INVESTOR

Montanaro UK Smaller Companies

Investment companies | Update | 28 April 2025

High growth, bigger yield

Montanaro UK Smaller Companies (MTU) has adopted a new enhanced dividend policy, paying out 1.5% of net asset value (NAV) every quarter. This will make it one of the highest-yielding UK equity strategies on the market. For traditional equity income investors, whose portfolios tend to be tilted towards more value-focused cash-generative stocks, MTU's combination of a high dividend yield and a strong focus on quality growth stocks differentiates it from peers.

UK equities were cheap relative to their history and to developed market peers prior to the tariff-related sell off; now they are even cheaper. In addition, the quality-growth small-cap stocks in which MTU invests have been out of vogue recently, with the market favouring large-cap value stocks instead.

As MTU's manager Charles Montanaro points out, the historic valuation gap provides investors with an attractive entry point. History has shown that buying stocks on these sorts of valuations can produce attractive long-term returns, and the magnitude of the discount of the UK's equity market relative to other developed global equity markets could in itself be a catalyst for the UK market to rerate.

UK small-cap with a bias to quality

MTU aims to achieve capital appreciation through investing in small quoted companies listed on the London Stock Exchange or traded on AIM, and to outperform its benchmark, the Deutsche Numis Smaller Companies Index (excluding investment companies).

Sector	UK smaller companies
Ticker	MTU LN
Base currency	GBP
Price	94.8p
NAV	105.3p
Premium/(discount)	(10.0%)
Yield	4.9%

UK equities are even better value following the tariff-related sell off, which could produce attractive long-term returns

A higher dividend profile from MTU has likely increased the range of potential investors in the trust

MTU's preference is to invest in high-quality, high-growth companies

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Domicile	England & Wales
Inception date	16 March 1995
Manager	Charles Montanaro
Market cap	130m
Shares outstanding (exc. treasury shares)	137.3m
Daily vol. (1-yr. avg.)	367,262 shares
Net gearing	0%

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Click to provide feedback to the company

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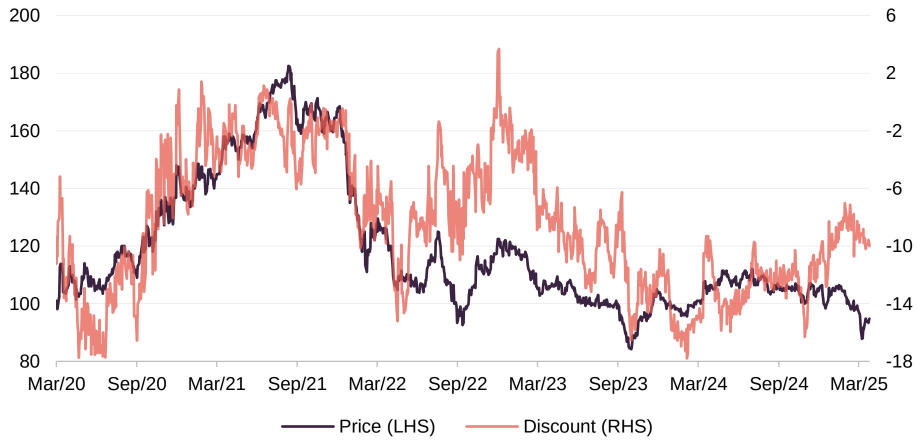
At a glance

Share price and discount

Over the year ending 31 March 2025, MTU's shares traded within a discount to NAV range of 17.8% to 7.0%, with an average discount of 12.5% and a median discount of 12.4%. As of 24 April 2025, MTU's shares were trading at a discount of 10.0%.

MTU's discount widened significantly over 2023, primarily due to the impact of higher interest rates on investor demand for growth stocks and related funds. However, as shown in Figure 30, the discount has begun to narrow over the past year.

Time period 31 March 2020 to 24 April 2025

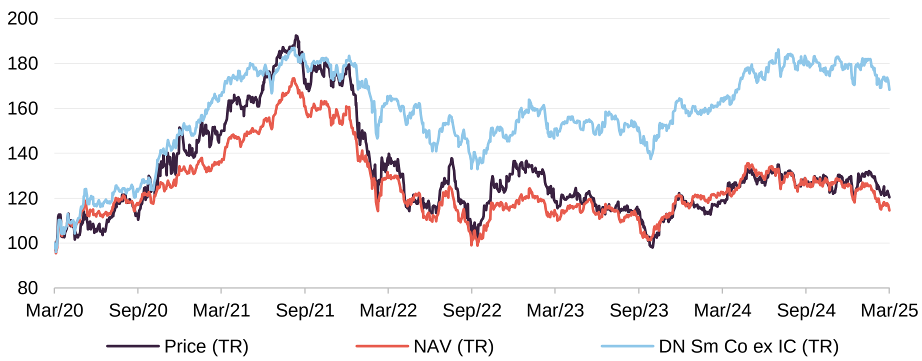


Source: Morningstar, Marten & Co

Performance over five years

As shown in Figure 16, MTU's NAV gave back much of its previous outperformance relative to its benchmark between late 2020 and 2021, coinciding with the broader sell-off in growth stocks compared to other investment styles. This decline was driven by the then-rising interest rate environment, with post-lockdown inflation prompting the Bank of England to raise rates to levels not seen since the 2008 financial crisis.

Time period 31 March 2020 to 31 March 2025



Source: Morningstar, Marten & Co

Year ended	Share price total return (%)	NAV total return (%)	Deutsche Numis SC ex IC TR (%)	MSCI UK TR (%)
31/03/2021	48.2	36.3	65.7	20.5
31/03/2022	(9.0)	(5.3)	(1.2)	18.6
31/03/2023	(12.0)	(11.1)	(7.9)	5.5
31/03/2024	0.3	6.9	9.0	8.7
31/03/2025	1.1	(6.6)	2.3	12.0

Source: Morningstar, Marten & Co

Fund profile

More information is available at the manager's website www.montanaro.co.uk/muscit

MTU is a UK smaller companies trust with a focus on capital growth. Montanaro Asset Management Limited (MAML) is the trust's AIFM (Alternative Investment Fund Manager). Charles Montanaro established MAML in 1991, and MTU was launched in March 1995 with Charles as its lead manager. He has been the trust's named manager for over three-quarters of its life. Charles has assured the board that he is happy to remain as MTU's named manager until at least 2026, but he is nonetheless cognisant of the eventual need for a well-managed transfer of responsibilities. Adam Montanaro is the back-up manager for MTU.

The trust raised £25m at launch in 1995 and topped that up with a £30m C share issue the following year. Today, the trust has a market cap of £130m. Whilst MTU has always retained the same focus on UK small-cap opportunities, it has evolved its dividend policy and pays out c.6% of its NAV each year (described in the next section).

Readers may wish to refer to our last note on MTU

MAML has one of the largest teams in Europe (and the largest in the UK) focused on researching and investing in quoted small- and mid-cap companies. It boasts 39 team members, including 18 investment professionals. The team is experienced, multi-lingual and multi-national (12 different nationalities), and there is relatively little turnover of staff. MAML's managers believe that the company is best served by operating with a maximum of approximately 40 staff members, so as to preserve the culture of a boutique outfit (smaller size with a specialised culture). We find it encouraging that MAML will continue to devote its resources towards its current strategies, as opposed to aggressively growing the company, for example.

MAML has AUM (assets under management) of more than £3bn. Charles Montanaro and his family together own 60% of the business. Furthermore, the CEO, Cedric Durant des Aulnois, owns 5%, while the head of investments, Mark Rogers, also owns 5%, with the remaining 30% owned by Montanaro's staff though an employee benefit trust established in 2025.

The trust is benchmarked against the Deutsche Numis Smaller Companies Index (excluding investment companies), and we have also used the MSCI UK Index as a performance comparator in this report. The benchmark plays no part in determining which stocks are selected for the portfolio, or how large positions are as a percentage of net assets.

In June 2024, MAML said that it had increased its ownership of the trust to over 6%. With Charles Montanaro and family owning a further 3%, this helps align MAML's interests with those of other shareholders.

New year – new dividend policy

MTU's new 6% dividend is a key differentiator, and unique attraction

As flagged in MTU's semi-annual results released in December 2024, effective from 31 December 2024, MTU began paying a regular quarterly dividend equivalent to 1.5% of its NAV (up from 1% per quarter under its previous enhanced dividend policy), resulting in an annual yield of approximately 6% of NAV. This equates to a yield on its share price of around 6.6% at the current c. 10.0% discount, effectively positioning MTU as one of the highest-yielding trusts in its sector, and one of the highest of all UK-focused investment companies.

MTU's preference is to invest in high-quality, high-growth companies, which typically reinvest cash rather than distributing this as dividends, and so, under its new enhanced dividend policy, the trust will offer a significantly higher payout than the natural yield generated from its holdings. For 2024, MTU reported a yield on the underlying portfolio of 3.7%.

This change in policy allows UK income investors to continue to generate a high yield, but from exposure to an asset class that would usually be off the table (small-cap growth stocks are traditionally low-yielding), potentially increasing demand for MTU's shares.

