



Montanaro European Smaller Companies

Investment companies | Annual overview | 23 August 2024

Primed for ignition

With its dedication to high-quality, high-growth companies, Montanaro European Smaller Companies (MTE) has fallen awry of recent market trends. MTE's manager, George Cooke, notes that the market is currently favouring low-quality, low-value companies. This may be due either to improving sentiment around Europe's economy (having seemingly dodged a recession) or the initial effect of falling interest rates.

These are macro-level events, however, and George is more focused on stock picking. He believes such short-term volatility can create opportunities to pick up positions at attractive valuations. We believe that this not only applies to MTE's underlying holdings, but also to the trust itself. Having previously traded at a premium, MTE derated heavily during 2022 as interest rates rose and economic uncertainty increased. Whilst nerves have settled a little, the current 13.0% discount remains wide relative to history and offers an attractive potential upside. Irrespective of the short-term picture, MTE has still outperformed its peers and benchmark over the long term, and its holdings have shown few signs of diminishing quality or revenue growth in aggregate.

Continental European smaller companies

MTE aims to achieve capital growth by investing principally in Continental European quoted smaller companies. The benchmark index is the MSCI Europe ex UK Small Cap Index (in sterling terms).

Year ended	Share price total return	NAV total return	MSCI Europe ex UK small cap TR. (%)	MSCI Europe ex UK TR
31/07/2020	17.9	16.3	0.6	(3.4)
31/07/2021	55.5	48.2	38.3	25.6
31/07/2022	(29.4)	(19.7)	(14.1)	(7.3)
31/07/2023	(1.9)	0.3	5.3	15.1
31/07/2024	7.4	6.3	8.7	10.1

Source: Morningstar, Marten & Co

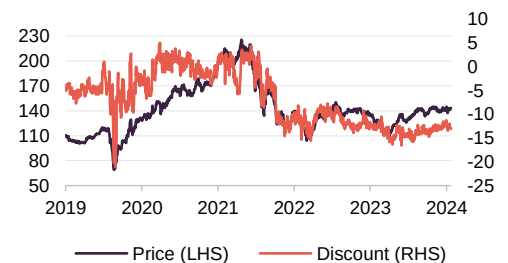
Sector

European smaller companies

Ticker	MTE LN
Base currency	GBP
Price	143.5p
NAV	165.0p
Premium/(discount)	(13.0%)
Yield	0.8%

Share price and discount

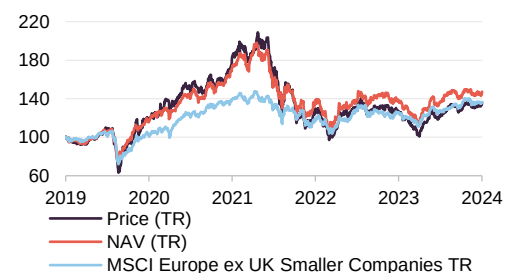
Time period 31/07/2019 to 21/08/2024



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/07/2019 to 31/07/2024



Source: Morningstar, Marten & Co



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Domicile	Scotland
Inception date	4 September 2006
Manager	George Cooke
Market cap	275m
Shares outstanding (exc. treasury shares)	189.4m
Daily vol. (1-yr. avg.)	282,845 shares
Net gearing	1.9%

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More information is available from the manager's website www.montanaro.co.uk

MAML believes that it has the largest and most experienced team in Europe

Fund profile

MTE aims to achieve capital growth by investing principally in smaller quoted, Continental European companies (those within the European Union, Norway and Switzerland), but is not restricted from investing in smaller companies quoted on other European stock exchanges. The benchmark index is the MSCI Europe ex UK Small Cap Index (in sterling terms).

The original company dates back to 1981, but Montanaro Asset Management Limited (MAML) took on the management of the trust in September 2006 and the European small-cap investment approach dates from then.

The manager

MAML was established in 1991 and is chaired and 95% owned by Charles Montanaro and family. Fund manager Mark Rogers owns 5%. However, the wider team has options over about half of the equity. The CEO is Cédric Durant des Aulnois, the lead manager on MTE is George Cooke (who is also head of investments at MAML), and Stefan Fischerfeier acts as George's back-up. Charles, Mark and George are all members of the investment committee, which also includes Alex Magni (see page 22 for more detail on the team). MAML also owns 5% of the outstanding shares of MTE, having increased its holding in July 2024.

They are supported by what MAML believes is the largest and most experienced team in Europe, specialising in researching and investing in quoted small- and mid-cap companies. The team is multi-lingual and multi-national. All but two of the fund managers also have research responsibilities.

Montanaro's managers believe that the company is best served by operating with a maximum of 40 staff members, as to preserve the advantages of a boutique outfit. With 38 current staff members (17 of whom are analysts and fund managers), Montanaro is now effectively maturing as a boutique and as such will continue to devote its resources towards its current strategies, as opposed to aggressively growing the company for example.

In addition to MTE, the team manages a range of funds focused on UK and European equities, the Montanaro Better World Fund (an open-ended fund investing in small- and mid-cap companies supporting the UN Sustainable Development Goals), and two global equity funds. MAML has about £3.3bn of assets under management.

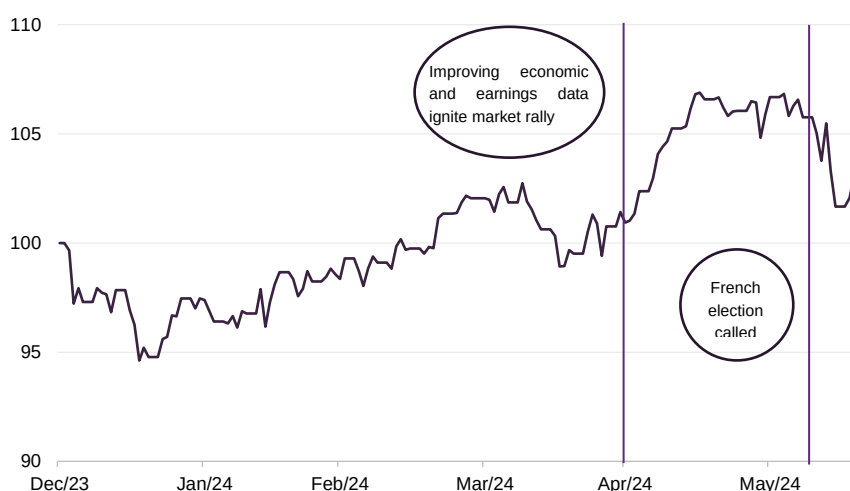
Market update

George typically pays little attention to the day-to-day trends of European economics or politics, preferring instead to let his companies drive performance. He says that, over the longer term, the operational performance of MTE's underlying holdings tends to be little affected by European macro trends, although he acknowledges that the wider market and share price volatility is often impacted in the near term. This has been very clear since interest rates began to rise in 2022

and, while inflation has been edging down this year (see below), markets have still been challenging against a backdrop of higher political risk and lower inflation expectations, but stronger economic data.

