European Smaller Companies Trust

★★★★– Morningstar Rating™
(as at 31/12/11)

MONTANARO

Monthly Fact Sheet: December 2011

Montanaro, an independent specialist fund manager, was established in 1991 to research and invest in UK and Continental European quoted SmallCap companies. Funds under management are currently €1.3 billion. The European Smaller Companies Trust invests in quoted European (excluding UK) companies with a focus on companies below €1 billion in size. It is listed on the London Stock Exchange.

Monthly Review

In a difficult market environment marked by events that will make their way into our history books – the Arab Spring, Japan's deadly tsunami, two European bailouts, the loss by the US of its perennial AAA rating - we are pleased to report that the Trust ended the calendar year 3.5% ahead of its benchmark.

The strongest contributor in December was **Newave**. The Swiss company that designs and sells uninterruptible power supply solutions received a take-over offer from ABB at a premium of 22%. **Belimo**, a Swiss manufacturer of actuators, bounced back from its November lows as concerns over a sharp deceleration in global economic growth faded. **Kapsch TrafficCom**, the Austrian road toll provider, rose after it secured a major order win in Russia, underscoring the company's long-term growth potential.

On the downside, **Vacon**, a Finnish supplier of variable speed drives, reduced its full-year guidance owing to problems securing a receivable and continued slowdown in its end market. **GFK**, the German market research company, continued to trade down following a mixed Q3 report in November. It has since stabilised. **LEM**, the Swiss manufacturer of electrical transducers, declined by c.7% after the shares had a good run in November.

In December, we visited **Wincor Nixdorf** at their headquarters in Paderborn, Germany. Wincor specialises in hardware, software and services for ATMs and automatic check-out systems for retailers. Wincor is the second largest player in the world in both ATMs and retail solutions. Montanaro have been investors in Wincor for years but the company is not one of our top holdings.

A key component of Wincor's growth strategy is its ability to supply products that are optimised, from a cost point of view, for the various markets, which is crucial to maintaining its margins. Our German factory tour confirmed that Wincor has an attractive product architecture - based on modules - which makes it possible for the company to produce its products in any of its factories. With transportation costs potentially high relative to total product cost, this flexibility is essential. We also understood that there is still potential to take out costs in both production and sourcing, which should allow Wincor to preserve margins in the face of maturing markets.

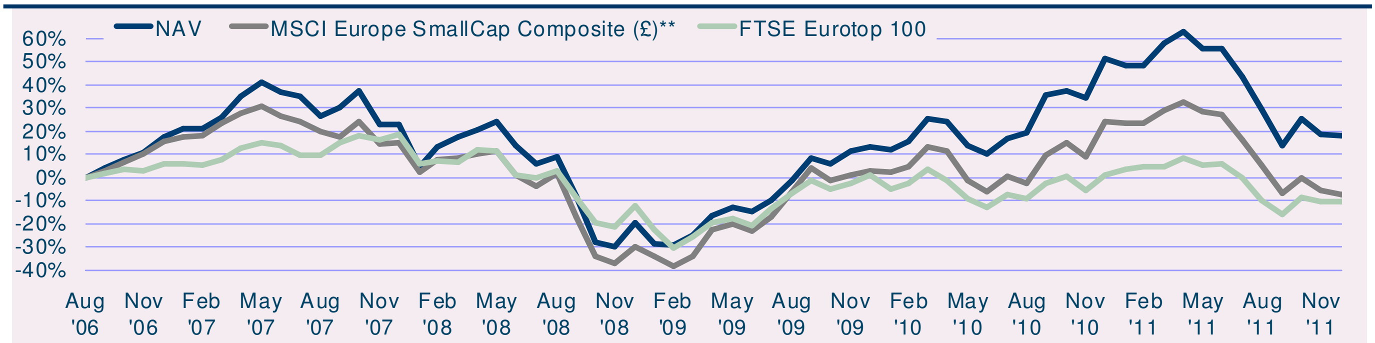
As we enter 2012, two of last year's themes will inevitably continue to dominate market sentiment: the EMU's transition from a currency to a fiscal union; and the tug-of-war between monetary reflation and fiscal consolidation. Elections in the US, China and France will also be important milestones. German-led austerity may well tip Europe's economy into a mild recession. Politicians everywhere are in the driving seat and as investors we are at their mercy perhaps to a greater degree than ever before. 2012 will be a volatile year.

However, companies are sitting on large cash piles which will need to find a home. We see room for M&A activity to gain steam as large firms start looking at external growth to offset slowing earnings growth.

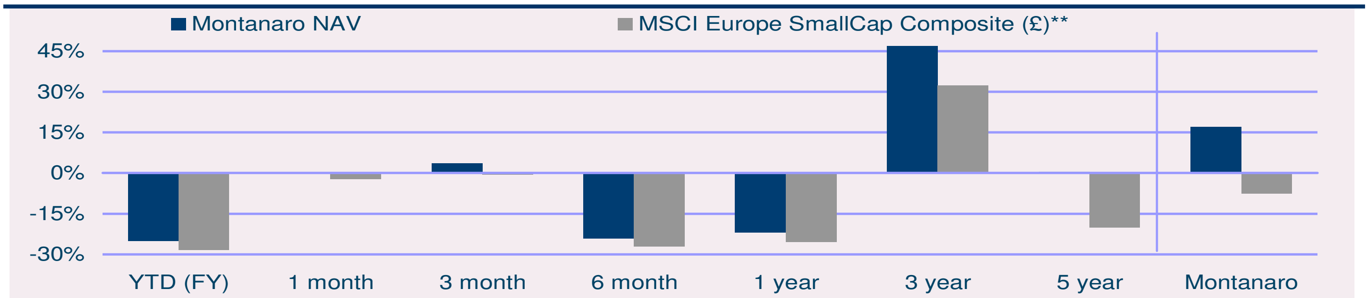
In stark contrast to last year, investor portfolios are positioned defensively with larger cash allocations, a reflection of the prevailing gloom in Europe. We estimate that the market is already pricing in a 13% decline in European SmallCap earnings in spite of the benign global growth environment. Our interpretation is that current valuations limit the downside risk. Under-owned and under-loved, European SmallCap could surprise on the upside this year.