Amongst the almost-400 UK equity strategies covered by either the Investment Association (covering open-ended funds) and the Association of Investment Companies, the 6.5% yield implied by MTU's new enhanced dividend policy would place it in the top 10 highest-yielding UK equity funds as at time of writing (and one of only seven strategies offering yields in excess of 6%) and therefore in the top 2% of the wider group regardless of investment style. It would also be only one of two strategies that offer exposure to the "growth" and "small cap" styles (according to Morningstar's classifications) to offer yields in excess of 3%.

Additionally, MTU has implemented a subtle yet impactful change to its fee structure. Starting in October 2024, the management fee of 0.5% will be calculated based on net assets rather than gross assets. This adjustment ensures that assets generated through gearing will no longer influence the fee calculation, which we welcome.

Market update

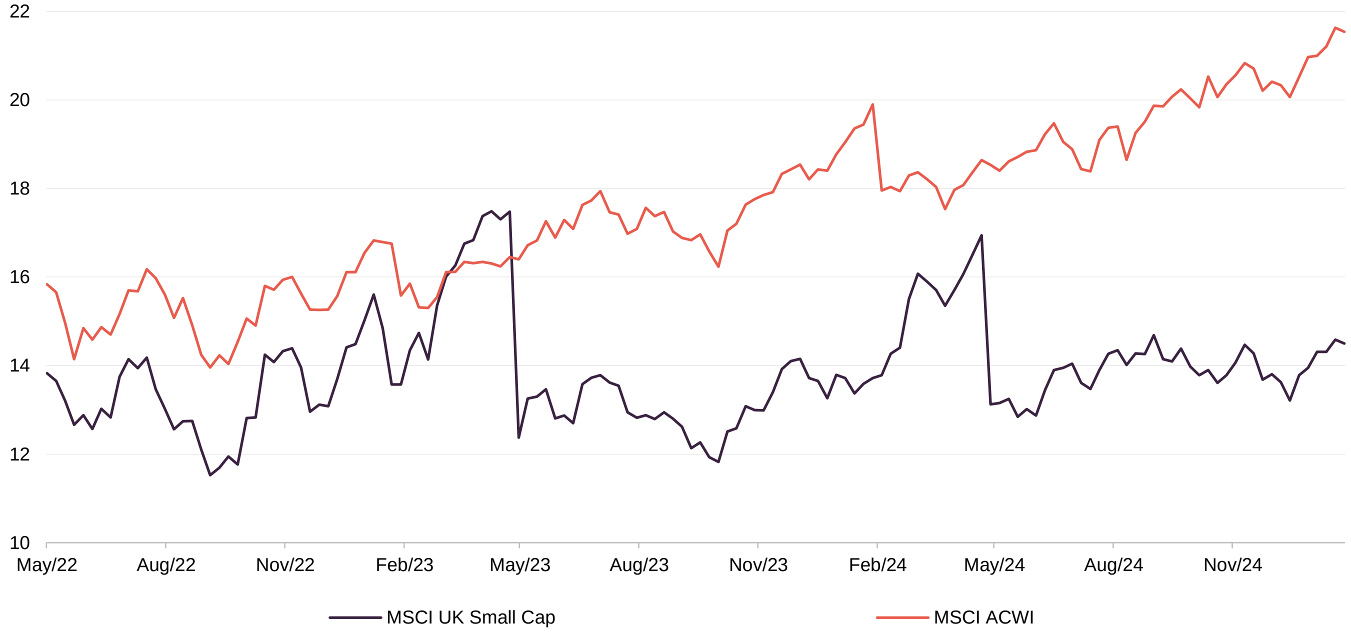
Valuation opportunities in UK equities

UK small caps are at historically wide discounts compared to global equities

As discussed in our previous notes, the UK equity market remains one of the most attractively valued among developed markets. This is particularly true for smaller companies, which not only offer compelling valuations, but also a broader diversity of businesses compared to the UK's large-cap sector, which is dominated by energy, materials, and financial firms.

When comparing the expected valuations of the UK small-cap market to the global equity universe using forward P/E ratios (a common measure of how expensive or cheap stocks are relative to expected profits), we find that the UK small-cap segment (based on data from the MSCI UK Small Cap Index) trades at a forward P/E ratio (one based on future anticipated earnings) that is less than 70% of that of global equities. Currently trading on a P/E ratio of 14.5x, this ratio has remained below 0.7x that of global equities since the end of 2024, with the MSCI ACWI (a global index that tracks the performance of over 3,000 equities across developed and emerging markets) trading on a current forward P/E ratio of 21.5x. This represents a new threshold for the relative cheapness of UK equities, marking the only three-month period in the last 15 years where the UK small-cap sector has traded at valuations less than 70% of the wider global market.

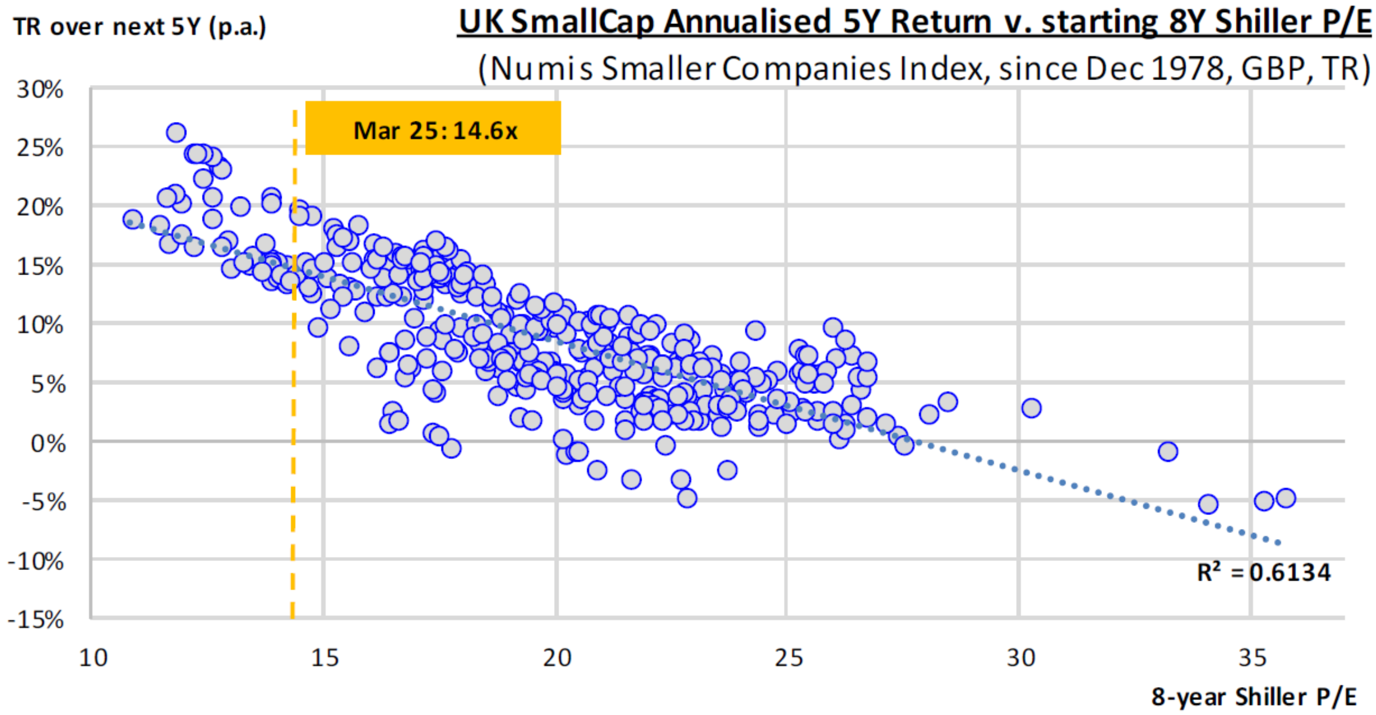
Figure 1: Forward P/E of MSCI UK Small Cap versus MSCI ACWI



Source: Source: Bloomberg, using Bloomberg estimates. Data as of 24 February 2025.

Charles has highlighted the compelling entry point presented by UK valuations. As illustrated in Figure 2, investing in the UK small-cap market when valuations are at the lower end of their historical range has historically led to stronger long-term returns. Notably, investors who entered the market at valuation levels similar to those at the end of 2024 – when its adjusted P/E stood at 15.6x – could have expected an annualised return of approximately 15% over the subsequent five years.