As can be seen in Figure 1, the market volatility associated with the first round of the French election offset a large portion of the gains made from the softening of monetary policy expectations.

Figure 1: MSCI Europe ex UK small-cap performance



Source: Morningstar

Inflation – much better controlled

Since our last note, there has been a clear shift in global inflation expectations, with the developed world experiencing its anticipated "soft landing." Major economies, including those in Europe, have largely succeeded in controlling inflation without causing substantial economic decline. Europe's GDP growth has edged forward, with the Eurozone reporting an annualised quarterly growth rate of 0.1% in Q3 2023, 0.2% in Q4 2023, and 0.4% in Q1 2024. However, growth rates varied, with Germany narrowly avoiding a technical recession after experiencing a GDP decline in Q4 2023.

Inflation has been moving downwards, Eurozone inflation slowed to 2.5% in June and seems to be hovering around this level. While this remains above the ECB's 2% target, mainly due to high services inflation, the central bank cut its interest rate from 4.0% to 3.75% in June in expectation of further disinflation over coming months. Falling interest rates could lead to a rerating in the kinds of growth stocks that MTE holds.

In July, the ECB kept rates at 3.75%. However, Christine Lagarde, head of the ECB, stated she is still "wide open" to a September interest rate cut, and downplayed concerns about "sticky" inflation.

Going to the polls

An unexpected French election has rattled European markets

In June, French President Emmanuel Macron shocked markets by announcing a snap parliamentary election, with the first round held on June 30. This sudden announcement followed his centrist party, Renaissance, being soundly defeated by the far-right Rassemblement National in the recent European Parliament election. This unexpected news unsettled European markets (as is illustrated in Figure 1), with the French market retreating sharply; the CAC 40 dropped 6% in the week following the announcement.

However, in a surprise about-turn, the second round of voting saw an upsurge in support for the left, and it was ultimately a coalition of left-wing parties that formed the majority in France's new parliament. Although, with no clear majority, the French Parliament is currently at a political standstill under a caretaker government, and we will need to wait until President Macron decides to name a new Prime Minister.

This result is likely a double-edged sword for investors. Whilst a fractured parliament will prevent the passage of radical policies, it also introduces significant uncertainty regarding policy direction. As a result, French markets have remained relatively stagnant since the election results, down 1% in July, with investors likely waiting for greater clarity.

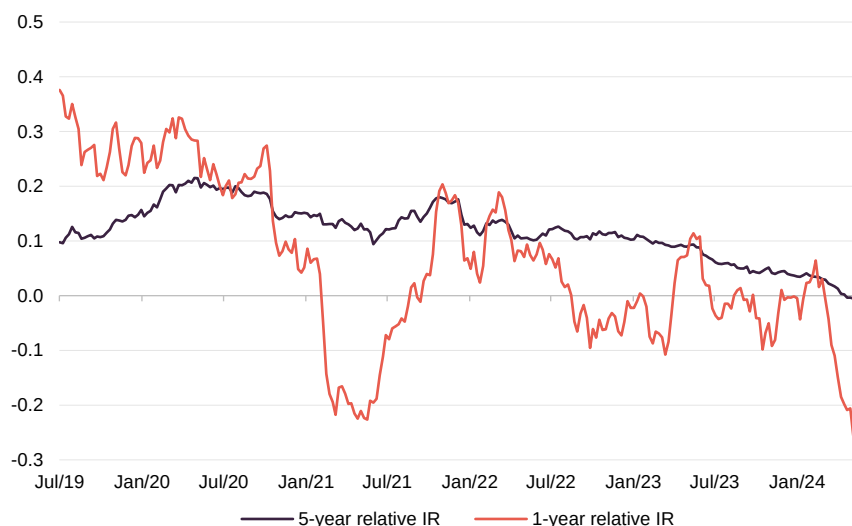
Buying the dip

The market's recent aversion to quality-growth stocks has created an opportunity

Figure 2 shows MTE's information ratio (IR) – a figure that indicates the value-add of a manager (specifically the relative returns of a strategy versus its benchmark, divided by the volatility of said relative return) relative to those of its peers, calculated for information ratios over one-, three- and five-year rolling periods (the data has been sampled weekly). While the description may sound complex, what each individual data point shows is how much more (or less) value George added as an investment manager relative to that of his average peer, sampled over different time frames. Two interesting features of this chart are the higher volatility in the one-year relative figure as well as its tendency to mean revert towards the three- and five-year numbers.

Inspection of Figure 2 shows a sharp widening of the one-year relative figure. The last time that this happened, MTE experienced an equally sharp recovery. We think that this could signal a potential buying opportunity for MTE.

Figure 2: MTE information ratio relative to peers



Source: Morningstar. Information Ratio calculated in respect to the MSCI Europe ex UK Small Cap Index

We think that the sudden deterioration of MTE's one-year IR ratio reflects the market's current aversion of European small-cap growth stocks, with MTE suffering as it is the most growth-biased strategy within its sector by some margin (according to data from Morningstar, which shows that MTE has a 70% greater growth-stock bias than its average peer). This suggests that MTE has significant recovery potential.

George also adopts an approach of buying stocks that he likes when they are out of favour. He typically prefers to assess a company's value over a five-year period. George is happy to hold companies through periods of short-term weakness when this has been driven by non-fundamental issues, such as macroeconomic trends or political volatility (as we are likely seeing now), on the expectation that the fundamentals of a company will assert themselves over the longer term.

Investment approach and process

MAML avoids trying to time macroeconomic shifts, preferring to focus on the long term.

It wants to invest in:

- simple businesses that it can understand;
- niche businesses in growth markets (non-cyclical companies, growing organically rather than businesses that tend to focus on acquisitions);
- market leaders (strong, defensible market positions and pricing power);
- companies with high operating margins and high returns on capital (barriers to entry/a sustainable competitive advantage);
- profitable companies trading at sensible valuations; and

Simple, niche, market leaders with high and sustainable returns, profitable and with good management

- good management that it trusts (aligned to shareholders and demonstrating sound ESG practices).

This could be summed up as investing in high-quality businesses at sensible prices. Furthermore, MAML believes it is important to:

- do the work yourself (rather than relying on brokers);
- be passionate; and
- learn from mistakes (humility goes a long way).

Easier to add value through stock selection for a small-cap portfolio

In addition, MAML believes that it is easier to add value through stock selection for a small-cap portfolio, especially given the relative paucity of research available on these companies. MAML observes that some large companies are covered by 50 or more brokers, while many European smaller companies have little or no coverage. Firm evidence for the success of this approach is provided in Figure 21 on page 17.

