MONTANARO

European Smaller Companies Trust plc

Interim Report 2008

The investment objective of **Montanaro European Smaller Companies Trust plc** ("the Company") is to achieve capital growth by investing principally in European quoted smaller companies.

The Company's benchmark index is the MSCI Europe SmallCap Index (in sterling terms).

The Company was launched in May 1981. Its current objective and benchmark were adopted in September 2006. It is listed on the London Stock Exchange.

Highlights
for the six months ended 30 September 2008

Results

> Net asset value per Ordinary Share ("NAV") -21.1% (£53.3 million)

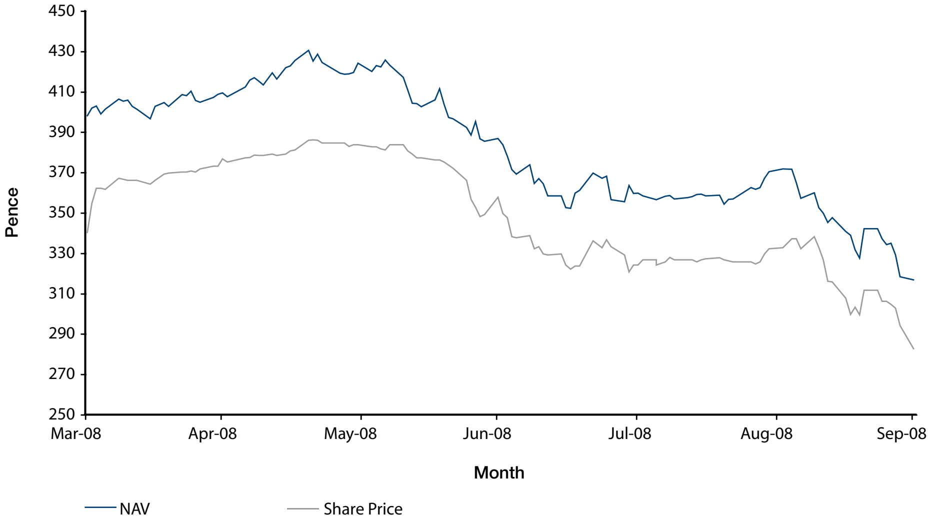
> Benchmark index -23.7%

> Total assets -33.2% (£53.4 million)

> Share price -16.9%

	As at 30 September 2008	As at 31 March 2008
NAV per Ordinary Share	316.97p	401.56p
Ordinary Share Price	282.50p	340.00p
Discount	10.9%	15.3%
Net Cash	3.1%	2.2%

NAV and Share Price for the six months ended 30 September 2008



Chairman's Statement

Performance

Over the six month period ended 30 September 2008, the Company's net asset value ("NAV") fell by 21.1% to 316.97 pence per share. This compares to a fall of 23.7% in the benchmark index, the MSCI Europe Small Cap Index.

During the first part of the period under review, rising food and energy prices led to higher inflation and concerns increased over slowing economic growth. These fears, however, were overtaken by ever increasing concerns over the implications of the continuing global credit crisis. Initially in the US, and then in the UK and Europe, a number of major financial institutions faced collapse. Government intervention has been required to ensure the continuing stability of the banking sector and significant amounts of liquidity have been provided by central banks around the world to help restore confidence to the sector. Whilst there are signs that the crisis in financial markets may be reaching its final stages, it has undoubtedly contributed to the downturn in the economies of Europe and the UK.

While many stocks in which the Company has invested have been reporting positive earnings growth, their outlook statements have, unsurprisingly, become much more subdued. It is likely that the number of profit warnings will increase as companies deal with the challenge of recession. Valuations have become selectively attractive but there is sufficient uncertainty over future earnings potential to cause stockmarket volatility to remain for some time.

Earnings and Dividends

Revenue earnings per share were 7.01 pence in respect of the six month period ended 30 September 2008 (2007: 3.04 pence). The increase is due to good dividend growth within the portfolio. It is also due to the recovery of VAT, as explained in more detail below.