Figure 2: UK small-cap annualised return versus its P/E ratio



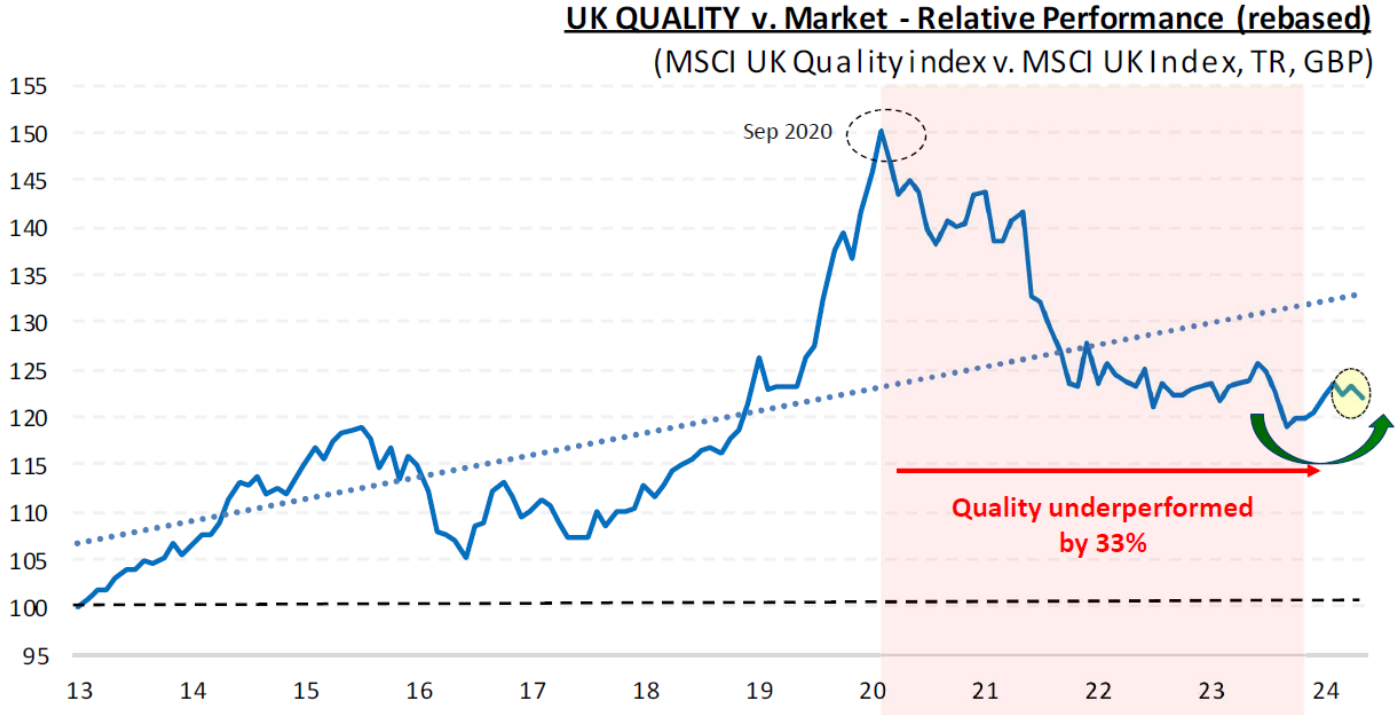
Source: Montanaro. Data as of 31/03/2025

What goes down may come up?

MTU is not only well-positioned to benefit from the historically cheap valuations of UK small-cap equities, but also from its emphasis on "quality growth" companies (those with strong profitability, stable earnings, and growth potential). The relative performance of the "quality" factor, compared to the wider UK market, has now fallen significantly below its long-term average, as shown in Figure 3, suggesting significant potential for recovery.

Although this relative underperformance can be partially attributed to the sharp correction from historic highs – driven by the effects of rising inflation and interest rates on highly valued stocks – the market sell-off looks excessive, with data in Figure 3 indicating that performance is well below its two-decade norm.

Figure 3: Returns of the UK quality factor relative to long-term average



Source: Montanaro. Data as of 31/12/2024.

> The significant deviations in performance and valuation may be sufficient to pique investor interest

Whilst we cannot pinpoint the exact catalyst that may reverse this valuation gap, deviations of this scale typically suggest either a fundamental shift in market conditions or a potential reversion to their averages. Historically, such dislocations tend to attract opportunistic investors who close the valuation gap – something already evident in the uptick of private equity activity within the UK, as highlighted in the next section.

Increased investor confidence

The UK economy is still working through the implications of Labour's first budget, announced at the end of October, but alongside this, it is now dealing with the impact of a new Trump presidency in the US and the chaos and uncertainty that this implies, particularly with regard to his trade policies. Business confidence has been mixed, as a result. Manufacturing has been in a steady decline since October 2024, having failed to register a PMI figure above 50 since (Purchasing Managers' Index - an economic indicator that measures the health of the manufacturing and services sectors**,** a PMI below 50 indicates contraction).

However, the UK services sector continues to report improving confidence, consistently posting month-on-month PMI figures above 50 over the past 18 months. Consumer confidence remains negative, although the recent reading of -20 at the end of February, from -22 at the end of January, suggests a slightly less negative outlook (the consumer confidence index ranges between -100 and +100 , although rarely approaches those extremes, with increasingly positive numbers indicating growing consumer confidence and increasingly negative values indicating greater consumer pessimism).

Whilst it may take time for this period of uncertainty to ease, some investors have already begun to take advantage of the opportunities presented by current valuations. Private equity (PE) activity within the UK remains elevated, with transaction volumes up 4.4% over 2024 and deal values increasing by 12%. Although these figures are surpassed by the post-COVID-19 surge in PE activity, which marked an all-time high, transaction volumes in 2021 and 2022 were driven by pent-up demand following COVID and an abundance of cheap financing (low-interest borrowing) that were not present last year. Deal volumes in 2024 remained above their pre-COVID levels and market commentators suggest there is potential for further growth into 2025.

There are some tentative signs of renewed interest in the UK market.

More importantly, the UK's listed equity market has finally shown tentative signs of revival. Despite experiencing another year of investor outflows and underperformance in 2024, the UK market has started 2025 on a stronger footing. As of 24 February 2025, the MSCI UK All Cap Index has outperformed the MSCI ACWI ex UK Index year-to-date, returning 7.0% versus global equities' 2.0%. Likewise, the UK fund market recorded its first net positive inflow in November 2024 on the back of the Labour budget. Whilst this is a small fraction compared to the £9.5bn in total outflows over 2024, it broke a 41-month streak of continuous outflows from UK equities, although it has reverted back to outflows in the months that have followed.

The UK market still has considerable ground to recover to reverse years of investor apathy; its rock-bottom valuations – coupled with comparatively stable political conditions, given recent global headlines – may be sufficient to sustain a revival in investor interest. Regardless of how quickly investor sentiment improves, MTU's portfolio companies continue to report robust earnings, as outlined on page 10, demonstrating resilience despite the historic scepticism towards the UK.

Trump's double-edged tariffs

Trump's Liberation Day tariffs have hit global equity markets hard, Britain's included. However, as things currently stand Trump has given a 90-day reprieve to countries that have not yet implemented reciprocal tariffs, such as the UK, in an apparent attempt to force its trading partners back to the negotiation table.

While anything could happen over the 90 days, as things stand the UK has been less impacted than most. A key reason for this is that the new tariff regime is targeting exports of goods into the US, and the UK, with its predominantly service driven economy (services account for over 70% of UK GDP), is inherently less exposed than countries such as Germany, that have large manufacturing sectors. Furthermore, exports of goods from the UK to the US are just subject to Trump's minimum 10% levy (a tax or duty imposed by a government on imported or exported goods); while reprieved for the time being, other nations were facing the prospects of their goods exports being subject to higher rates. Goods from the EU face a potential 20% tariff, for example.

And while the story is developing with each passing day market pundits have already begun to wonder whether the UK's competitive advantage may improve as a result of these tariffs (assuming higher tariff levels kick in for some of the UK's competitors after the 90 period ends). With its good exports set to receive the minimum 10% charge, the UK could find that it is able to price its output more competitively than some other, harder hit, developed market exporters. This may partly explain why the UK government has taken a more diplomatic response to the new regime than others.

When looking at the possible impact on the UK market, it is important to remember that many of the largest companies in the index are global businesses that have been beneficiaries of the trend towards globalisation in the past. Many are also exposed to the knock-on effects of the tariffs on global growth. And while UK small caps may not rack up the same volumes of exports to the US, the international nature of global supply chains, plus the global market leadership of some of MTU's holdings, means that they will still be impacted.

How does Montanaro pick their 'ideal' company?

MAML's purpose is to deliver strong and sustainable investment returns to investors by investing responsibly in quoted, high-quality growth smaller companies. It invests conservatively and for the long term, and does not invest in derivatives or lend the stock in its portfolios. It avoids loss-making companies, highly-leveraged companies, and unquoted/illiquid stocks. MAML's staff are encouraged to invest in its funds, to better align their interests with those of the underlying investors.

MAML has a strong emphasis on proprietary research

The underlying philosophy

MAML's core values underpin its business and its approach to investing. They are:

- "My word is my bond." (integrity in all dealings)
- "Look after your clients and they will look after you."
- "Share the same investment risks that your clients do." (managers are often co-investors alongside clients)
- "You cannot be good at everything – stick to what you are good at."
- "Stay humble."
- "Treat your team as you would your family."

MAML invests in:

- simple businesses that it can understand;
- niche businesses in growth markets (non-cyclical companies, growing organically);
- 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;
- good management that it trusts (aligned to shareholders and demonstrating sound ESG practices); and
- companies that can deliver self-funded organic growth and remain focused on their core areas of expertise, rather than businesses that spend a lot of time on acquisitions.

The company invests in simple businesses it can understand

This could be summed up as investing in high-quality growth businesses at sensible prices.