Sifting through the universe

Deep pool of stocks to choose from

The constituents for MTE's portfolio are drawn from a universe of about 4,000 companies listed in Europe. The focus is on those with a market cap between €100m and €5bn (about 2,300) and, as described below, unprofitable companies are excluded which reduces the pool to about 1,700 stocks. The benchmark index currently includes stocks with market caps of up to about €7bn.

MAML has always generated its own investment ideas rather than relying on external analysts

MTE is a true stock-picking portfolio; index-weightings play no part in forming its portfolio construction. MAML has always generated its own investment ideas rather than relying on external analysts. There are many good reasons for this, but it is also fortunate as the availability and quality of external analysis – which MAML believes has been on a declining trend for some time – was exacerbated by MiFID II. This gives MAML a competitive edge, which is sharpened by the strength and depth of its research team.

The depth and experience of MAML's team gives the firm a competitive edge

MAML is an entrepreneurial boutique with a flat structure that allows for quick decision-making and avoids the politics that bog down more bureaucratic, large asset managers. MAML does not encourage the development of 'star' fund managers, but is focused on staff retention, including the granting of staff options over MAML equity. MAML's 'back office' functions are carried out in-house rather than being outsourced (as they are in many smaller investment management boutiques).

Research responsibilities are distributed amongst the team on a sector, global basis. Emphasis is placed on being well-prepared for meetings, which is possible as the research team is well-resourced. MAML's analysts can then set the agenda, challenge management and get the information that they need. Site visits are encouraged (another perk of having a large team is that it is not desk-bound).

On average, each analyst will seek to identify 20 stocks within their sector coverage worthy of closer scrutiny. These will form the pool from which portfolio constituents are drawn. The first part of the process is to eliminate poor-quality companies. These stocks are identified by applying a quantitative screen to the wider universe. Loss-making companies, those with poor cash flow, and highly indebted businesses

All stock ideas are reviewed and approved by an investment committee

Value is assessed on a range of measures but only after the quality evaluation is complete

Position sizes determined by strength of conviction

are rejected. Stocks that fit structural growth themes that the team has identified may be prioritised. Each company within the universe is assigned a quality rating.

The analysts then build a financial model and conduct a proprietary checklist for each stock. They also check whether a stock meets MAML's ESG criteria (see below). Then the idea is put before MAML's investment committee, who challenge assumptions and ask for more information if they feel this is warranted. Stocks that pass these quality thresholds may then go on to an approved list of approximately 250 companies. No fund manager can buy a company that is not on the approved list.

Various valuation tools are considered (primarily discounted cash flows), but include P/E, free cash flow yield, dividend yield and relative to peers and the team operates with a time horizon of five to 10 years. The ideal investment should provide a margin of safety in excess of 25% over its intrinsic value. Analysts will also look at risk factors, and will then assign a recommendation to each stock. These will be presented to the whole team at weekly meetings and the fund managers will then decide which stocks make it into portfolios. Once a stock makes it into a portfolio, it will usually remain there for many years.

Portfolio construction

MTE's investment policy is more fully described in its annual report. It only invests in listed securities and MAML says that unquoted companies are not eligible for consideration.

Some other rules apply:

- MTE does not hedge its currency exposure;
- MAML will hold no more than 10% of the voting rights in any company (across all funds managed by MAML); and
- no more than 10%, in aggregate, of the value of its total assets at the time of investment will be invested in other investment trusts or investment companies admitted to the Official List of the UK Listing Authority. Currently, MTE has no holdings in other investment trusts, nor does it expect ever to do so.

Typically, the target weighting for a position will be between 1% and 3.5%, depending on both the strength of conviction that the manager has in the stock, and its liquidity. The total number of holdings is typically around 50. There is no obligation to sell a company if its market cap exceeds €5bn, but these will be gradually recycled into lower-market-cap companies. The manager will ensure that a single position does not exceed 7.5% of the portfolio.

George does however have a tendency to let his winners run, which can see their position sizes increase rapidly. This can mean that in periods of particularly strong tailwinds, MTE can demonstrate a strong exposure to the momentum factor, as well as rapidly shifting asset allocation biases. Though this is only done in the context of George being confident in the investment case of his companies, rather than intentionally trading around momentum. We note that this ability to hold onto winners does explain part of MTE's high beta, which is currently at 1.1 over a five-year period, based on monthly data.

ESG principles are at the heart of MAML's stock selection decisions

ESG analysis

MAML's focus on quality is supported by its commitment to ESG principles, which have been ingrained within its investment approach for many years. It believes that there is a clear correlation between how well a business fares on ESG grounds and the value it creates for its shareholders.

Ed Heaven chairs an internal sustainability committee of seven, which meets quarterly and oversees MAML's efforts in this area. The team includes two dedicated ESG and impact specialists, Kate Hewitt and Harriet Evans. MAML also has its own ESG handbook, policies and checklists. It votes the shares it controls, and it engages with companies. MAML expects the companies that it invests in to improve their ESG awareness and it monitors their progress.

Some sectors are excluded from portfolios on ESG or ethical grounds. MAML portfolios will not contain tobacco companies; companies manufacturing weapons, facilitating gambling or manufacturing alcohol; companies engaged in oil-, coal- and gas-related E&P; companies involved with pornography; companies making high-interest-rate loans; or companies engaged in animal testing unless it is required by law. Corporate governance checks include an assessment of a company's remuneration policy.

MAML's attention to ESG issues extends to its own business. Following an extensive evaluation process, it was made a Certified B Corporation in June 2019 (more information is available at [bcorporation.net](https://www.bcorporation.net)). Early in 2021, MAML joined the Net zero asset managers initiative (more information at netzeroassetmanagers.org), supporting the goal of net zero greenhouse gas emissions by 2050 or sooner. MAML is a member of the GFANZ taskforce (see [gfanzero.com](https://www.gfanzero.com)) and sits on the real economy transition workstream group.

MAML has won several ESG & Impact awards and has most recently been awarded the "Best Small & MidCap Sustainable Investment Boutique" award by Ethical Finance.

Sell discipline

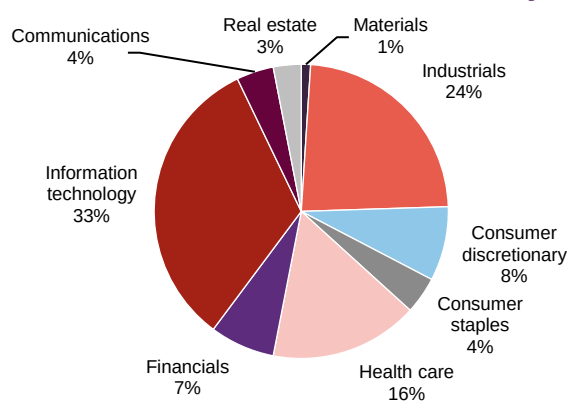
Stocks exit the portfolio for a variety of reasons – for example, when they become significantly overvalued, if they become too big, or due to takeovers.