The Board has declared an interim dividend of 1.75 pence per Ordinary Share, payable on 9 January 2009 to shareholders on the register on 12 December 2008. Reflecting the enhancement to earnings from the provision for the recovery of VAT during the period, the Board has also declared a special dividend of 1.05 pence per share. This dividend will also be paid on 9 January 2009 to shareholders on the register on 12 December 2008.

Share Buy-Backs and Discount Management Policy

The discount of share price to NAV as at 30 September 2008 was 10.9%.

Shareholders will be aware that the Board has stated its intention to apply an active discount management policy, buying back shares if the discount is greater than 5% for a sustained period. The Board remains committed to this policy. However, the abnormal market conditions and significant stockmarket volatility experienced during the period made it difficult to maintain the discount at this level.

In line with its policy, the Company bought back 380,000 shares during the period, equivalent to 2.2% of its shares, at an average discount of 8.6%. These buy-backs provided an enhancement of 0.9 pence per share to the NAV. The shares were bought back to be held in treasury, for subsequent re-issue or cancellation in accordance with the Company's policy on treasury shares.

Since the end of the period, the Company has bought back a further 35,000 shares to be held in treasury.

Borrowings

Reflecting the Manager's continuing cautious view of markets, the Company held a net cash position throughout the period under review. The Company does, however, continue to have a flexible revolving credit facility. This will enable the Manager to put gearing in place when the timing is considered appropriate.

VAT on Management Fees

Following the European Court of Justice ruling in June 2007 that investment trusts should be regarded as special investment funds, management fees paid by the Company are no longer subject to VAT.

The Board has taken the steps necessary to ensure that the Company's position is protected to enable it to recover some of the VAT paid in the past on investment management fees. Legal rulings enable the Company to recover VAT in respect of the periods 1990-1996 and 2001-2007, at which point the Company stopped paying VAT on these fees. The accounts include a provision for the recovery of £512,000 in respect of the period since 1 January 2001. This has been allocated between revenue and capital in accordance with the accounting policies applicable to the allocation of fees at the time the VAT was suffered. It provides an enhancement of 3.04 pence per share to the NAV and 1.05 pence to the revenue earnings per share. The Company expects to be able to make a provision for the recovery of VAT in respect of the earlier period before the end of the current financial year once the amounts involved can be estimated with sufficient accuracy.

The Company is also expecting to receive interest on the recoveries. However, at this stage, the amounts involved and timings of the payments are uncertain and no provision has therefore been made in these accounts.

Post Balance Sheet Events and Outlook

Stockmarkets in Europe have fallen further as concerns have continued over the strength of the banking sector and economic growth forecasts have been revised downwards. At the time of writing, the benchmark index has fallen by 25.5% since the end of the period and the Company's NAV per share has fallen by 25.0%.

The decisive actions taken by central banks to shore up the banking sector will take some time to take effect, and it is likely to be supported by interest rate cuts, which have already begun and will most likely continue into 2009. There is also likely to be an increase in government spending to boost domestic demand. Continuing proactive action by governments should be positive for European economies.

In these difficult and uncertain times, the Company remains defensively positioned. However, since the Bear Market began in June 2007, the benchmark index has fallen by more than 50% and, for long-term investors, the potential for attractive returns has improved from these levels. The Manager continues to seek to invest in high-quality, well-managed companies in growth markets of the Pan-European region which, whilst not wholly immune to a downturn, should prove resilient. The best companies will find interesting opportunities during this period and will emerge much stronger.