In addition, MAML believes that it is easier to add value through stock selection for a small and mid-cap portfolio, especially given the relative paucity of research available on these companies.

Selecting the underlying companies

An internal investment committee reviews the portfolio every quarter

An internal investment committee, chaired by Charles, reviews the portfolio every quarter, which reduces the dependence on any one individual – including Charles – for performance (providing oversight and ensuring continuity in the investment approach).

MAML follows a two-staged investment process, designed to identify stocks that are both good businesses and good investments. MTU's portfolio is drawn from a universe of around 1,500 companies, but the trust has a focus on those with a market cap between £100m to £1.5bn. Microcap companies (those with a market capitalisation less than £100m) are avoided due on the liquidity risk they can pose.

The trust, by virtue of its structure, can have exposure to less-liquid stocks and MAML has permission to hold up to 40% in AIM stocks. This is less than some of its competitors. In practice, though, it is unlikely that it would hold more than 30%.

A well-resourced team allows analysts to be well prepared and to set the agenda for meetings with investee companies.

Within its portfolios, including MTU's, MAML will not invest in tobacco companies; companies manufacturing weapons; those facilitating gambling or manufacturing alcohol; companies engaged in oil and coal-related exploration and production; companies involved with pornography; and those making high-interest-rate loans. MAML's corporate governance checks include an assessment of a company's remuneration policy (ensuring executive pay is aligned with shareholder interests). The application of this ethical screen, combined with MAML's minimum liquidity requirements, reduces the target list to about 415 stocks.

MAML has always generated its own investment ideas rather than relying on brokers, which is fortunate as research coverage of MTU's target universe continues to fall (analyst coverage of small and mid-cap stocks has declined significantly post-MiFID II). A team of analysts, each with their own sector expertise, continually screens the investable universe for new ideas. Research responsibilities are distributed amongst the team on a sector basis (although analysts may also compare and contrast UK companies to global peers). Emphasis is placed on being well-prepared for meetings with potential investee companies, 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

On average, each analyst will seek to identify around 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. Stocks are ranked based on 14 quality criteria.

Growth

- Five-year sales growth
- Five-year EBIT growth
- Five-year EPS growth

Profitability

- EBIT margin
- Return on assets
- Return on equity
- 5-year average RoE

Leverage

- Net debt/equity
- Interest cover

Cash

- Cash ratio
- Cash conversion ratio

Volatility

- Five-year sales growth
- Five-year EBIT growth
- Five-year EPS growth

Loss-making companies, those with poor cash-flow, and highly indebted businesses 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 (D to AAA).

Both management and the board of potential investee companies are closely examined, as MAML looks to predict where a company might be in five to ten years.

- Management's track record is analysed to understand their goals and aspirations.
- The board structure is examined, as are the corporate governance and remuneration policies.
- The level of insider ownership is evaluated.
- On site visits, the team will meet employees who have often not met investors before, believing that doing so allows them to gain a better insight into the products and services provided and observe the culture of the company in a way that is hard to decode from reading an annual report.

Then the detailed work starts. The analysts build a financial model and conduct a "SWOT" analysis on each stock (assessing strengths, weaknesses, opportunities, and threats). They also check whether a stock meets MAML's environmental, social and governance (ESG) criteria. 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 over 250 companies (which includes non-UK companies). No fund manager can buy a company that is not on the approved list.

Various valuation tools are considered and the team operates with a time horizon of five to 10 years

Then attention turns to valuation, which is considered as a distinct, second step in the investment process. In this second step, the team has to give consideration to the question of will the good company that it has identified actually make a good investment? These are two separate issues. Various valuation tools are considered (primarily discounted cash flows but also P/E, free cash flow yields, and dividend yields 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% of its intrinsic value (meaning the stock should be trading at least 25% below the team's estimate of its fair value).

Analysts will also look at risk factors. Analysts 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.

Asset allocation

As of 31 December 2024, MTU held 41 portfolio companies, an increase from 35 holdings in March 2024 (as referenced in our previous note). The median market capitalisation of these companies was £971m.

MTU's portfolio retains the same high-quality metrics that are typically attributed to its holdings, with MTU reporting superior return on equity, earnings margins, balance sheet strength, and sales growth when compared to its benchmark, Deutsche Numis SmallCap (excluding investment companies) Index (according to market expectations for 2025).

Figure 4: MTU portfolio metrics versus benchmark

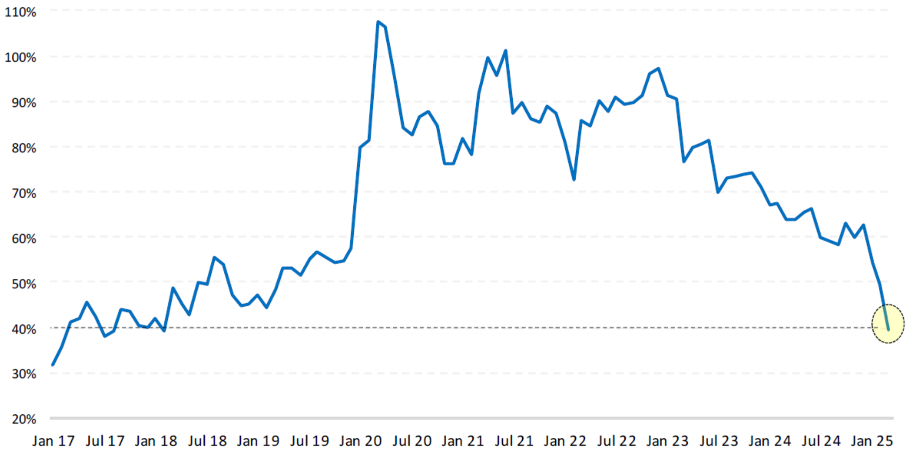
	P/E ratio	EBIT margin (%)	RoE (%)	% of companies with net cash	Sales growth (%)
MTU	16.9	25	20	61	4.7
Deutsche Numis SmallCap (ex-IC) Index	10.4	21	13	21	4.3

Source: Montanaro. Benchmark data as at 31 December 2024.

Likely reflecting the strength of these metrics, MTU's holdings tend to trade at a premium relative to its benchmark. However, this relative premium has begun to decrease, and MTU's portfolio's relative premium to the benchmark is now at a seven-year-low (as measured by the ratio of its P/E relative to its benchmark's – see Figure 5).

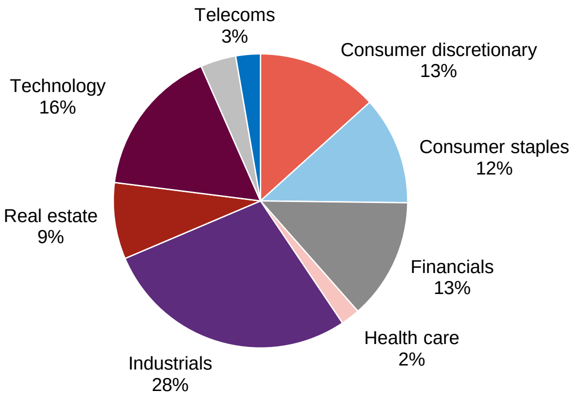
Given MTU's inherently low turnover (the extent to which a portfolio's holdings change over a year with higher turnover implying more active trading and vice versa) and preference for sustained earnings growth, we think the reduction in the premium is likely a result of the market's aversion to UK stocks, rather than Charles's trading activity or investment performance – further evidence of the valuation opportunity presented by MTU and the UK market.