Furthermore, stocks may leave the portfolio if the analysts identify unfavourable changes in the fundamentals of the business or an unfavourable management change.

Stocks will also be sold if they no longer pass MAML's quality threshold, or if a new opportunity comes along that offers better prospects.

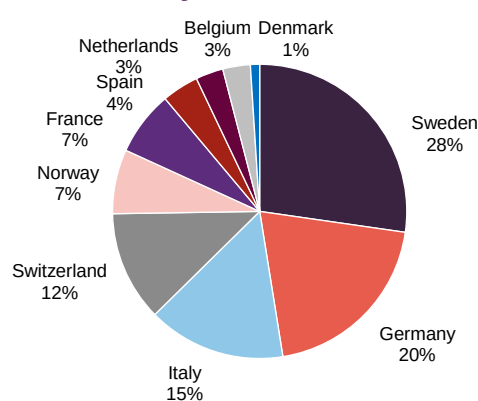
Asset allocation

Figure 3: Sector allocation as at 31 May 2024



Source: MAML

Figure 4: Country allocation as at 31 May 2024



Source: MAML

There were 50 holdings in the portfolio at the end of July 2024, up slightly from the 49 at the time of our previous note (which had data as of June 2023). Gearing remains low, at 1.9%, slightly lower than the 2.6% when we last published. The level of gearing reflects the stock-specific opportunities available to the team, rather than the prevailing macroeconomic environment.

Geographic and sector allocations are driven by stock selection. MTE has maintained a long-term overweight exposure to healthcare and technology companies relative to its benchmark. There has been little change in both sector and regional allocations since our last publication. An overweight in healthcare and technology is typical of its quality-growth investment style due to the innovation in these sectors and the often-non-cyclical nature of their cash flows. Conversely, MTE continues to underweight financials, energy, and materials, which are more cyclical and generally considered lower-quality industries. This inherent underweight has negatively impacted MTE's recent relative performance, as outlined on page 15.

Portfolio characteristics

As can be seen in Figure 5, MTE continues to demonstrate the same high-quality, high-growth characteristics that it had in our prior note. Figure 5 illustrates that, while MTE's portfolio has become better value, based on its Price/earnings and EV/EBITDA multiples, EPS growth has also increased – likely aided by an improving economic outlook, which should feed through to improving dividend growth in due course. Net cash has also continued to improve, as can be seen by the decrease in the net debt/equity ratio.

Figure 5: Portfolio characteristics

Ratios	30 June 2024 (FY25)	30 June 2023 (FY24)
Active share	92.3%	92.8%
Price/earnings	22.5x	23.4x
EPS growth	14.9%	12.6%
Dividend yield	2.0%	1.9%
Dividend growth	9.3%	11.6%
Return on equity	16.3%	16.3%
EV/EBITDA	17.0x	17.7x
EBIT Margin	21.1%	22.6%
Net debt/equity	(8.6%)	(5.9%)

Source: MAML, ratios for June 2023 are for FY24, and for June 2024 are for FY25

10-largest holdings

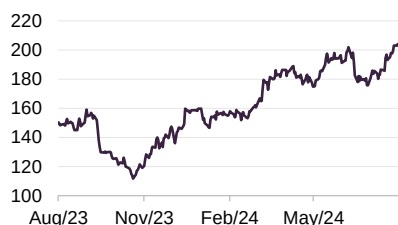
Reflecting the multi-year investment thesis MTE follows, there has been little change to the constituents of MTE's top 10 since we last published. There are two changes in the top 10, the addition of Esker and Reply, replacing Brembo and Melexis. Esker and Reply are not new holdings for the trust, however, and their moves up into MTE's top 10 reflects the growth in their share prices over the period. We note that Brembo and Melexis are still part of MTE's portfolio.

Figure 6: 10 largest holdings as at 30 June 2024

	Holding 30/06/24 (%)	Holding 30/06/23 (%)	Change (%)	Country	Sector
NCAB Group	5.5	6.0	(0.5)	Sweden	Printed circuit boards
MTU Aero Engines	4.6	4.7	(0.1)	Germany	Aero engine manufacture
CTS Eventim	4.0	3.0	1.0	Germany	Ticketing and events
Fortnox	3.9	3.5	0.4	Sweden	Accounting software
Atoss Software	3.7	3.5	0.2	Germany	Workforce management software
VZ Holding	3.3	3.5	(0.2)	Switzerland	Financial consultant and wealth manager
Esker	3.1	2.5	0.6	France	Software developer
Kitron	3.0	4.7	(1.7)	Norway	Electronics manufacturing
Reply	3.0	2.3	0.7	Italy	IT consulting, system integration, and digital services
IMCD	3.0	3.1	(0.1)	Netherlands	Speciality chemicals and food ingredients
Total	37.1				

Source: MAML

Figure 7: Esker (FRA)



Source: Bloomberg

Esker

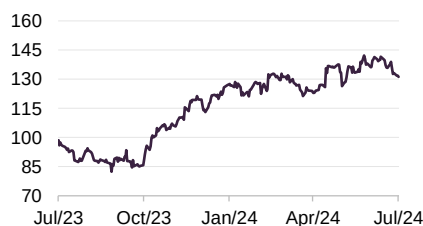
Esker (esker.com) is a French software developer specialising in document automation and order management solutions. Rather than being proactively increased by George, Esker entered MTE's top 10 due to strong share-price performance over the last 10 months. Previously, Esker was viewed as a COVID-19 winner, performing strongly on the back of this, but gave some of this back as economies re-opened.

George believes that the fundamentals of his investment thesis remain intact, with Esker continuing to be supported by the tailwinds of digitisation. Esker's recent financial results showed solid growth during its 2023 financial year (ending December 31), despite management's acknowledgment of a challenging economic environment. Revenue increased by 12% to €178.m, driven primarily by the continued success of Esker's cloud automation solutions, which grew by 17% to €14m, accounting for 82% of total sales. Esker's profitability was impacted by currency effects and higher compensation costs due to staff growth and sales commissions.

Esker has started 2024 strongly, reporting its best Q1 in history with a 12% year-over-year increase in sales, reaching €47.7m for the first three months. This revenue growth was driven by its software-as-a-service arm, which saw recurring subscription-based revenues grow by 83% year-over-year. These results have contributed to a 29% year-to-date increase in Esker's share price, although it was impacted by France's snap election call, resulting in a 9% decline in the days following the announcement, but has recovered since.

Reply

Figure 8: Reply (ITA)



Source: Bloomberg

Reply (www.reply.com) is an Italian company that provides consulting, system integration, and digital services to both the public and private sectors. Reply advises its customers on a wide variety of issues, ranging from complex digital solutions like quantum computing and AI to more conventional issues such as supply chain management and compliance.

