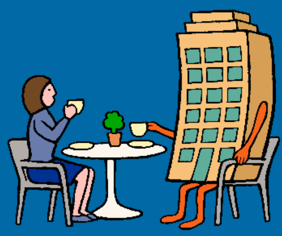
MONTANARO

ASSET MANAGEMENT

MUSCIT

Montanaro UK Smaller Companies Investment Trust

Quarterly review – Q2 2025



Q2 Returns – SmallCap rebounds:

- UK SmallCap had a strong Q2 (reversing Q1) but is still lagging LargeCap by 2% YTD
- **Numis SmallCap (ex-IC) Index +14% in Q2, <u>outperforming</u> LargeCap by a quite remarkable +11.5%**
- Q2 rally offsets earlier underperformance
- Investor sentiment improving but outflows continue

Drivers / catalysts:

- BoE's first rate cut and renewed M&A interest in undervalued UK assets
- UK macro data stabilising, although political uncertainty and inflation persist

Valuations / earnings:

- SmallCap valuations remain deeply discounted vs. LargeCap and global peers
- Earnings updates mixed, with cost pressures and weak end-market demand weighing on some names

The investment trust sector in the UK has faced a period of significant challenge and volatility this year, with persistent discounts and heightened scrutiny from activist shareholders such as SABA driving change across the industry. Against this backdrop, we remain fully committed to delivering value for shareholders in the Montanaro UK

Smaller Companies Investment Trust ("MUSCIT").

The Board has taken decisive action to support the Trust's share rating and improve liquidity. MUSCIT's buyback authority has been renewed, ensuring we retain the flexibility to continue our active share buyback policy with a target of maintaining the discount to NAV within single digits under normal market conditions. MUSCIT has repurchased over 23 million shares. SABA is no longer a shareholder.

We actively engage with our shareholders and invite you to listen to the recent webinar. I also made my first (and last) podcast which you can find here.

Portfolio

During the quarter, MUSCIT's NAV gained by 10% compared to the benchmark which rose by +14% (inclusive of AIM + 14%].

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

- **Tristel** – the provider of disinfection products for invasive medical devices, gained after securing its second US regulatory approval, supporting its international growth ambitions.

- **BOKU** – the provider of mobile payment and identity verification solutions, continued to deliver strong growth, supported by new client wins such as Disney that bolstered its revenue trajectory.

- **discoverIE** – the designer and manufacturer of customised electronics for industrial applications, saw sentiment turn positive following another solid set of results, with upgraded margin guidance and an organically double-digit increase in the Q4 order book.

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

- **Bloomsbury** – the publisher well known for fiction (such as Harry Potter and Sarah J Maas), non-fiction and academic titles declined due to pressures in the US academic market.

- **Gamma Communications** – the provider of unified communication and cloud services, softened as a weakening macroeconomic backdrop began to impact its small and medium-sized business client base.

- **JTC** – the provider of fund, corporate and private client services, drifted lower as investors grew concerned about the impact of heightened macro uncertainty on corporate activity.

Manager comment

We have been investing in UK quoted smaller companies for some time now, even before the launch of MUSCIT in March 1995. We have had the privilege of meeting many outstanding companies and management teams. Although we are genuine long-term investors, we will take profits if we anticipate challenging times ahead or particularly if management changes. We will also revisit the investment case as things change. Hill & Smith is one such example.

Back in 2006, Richard Dyett of Investec arranged for us to meet the charismatic CEO (later Chairman in 2007) David Grove of Hill & Smith PLC. Richard also acted as adviser to Lynx Holdings plc where I served as a non-executive director (taken over by Skandia in 2001) working with the CEO Richard Last who later became Chairman of

Gamma Communications. It is a small world.

David came to our office on numerous occasions and got us excited about the opportunities for their Flexbeam motorway crash barriers and the recent award of a contract to widen the M1, as well as a strong order book from Highways Agency. They had acquired Ash & Lacey in 2000, a company we knew well. We did not need much persuading and first invested on 6 November 2006.

He received an OBE for services to business in 2009; was a former president of the Birmingham Chamber of Commerce; and was the High Sheriff of the West Midlands when he sadly passed away unexpectedly at the age of 63 in November 2011. We ceased being shareholders having made a positive (albeit modest) profit.

Wind the clock forward almost 15 years, we decided to revisit the company to see how it has evolved. We like companies that have been around a long time so that we can see how they have performed through various cycles. Founded as Edward Hill and Henry Smith in the West Midlands in 1824, last year they celebrated their 200th anniversary (!).

Over that time, they have provided fencing to Queen Victoria's country estates; in the First World War they provided iron screws to make barbed-wire defences; they then returned to fencing and bridges, helping to make the Sydney Harbour Bridge; in the Second World War, they made steel structures for bomb shelters and anti-tank defences; and in 1998, David Grove joined and changed the focus to infrastructure. They were listed on the London Stock Exchange in 1996 valued at £600,000.