Figure 4: Ratio of MTU's P/E relative to its benchmark



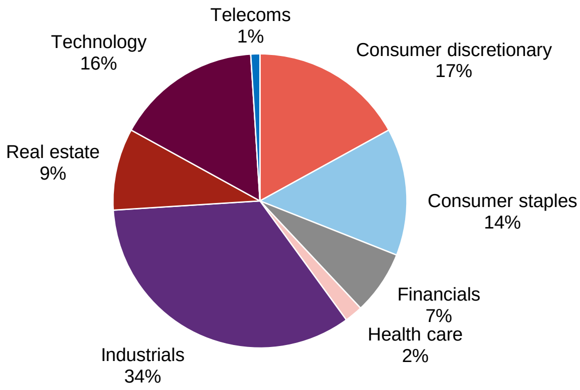
Source: Montanaro, as of 31 March 2025

Figure 5: MTU sector split at 31 March 2025



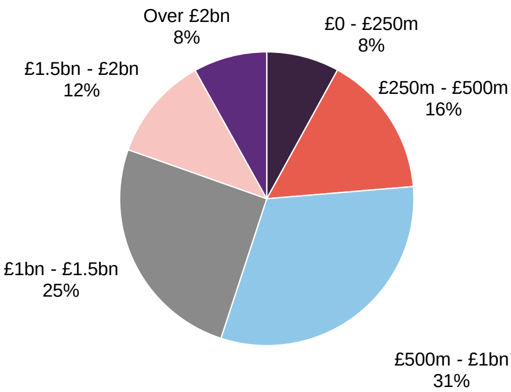
Source: MAML, Marten & Co

Figure 6: MTU sector split at 31 March 2024



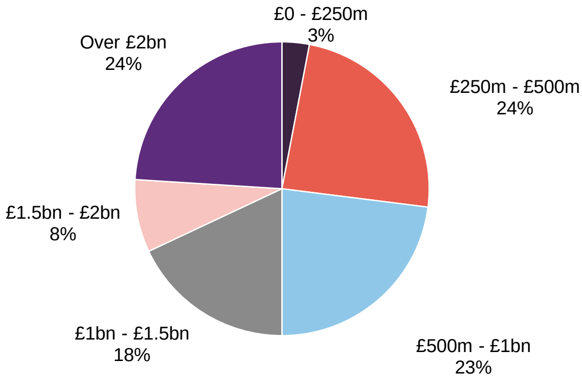
Source: MAML, Marten & Co

Figure 7: MTU split by market cap at 31 March 2025



Source: MAML, Marten & Co

Figure 8: MTU split by market cap at 31 March 2024



Source: MAML, Marten & Co

MTU's asset allocation is driven by stock-specific decisions rather than Charles's views on the broader economy. In terms of sector positioning, there have been notable shifts: MTU's allocation to industrials has decreased, while its exposure to financials has increased correspondingly. This shift is largely explained by MTU's sale of its entire holding in Diploma, a specialist industrial manufacturer, and its purchase of IntegraFin Holdings, the UK's largest investment platform. Despite this rotation, MTU continues to maintain an overweight position in industrials, as well as in technology and consumer staples, with its 11% overweight in technology representing its largest active position.

MTU's portfolio has moved away from the largest and smallest segments of its universe

Changes in MTU's market capitalisation exposure have been more deliberate. Charles has moved away from both the larger and smaller ends of its investable universe, reflecting a conscious decision to decrease exposure to certain segments of the AIM market, as discussed in our previous note.

Top 10 holdings

Since our last note (which used 31 March 2024 data) there have been five new entrants to MTU's top 10 holdings: Hilton Foods, Baltic Classifieds, Bytes Technology, Telecom Plus, and JTC. These replaced Marshalls, Greggs, Games Workshop, Clarksons, and Cranswick. We note that of the new entrants, only Baltic Classified, Telecom Plus, and were the result of significant new investment by Charles. Charles also trimmed his exposure to Cranswick and Greggs over the period.

Figure 9: MTU top 10 equity holdings at 31 March 2025

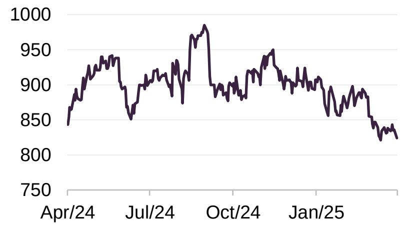
	Business	% as at 31 March 2025	% as at 31 March 2024	Change (%)
discoverIE	Electronic and electrical equipment	5.2	4.6	0.6
XPS Pensions	Pension provider	4.8	3.9	0.9
Big Yellow	Self-storage	4.7	5.2	(0.5)
Hilton Food	Food processing and packaging	4.4	3.1	1.3
Telecom Plus	Telecommunications and utilities	3.9	0	3.9
Baltic Classified	Baltic online classified portals	3.8	0	3.8
Porvair	Filtration products	3.7	3.8	(0.1
4Imprint	Promotional material	3.5	5.4	(1.9
Bytes Technology Group	Computer software reseller	3.5	3.1	0.4
JTC	Professional services	3.5	0	3.5
Total		40.9	46.0	(5.1)

Source: MAML, Marten & Co. Note 1) Total of top 10 includes stocks not listed here

Of the four new entrants, Bytes Technology was covered in our previous note, with Hilton Foods, Baltic Classified, Telecom Plus, and JTC described below. We also include a description of IntegraFin, a noteworthy purchase made since our last note, as well as descriptions of the major sales over 2024.

Hilton Foods

Figure 10: Hilton Foods



Source: Bloomberg

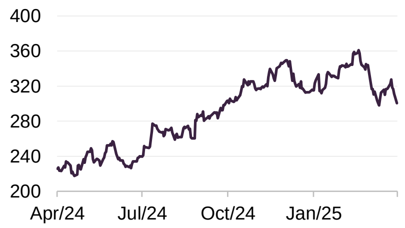
Hilton Foods (hiltonfoods.com) is a food processing and packaging company specialising in meat, seafood, and vegetarian products. Headquartered in the UK, the company operates across Europe and Oceania and is seeking further expansion into the Asia-Pacific region.

Hilton's recent results for the six months ending 30 June 2024 were broadly positive, despite showing a mix of sales volume growth and price contraction. Revenue declined by 8.4% to £1.94bn over the six months, but still reflected a year-on-year increase of 1.0% Notably, these results were outweighed by a significant improvement in profitability, which grew by 23% year-on-year, with margins increasing to 2.4% (profit margin improvement reflects better efficiency and pricing control). This growth was driven by stronger performance in the company's meat and seafood divisions.

Management remains committed to sustaining Hilton's recent growth trajectory, investing £27m in capital expenditure during the period, with a clear emphasis on automation and operational efficiency improvements. Free cash flow nearly doubled over the period, net borrowings declined significantly (falling 20% to £232m) and are now fully covered by its EBITDA (earnings before interest, taxes, depreciation, and amortisation, a common cash flow proxy), and the dividend was raised by 6.7%.

Baltic Classifieds Group

Figure 11: Baltic Classifieds Group



Source: Bloomberg

Baltic Classifieds Group (BCG) (balticclassifieds.com) is a UK-listed Lithuanian company operating multiple online classifieds websites across the Baltic region (Lithuania, Estonia, and Latvia). Its platforms cover four distinct business lines: automotive, real estate, employment, and general classifieds. MTU initiated a position in BCG in the third quarter of 2024.

BCG is well-positioned to capitalise on growth in the Baltic region. This trend was evident in BCG's recent half-year results, with revenue increasing by 17% over the six months to 31 October 2024. All segments reported positive growth during the period, with real estate leading the way with a 26% increase in revenue. Management attributed this strong performance to improving economic conditions, which have particularly benefitted real estate demand.

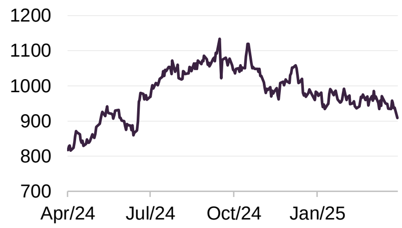
The company's revenue growth has been accompanied by rising profitability, with operating profit increasing by 26% over the period and an impressive 99% cash conversion rate (meaning almost all reported profit was turned into actual cash flow). BCG's improved financial performance is also the result of management-led business initiatives, notably the successful implementation of pricing and packaging changes across both B2C (business-to-consumer) and C2C (consumer-to-consumer) segments.

BCG's management maintains a positive outlook for the second half of its financial year, forecasting revenue growth of at least 15% and further margin expansion as the year progresses. Key structural drivers supporting this optimism include the ongoing recovery in real estate transaction volumes, increased mortgage uptake, and the broader shift towards digital classified ads.

In addition to driving operational improvements, management has taken steps to strengthen the company's financial position. This includes the voluntary repayment of €12m in debt, the repurchase of €13.5m worth of shares, and a 20% increase in the dividend.

JTC

Figure 12: JTC



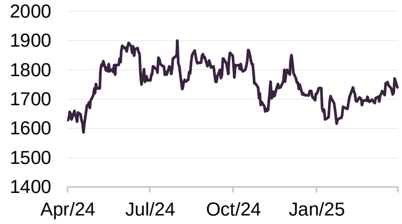
Source: Bloomberg

JTC (www.jtcgroup.com) describes itself as a professional services business that offers fund services, corporate services, private client services and institutional client services (for example, fund accounting, tax reporting, and private trust structuring). JTC reported 2024 revenue growth above management's expectations, with organic growth coming in at 11.3% versus the 10% anticipated. Revenue growth was enhanced by successful acquisitions of six companies over the period, adding an additional 7.3% to its revenue (for a total of 18.6%, with reported revenues of £305.4m). 2024 was also the 37th consecutive year of revenue and profit growth for JTC, with before-tax profits increasing by 17.1%.

JTC's management note that the implementation of their "Cosmos" strategic plan as being a major driver of their returns. Having been initiated in 2024, the objective of the plan is to double JTC's size by 2027 – targeting revenues of £500m and an EBITDA of £170m. JTC's management intend to achieve this through a combination of strategic acquisitions, improving organic growth (targeting 10% per annum), and the adoption of new technologies. With JCT having already hit the annual key targets of its plan over 2024, management expects the business to be on track to deliver similar numbers over 2025.

Telecom Plus

Figure 13: Telecom Plus



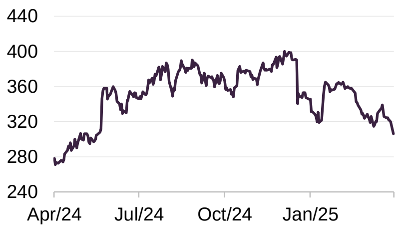
Source: Bloomberg

Telecom Plus (telecomplus.com) is a telecommunications and utilities provider, offering telephone, gas, electricity and internet services to residential and small business customers in the UK. Telecom Plus was the second-largest purchase made by MTU over 2024, with it investing £5.5m in the firm. Telecom Plus has since reported mixed results, with its revenues declining but profitability improving (over the six months to September 2024).