Reply's financial results for both 2023 and the first quarter of 2024 (its financial year ends on December 31) demonstrate strong performance. In 2023, Reply's revenue grew by 12%, with a 6.5% year-over-year increase in Q1 2024. However, profitability declined in 2023 due to COVID-related expenses, with EBITDA growing only 3.5%, representing a 16.6% margin. Excluding these extraordinary items, EBITDA growth would have been 20%. As a result, EBITDA growth accelerated to 7.8% year-over-year in Q1 2024.

Reply's growth has been broad-based, with all major regions reporting positive growth. Management notes that high demand for expertise in emerging technologies, particularly artificial intelligence, has driven this performance, with the technologies business unit contributing 61% of revenue. Reply has invested heavily in AI capabilities over the past decade, positioning itself advantageously in the sector. Management is optimistic about the future, highlighting the accelerating adoption of AI as a key driver of growth and is continuing to invest accordingly.

Other purchases

There have been several new additions to the portfolio over the last 12 months whose position sizes are too small to be captured by Figure 6. The most noteworthy purchases include, in order of value: Interpump Group, Borregaard, Schott Pharma, BioGaia, Bouvet. These purchases were funded by sales of Novozymes, VZ, SimCorp, Brunello Cucinelli, and Marel. In regards to Novozymes, George held Chr Hansen, which merged with Novozymes in January 2024, and sold his shares in Novozymes that he receives as part of the merger. Marel was sold due to its deteriorating fundamentals, SimCorp was sold as part of its acquisition by Deutsche Boerse in September 2023, while VZ and Brunello Cucinelli were trimmed on strength.

Interpump Group

Interpump Group (www.interpump.co.uk) is an Italian manufacturer of very high-pressure water pumps and hydraulics.

In George's view, Interpump is an example of a high-quality, niche Italian manufacturer. After a challenging 12 months for the company, George decided to initiate a position, believing that Interpump was undervalued, as it currently trades at a P/E ratio of 17x. He believes that the sell-off was due to the cyclicality in the European market and that the company has a strong long-term outlook. He expects the share price to recover once concerns about near-term economic slowdowns dissipate.

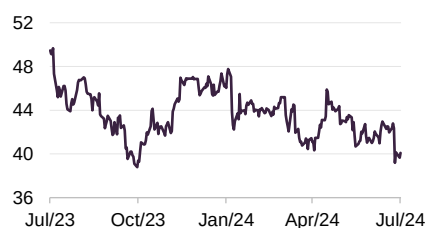
Interpump's most recent full-year results (for the year ending 31 December) have already alleviated some market concerns about the cyclicality of its earnings. Interpump reported full-year revenues of €2,240m, representing a 7.8% year-over-year growth. This growth was driven by a 6% increase in hydraulic sales and a 12.9% increase in water-jetting sales. Management attribute this growth to its diversified business model and global presence, noting growth across most regions. They also credit this growth to structural drivers supporting the company, such as the ongoing trend toward automation and efficiency in industrial processes, as well as the company's economic moats, which involve operating in niche markets whose complexity inherently reduces competition.

Borregaard

Borregaard (www.borregaard.com) is a Norwegian company that operates one of the world's most advanced and sustainable biorefineries, producing chemicals from renewable raw materials such as timber.

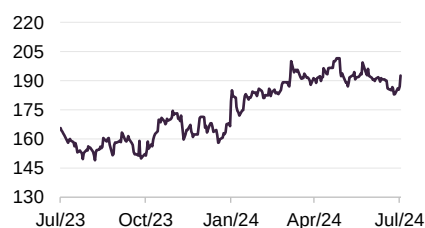
Thanks to the tailwinds supporting the demand for sustainable, bio-based alternatives to petrochemicals, such as stricter environmental regulations and preference for lower carbon-footprint production, Borregaard was able to report its strongest ever set of full year results. For the year ended 31 December 2023, it reported an all-time high EBITDA of NOK1.8m, equal to a margin of 25%, while also reporting all-time high revenues of NOK7.1m. This growth was attributed to not only the higher prices Borregaard was able to charge across its business segments, but also the diversified market strategy it uses, helping to mitigate slowdowns in certain end-markets.

Figure 9: Interpump Group (ITA)



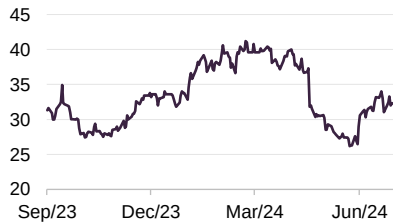
Source: Bloomberg

Figure 10: Borregaard (NOK)



Source: Bloomberg

Figure 11: Schott Pharma (GER)

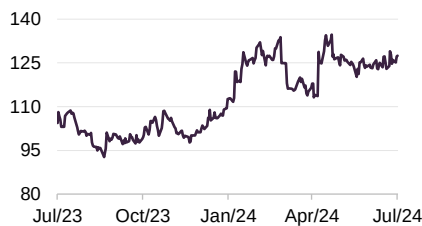


Source: Bloomberg

Schott Pharma

Schott Pharma (www.schott-pharma.com) is a German company specialising in drug containment solutions and delivery systems for injectable drugs. MTE participated in Schott Pharma's IPO when the company went public in September 2023. Schott Pharma began its life as a listed company on a strong footing, with sales of its drug delivery products reporting 29% growth (adjusted for currency impact) in their most recent interim results. Overall, revenue grew 3.9% year-over-year to €466.5 million. However, due to the international nature of its markets, currency effects led to a decrease in profitability, with its EBITDA margin falling from 29.4% to 25.1% year-over-year. Adjusted for currency, its margins grew by 1.8%. Schott Pharma's management remains confident in the fundamental strength of the business and expects 9-11% organic revenue growth for the full year, with an EBITDA margin approximately at the previous year's level of 26.6%.

Figure 12: BioGaia (SWE)



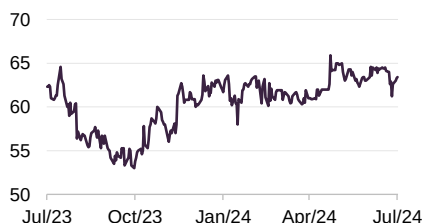
Source: Bloomberg

BioGaia

BioGaia (www.biogaia.com) is a Swedish biotechnology company that develops, markets and sells a range of probiotic products. 2023 was an exceptionally strong year for BioGaia, which reported a 17% increase in sales and a 23% increase in its operating margin, reaching 35%. In BioGaia's 2023 results, the company reported approximately 35% growth in both the Americas and Asia-Pacific regions, which more than offset a 4% decline in its European markets.