A R IRVINE
Chairman
28 November 2008

Twenty Largest Holdings
as at 30 September 2008

Holding	Country	Sector	Value £'000	% of portfolio
Poyry	Finland	Construction and building materials	2,142	4.1%
Prosegur Seguridad	Spain	Support services	2,108	4.1%
Sweco	Sweden	Support services	1,626	3.1%
GFK	Germany	Media	1,582	3.1%
AF	Sweden	Industrial engineering	1,524	3.0%
Vacon	Finland	Electronic and electrical equipment	1,489	2.9%
Fugro	Netherlands	Oil equipment services and distribution	1,469	2.8%
Smit International	Netherlands	Industrial transport	1,442	2.8%
Arcadis	Netherlands	Support services	1,439	2.8%
Victrex	United Kingdom	Chemicals	1,429	2.8%
Andritz	Austria	Industrial engineering	1,300	2.5%
Grontmij	Netherlands	Construction and building materials	1,269	2.5%
Fuchs Petrolub	Germany	Chemicals	1,247	2.4%
Studsvik	Sweden	Industrial engineering	1,202	2.3%
Imtech	Netherlands	Support services	1,129	2.2%
Guerbet	France	Pharmaceuticals and biotechnology	1,112	2.2%
Lassila and Tikanoja	Finland	Support services	1,085	2.1%
Frigoglass	Greece	Industrial engineering	1,061	2.0%
Aryzta	Switzerland	Food producers and processors	1,036	2.0%
Genus	United Kingdom	Pharmaceuticals and biotechnology	1,020	2.0%
Twenty largest holdings			27,711	53.7%

Condensed Group Income Statement (unaudited)

for the six months ended 30 September 2008

	Notes	Six months to 30 September 2008 Revenue £'000	Six months to 30 September 2008 Capital £'000	Six months to 30 September 2008 Total £'000	Six months to 30 September 2007 Revenue £'000	Six months to 30 September 2007 Capital £'000	Six months to 30 September 2007 Total £'000	Year to 31 March 2008 Revenue £'000	Year to 31 March 2008 Capital £'000	Year to 31 March 2008 Total £'000
Income										
Investment income		1,321	–	1,321	1,089	–	1,089	1,827	–	1,827
Other operating income		145	–	145	87	–	87	242	–	242
		1,466	–	1,466	1,176	–	1,176	2,069	–	2,069
(Losses)/gains on investments held at fair value		–	(15,350)	(15,350)	–	3,210	3,210	–	(2,775)	(2,775)
Exchange differences		–	73	73	–	(321)	(321)	–	(1,059)	(1,059)
Total income		1,466	(15,277)	(13,811)	1,176	2,889	4,065	2,069	(3,834)	(1,765)
Expenses										
Investment management fee	3	80	148	228	(153)	(1,140)	(1,293)	(265)	(492)	(757)
Other expenses		(182)	–	(182)	(268)	–	(268)	(547)	–	(547)
Profit/(loss) before finance costs and tax		1,364	(15,129)	(13,765)	755	1,749	2,504	1,257	(4,326)	(3,069)
Finance costs		(49)	(90)	(139)	(93)	(173)	(266)	(212)	(393)	(605)
Net operating profit/(loss) before tax		1,315	(15,219)	(13,904)	662	1,576	2,238	1,045	(4,719)	(3,674)
Tax		(124)	–	(124)	(132)	–	(132)	(204)	83	(121)
Net profit/(loss)		1,191	(15,219)	(14,028)	530	1,576	2,106	841	(4,636)	(3,795)
Earnings per share	4	7.01p	(89.62)p	(82.61)p	3.04p	9.03p	12.07p	4.84p	(26.66)p	(21.82)p

The total column of this statement is the Profit and Loss Account of the Group.

All revenue and capital items in the above statement derive from continuing operations.

No operations were acquired or discontinued during the period.

Condensed Group Balance Sheet (unaudited)
as at 30 September 2008

	Notes	As at 30 September 2008 £'000	As at 30 September 2007 £'000	As at 31 March 2008 £'000
Non-current assets				
Investments held at fair value		51,634	88,851	67,552
Current assets				
Other receivables		619	51	223
Cash and cash equivalents		1,195	2,315	12,236
		1,814	2,366	12,459
Total assets		53,448	91,217	80,011
Current liabilities				
Revolving credit facility		–	(13,851)	(10,658)
Other payables		(139)	(1,206)	(292)
Total liabilities		(139)	(15,057)	(10,950)
Net assets		53,309	76,160	69,061
Capital and reserves				
Called-up share capital		8,724	8,724	8,724
Share premium account		3,935	3,935	3,935
Capital redemption reserve		2,212	2,212	2,212
Capital reserve – realised		43,506	45,582	46,334
– unrealised		(7,826)	13,761	5,904
Revenue reserve		2,758	1,946	1,952
Shareholders' funds		53,309	76,160	69,061
Net asset value per share	6	316.97p	436.49p	401.56p