Revenues fell 21% over that six months due to lower retail energy prices over the year (energy revenues are sensitive to wholesale price movements). Thankfully Telecom Plus's management was more than able to offset the fall in revenues with improving profitability, with gross profits up 1.7%. This can be attributed to the third consecutive year of double-digit customer growth – up 13% over the period – as well as the launch of several new products, including faster broadband, electric vehicle-specific tariffs, and the incorporation of Apple Pay.

Despite the headwinds from energy price volatility and the costs associated with Labour's recent budget, Telecom Plus's managers are supportive of the near-term. They highlight cost-of-living challenges driving demand for their money-saving bundled services, improving customer signups from their partnership model (e.g. referrals from professional services firms), and the general growth in demand for electric vehicle charging and high-speed broadband. Management has reiterated its medium-term target of 2m customers, with 12-14% customer growth over the next six months, and a pre-tax profit between £124–128m (with six-month pre-tax profits of £46.1m).

Figure 14: IntegraFin



Source: Bloomberg

IntegraFin

IntegraFin (www.integrafin.co.uk) is the UK's largest investment platform. It is primarily used by financial advisors and best known for its ownership of Transact, the retail investment platform. The company has over £60bn in funds held on its platform and is used by over 8,000 advisors.

IntegraFin has continued to hit all-time highs for asset inflows, adding £900m in new assets being during the first three months of the current financial year alone. This was driven by a combination of improved digitisation of its services, allowing it to appeal to a wider audience; improved investment performance, with management highlighting the US election and UK budget as key flashpoints for increased investor activity; and ongoing improvements to its platform's functionality.

IntegraFin's market dominance and asset growth have been translated into strong financial performance, with revenues growing 7.4% over its 20204 financial year – up to £144.9m. Gross profit margins reached an impressive 98% (percentage of revenue that remains after subtracting the cost of goods sold), showing how efficiently a company produces and sells its products reached an impressive 98%, a consequence of its asset-light business model (operates without heavy physical infrastructure costs). However, its operating profit margin is much lower, though still a respectable 39.3%. Thanks to its exceptionally high gross margins, IntegraFin is able to increase its investment expenditures without compromising its balance sheet.

Disposals – Diploma, Judges Scientific

MTU made two significant disposals over 2024, selling their entire holdings in Diploma, the specialist industrial manufacturer, and Judges Scientific, an acquisition group focused on scientific instrument businesses. Prior to its sale, MTU held a £11m position in Diploma. Charles and the team had previously raised concerns around the frequent changes to its renumeration policy, with the salary increases for its CEO and CFO being standout issues. MTU also sold its entire £4.3m stake in Judges Scientific due to its declining earnings outlook.

Performance

Figure 15: MTU NAV relative to Deutsche Numis Smaller Companies ex Investment Companies Index in total return terms over five years to 31 March 2025

Source: Morningstar, Marten & Co

Figure 16: Total return performance over periods ending 31 March 2025

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
MTU share price	(5.8)	(5.5)	(5.8)	1.1	(10.8)	20.3
MTU NAV	(4.5)	(8.5)	(10.5)	(6.6)	(11.3)	14.5
Deutsche Numis Smaller Companies ex IC	(3.7)	(5.3)	(7.5)	2.3	2.7	68.2
Peer group median NAV[1]	(4.0)	(7.7)	(10.8)	(3.1)	(11.9)	54.0

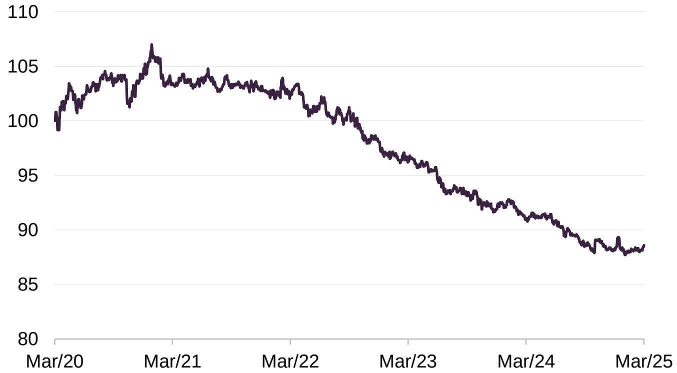
Source: Morningstar, Marten & Co. Note 1) peer group is defined on page 23.

As shown in Figure 16, MTU's NAV gave back much of its previous outperformance relative to its benchmark between late 2020 and 2021, coinciding with the broader sell-off in growth stocks compared to other investment styles. This decline was driven by the then-rising interest rate environment, with post-lockdown inflation prompting the Bank of England to raise rates to levels not seen since the 2008 financial crisis (higher interest rates tend to reduce the valuations of growth stocks, which tend to have a greater proportion of their value discounted back from the future).

Although relative performance began to stabilise in 2022, UK small-cap value stocks have continued to outperform growth stocks, leading to a gradual widening of the performance gap between MTU and its index. Another key factor affecting MTU's recent performance has been the changes to the tax treatment of AIM-listed stocks, announced in the recent Labour budget. The reduction in tax benefits (previously, certain AIM stocks qualified for inheritance tax relief) has intensified selling pressure in the sector. MTU maintains approximately 16% exposure to AIM, whereas its benchmark does not, which has inevitably impacted MTU's relative performance. It is worth noting that the Deutsche Numis Smaller Companies plus AIM ex IC Index underperformed its non-AIM equivalent (MTU's benchmark) by 13.0%, as shown in Figure 18.

Figure 19 acts as evidence how UK small-cap growth stocks have generally underperformed their value counterparts, mirroring MTU's relative underperformance of its benchmark – supporting Charles's comments around the macro headwinds facing dedicated growth managers.

Figure 17: Deutsche Numis Smaller Companies plus AIM ex IC relative to the equivalent plus IC



Source: Morningstar, Marten & Co

Figure 18: MSCI UK Small-Cap Growth relative to MSIC UK Smal-Cap Value

Source: Morningstar, Marten & Co

Further, when comparing the MSCI UK Small Growth Index to MTU's benchmark (the Numis Smaller Companies ex Investment Companies Index), the relative underperformance closely tracks that of MTU. Given MTU's higher exposure to the "growth" and "quality" style factors than the MSCI UK Small Growth Index, one might have expected the macroeconomic headwinds to have had an even greater impact on MTU. This suggests that Charles's stock selection may have mitigated potential losses. It is worth reiterating that Charles does not factor macroeconomic considerations into portfolio construction. Instead, he focuses on long-term company fundamentals (such as returns on equity, balance sheet strength, and market leadership), aiming for performance to be driven by the sustained success of their portfolio holdings rather than attempting to time macroeconomic events (such as interest rate cycles or economic recessions).

Attribution

Figure 19: Relative performance attribution, 12 months to 31 December 2024

Positive		Negative	
XPS Pensions	1.4%	YouGov	(1.8%)
Raspberry PI	1.2%	Tracsis	(1.6%)
Games Workshop	1.1%	Big Yellow	(1.3%)
Cranswick	0.7%	Kainos	(1.0%)
Boku	0.7%	Bytes Technology	(1.0%)
Total	5.1%	Total	(6.6%)

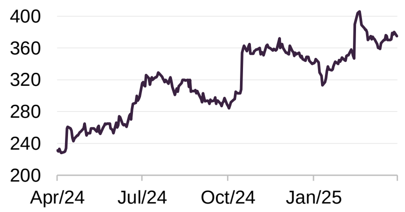
Source: Montanaro UK Smaller Companies.

There were a number of standout performers as well as key detractors over 2024. The top and bottom five performers are listed in Figure 18, and more information about some of them is detailed in the following pages.

Positive contributors

XPS Pensions

Figure 20: XPS Pensions



Source: Bloomberg

XPS Pensions (xpsgroup.com) is a pensions consultancy and administration firm. Its share price rose by 68% over the 12 months to the end of January 2025 and rallied a further 17% in February following a positive trading update.

In the first half of its 2025 financial year (the six months ending 30 September 2024), XPS reported strong revenue and profit growth, increasing by 23% and 27%, respectively. Revenue growth partly reflects broader structural drivers in the pensions industry, including higher interest rates improving pension scheme funding (as liabilities fall when discount rates rise) and elevated inflation enabling fees to be increased. Regulatory changes have also benefited certain business segments, with XPS's administration services posting an impressive 40% year-on-year growth.

XPS Pensions's management noted that profit growth has been supported by increased uptake of higher-margin services, such as risk transfer advisory, and improved operational leverage – the company's ability to convert revenue growth into proportionally higher profits.

Whilst management had anticipated a more challenging market environment in the second half of the financial year, it now expects full-year results to show 15–16% year-on-year revenue growth, supported by sustained demand continuing into the latter half of the year.

