	10,000	61,000	0.81
Premier Oil	2,500	48,525	0.64
Ricardo	57,500	163,875	2.17
Severfield Rowen	70,000	214,375	2.84
Shaftesbury	10,000	44,570	0.59
Victrex	5,000	74,050	0.98
Wilmington Group	125,000	191,250	2.53
WSP Group	45,446	161,333	2.14
		<b>3,028,166</b>	<b>40.12</b>
<b>Total financial assets at fair value through profit and loss</b>		<b>7,483,886</b>	<b>99.13</b>
Cash at bank (December 2009: 3.09%)		18,630	0.25
Other net assets (December 2009: 0.47%)		7,234	0.10
<b>Total net assets attributable to holders of redeemable participating shares</b>		<b>7,509,750</b>	<b>99.48</b>
Adjustment from bid prices to last traded prices		39,509	0.52
<b>Total net assets attributable to holders of redeemable participating shares (at last traded prices)</b>		<b>7,549,259</b>	<b>100.00</b>
<b>Analysis of Total Gross Assets (unaudited)</b>			<b>% of Total Gross Assets</b>
Transferable securities and money market instruments admitted to an official stock exchange listing or traded in a regulated market			99.61
Other current assets			0.39
<b>Total</b>			<b>100.00</b>

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

**PORTFOLIO CHANGES – LARGEST 20 ACQUISITIONS (unaudited)**

*For the year ended 31 December 2010*

	Nominal	Cost €
Domino Printing Sciences	2,963,978	17,124,843
DiaSorin	550,000	16,426,349
Christian Hansen Holding	1,100,000	14,768,401
Elekta AB	650,000	14,739,866
Subsea 7	1,000,000	13,515,713
Stallergenes	170,000	10,317,945
LEM Holding	32,000	10,086,295
TGS Nopec Geophysical Co	850,000	9,918,976
Croda International Plc	535,000	9,262,938
Pfeiffer Vacuum Technology	104,390	8,734,229
ElringKlinger AG	395,000	8,245,408
Avanza Bank Holding	334,237	8,234,165
Euler Hermes	135,000	8,200,118
JM	650,000	7,590,506
SDL	1,226,790	7,293,219
GAM Holding	675,000	6,781,968
CTS Eventim	179,247	6,777,927
Kapsch TrafficCom	180,000	6,340,128
GFK	209,438	6,235,897
SILIC	55,000	5,140,316

**PORTFOLIO CHANGES – LARGEST 20 DISPOSALS (unaudited)**

*For the year ended 31 December 2010*

	Nominal	Proceeds €
Chloride Group Plc	5,291,455	21,178,075
Andritz AG	260,500	12,168,120
Dana Petroleum Plc	614,000	12,102,863
Neopost	170,000	10,137,288
Bureau Veritas SA	175,000	9,952,440
Imtech NV	400,000	8,882,200
Koninklijke Vopak NV	215,000	8,711,856
Azimut Holding SpA	1,168,333	7,628,795
Poyry Oyj	750,000	7,037,765
DnB NOR ASA	794,444	6,810,681
Scott Wilson Group Plc	2,138,227	6,405,190
Rensburg Sheppards Plc	605,000	5,842,260
Grifols SA	500,000	5,710,786
Smit International	90,000	5,541,894
Nokian Renkaat Oyj	255,000	5,484,483
Julius Baer Group Ltd	225,000	5,198,545
Aryzta AG	175,000	4,937,798
Arcadis NV	306,000	4,877,879
Konecranes Oyj	230,000	4,486,749
Banque Cantonale Vaudoise	12,500	4,371,785

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

**PORTFOLIO CHANGES – LARGEST 20 ACQUISITIONS (unaudited)**

*For the year ended 31 December 2010*

	Nominal	Cost £
Koninklijke Boskalis Westminster NV	7,000	203,710
Tecnicas Reunidas SA	5,000	185,944
Ashmore Group	65,000	177,877
Cineworld Group	85,000	175,020
Devro	75,000	172,988
Avanza Bank Holding	8,500	172,619
SkiStar AB	15,000	172,589
Euler Hermes	3,250	170,417
Consort Medical	40,000	169,055
Viscofan SA	8,000	158,287
Konecranes Oyj	7,700	155,808
Indra Sistemas SA	12,500	155,728
Ricardo	57,500	151,060
GAM Holding AG	15,000	150,822
Croda International	10,000	150,763
LEM Holding SA	475	140,173
Rational AG	1,320	139,059
CTS Eventim	4,100	137,840
JM	10,000	137,065
Beter Bed Holding NV	7,000	129,279

**PORTFOLIO CHANGES – LARGEST 20 DISPOSALS (unaudited)**

*For the year ended 31 December 2010*

	Nominal	Proceeds £
Senior	250,000	283,182
Pfeiffer Vacuum Technology AG	3,400	235,108
Holidaybreak	57,555	160,033
Outotec Oyj	6,000	140,735
VP	84,119	137,251
Corio NV	3,500	133,205
Andritz AG	2,500	97,207
Ashmore Group	25,000	95,650
Prosegur Cia de Seguridad SA	3,000	92,276
Neopost	1,400	73,201
London Capital Group Holdings	65,000	68,258
Wincor Nixdorf AG	1,400	65,363
Fielmann AG	1,200	59,880
AF AB	3,000	59,320
Imtech NV	3,200	59,085
James Halstead Plc	8,600	51,281
Domino Printing Sciences	12,000	50,388
Hansard Global Plc	25,000	43,412
Fugro NV	1,000	42,752
Banque Cantonale Vaudoise	140	41,207