2024 has been more mixed, as inventory overstocking led to a decline in American revenues. However, this was offset by growth in Europe and Asia, with net sales up 1% in Q1 2024. Inventory issues are expected to be temporary, and BioGaia's board remains optimistic about the future. They expect the flat Q1 to be an exception, citing their strong product portfolio, ongoing research initiatives, and expansion in direct markets. The board anticipates maintaining an operating margin of 34% and achieving revenue growth similar to the strong figures reported in 2023. Management also plans to continue investing in research, product development, and brand building while organically growing core businesses through increased direct distribution and pursuing breakthrough innovations to accelerate growth.

Figure 13: Bouvet (NOK)



Source: Bloomberg

Bouvet

Bouvet (www.en.bouvet.no) is, in George's mind, a leading Scandinavian IT consultancy headquartered in Norway, specialising in a range of end-to-end products, including integrating mixed reality headsets, adopting cloud AI, and advising on cybersecurity. George notes that one of Bouvet's key advantages is its ability to retain customers, providing such high-quality service that Bouvet becomes the default supplier, sometimes even bypassing the tender process entirely.

Bouvet's strong positioning led to impressive performance in its 2023 financial year, a trend that continued into the first quarter of 2024. In 2023, Bouvet's operating revenue increased by 14.3% to NOK 3,525.8m. Operating profits rose by 1.3% to NOK407m, with an EBIT margin of 11.5%. Similar results were observed in the first quarter of 2024. Bouvet attributes its growth to strong demand for a wide range of solutions, particularly in cloud technology, data platforms, artificial intelligence, and cybersecurity. Management highlighted particularly strong demand from the oil and gas, power, and public sectors.

A notable challenge for the company in 2023 was the impact of wage inflation and increased costs, which weighed on Bouvet's margins. However, it was able to offset these through price increases (a benefit of a loyal customer base) and by improving operational efficiency.

Performance

Over the past five years, MTE has generated a NAV total return that surpasses both its benchmark (MSCI European Smaller Companies Index ex-UK) and its open and closed-ended peers over the long term. Much of MTE's outperformance can be attributed to its strong performance during the COVID-19 period, as shown in Figure 14. However, MTE began to lose its lead at the start of 2022 due to rising global inflation and interest rate expectations, which led to a sell-off in the highly valued growth companies typically comprising MTE's portfolio.

Figure 14: MTE NAV total return performance relative to benchmark and listed peer group



Source: Morningstar, Marten & Co. Note: MTE's benchmark is the MSCI European Smaller Companies Index ex-UK. Listed peer group is European Assets, JPMorgan European Discovery, and The European Smaller Companies Trust.

MTE remains the best performing European small cap trust over the long term

However, as mentioned on page 6, MTE has begun to lag behind its index and peers over the past 12 months. George attributes this to a sharp rally in lower-quality companies, citing some of Europe's small-cap banks as examples. Such companies are excluded from MTE's portfolio through George's investment process (which we described in detail in [our previous note](#)). The high cyclicality and historically low shareholder returns of these banks, especially those in the smaller-cap index, fail to meet George's basic investment criteria.

Nonetheless, the combination of an improving outlook for Europe's economy and higher earnings from income portfolios (due to higher interest rates) has increased investor demand in the near term. For example, BPER Banca, an Italian bank and

the 8th-largest constituent in MTE's benchmark, is up 50% year-to-date but only 14% over the last 10 years. George remains optimistic in this environment, believing that the rally reflects short-term macroeconomic factors rather than improving business practices.

Figure 15: Cumulative total returns for periods ending 31 July 2024

	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
NAV	3.5	7.5	6.3	(14.5)	47.4
Share price	6.2	11.4	7.4	(25.6)	36.4
Benchmark ¹	3.2	7.0	8.7	(1.7)	36.8
Listed peer group NAV average ²	3.2	10.3	10.6	(6.8)	41.2
Open-ended peer group average ³	(0.4)	2.8	8.3	(7.2)	26.6

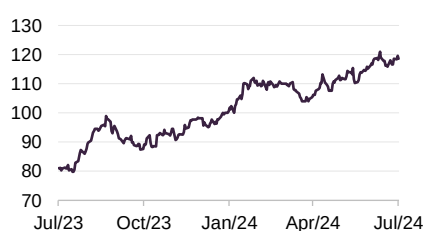
Source: Morningstar, Marten & Co. Note: 1) MTE's benchmark is MSCI European Smaller Companies Index ex-UK. 2) Listed peer group is European Assets, JPMorgan European Discovery, and The European Smaller Companies Trust. 3) Open-ended peer group is based on the IA European Smaller Companies average, with data as of 30/06/2024.

Top contributors

In our recent conversations with George, he has highlighted three companies that have been the largest contributors to MTE's performance over the first half of 2024. These are: VZ Holding, Esker, and AAK. We covered Esker on page 12.

VZ Holding

Figure 16: VZ Holding (CHE)

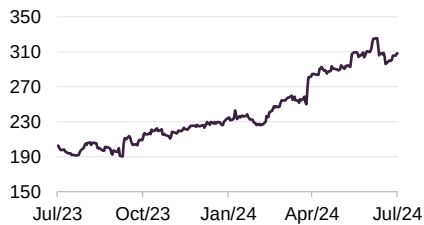


Source: Bloomberg

VZ Holdings is a Swiss independent wealth manager, focusing on financial advisory and asset management services. As a founder-led company, VZ Holdings has maintained a return on equity of approximately 20% for the last 10 years, in contrast to the single-digit average of BPER Banca.

George attributes VZ's recent performance to the collapse of Credit Suisse, which disrupted the Swiss wealth management market and provided a new pool of prospective clients for VZ to target for wealth management services. The aftermath of Credit Suisse's collapse may also explain the 20% revenue growth reported in VZ's most recent semi-annual report (for the six months ending August 2023), marking the largest six-month increase in revenue in over a decade. Whilst VZ's management acknowledges the likely increase in the number of people seeking independent financial advice, they attribute the growth more to VZ Holding's "excellent reputation, growing brand recognition, and presence in all major cities throughout Switzerland".

