European Smaller Companies Trust

★★★★– Morningstar Rating™
(as at 31/10/11)

MONTANARO

Monthly Fact Sheet: October 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 €1.4 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

October saw the largest relief rally for some time as European leaders sought a solution to the sovereign debt issues. The portfolio rose by nearly 10% and outperformed its benchmark by over 2% over the month.

JM Group, the Swedish house builder, performed well after announcing a strong set of Q3 results with no indications of any material decline likely in Q4. **Outotec**, the leading Finnish designer of mining machinery, also rose by more than 20% in sympathy with their underlying customers. Q3 results impressed with the company having a very strong order book. **GFK**, (Germany) one of the world's leading consumer research companies, rebounded on hopes that an economic crisis had been averted.

On the downside **Diasorin**, the Italian seller of diagnostic testing kits (particularly strong in Vitamin D), suffered as competitors launched new products and sales in the US came under some pressure. The company has subsequently been buying stock back and these lower prices. **Rational**, the German manufacturer of commercial kitchen ovens, has seen it shares perform well this year and some investors took the opportunity to switch into lower quality cyclical investments during October. **LEM**, (Swiss transducer manufacturer) has seen a significant decline in sales to the Solar industry and some destocking. It remains a well managed business.

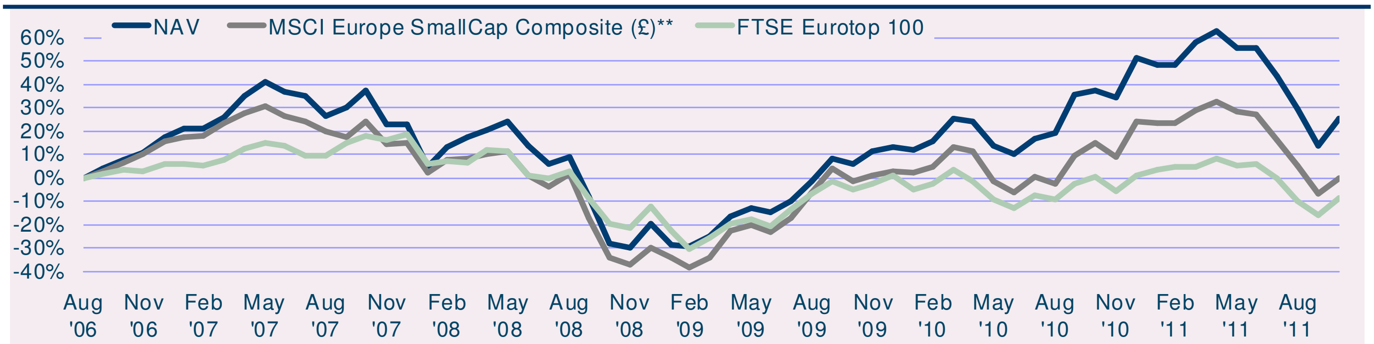
We recently had a meeting with **Schoeller Bleckman** (SBO) one of our top holdings in the oil services sector. **SBO** manufactures non-magnetic drill string components for directional drilling so that oil companies can drill horizontally as well as vertically. We had previously visited the company's manufacturing facilities in Austria and been impressed by the quality of the facilities. As oil becomes ever scarcer, the technology required to maximise oilfield production will increase, and benefit companies such as **SBO**.

After considerable destocking in 2008/9, we have been tracking the rig count data closely. Currently the outlook is positive - the horizontal rig count is 75% higher than its previous peak and 200% above the trough seen in 2009. Management confirmed that the recent expansion into counties such as Brazil and Singapore has gone well, helping the group to raise operating margins above 20% at the interim stage. Strong order intake and a rise in the order backlog suggest that trading in the second half of the year should remain robust. Additional growth will be seen from the recently acquired Drilling Systems International, which is based in Dubai and further broadens the product offering.

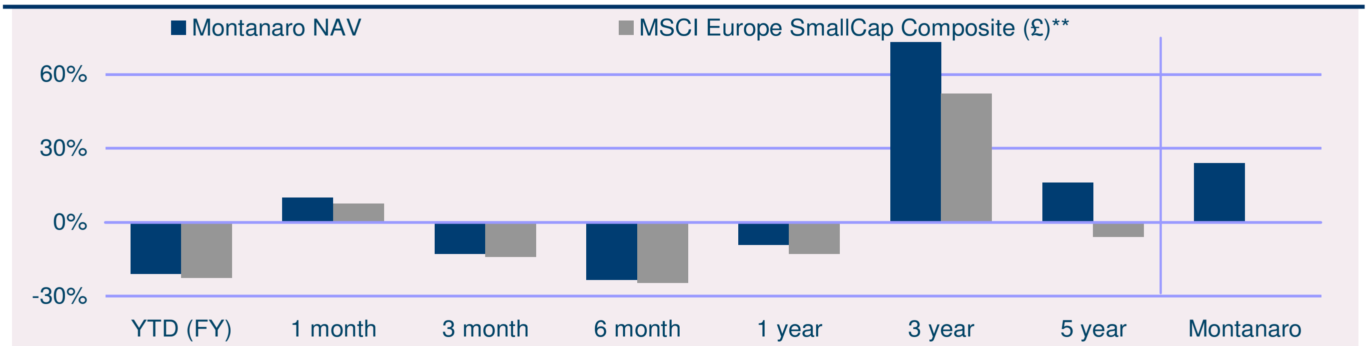
After all meetings, our analysts take a closer look at out internal models particularly with reference to consensus numbers. We have concluded that there is room for some modest upside in consensus forecasts much as we would expect from such a well-managed, high quality business. We believe margins could return to or exceed their previous peak of 24%. **SBO** remains a core holding.