Raspberry Pi

Figure 21: Raspberry Pi

Source: Bloomberg

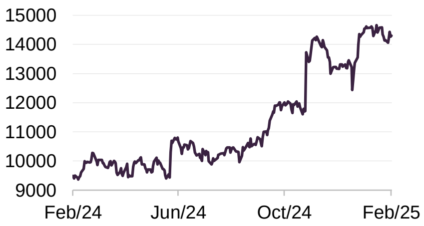
Raspberry Pi (raspberrypi.org) is a Cambridge-based designer and manufacturer of small, single-board computers – which can be programmed for a wide variety of uses. The company IPO'd in 2024, joining the FTSE 250, and stands out for being a domestic UK technology company that has bucked the trend by listing in the UK rather than the US.

The company's share price has more increased 65% from its 360p listing price to 595p per share as of 28 February 2025. The majority of these gains occurred in December 2024, driven by two key events. Firstly, the company announced a strategic partnership with SECO, an Italian developer, enabling SECO to bring to market a new Human-Machine Interface solution based on Raspberry Pi's latest product, the CM5. Secondly, it was revealed that US hedge fund SW Investment Management had acquired a 3.59% stake in the company, further boosting investor confidence.

Raspberry Pi also reported positive results for the first six months of its financial year (to 30 June 2024), with profits exceeding market expectations, although sales volumes were slightly below forecasts. Nevertheless, management reiterated its full-year guidance, anticipating higher unit volumes in the second half of the year.

Games Workshop

Figure 22: Games Workshop



Source: Bloomberg

Games Workshop (games-workshop.com) is a specialist UK hobby retailer, best known for its Warhammer line of miniatures and tabletop wargames. Following several years of strong earnings and share price growth, Games Workshop's shares rallied significantly in November after the release of another positive set of results for the six months ending 1 December 2024.

Management reported revenue growth of 21%, driven by increased demand for both its core wargaming products and its licensing revenues (royalties from third-party adaptations of its intellectual property). Notably, the company also reported growth in its physical retail stores – a channel that has been under sustained pressure for many other retailers. Profits grew at an even faster pace, with pre-tax profits rising by 33%. The final two months of the financial period were particularly robust, with management expecting similarly strong performance in the second half of the financial year.

To sustain this sales momentum, management has continued to invest in the business. Plans include opening 30 new stores across East Asia and expanding production capabilities through new manufacturing and paint facilities, with capital expenditure more than doubling over the period to £14.3m.

One of the most significant headlines from the company's annual report was the announcement of an agreement with Amazon to adapt the Warhammer 40,000 universe into films and television series – a development that could further enhance the brand's global reach.

Detractors

The three major detractors from MTU's performance were market research and data firm YouGov; transportation software developer Tracsis; and self-storage company Big Yellow.

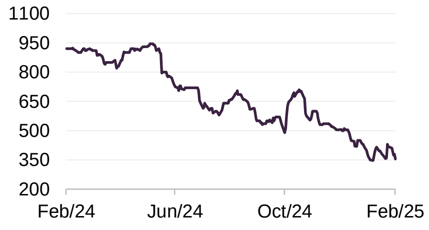
Figure 23: YouGov

Source: Bloomberg

YouGov

YouGov's shares plummeted by 46% in a single day in June after issuing a profit warning, revising its 2024 revenue forecast down by 6% and profit expectations by 36%. Despite the downgrade, YouGov still projected year-on-year revenue growth and later softened the extent of the revision in the weeks following the announcement. In response, the CEO appointed in August 2023 has stepped down and Stephan Shakespeare, one of the founders of the company, has taken on the role on an interim basis. The company has also appointed a new non-executive chair, Deborah Davis, again on a temporary basis.

Figure 24: Tracsis



Source: Bloomberg

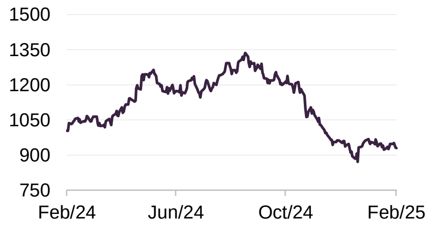
Tracsis

Tracsis's share price has been on a steady downward trajectory for much of the past 12 months. The company has been an unfortunate casualty of UK political developments, with the rail sector – one of its key customer bases – impacted by stalled government spending during the summer general election period. The arrival of the Labour government has added further uncertainty regarding future revenues. Tracsis has also been affected by the broader sell-off in AIM-listed stocks (AIM companies, often smaller and growth-focused, have been particularly vulnerable to recent shifts in investor sentiment and regulatory changes).

Big Yellow

Big Yellow's share price declined by 20% over the final two months of 2024, primarily due to macroeconomic factors rather than company-specific developments. Sluggish UK economic growth and a weakening housing market have weighed on investor expectations surrounding demand for storage solutions.

Figure 25: Big Yellow



Source: Bloomberg

Peer group comparison

The peer group that we have used in this note is a subset of funds within the AIC's UK smaller companies sector. We have omitted split-capital companies, trusts with a small market capitalisation, and those with an exclusive focus on micro-cap companies.

MTU's long-term performance sits towards the bottom of its peer group, although as we commented in the previous section, MTU's relative performance may be explained in part by its strong bias to what Charles considers to be quality-growth companies (with Morningstar classifying MTU as having the second-highest growth bias of our peer group), as well as its exposure to AIM stocks. MTU's ranking has improved in recent months, however.

Figure 26: Listed UK smaller companies peer group NAV total return performance over periods ending 28 February 2025

	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
MTU	(5.6)	(8.6)	1.5	(6.9)	0.1
Aberforth Smaller Companies	(6.4)	(11.7)	6.5	11.7	28.0
abrdn UK Smaller Companies Growth	(3.6)	(6.1)	11.6	(13.4)	3.1
BlackRock Smaller Companies	(7.3)	(12.3)	(0.0)	(16.1)	5.5
BlackRock Throgmorton	(7.3)	(10.6)	0.6	(14.0)	12.8
Crystal Amber	6.7	9.7	69.9	73.6	97.4
Henderson Smaller Companies	(5.6)	(11.0)	3.9	(16.6)	4.5
Invesco Perpetual UK Smaller	(8.1)	(16.3)	(3.3)	(22.6)	(6.9)
JPMorgan UK Small Cap Growth & Income	(3.1)	(7.8)	5.7	(1.7)	29.3
Odyssean	(5.0)	(16.6)	(3.5)	(8.0)	35.3
Oryx International Growth	(1.1)	(6.0)	2.3	6.7	44.4
Rights & Issues	(7.0)	(12.8)	5.4	(6.5)	27.3
Rockwood Strategic	0.5	(1.3)	25.8	95.6	110.6
Strategic Equity Capital	(6.7)	(13.7)	0.8	3.9	32.1
Peer group median	(0.6)	(7.9)	5.6	(5.1)	20.1
MTU rank	7/14	6/14	9/14	8/14	13/14

Source: Morningstar, Marten & Co

Comparing MTU on other measures, as shown in Figure 27, it is a reasonable size – once again sitting roughly middle of the pack for this peer group.

We note that the yield presented in Figure 28 reflects historic dividend payments. However, following the implementation of its new 6% of NAV payout, it should, all other things being equal, rank at as the highest-yielding trust in the sector.

MTU's ongoing charges ratio sits in line with the peer group median and is comparable to those of much bigger funds in the peer group, although its ranking has the potential to improve, given the changes outlined on pages 3 and 4.

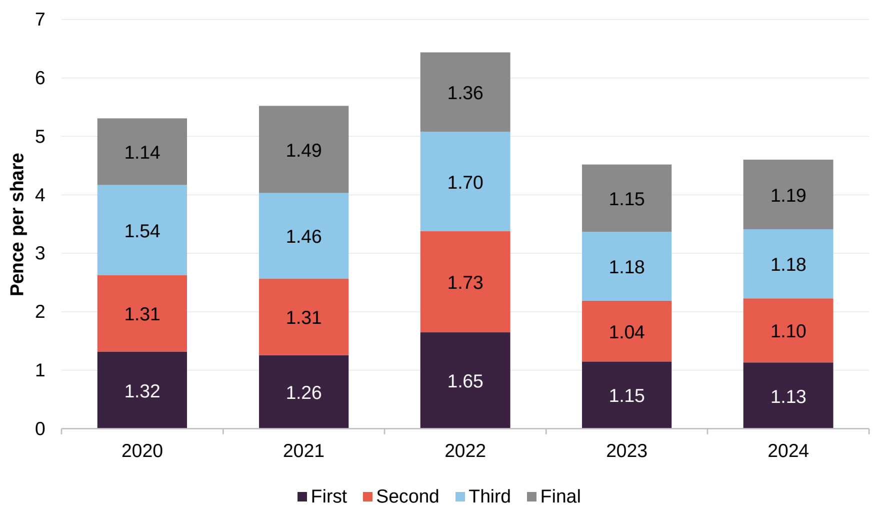
Figure 27: Listed UK smaller companies funds, comparison as at 24 April 2025

	Market cap (£m)	Discount (%)	Dividend yield (%)	Ongoing charges ratio (%)
MTU	130	(10.0)	4.85	0.91
Aberforth Smaller Companies	1,114	(9.6)	3.66	0.78
abrdn UK Smaller Companies Growth	301	(8.7)	2.56	0.92
BlackRock Smaller Companies	529	(11.4)	3.75	0.8
BlackRock Throgmorton	411	(11.1)	3.42	0.56
Crystal Amber	84	(31.2)	7.94	-
Henderson Smaller Companies	535	(10.4)	3.61	0.45
Invesco Perpetual UK Smaller	105	(13.6)	4.9	1.01
JPMorgan UK Small Cap Growth & Income	375	(11.4)	3.51	0.64
Odyssean	170	(0.2)	0	1.45
Oryx International Growth	147	(35.7)	0	1.37
Rights & Issues	90	(16.7)	2.3	0.9
Rockwood Strategic	96	0.1	0	1.75
Strategic Equity Capital	133	(9.7)	1.18	1.2
Peer group median	159	(10.7)	3.47	0.91
MTU rank	10/14	6/14	3/13	7/14

Source: Morningstar, Marten & Co

Dividend

Figure 28: MTU ordinary dividends (pence per share), 2020-2024*



Source: MAML, Marten & Co. *Note: 31 March financial year-ends.

