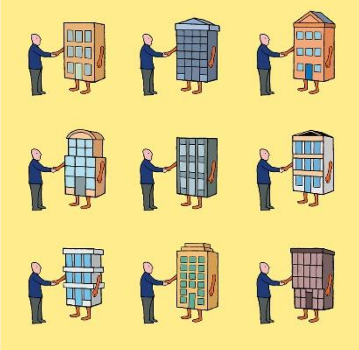
MONTANARO

ASSET MANAGEMENT

The UK Income Strategy

- Montanaro UK Income Fund (Dublin)
- WS Montanaro UK Income Fund (UK)

Quarterly review – Q4 2025



2025 was a great year for the UK market:

- ➢ The FTSE All-Share rose 24% in 2025, its best year since 2009, driven by LargeCap and Value, particularly Financials
- ➢ Material outperformance vs the MSCI World or NASDAQ indices in GBP terms (both only +13% in 2025)

But SmallCap, Quality and Growth remain deeply out of favour:

- ➢ SmallCap trailed LargeCap by 12% for the year & 5% in Q4*
- ➢ SmallCap Growth recorded a fifth consecutive full year of underperformance versus Value in the UK – and trailed 3% in Q4**
- ➢ Quality lagged the broader UK market by 15% in 2025 – its worst year in over a decade – and by 4% in Q4***

Encouraging economic backdrop:

- ➢ Inflation continued to ease during Q4, with a further rate cut in December
- ➢ Late-Nov Budget could be clearing event; consumer confidence now at highest level in 16 months

Note: All returns are Total Returns in GBP.
** based on the MSCI UK SmallCap vs LargeCap indices ** based on MSCI UK SmallCap Growth vs MSCI UK SmallCap Value*
**** based on MSCI UK Quality vs MSCI UK Index*

UK equities delivered a mixed backdrop over 2025, with headline index performance masking a challenging environment for SmallCap and Quality-focused strategies in particular. While parts of the market were supported by strong factor and sector tailwinds –

notably banks, defence-related names, commodity-linked stocks, low-margin contract services business and gambling companies – these are areas where we have no exposure due to concerns around balance-sheet risk, earnings volatility, capital intensity or sustainability of cash flows. As a result, dispersion within the FTSE 250 remained high, and style effects dominated returns.

Against this backdrop, 2025 was a difficult year for the Fund. The combination of extreme style dispersion, narrow sector market leadership and a prolonged preference for cyclical and lower-quality exposures created a challenging backdrop for portfolios built around durable growth, high returns on capital and balance sheet strength. While share price performance was disappointing over the period, the underlying businesses we own continued to execute their strategies and perform well operationally. To illustrate this, of our companies that reported in Q4, roughly 85% beat consensus expectations. The figure is similar when looking at the full year. Income generation also remained robust, with the Fund's 2025 distribution growing by c. 12% over 2024.

As style headwinds continued throughout Q4, the gap between price action and underlying business quality and performance continues to widen. The elevated levels of M&A in the UK market show that some are noticing and taking advantage of this exceptional situation. While actively managing the portfolio to recycle capital into the most attractive opportunities, we remain true to our "Quality-Growth-Income" investment approach. We remain confident that the excellent fundamentals of our holdings will be rewarded in share prices.

Performance & Portfolio

During the quarter, the NAV of the Sterling seed share class of the **Dublin domiciled Fund** rose by 1.0%, compared to a benchmark return (IA All Companies Sector) of 3.9%.

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

- **Games Workshop** – the creator of tabletop miniature games and fantasy products advanced on a better-than-expected trading update, with core revenues growing by over 15 percent.

- **Man Group** – the alternative investment management company advanced as improved performance across its strategies lifted expectations for performance fee generation.

- **Big Yellow** – the provider of self-storage solutions rose following bid speculation, although much of the initial gain was later reversed after the board terminated discussions. The Fund had taken some profits after the initial positive share price reaction.

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

- **Telecom Plus** – the provider of bundled utility services lagged as changes in industry dynamics shifted profit weighting more towards the second half, prompting a de-rating despite no changes to guidance.

- **Baltic Classifieds** – the operator of online classified portals in the Baltic region declined amid industry-wide concerns that generative AI could disrupt classifieds models, compounded by slower vehicle sales in Estonia.