If the October rally has taught us anything, it is that there is a lot of cash sitting on the sidelines waiting to be invested. Investor confidence is low and volatility high, normally good ingredients for investing. Our internal market timing model gave a strong Buy signal in September and remains positive. European SmallCap is under-owned and unloved. A resolution of the Euro "crisis" could see a return to the asset class and a change in sentiment which can be very fickle. In summary Q4 still looks set to finish the year on a positive note even if the ride is not as smooth as the politicians would like.

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	-20.9%	9.8%	-12.8%	-23.2%	-9.2%	73.2%	16.0%	24.0%
MSCI Europe SmallCap Composite (£)**	-22.6%	7.6%	-14.1%	-24.6%	-12.8%	52.1%	-5.9%	-0.1%

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

Analysis

	Fund	Index
NAV	424.1	146.5
Share Price	368.3	na
Discount	-13.2%	na
Alpha (annual) *	6.0%	na
Beta *	0.89	1.00
Standard Deviation *	24.3%	25.9%
Sharpe Ratio *	0.79	0.54
Tracking error *	8.5%	na
P/E 12F†	12.7	10.7
EPS Growth 12F†	13.0%	11.7%
Dividend Yield 12F†	3.5%	3.7%

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

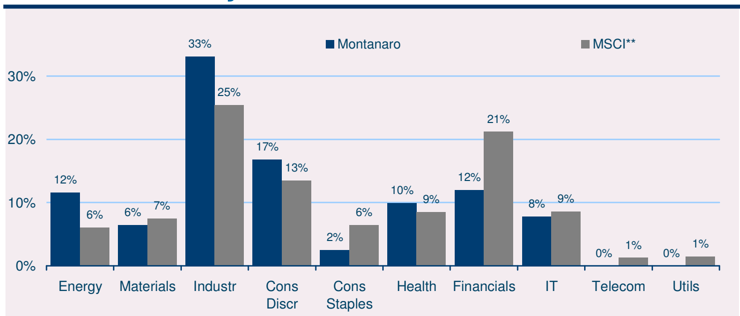
Details

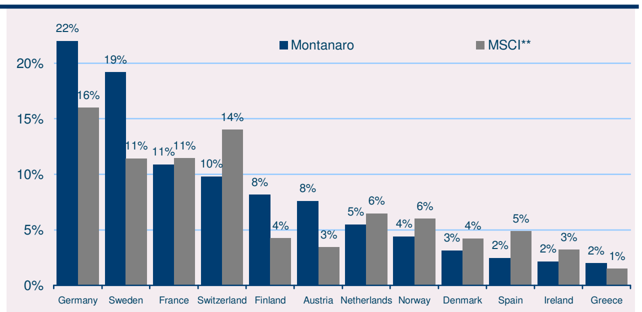
Managed Since	September 2006
Gross Assets	€91 million
Net Assets	€86 million
Net Gearing	5.2%
No. of holdings	46
Median Mkt Cap	€1127 million
Mgmnt Fee	Annual 1%
Perf Fee	See below*
Legal Status	UK closed-end Investment Trust
Listing	London Stock Exchange
Valuation	Daily
Dividends	January and July

Top Ten Holdings

	Name	Country	Sector	% of portfolio
1	Rational	Germany	Machinery	3.5%
2	Virbac	France	Pharmaceuticals	3.4%
3	GfK AG	Germany	Media	3.3%
4	Kapsch TrafficCom	Austria	Electronic Equipment & Instruments	3.3%
5	Fuchs Petrolub	Germany	Chemicals	3.3%
6	Christian Hansen	Denmark	Chemicals	3.1%
7	AF Group	Sweden	Professional Supplies	3.0%
8	Belimo	Switzerland	Building Products	2.8%
9	Elekta	Sweden	Health Care Equipment & Supplies	2.8%
10	Enquest	Sweden	Oil, Gas & Consumable Fuels	2.7%
			TOTAL	**31.3%**

Sector & Country Distribution





***see footnote on previous page*

Montanaro Asset Management
53 Threadneedle Street
London EC2R 8AR

Tel: **020 7448 8600**
Fax: 020 7448 8601
Website: **www.montanaro.co.uk**

Manager: **Charles Montanaro**
E-mail: cmontanaro@montanaro.co.uk
Ticker: MTE LN Equity

*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