



**MONTANARO**

European Smaller Companies Trust plc

Interim Report 2009

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 (ex UK) Index (in sterling terms).

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

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# Highlights

for the six months ended 30 September 2009

## Results

> Net asset value ('NAV') per Ordinary Share +44.4%

> Share price +49.0%

> Benchmark index +57.5%\*

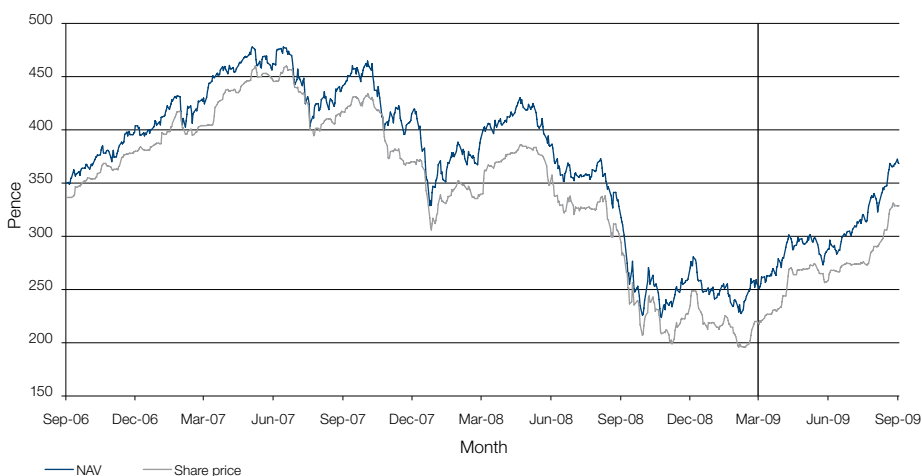
> Total assets +57.7% (£71.8 million)

\* MSCI Europe SmallCap Index (in sterling terms) until 31 May 2009. MSCI Europe SmallCap (ex UK) Index (in sterling terms) from 1 June 2009.

	As at 30 September 2009	As at 31 March 2009
NAV per Ordinary Share	371.62p	257.36p
Ordinary Share Price	329.00p	220.75p
Discount	11.5%	14.2%
Net gearing**	8.9%	(4.7)%

\*\* (Current liabilities – current assets)/net assets.

## NAV and Share Price for the three years ended 30 September 2009



# Chairman's Statement

## Highlights

- Share price +49.0%
- European SmallCap outperformed European LargeCap by 25.8%

## Performance

I am happy to report a considerable recovery in the Company's net asset value ('NAV') over the six month period ended 30 September 2009. It rose by 44.4% from 257.36p to 371.62p per share; notably it ended the period 17.2% higher than a year ago when the financial crisis erupted. Even better still, the share price rose by 49.0% to 329.00p

European stock markets performed strongly over the period, as investor risk appetite rapidly improved and evidence accumulated of an improvement in economic conditions in Europe, reflecting the stimulative fiscal and monetary policies initiated globally in late 2008. There was also an improvement in the outlook for corporate profits, with signs that the levels of profit warnings and dividend cuts had peaked.

In these circumstances the benchmark (expressed in sterling) rose by 57.5%. The best performing shares were those of companies which were either heavily indebted or whose shares and profits had significant cyclical exposure. The share prices of more stable and soundly financial companies, in which the Company typically invests, did not perform as well, having, generally speaking, not fallen as far during the financial crisis. This is the principal reason for the underperformance of our NAV over this short period of time.

Over the longer three year period ended 30 September 2009 since the appointment of Montanaro Asset Management Ltd as investment managers, the Company's NAV rose by 5.7% outperforming the benchmark which rose by 1.3% over that period.

## Realignment of Portfolio

As stated in the recent Annual Report, since the change of Manager in 2006, the Company has invested in companies quoted both within Continental Europe and in the United Kingdom. As at 31 March 2009, 17.7% of the Company's portfolio was invested in UK quoted companies.

After discussions with advisors and investors, the Board decided that it would be more appropriate for the Company to be invested in, and only in, Continental European quoted companies. During the period under review, the Manager therefore realigned the portfolio, selling all the positions in UK quoted companies. To reflect this change, with effect from 1 June 2009, the Company's benchmark changed to the MSCI Europe SmallCap (ex UK) Index (in sterling terms), which comprises only companies in Continental Europe.

