MONTANARO
ASSET MANAGEMENT

MESCT

Montanaro European Smaller Companies Trust

Quarterly review – Q2 2025

Q2 Returns – European "SmallCap Effect" returns:

- European SmallCap outperformed LargeCap by c.6% in Continental Europe during Q2 (EUR)
- Strong gains across the Continent, highlighting a broadening recovery

Drivers / Catalysts:

- SmallCap rebound supported by rate cuts from ECB and BoE, plus £369m inflows into European equities in May – the strongest since June 2024
- NATO's 5% defence spending pledge adds tailwind to Defence stocks

Earnings / Valuations:

- European SmallCap valuations remain compelling with P/E discounts vs. LargeCap still near 20-year lows
- Relative earnings momentum stable

The Investment Trust sector has experienced a period of challenge and turbulence this year, with activist investors challenging the status quo across the industry. We remain as committed as ever to ensuring that the Montanaro European Smaller Companies Trust ("MESCT") offers value and an attractive opportunity to shareholders. To this end, the Board recently announced three strategic initiatives that we would like to remind our shareholders of here:

1. **Regular tender offers** – shareholders will have the opportunity twice a year to tender shares at a 5% discount to NAV, helping to improve liquidity while considering the underlying portfolio's constraints. The first tender is expected in Autumn 2025. Each tender will be capped at 5% of the shares in issue.

2. **Active share buyback policy** – a more proactive buy-back approach will target a single-digit discount to NAV in normal market circumstances, aiming to reduce discount and share price volatility while enhancing NAV accretion for shareholders.

3. **Reduced management fees** – the Board agreed with the Manager to reduce management fees for the second time in four years, with the ongoing charges figure expected to remain below 1%. The new fee structure will take effect from 1 April 2025.

The first half of the calendar year was a strong period for MESCT. A welcome resurgence of the "SmallCap Effect" in Continental Europe was a further sign that investors continue to diversify away from areas of the market where many have had high exposures, most notably US LargeCap. After so long in the investment wilderness, it was heartening – and reassuring – to see smaller companies once again outperform, reflecting many of the dynamics that make SmallCap investing compelling: the inherent inefficiencies from limited research coverage, potential for operating leverage, greater prospects for growth, increased M&A activity and the agility of smaller businesses, allowing them to respond swiftly to changing economic conditions.

One of MESCT's key advantages lies in its closed-ended structure, which enables the Trust to invest confidently in smaller, less liquid companies that are often inaccessible to open-ended funds. This ability to own truly niche businesses has been instrumental in the Trust's success, allowing us to capture the growth potential of unique companies that are overlooked by larger investors. Our disciplined focus on profitability, quality and operational strength remains central to our strategy, helping the Trust navigate challenging periods even when factors like country or currency dynamics create temporary headwinds.

Portfolio

During the quarter, the NAV total return of MESCT was +17.35% in GBP, an outperformance of c.5% relative to the MSCI Europe SmallCap (ex UK) Index.

The **strongest contributors** during the quarter were:

- **Kitron –** the Norwegian electronics manufacturing services provider has benefited from increased exposure to the defence sector, which has driven a stock re-rating. The company is seen as the best-positioned European EMS player and has announced multiple defence contract wins, building a substantial order book.

- **Plejd –** the Swedish developer of smart lighting and home automation solutions continued its significant growth trajectory, driven by new product launches and geographical expansion.

- **Belimo –** the Swiss manufacturer of HVAC control systems and actuators upgraded its 2025 guidance for revenue growth and EBIT margin, supported by strong momentum in its datacentre offering.

The **weakest contributors** during the quarter were:

- **NCAB** – the distributor of printed circuit boards was impacted by tariff uncertainty, given the PCB industry's reliance on products sourced from China. Additionally, weakness across its end markets continued to weigh on performance.

- **AAK** – the producer of high-value-added vegetable oils and fats fell after reporting a quarter of declining volumes.

- **IMCD** – the leading global specialty chemicals distributor continued to drift despite posting reassuring Q1 results.

Outlook

We remain optimistic about the outlook for European SmallCap, particularly as quality and growth factors have stabilised after being persistent headwinds earlier in the year. The sustained recovery supports our conviction and highlights the potential for European SmallCap to play a growing role in diversified portfolios, particularly as valuations relative to both LargeCap and US markets remain attractive.

Companies like **Plejd**, a Swedish innovator in smart lighting systems, exemplify the type of niche, high-quality business we believe can continue to deliver attractive long-term returns. Plejd's unique hardware and software ecosystem enables seamless, app-based control of lighting in homes and businesses, and the company continues to expand its market share in the Nordics thanks to strong brand recognition and a loyal installer base. Given the significant run-up in its share price, we have trimmed our position to manage risk while remaining confident in its long term fundamentals.

Similarly, **Dynavox**, a leading provider of assistive technology devices for individuals with speech and communication difficulties, demonstrates the Portfolio's exposure to differentiated growth stories underpinned by strong social impact and defensible market positions. Dynavox's specialised products address an underserved and essential need, giving the company a resilient demand profile.

At the same time, we are actively exploring new opportunities to diversify the portfolio with companies that align with our emphasis on quality, profitability, and strong market positions. We are particularly focused on businesses operating in structurally growing markets, where disciplined management teams and sustainable competitive advantages can drive long-term value creation. Adding such positions enhance the portfolio's resilience and support our objective of delivering attractive, risk-adjusted returns for shareholders.

We are also mindful of the need to reduce exposure to stocks that have become overly expensive relative to their fundamentals. For example, **Belimo**, a Swiss manufacturer of energy-efficient HVAC control devices, has delivered excellent results but now trades at valuations that warrant a disciplined approach.

In the coming months, we plan to continue reviewing holdings systematically, ensuring we maintain a balanced Portfolio positioned to benefit from the ongoing recovery in European

SmallCap. As ever, our closed-ended structure remains a key advantage. We believe the flexibility offered, combined with our unwavering focus on profitability, quality and operational excellence, leaves MESCT well placed to deliver attractive, risk-adjusted returns as market dynamics evolve.

George Cooke
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