We contacted the investor relations contact of the company who is Chris Dyett, none other than the son of Richard Dyett, who had followed in his father's footsteps starting at Investec in 2003. He left in 2018 to work for a range of companies as an investor relations professional where a full-time role isn't needed. He has known Hill & Smith for 20 years.

Hill & Smith is now a much larger business, operating as a portfolio of infrastructure-focused businesses across three main divisions. The first, US Engineered Solutions, includes Creative Composites Group which designs and manufactures advanced composites used in infrastructure applications like telegraph poles that last longer and are resistant to rot, pests and weather damage - offering significant advantages over traditional wood. A story that captures the imagination is that wooden poles are vulnerable to damage by woodpeckers unlike composite poles which are also fire resistant (the recent LA fires come to mind). Did you know that (I didn't)?

This division also produces structural steel for electricity distribution networks, including pylons and substations, supporting America's ageing grid and the transition to cleaner energy. Despite a recent setback with its US road safety acquisition, margins in this segment remain healthy at around 18%, underscoring the value-add of their specialised solutions.

The second division, Galvanizing Services, provides corrosion protection for steel components. Unlike paint coatings that require frequent maintenance every 5 - 15 years, galvanised steel can last 70 - 100 years, making it a preferred solution for long-life infrastructure. Galvanising is a highly localised business as steel is costly to transport over long distances, which limits competition and allows Hill & Smith to sustain strong margins - exceeding 30% in the US - driven by tight regional dynamics.

The third division focuses on UK roads, supplying temporary and permanent safety barriers and other roadside equipment. While recent investments in this segment have disappointed due to delayed UK infrastructure spending, it still provides a stable, if lower-margin, revenue stream.

What makes Hill & Smith compelling is its decentralised structure, empowering local management teams to drive pricing, client relationships and even acquisitions, ensuring agility and deep market insight. Over 75% of revenues are tied to US and UK infrastructure - markets benefiting from renewed investment cycles, especially with the US Infrastructure Investment and Jobs Act ramping up spending on roads, utilities, and grid upgrades.

During the quarter, the Trust initiated a small position in Hill & Smith which has grown and now has a market capitalisation of around £1.5 billion. It reflects our conviction in the company's unique exposure to essential infrastructure spend, particularly in the US, and its ability to compound earnings through a decentralised operating model. The investment provides MUSCIT with differentiated exposure to US infrastructure at attractive valuations, something largely missing from the current portfolio.

We have long argued that investing in UK SmallCap is all about people. As you get older, your network gets wider as a result of meeting so many management teams. Just as my son Adam helps me today having joined Montanaro a couple of years ago, so I smiled to see Chris has followed his father Richard Dyett into the City. In talking about the current management team at Hill & Smith, we talked about Hooman Jaavi, hired under Paul Simmons as one of three divisional presidents. He decided to move on and joined Porvair as Chief Executive in September 2024. Hooman came to our office just last week.

Outlook

We have all become somewhat tired of hearing how unloved the UK equity market is. It is worth remembering that within the portfolio are many vibrant, entrepreneurial businesses that are not well-known - the kind of “hidden gems” MUSCIT that has a proven track record of uncovering. Our long-term multi-baggers include companies such as Dechra (5,385% total return over 23 years); NCC Group (440% over 20 years); and Clarksons (560% over 15 years). These are but a few examples.

As we wait for a more supportive backdrop for growth, MUSCIT’s dividend policy provides an attractive balance for investors. Since December 2024, MUSCIT has paid over 6% per annum, distributed quarterly based on 1.5% of the net asset value (NAV) - a policy intended to reward shareholders while they wait for capital appreciation. These dividends can be paid both from income and capital reserves without needing to sell investments. Current reserves could support payouts for over 28 years even with no capital or income growth. As major shareholders ourselves, we welcome the income as we look forward to capital growth. As this second quarter shows, this can be significant.

Charles Montanaro
July 2025

The views expressed in this article are those of the author at the date of publication and not necessarily those of Montanaro Asset Management Ltd. The information contained in this document is intended for the use of professional and institutional investors only. It is for background purposes only, is not to be relied upon by any recipient, and is subject to material updating, revision and amendment and no representation or warranty, express or implied, is made, and no liability whatsoever is accepted in relation thereto. This memorandum does not constitute investment advice, offer, invitation, solicitation, or recommendation to issue, acquire, sell or arrange any transaction in any securities. References to the outlook for markets are intended simply to help investors with their thinking about markets and the multiple possible outcomes. Investors should always consult their advisers before investing. The information and opinions contained in this article are subject to change without notice.

Montanaro Asset Management Ltd | 53 Threadneedle Street | London EC2R 8AR

T: +44 20 7448 8600 www.montanaro.co.uk