## Earnings and Dividends

Revenue earnings per share were 3.39p in respect of the six month period ended 30 September 2009 (2008: 7.01p). The decrease in earnings for the period is due principally to lower levels of income from the portfolio and the absence of recoveries associated with VAT on investment management fees. Special dividends of 2.83p per share were paid in respect of VAT

related recoveries during the year ended 31 March 2009. As previously reported, those special dividends were of an exceptional nature and will therefore not be repeated in future years.

The Board has declared an unchanged interim dividend of 1.75p per Ordinary Share, payable on 8 January 2010 to shareholders on the register on 11 December 2009.

### **Borrowings**

As a reflection of our more optimistic outlook, the Company's borrowings increased from £2.5 million to £10.1 million during the period.

The Company's borrowings are represented by a flexible revolving credit facility, which enables gearing to be increased or decreased as considered appropriate.

### **Outlook**

Although there are uncertainties as to the eventual shape of the economic recovery in Europe, the outlook is more promising than it was earlier in the year. However, the level of public debt in many countries is very high by historic standards, and unemployment is likely to continue to rise. These factors may temper the recovery. Furthermore, following the very strong rally over the period, stock markets may be considered overdue for a correction.

That said, equities remain reasonably valued and SmallCap equities are not expensive relative to LargeCap equities. In the months ahead there are likely to be positive earnings surprises as well as a continued pick-up in mergers and acquisitions activity, which should support the continued outperformance of smaller companies relative to their larger counterparts.

### **A R IRVINE**

Chairman

13 November 2009

## Twenty Largest Holdings

as at 30 September 2009

Holding	Country	Sector	Value £'000	% of portfolio
Poyry	Finland	Construction and building materials	2,338	3.5
Prosegur Seguridad	Spain	Support services	2,232	3.3
Virbac	France	Pharmaceuticals and biotechnology	2,067	3.1
Andritz	Austria	Industrial engineering	2,024	3.0
Fugro	Netherlands	Oil equipment services and distribution	1,982	2.9
Azimut	Italy	Financial	1,948	2.9
AF Group	Sweden	Industrial engineering	1,911	2.8
Fuchs Petrolub	Germany	Chemicals	1,869	2.8
Indra Sistemas	Spain	Software and computer services	1,868	2.8
Skistar	Sweden	Travel and leisure	1,811	2.7
Viscofan	Spain	Food producers	1,747	2.6
GFK	Germany	Media	1,744	2.6
TGS Nopec Geophysical	Norway	Oil equipment services and distribution	1,678	2.5
Vacon	Finland	Electronic and electrical equipment	1,669	2.5
Koninklijke Vopak	Netherlands	Industrial transportation	1,621	2.4
Silic	France	Real estate	1,609	2.4
Arcadis	Netherlands	Support services	1,608	2.4
Wincor Nixdorf	Germany	Software and computer services	1,605	2.4
Neopost	France	Technological hardware and equipment	1,583	2.4
Smit International	Netherlands	Industrial transport	1,545	2.3
<b>Twenty largest holdings</b>			<b>36,459</b>	<b>54.3</b>

## Condensed Group Income Statement (unaudited)

for the six months ended 30 September 2009

Notes	Six months to 30 September 2009			Six months to 30 September 2008			Year to 31 March 2009		
	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
<b>Income</b>									
Investment income	1,136	–	1,136	1,321	–	1,321	2,005	–	2,005
Other operating income	9	–	9	145	–	145	403	–	403
	1,145	–	1,145	1,466	–	1,466	2,408	–	2,408
Gains/(losses) on investments held at fair value	–	19,599	19,599	–	(15,350)	(15,350)	–	(26,364)	(26,364)
Exchange differences	–	(372)	(372)	–	73	73	–	880	880
<b>Total income</b>	1,145	19,227	20,372	1,466	(15,277)	(13,811)	2,408	(25,484)	(23,076)
<b>Expenses</b>									
Management expenses	3 (80)	(148)	(228)	80	148	228	88	164	252
Other expenses	(272)	–	(272)	(182)	–	(182)	(433)	–	(433)
<b>Profit/(loss) before finance costs and tax</b>	793	19,079	19,872	1,364	(15,129)	(13,765)	2,063	(25,320)	(23,257)
Finance costs	(28)	(52)	(80)	(49)	(90)	(139)	(82)	(153)	(235)
<b>Net operating profit/(loss) before tax</b>	765	19,027	19,792	1,315	(15,219)	(13,904)	1,981	(25,473)	(23,492)
Tax	(204)	99	(105)	(124)	–	(124)	(494)	322	(172)
<b>Net profit/(loss)</b>	561	19,126	19,687	1,191	(15,219)	(14,028)	1,487	(25,151)	(23,664)
<b>Earnings per share</b>	4 3.39p	115.40p	118.79p	7.01p	(89.62)p	(82.61)p	8.82p	(149.16)p	(140.34)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 2009