Consolidated Statement of Changes in Equity (unaudited)

for the six months ended 30 September 2008

	Share capital £'000	Share premium account £'000	Capital redemption reserve £'000	Capital reserve realised £'000	Capital reserve unrealised £'000	Revenue reserve £'000	Total £'000
Balance at 1 April 2008	8,724	3,935	2,212	46,334	5,904	1,952	69,061
Net loss on realisation of investments	–	–	–	(1,091)	–	–	(1,091)
Decrease in unrealised appreciation	–	–	–	–	(14,259)	–	(14,259)
Exchange (losses)/gains	–	–	–	(456)	529	–	73
Net management fee refunded to capital	–	–	–	148	–	–	148
Interest charged to capital	–	–	–	(90)	–	–	(90)
Ordinary Shares purchased to be held in treasury	–	–	–	(1,339)	–	–	(1,339)
Retained net revenue for the period	–	–	–	–	–	1,191	1,191
Dividends paid	–	–	–	–	–	(385)	(385)
Balance at 30 September 2008	8,724	3,935	2,212	43,506	(7,826)	2,758	53,309

	Share capital £'000	Share premium account £'000	Capital redemption reserve £'000	Capital reserve realised £'000	Capital reserve unrealised £'000	Revenue reserve £'000	Total £'000
Balance at 1 April 2007	8,724	3,935	2,212	44,552	13,215	1,809	74,447
Net gain on realisation of investments	–	–	–	2,262	–	–	2,262
Increase in unrealised appreciation	–	–	–	–	948	–	948
Exchange gains/(losses)	–	–	–	81	(402)	–	(321)
Management fee charged to capital	–	–	–	(1,140)	–	–	(1,140)
Interest charged to capital	–	–	–	(173)	–	–	(173)
Retained net revenue for the period	–	–	–	–	–	530	530
Dividends paid	–	–	–	–	–	(393)	(393)
Balance at 30 September 2007	8,724	3,935	2,212	45,582	13,761	1,946	76,160

	Share capital £'000	Share premium account £'000	Capital redemption reserve £'000	Capital reserve realised £'000	Capital reserve unrealised £'000	Revenue reserve £'000	Total £'000
Balance at 1 April 2007	8,724	3,935	2,212	44,552	13,215	1,809	74,447
Net gain on realisation of investments	–	–	–	4,081	–	–	4,081
Decrease in unrealised appreciation	–	–	–	–	(6,856)	–	(6,856)
Exchange losses	–	–	–	(604)	(455)	–	(1,059)
Management fee charged to capital	–	–	–	(492)	–	–	(492)
Interest charged to capital	–	–	–	(393)	–	–	(393)
Taxation	–	–	–	83	–	–	83
Ordinary Shares purchased to be held in treasury	–	–	–	(893)	–	–	(893)
Retained net revenue for the year	–	–	–	–	–	841	841
Dividends paid	–	–	–	–	–	(698)	(698)
Balance at 31 March 2008	8,724	3,935	2,212	46,334	5,904	1,952	69,061

Condensed Group Statement of Cash Flows (unaudited)

for the six months ended 30 September 2008

	Six months to 30 September 2008 £'000	Six months to 30 September 2007 £'000	Year to 31 March 2008 £'000
Net cash flow from operating activities	831	560	620
Cash flows from investing activities	567	(7,119)	8,157
Cash flows from financing activities	(12,512)	2,641	(2,089)
	(11,114)	(3,918)	6,688
Currency gains/(losses)	73	81	(604)
(Decrease)/increase in cash and cash equivalents	(11,041)	(3,837)	6,084

Reconciliation of net operating (loss)/profit before finance costs and tax to net cash flow from operating activities

Net operating (loss)/profit before finance costs and tax	(13,765)	2,504	(3,069)
Losses/(gains) on investments held at fair value	15,350	(3,210)	2,775
Exchange differences	(73)	321	1,059
Withholding tax	(124)	(132)	(121)
Changes in working capital and other non-cash items	(557)	1,077	(24)
Net cash flow from operating activities	831	560	620

Statement of Principal Risks and Uncertainties

The principal risk faced by the Company is that it fails to produce the capital appreciation stated as its objective, and the NAV does not rise over the longer-term. The risks which might give rise to this can be categorised as external, manager, investment and strategy, portfolio liquidity, gearing, regulatory, operational, financial, banking and reputational. In addition, shareholders face the risks of liquidity of the Company's shares and discount volatility.