The context of high uncertainty should translate into further outperformance of the "quality growth" theme - companies offering secure earnings growth and good visibility. Balance sheet strength is also crucial at a time when bank lending may be restricted. Montanaro are well positioned to take advantage of a scramble for the highest quality "blue-chip" small companies. We wish all our investors a Happy New Year!

Performance



Relative Performance



***Effective June 1st 2009 the index used in this factsheet for comparison purposes is the MSCI European Smaller Companies Index ex-UK. The performance history prior to June 1st 2009 remains the MSCI European Smaller Companies Index.*

Performance

Y/E: March	YTD (FY)	1 month	3 month	6 month	1 year	3 year	5 year	Montanaro
Montanaro NAV	-25.2%	-0.3%	3.7%	-24.3%	-22.0%	46.9%	0.6%	17.2%
MSCI Europe SmallCap Composite (£)**	-28.4%	-2.2%	-0.4%	-27.1%	-25.4%	32.4%	-20.1%	-7.6%

Source: Montanaro, Bloomberg. NAV to NAV, fully diluted ***see footnote on previous page*

Analysis

	Fund	Index
NAV	400.6	135.5
Share Price	345.8	na
Discount	-13.7%	na
Alpha (annual) *	4.7%	na
Beta *	0.86	1.00
Standard Deviation *	23.2%	25.4%
Sharpe Ratio *	0.55	0.35
Tracking error *	8.3%	na
P/E 12F†	13.4	10.5
EPS Growth 12F†	10.0%	10.4%
Dividend Yield 12F†	3.4%	3.8%

* risk statistics over three years † Source: Factset consensus estimates

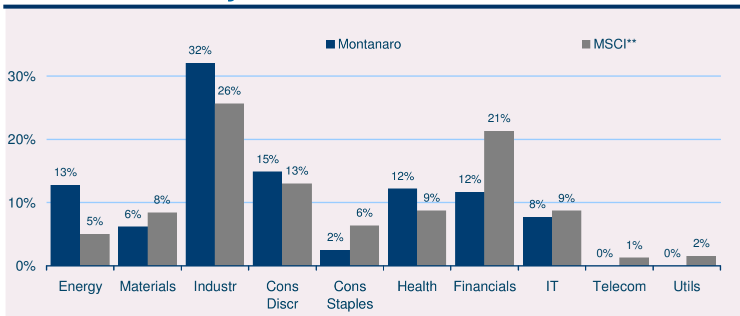
Details

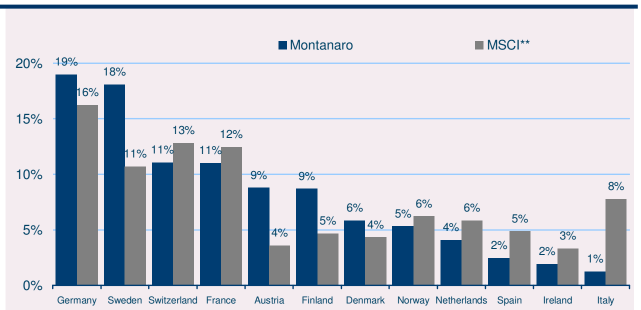
Managed Since	September 2006
Gross Assets	€93 million
Net Assets	€83 million
Net Gearing	11.6%
No. of holdings	45
Median Mkt Cap	€1057 million
Mgmnt Fee	Annual 1%
Perf Fee	See below*
Legal Status	UK closed-end Investment Trust
Listing	London Stock Exchange
Valuation	Daily
Dividends	January and July

Top Ten Holdings

	Name	Country	Sector	%
1	Rational	Germany	Machinery	3.6%
2	Kapsch Trafficcom	Austria	Electronic Equipment, Instruments & Components	3.5%
3	Elekta	Sweden	Health Care Equipment & Supplies	3.2%
4	Virbac	France	Pharmaceuticals	3.2%
5	Christian Hansen Holding	Denmark	Chemicals	3.2%
6	Fuchs Petrolub	Germany	Chemicals	3.0%
7	Belimo Holding	Switzerland	Building Products	3.0%
8	Nokian Renkaat	Finland	Auto Components	2.9%
9	Bureau Veritas	France	Professional Services	2.9%
10	TGS Nopec	Norway	Energy Equipment & Services	2.9%
			TOTAL	**31.4%**

Sector & Country Distribution





***see footnote on previous page*

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*Performance fee is calculated at 15% outperformance of MSCI European SmallCap Index Excluding UK (£) plus 2%, capped at 2%, with a hurdle of 536.02p