- **B&M European Value Retail** – the everyday low-cost retailer with operations in the UK and France weakened following issues around freight cost assumptions and higher-than-expected UK business rates.

Looking at 2025 overall, we saw strength in some global industrials (e.g. Diploma, Smiths, IMI, Renishaw) and Financials (both insurers like Hiscox and Admiral (since sold due to size), as well as asset & wealth managers like Jupiter and Rathbones). Water companies and REITs also did well as rate expectations continue to decline. Games Workshop was a standout performer throughout the year, and the recommended acquisition of JTC also contributed strongly.

In contrast, UK retail exposure was challenged by the 2024 Budget (e.g. Greggs (since sold), B&M, Hilton Food Group). Staffing (SThree, FDM (since sold)) remains in its longest downturn since 2000, although the recent update by SThree was encouraging. Some perceived tariff and/or AI losers also suffered (e.g. Bloomsbury, Baltic Classifieds, 4imprint).

Engagement & ESG

Macfarlane Group – UK protective packaging distributor

We engaged with Macfarlane following the fatal accident at its Pitreavie corrugated packaging facility to understand the circumstances and actions taken. Operations were suspended immediately, with well-being support offered to affected employees. At the time of engagement, a phased restart was under way, with safety and staff welfare prioritised. The company was cooperating with Police Scotland and the Health and Safety Executive, with investigations ongoing. Management noted that the site was modern, well maintained and operated under established safety procedures, with any further actions to be determined following the conclusion of the investigation. Following the incident, we sold our holding in Macfarlane to reflect heightened governance and operational risk.

Volution Group – UK manufacturer of ventilation and indoor air quality solutions

We engaged with Volution to discuss its approach to fair pay and living wage considerations. Management highlighted recent increases in statutory minimum wage levels and outlined the company's “mind the gap” approach, which seeks to preserve pay differentials above the minimum. Volution is also developing a pay-for-skills framework to strengthen alignment between pay and capability. The company welcomed continued dialogue and we will continue to engage with the company.

Outlook

As we look ahead to 2026, we are increasingly constructive on the opportunity for the Fund. While 2025 was dominated by macro narratives and style rotations, the underlying fundamentals of many of the businesses we own remain intact – and in many cases have strengthened. Earnings visibility, balance-sheet resilience and long-term structural growth drivers have not disappeared; they have simply been overlooked.

Encouragingly, the UK economic indicators are showing some signs of life. Inflation continues to ease and the base rate is on a gentle glide path downwards. Since the Budget, consumer sentiment has reached a 16-month high and PMIs have ticked up. This all should translate into stronger growth in the UK, which should support the performance of domestically-focused UK SMidCap stocks in 2026.

We expect the drivers that dominated 2025 to gradually lose influence. The last few years have seen stark underperformance of SmallCap against LargeCap, of Growth against Value and of Quality against the market, compounded by the narrow sector market leadership of 2025 in areas we avoid. History suggests that periods of such extremes rarely persist. The reversal could be sharp, as it has been in the past.

In the meantime, we are staying close to our companies, speaking to management teams and visiting their manufacturing sites. Indeed, in the second half of 2025 alone, we had c. 60 meetings with companies in the Fund (of which there are only c. 50), had a further c. 30 meetings with companies on our watchlist and conducted four site visits.

The message from our companies is clear: they are positive and in growth mode. Investments to drive future growth continue apace, both in terms of manufacturing expansion & factory automation (e.g. Volution, Games Workshop etc), as well as product innovation and development (e.g. Sage, Renishaw, AG Barr etc). They are also driving internal efficiencies (including through digital transformation) to improve margins (e.g. SThree, MONY etc). Selective M&A is continuing, with synergies being realised (e.g. DiscoverIE, XPS Pensions, Jupiter etc). Our companies continue to take share (e.g. Howden Joinery, Integrafin, Clarkson etc) and are demonstrating strong pricing power (e.g. Sage, LondonMetric Property, Bloomsbury etc). Tariffs have in general been navigated well, and any disruption is abating. Industrial de-stocking is ending, which bodes well for 2026 (e.g. DiscoverIE, XP Power etc).

We remained active but disciplined, and focused on what we can control. We continue to apply our rigorous investment process, focusing on high-quality businesses with sustainable returns and the ability to compound capital over time.

Guido Dacie-Lombardo
January 2026

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

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