These risks, and the way in which they are mitigated, are described in more detail under the heading Principal Risks and Risk Mitigation in the Report of the Directors in the Company's Annual Report for the year ended 31 March 2008. The Company's principal risks and uncertainties have not changed materially since the date of that report and are not expected to change materially for the remaining six months of the Company's financial year.

Directors' Responsibility Statement

in respect of the Interim Report

We confirm that to the best of our knowledge:

- the condensed set of consolidated financial statements has been prepared in accordance with IAS34 'Interim Financial Reporting';
- the Chairman's Statement (constituting the Interim Management Report) together with the Statement of Principal Risks and Uncertainties include a fair review of the information required by the Disclosure and Transparency Rules ("DTR") 4.2.7R, being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of consolidated financial statements; and
- the Chairman's Statement together with the financial statements include a fair review of the information required by DTR 4.2.8R, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the Company during the period, and any changes in the related party transactions described in the last Annual Report that could do so.

On behalf of the Board,
A R IRVINE
Director
28 November 2008

Notes to the Interim Report

1. The accounting policies adopted in the preparation of the interim financial statements are consistent with those followed in the preparation of the Annual Report and financial statements for the year ended 31 March 2008.

2. Earnings for the first six months should not be taken as a guide to the results for the full year.

3. Investment Management Fee

	Six months to 30 September 2008			Six months to 30 September 2007			Year ended 31 March 2008		
	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
Investment Management Fee									
– basic fee	99	185	284	130	241	371	239	443	682
– performance fee	–	–	–	–	857	857	–	–	–
– VAT paid on management fees	–	–	–	23	42	65	26	49	75
	99	185	284	153	1,140	1,293	265	492	757
– VAT recoverable	(179)	(333)	(512)	–	–	–	–	–	–
	(80)	(148)	(228)	153	1,140	1,293	265	492	757

The Association of Investment Companies and JP Morgan Claverhouse Investment Trust plc lodged a joint appeal in 2004 for the payment of management fees by investment trusts to be treated as exempt from VAT. In June 2007, the European Court of Justice ("ECJ") found in favour of the appellants, declaring that investment trusts should be treated as special investment funds and thus exempted from VAT on management fees. HM Revenue & Customs ("HMRC") announced that it would not appeal against the ECJ decision.

The recoverable VAT above is in relation to agreement having been reached with HMRC in relation to the period from 1 January 2001. This has been recognised within the Income Statement and allocated between revenue and capital returns in accordance with the accounting policies applicable to allocation of fees at the time the VAT was suffered.

4. Earnings per Ordinary Share is based on a weighted average of 16,981,391 Ordinary Shares in issue during the period (year ended 31 March 2008: 17,390,589; six months ended 30 September 2007: 17,448,260).

5. The interim dividend of 1.75 pence per Ordinary Share and the special dividend of 1.05 pence per Ordinary Share will both be paid on 9 January 2009 to shareholders on the register on 12 December 2008.

6. The NAV per Ordinary Share is based on 16,818,260 Ordinary Shares in issue at the end of the period (31 March 2008: 17,198,260; 30 September 2007: 17,448,260), excluding those shares bought back and held in treasury.

7. The Group results consolidate those of MESCT Securities Limited, a wholly owned non-trading subsidiary.

8. These are not statutory accounts in terms of section 240 of the Companies Act 1985 and are unaudited. The information for the year ended 31 March 2008 has been extracted from the latest published financial statements which received an unqualified audit report and have been filed with the Registrar of Companies. No statutory accounts in respect of any period after 31 March 2008 have been reported on by the Company's Auditor or delivered to the Registrar of Companies.

Directors and Advisers

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R B M Graham
R A Hammond-Chambers
J Lumsden
R M Martin

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Montanaro European Smaller Companies Trust plc
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An investment company as defined under Section 833 of the Companies Act 2006.

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