Figure 17: Bouvet (SWE)



Source: Bloomberg

AAK

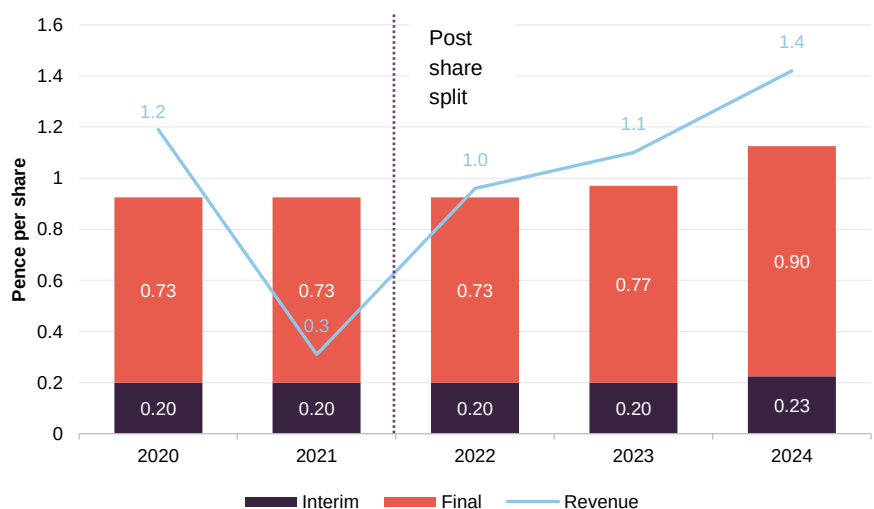
AAK is a Swedish producer of sustainable plant-based oils and fats used in various products, including food, confectionery, pharmaceuticals, and cosmetics. AAK's shares traded sideways in a range between SEK150 and SEK 200 until 2023. However, in June 2023, the share price broke out of this range, increasing by approximately 50% over the subsequent 12 months and returning 34% in 2024 in sterling terms.

This sudden breakout was not driven by unusually strong results, as AAK has maintained consistent margins for the last five years and achieved its highest revenue growth in 2021 and 2022, which did not affect its share price. Instead, George believes the recent rise in the price of cocoa brought AAK to the attention of many investors, as its products can replace cocoa fats at a lower cost.

Dividend

MTE's primary aim is to deliver capital growth to its shareholders, and its dividend is thus a by-product of its investment process, with MTE having a modest yield of 0.8% as at 23 July 2024. MTE does, however, have a substantial revenue reserve, enough to cover its dividend 2.1 times, thanks to the growth in dividends paid by its invested companies; a hallmark of a high-quality business. MTE's most recent dividend was fully covered by its revenues also. The reserve stood at £4.5m at the end of March 2024 (March 2023 £3.7m), equivalent to 2.0p per share.

Figure 18: MTE dividend history, accounting years ended 31 March

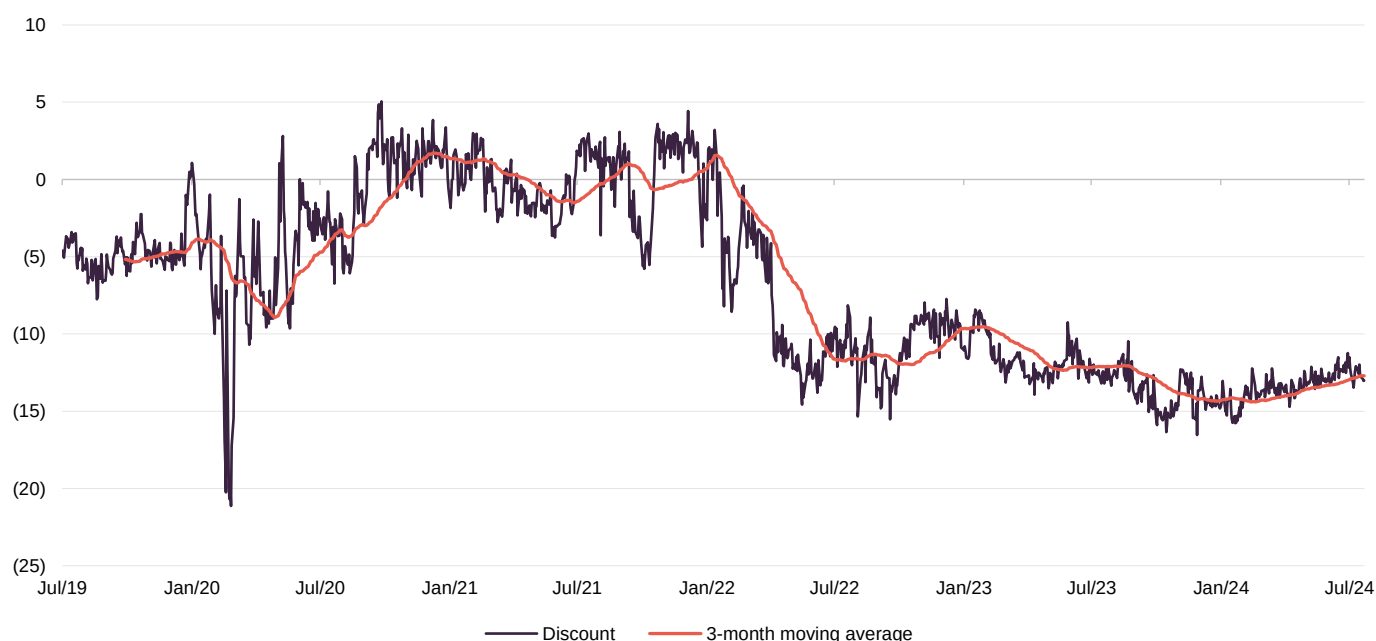


Source: MAML, Marten & Co. NB Figures prior to 2022 have been adjusted to reflect a 10x1 subdivision of MTE's shares

Premium/(discount)

Over the 12 months to the end of July 2024, MTE's shares traded within a range of a 16.5% discount to a 9.3% discount and an average discount of 13.5%. At 21 August 2024, the shares were trading at a discount of 13.0%.

Figure 19: MTE discount over five years ending 21 August 2024



Source: Morningstar, Marten & Co

MTE's discount has largely mirrored trends in the broader growth investing style. For example, MTE traded at a sustained premium during 2020 and 2021, a period marked by strong outperformance by both MTE and the broader growth-stock sector. However, MTE's discount has traded within a 10% to 15% range since the sell-off in growth stocks that was triggered by rising interest rates. Given that the sort of quality companies in which MTE invests have also de-rated, a double-digit discount on MTE is arguably a good way to gain exposure to the premium end of the European small-cap market on attractive valuations.

MTE has powers to issue and buyback shares, which it renews regularly at the AGM. Shares repurchased can be held in treasury and may be reissued. The board has said that these would only be reissued at a higher absolute price than the weighted average purchase price of the shares in treasury, and at a premium to NAV at the time of reissue or at a discount, provided this discount was lower than the weighted average discount at the time the shares were repurchased.

The net effect of this should be that purchasing the shares and reissuing them again is profitable for ongoing shareholders.

The board has stated that it will consider a buyback of shares, where the discount of the share price to the NAV per share is greater than 10% for a sustained period and is significantly wider than the average for similar trusts. It will take into

consideration the effect of the buyback on the liquidity of the company's shares. The board has yet to buy back shares since MTE began to trade on a discount.

In addition, the board encourages the manager to market the company to new investors.

Fees and costs

MAML is the company's investment manager and AIFM. It is entitled to receive a management fee of 0.9% of the first £500m of MTE's market capitalisation and 0.75% of the balance up to £750m and then 0.65% on any amount above £750m, payable monthly in arrears. Charging the fee on market capitalisation incentivises the manager to keep the company's discount narrow.