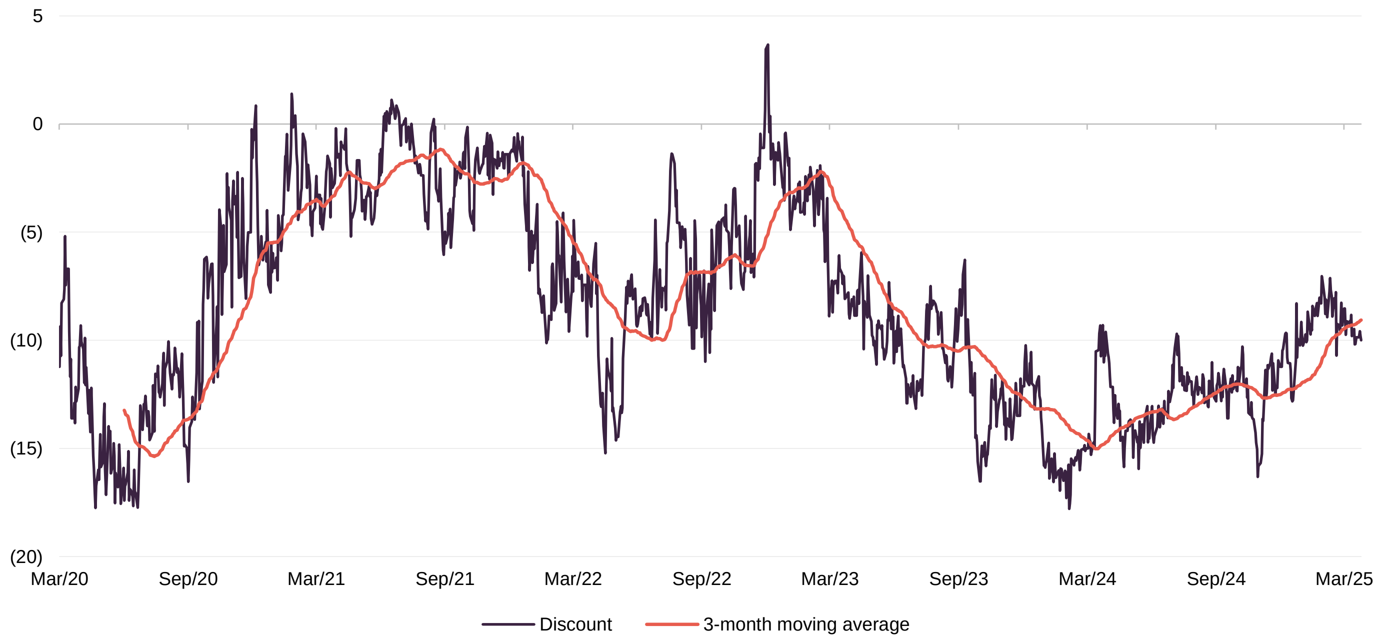
MTU offers the seldom-found combination of an attractive dividend and a growth-stock portfolio

As outlined on pages 3 and 4, MTU has increased its annual dividend payout from 4% to 6% of NAV. Dividends will continue to be paid quarterly, equivalent to 1.5% of the company's NAV on the last business day of the preceding financial quarter – specifically at the end of March, June, September, and December. Consequently, the nominal payout will vary with fluctuations in the NAV and therefore with movements in the underlying portfolio and markets.

The adoption of an enhanced dividend policy has not affected the way in which the portfolio is managed or the yield it generates by the underlying portfolio. In instances where MTU's revenues are insufficient to cover the dividend, the shortfall is met from reserves. MTU's primary objective remains capital growth, with income generated by the underlying portfolio considered a by-product of the manager's stock selection decisions. As noted on page 4, MTU's "quality-growth" investment approach typically does not produce high levels of income. The ability to offer this level of payout is a benefit of its investment trust structure.

Premium/(discount)

Figure 29: MTU premium/(discount) over five years ending 24 April 2025



Source: Morningstar, Marten & Co

Over the year ending 31 March 2025, MTU's shares traded within a discount to NAV range of 17.8% to 7.0%, with an average discount of 12.5% and a median discount of 12.4%. As of 24 April 2025, MTU's shares were trading at a discount of 10.0%.

MTU's discount widened significantly over 2023, primarily due to the impact of higher interest rates on investor demand for growth stocks and related funds. However, as shown in Figure 30, the discount has begun to narrow over the past year.

The recent narrowing of MTU's discount can be partially attributed to the changes outlined on pages 3 and 4. A higher dividend profile from MTU has likely increased the range of potential investors in the trust, such those whose income demands would have previously prevented ownership, which may have lead to greater demand for a unique product like MTU.

> MTU's management has repurchased 21.5% of the outstanding shares since the start of 2025.

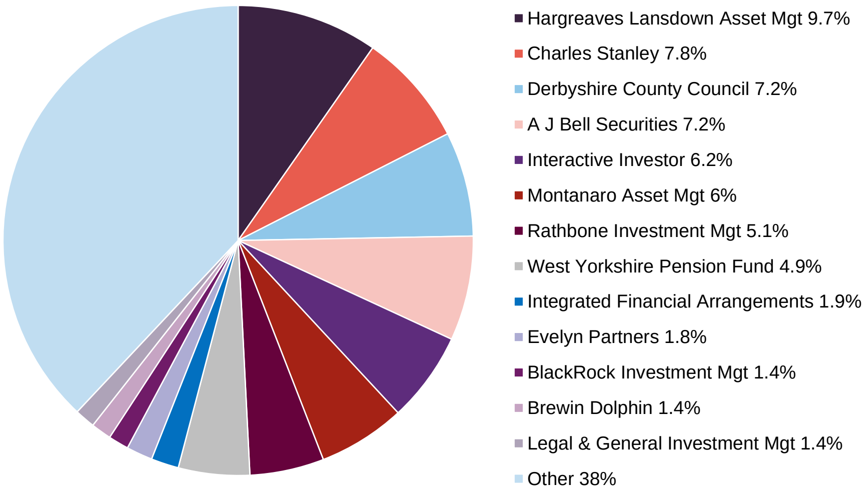
Whilst it has been given the authority to buy back shares, the managers and board believe that share buy-backs may not the best way to influence the discount, given its propensity to shrink trusts (reducing assets under management and market liquidity). Instead, they would rather that the inherent attractiveness of MTU's investment approach, and the advantages of its dividend profile, drive demand. The board has begun to utilise this facility, however, and has repurchased 30m shares since the beginning of 2025, equal to 21.8% of its current circulation. In January 2025 the board announced their intention to keep MTU's discount "at single digits in normal market conditions", with shareholders voting to renew MTU's buyback policy on 31 March 2025.

The most significant usage of its buyback facility, and MTU's largest buyback in recent memory, was made on 5 March 2025, when the board repurchased 12% of its outstanding shares for £20m. This transaction completely removed the activist investor Saba Capital from MTU's register, effectively removing a potential overhang on MTU's stock. Importantly, this buyback was done on the same terms as those offered to other investors while also being NAV accretive for remaining shareholders (meaning it increased the NAV per share).

Saba's recent attempts to take control of various UK investment trusts, or more recently unitise them (transforming them into open-ended structures), have been disruptive for its targets and may have been an impediment to MTU attracting new shareholders. With Saba gone, there's no longer an obvious threat to MTU's operations or the constancy of its investment approach, allowing potential shareholders to invest with confidence that MTU can continue to offer its strategy.

Major shareholders

Figure 30: Major shareholders as at 31 December 2024



Source: Bloomberg

Previous publications

Readers interested in further information about MTU may wish to read our previous notes listed below. You can read them by clicking on the links or by visiting the QuotedData website.

Figure 31: QuotedData's previously published notes on MTU

Title	Note type	Date
Reputation restored	Initiation	5 March 2020
Long COVID effect requires a focus on corporate health	Update	16 April 2021
Sell-off provides opportunities	Annual overview	04 July 2022
Riders on the storm	Annual overview	23 June 2023
A coiled spring?	Annual overview	14 June 2024

Source: Marten & Co

IMPORTANT INFORMATION

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