	Notes	As at 30 September 2009 £'000	As at 30 September 2008 £'000	As at 31 March 2009 £'000
<b>Non-current assets</b>				
Investments held at fair value		67,084	51,634	40,655
<b>Current assets</b>				
Other receivables		141	619	393
Cash and cash equivalents		4,600	1,195	4,491
		4,741	1,814	4,884
<b>Total assets</b>		<b>71,825</b>	<b>53,448</b>	<b>45,539</b>
<b>Current liabilities</b>				
Other payables		(10,236)	(139)	(2,886)
<b>Total liabilities</b>		<b>(10,236)</b>	<b>(139)</b>	<b>(2,886)</b>
<b>Net assets</b>		<b>61,589</b>	<b>53,309</b>	<b>42,653</b>
<b>Capital and reserves</b>				
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		44,324	35,680	25,198
Revenue reserve		2,394	2,758	2,584
<b>Shareholders' funds</b>		<b>61,589</b>	<b>53,309</b>	<b>42,653</b>
<b>Net asset value per share</b>	6	<b>371.62p</b>	<b>316.97p</b>	<b>257.36p</b>

# Consolidated Statement of Changes in Equity (unaudited)

for the six months ended 30 September 2009

	Share Capital £'000	Share premium account £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Total £'000
<b>Balance at 1 April 2009</b>	8,724	3,935	2,212	25,198	2,584	42,653
Net loss on realisation of investments	–	–	–	(4,047)	–	(4,047)
Increase in unrealised appreciation	–	–	–	23,646	–	23,646
Exchange losses	–	–	–	(372)	–	(372)
Management fee charged to capital	–	–	–	(148)	–	(148)
Interest charged to capital	–	–	–	(52)	–	(52)
Taxation	–	–	–	99	–	99
Retained net revenue for the period	–	–	–	–	561	561
Dividends paid	–	–	–	–	(751)	(751)
<b>Balance at 30 September 2009</b>	<b>8,724</b>	<b>3,935</b>	<b>2,212</b>	<b>44,324</b>	<b>2,394</b>	<b>61,589</b>

	Share Capital £'000	Share premium account £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Total £'000
<b>Balance at 1 April 2008</b>	8,724	3,935	2,212	52,238	1,952	69,061
Net loss on realisation of investments	–	–	–	(1,091)	–	(1,091)
Decrease in unrealised appreciation	–	–	–	(14,259)	–	(14,259)
Exchange gains	–	–	–	73	–	73
Management fee charged to capital	–	–	–	148	–	148
Interest charged to capital	–	–	–	(90)	–	(90)
Retained net revenue for the period	–	–	–	–	1,191	1,191
Ordinary Shares purchased to be held in treasury	–	–	–	(1,339)	–	(1,339)
Dividends paid	–	–	–	–	(385)	(385)
<b>Balance at 30 September 2008</b>	<b>8,724</b>	<b>3,935</b>	<b>2,212</b>	<b>35,680</b>	<b>2,758</b>	<b>53,309</b>

	Share Capital £'000	Share premium account £'000	Capital redemption reserve £'000	Capital reserve £'000	Revenue reserve £'000	Total £'000
<b>Balance at 1 April 2008</b>	8,724	3,935	2,212	52,238	1,952	69,061
Net loss on realisation of investments	–	–	–	(4,698)	–	(4,698)
Decrease in unrealised appreciation	–	–	–	(21,666)	–	(21,666)
Exchange gains	–	–	–	880	–	880
Management fee charged to capital	–	–	–	164	–	164
Interest charged to capital	–	–	–	(153)	–	(153)
Taxation	–	–	–	322	–	322
Retained net revenue for the year	–	–	–	–	1,487	1,487
Ordinary Shares purchased to be held in treasury	–	–	–	(1,889)	–	(1,889)
Dividends paid	–	–	–	–	(855)	(855)
<b>Balance at 31 March 2009</b>	<b>8,724</b>	<b>3,935</b>	<b>2,212</b>	<b>25,198</b>	<b>2,584</b>	<b>42,653</b>