MAML is also entitled to a fee of £50,000 a year for acting as the AIFM, though this will be reduced to £25,000 for FY2025 and waived for all subsequent years. There is no performance fee. The management contract can be terminated by either side on six months' notice. MTE charges 35% of the management fee against revenue and the balance against capital. The same methodology is applied to the accounting treatment for interest on MTE's borrowings.

From 1 July 2023 Juniper Partners Limited was appointed as company secretary and administrator, replacing the previous secretary, Link Company Matters Limited, and the previous administrator, Link Alternative Fund Administrators. Equiniti Limited acts as Registrar and The Bank of New York Mellon (International) Limited as the company's Depositary and Custodian. The company's auditor is PWC.

The company's ongoing charges ratio for the year ended 31 March 2024 was 1.0%, the same level as the prior year.

Capital structure and life

MTE has 189,427,600 ordinary shares in issue and no other classes of share capital. No shares are held in treasury. The company has an unlimited life.

MTE's accounting year end is 31 March. Annual accounts are published around the end of June/beginning of July and the AGM is usually held in August or September.

Gearing

The board has set a maximum limit on borrowing, net of cash, of 30% of shareholders' funds at the time of borrowing. The board, in discussion with the manager, regularly reviews the company's gearing strategy and approves the arrangement of any gearing facility. The board believes that the ability to use gearing offers a strong competitive advantage over alternative open-ended investment funds. Therefore, it strongly encourages the active use of gearing by the manager.

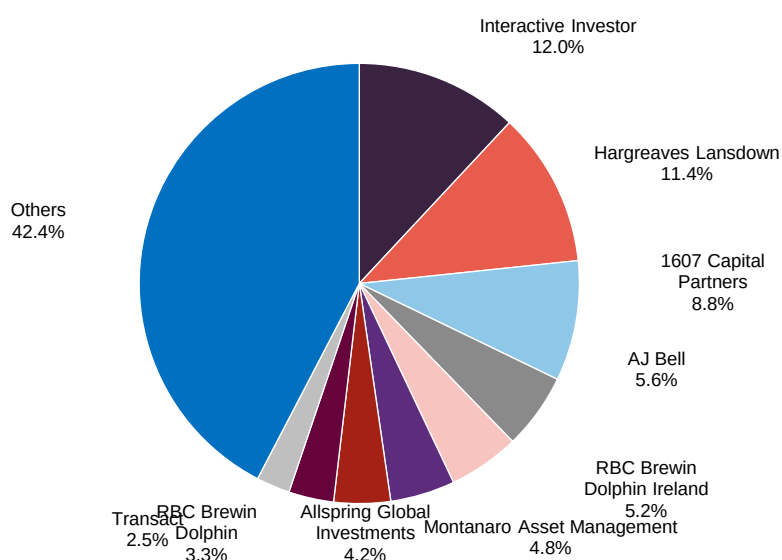
MTE has a €10m secured loan maturing on 13 September 2026 that carries a fixed rate of interest of 5.105%, and a €15m revolving credit facility until 13 September

2026, both provided by ING Bank NV. Drawdowns from the revolving credit facility are charged at a margin over the relevant EURIBOR rate.

At the end of July 2024, MTE had net gearing of 1.9%, marginally lower than the 2.6% at the time of our prior publication.

Major shareholders

Figure 20: Major shareholders as at 30 June 2024



Source: Montanaro

Management team

George Cooke

George joined MAML in July 2010. He graduated from the University of Nottingham in 2005 with an undergraduate degree in Management Studies. He then spent a further year of study there, at the end of which he was awarded a Masters (with Distinction) in Corporate Strategy & Governance. Immediately following this, he joined the graduate scheme at Aon Benfield (formerly Aon Re). Having completed this scheme, George settled as an analyst within the Resolutions department, where he specialised in assisting with the capital and runoff issues of insurance and reinsurance companies. During his time at the company, George received a Diploma in Insurance. He is also a CFA Charterholder.

Stefan Fischerfeier

Stefan joined MAML in 2007. He holds a B.A. in Business Administration from the University of Cooperative Education in Mannheim (1995) as well as a Diplom-Kaufmann (MBA equivalent) from the University of Mainz (1998). He graduated from the London Business School with an MSc in Finance (2006). After graduating from University of Mainz, Stefan spent more than six years at Accenture in Germany, Switzerland, France, and the UK as a management consultant for European banks

and asset managers. He then worked as an analyst at Nordwind Capital, a Munich-based private equity company, analysing the automotive industry, and as an investment consultant for a property fund in Romania assessing real estate investment opportunities in Eastern Europe.

Board

The board consists of three directors, all of whom are independent of the manager and who do not sit together on other boards. Each director offers himself or herself up for re-election at each AGM.

Figure 21: Board member – length of service and shareholdings

Director	Role	Appointed	Length of service (years)	Annual director's fee* (GBP)	Shareholding
Richard Curling	Chairman	2 November 2015	8.7	43,000	150,000
Gordon Neilly	Director	21 September 2020	6.7	31,000	62,293
Caroline Roxburgh	Senior independent director and chair of the audit committee	8 November 2017	3.9	37,500	62,833

Source: Marten & Co, *for the forthcoming 2025 financial year

Richard Curling

Richard was appointed to the board in 2015 and became chairman in 2018. He has over 30 years' experience as a fund manager and is currently an investment director at Jupiter Fund Management Plc. He also has extensive experience of investment trusts. Richard is also chairman of the nominations committee.

Gordon Neilly

Gordon was, until the end of August 2020, chief of staff at Standard Life Aberdeen, prior to which he was global head of strategy at Aberdeen Standard Investments and was responsible for developing the group's strategy and overseeing its implementation, as well as overseeing all corporate activity for the Group and its closed-end fund business. He joined Aberdeen in 2016 from Cantor Fitzgerald, where he held the position of joint CEO. Gordon is currently a non-executive director of Personal Assets Trust Plc.

Caroline Roxburgh

Caroline is a Chartered Accountant with over 30 years' experience in finance and audit across a number of industries and sectors, and was formerly a partner at PricewaterhouseCoopers LLP until her retirement in 2016. She chairs the audit committee and is the senior independent director. Caroline also holds a number of other board positions, including a non-executive directorship of the Edinburgh Worldwide Investment Trust Plc.

Previous notes

Readers interested in further information about MTE may wish to read our other notes. Click the links in the table or visit the QuotedData website.

Figure 22: QuotedData’s other notes on MTE

Note	Date published	Note type
Quality businesses at sensible prices	March 2019	Initiation
Focus on the small picture	September 2019	Update
Impressive returns in difficult market	October 2020	Annual overview
Unfazed by market turmoil	March 2022	Annual overview
No Continental drift	August 2023	Annual overview

Source: Marten & Co



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