# Condensed Group Statement of Cash Flows (unaudited)

for the six months ended 30 September 2009

	Six months to 30 September 2009 £'000	Six months to 30 September 2008 £'000	Year to 31 March 2009 £'000
Net cash from operating activities	582	831	2,000
Cash flows from investing activities	(6,804)	567	508
Cash flows from financing activities	6,206	(12,512)	(10,990)
	(16)	(11,114)	(8,482)
Exchange losses	125	73	737
Increase/(decrease) in cash and cash equivalents	109	(11,041)	(7,745)
<b>Reconciliation of net operating profit/(loss) before finance costs and tax to net cash flow from operating activities</b>			
Net operating profit/(loss) before finance costs and tax	19,872	(13,765)	(23,257)
(Gains)/losses on investments held at fair value	(19,599)	15,350	26,364
Exchange differences	372	(73)	(880)
Withholding tax	(105)	(124)	(172)
Changes in working capital and other non-cash items	42	(557)	(55)
<b>Net cash from operating activities</b>	<b>582</b>	<b>831</b>	<b>2,000</b>

# 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 2009. 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' and give a true and fair view of the assets, liabilities, financial position and profit of the Company;
- 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

13 November 2009

## Notes to the Accounts

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 2009.
2. Earnings for the first six months should not be taken as a guide to the results for the full year.
3. Management Expenses

	Six months to 30 September 2009			Six months to 30 September 2008			Year ended 31 March 2009		
	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
Investment management fee	80	148	228	99	185	284	163	303	466
VAT recoverable	-	-	-	(179)	(333)	(512)	(251)	(467)	(718)
	<b>80</b>	<b>148</b>	<b>228</b>	<b>(80)</b>	<b>(148)</b>	<b>(228)</b>	<b>(88)</b>	<b>(164)</b>	<b>(252)</b>

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 was in relation to agreement having been reached with HMRC for prior years. This was recognised within the Income Statement during the year ended 31 March 2009 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 16,573,260 Ordinary Shares in issue during the period (year ended 31 March 2009: 16,861,863; six months ended 30 September 2008: 16,981,391), excluding those shares brought back and held in treasury.
5. The interim dividend of 1.75p per Ordinary Share will be paid on 8 January 2010 to shareholders on the register on 11 December 2009.

6. The NAV per Ordinary Share is based on 16,573,260 Ordinary Shares in issue at the end of the period (31 March 2009: 16,573,260; 30 September 2008: 16,818,260), 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 434 of the Companies Act 2006 and are unaudited. The information for the year ended 31 March 2009 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 2009 have been reported on by the Company's Auditors or delivered to the Registrar of Companies.

# Directors and Advisers

## Directors

A R Irvine (Chairman)  
R B M Graham  
R A Hammond-Chambers  
J Lumsden  
R M Martin

## Manager

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## Company Secretary, Administrator and Registered Office

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Fax: 0131 225 2375

## Registrars

**EQUINITI LIMITED**  
Aspect House  
Spencer Road  
Lancing  
West Sussex BN99 6DA

Registrars' Shareholder Helpline\*  
Tel: 0871 384 2030

Registrars' Broker Helpline\*  
Tel: 0906 559 6025

## Stockbroker

**CENKOS SECURITIES LIMITED**  
6.7.8 Tokenhouse Yard  
London EC2R 7AS

## Financial Adviser

**INTELLI CORPORATE FINANCE LIMITED**  
7th Floor  
Cardinal Place  
80 Victoria Street  
London SW1E 5JL

## Custodian

**JP MORGAN CHASE BANK**  
125 London Wall  
London EC2Y 5AJ

## Auditor

**ERNST & YOUNG LLP**  
Ten George Street  
Edinburgh EH2 2DZ

## Solicitors

**DICKSON MINTO W.S.**  
16 Charlotte Square  
Edinburgh EH2 4DF

## Montanaro European Smaller Companies Trust plc

Registered in Scotland No. SC074677

An investment company as defined under  
Section 833 of the Companies Act 2006.

\*Calls to these numbers are charged  
at 8p per minute from a BT landline.  
Other telephony providers' costs may vary.



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