MONTANARO

European Smaller Companies Trust plc

Annual Report and Accounts 2018

The investment objective of **Montanaro European Smaller Companies Trust plc** (the 'Company') is to achieve capital growth by investing principally in Continental European quoted smaller companies.

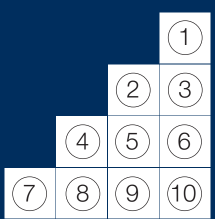
The Company's benchmark index is the MSCI Europe SmallCap (ex UK) Index (in sterling terms).

The Company was launched in May 1981. Its current objective and investment policy were adopted in September 2006. Its Ordinary Shares are listed on the Main Market of the London Stock Exchange.

The Company conducts its affairs so that its Ordinary Shares can be recommended by IFAs to ordinary retail investors in accordance with the FCA's rules relating to non-mainstream investment products and intends to continue to do so.

This document is important and refers to certain matters on which voting action is required. Shareholders who are in any doubt as to what action to take should consult an appropriate independent adviser immediately.

If any shareholder has sold or transferred all their shares in the Company, he or she should pass this document to the purchaser or transferee or to the person through whom the transfer or sale was effected for onward transmission to the transferee or purchaser.



Cover Images

1. **De Longhi's** Kenwood Cooking Chef
2. **Vitrolife's** EmbryoGlue
3. A cross section of the PW1000G engine, showcasing **MTU Aero Engines** components
4. **Rational's** VarioCooking Center
5. A **Sartorius Stedim** Flexboy bag
6. A **LEM** current transducer
7. Clothing by **Brunello Cucinelli**
8. An **I.M.A.** Evo Flex Rotary automatic assembly machine
9. Freeze-dried Lactic Culture for Direct Vat Set by **Christian Hansen**
10. A **Brembo** brake caliper

Highlights
for the year ended 31 March 2018

Results

> Net asset value ('NAV') per Ordinary Share +10.8%

> Share price +15.1%

> Benchmark index (capital return) +10.2%

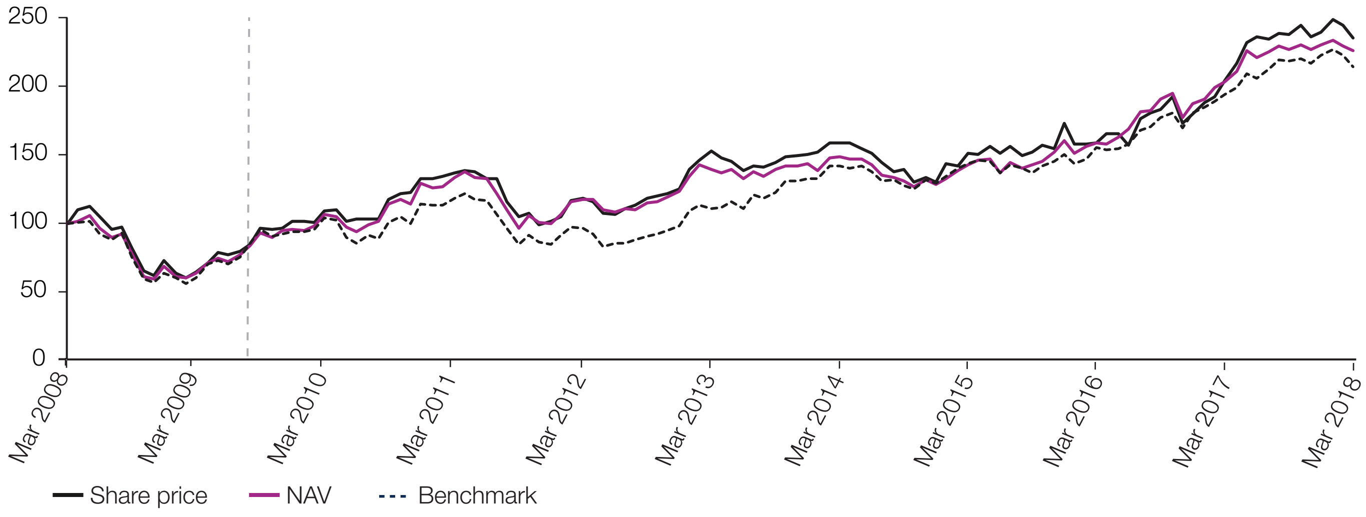
> Total assets +9.7% (£172.9 million)

	As at 31 March 2018	As at 31 March 2017
Net assets ('000s)	**£150,776**	£136,050
NAV per Ordinary Share	**901.1p**	813.1p
Ordinary Share price	**800.0p**	695.0p
Discount[1]	**11.2%**	14.5%
Dividends per Ordinary Share	**8.50p**	8.25p
Gearing[1]	**0.6%**	7.3%
Ongoing charges[1]	**1.2%**	1.2%

[1] Refer to Alternative Performance Measures on page 62.

NAV, Share Price and Benchmark Index 10 year performance graph

rebased to 100 at 31 March 2008



--- From 5 September 2006, the benchmark was the MSCI Europe SmallCap Index. The benchmark was changed on 1 June 2009 to the MSCI Europe SmallCap (ex UK) Index (in sterling terms).

Potential investors are reminded that the value of investments and the income from them may go down as well as up and investors may not receive back the full amount invested. Tax benefits may vary as a result of statutory changes and their value will depend on individual circumstances.

Chairman's Statement
for the year ended 31 March 2018

Results
The year to 31 March 2018 was another positive one for investors in European smaller companies: the MSCI Europe SmallCap (ex UK) Index (in sterling terms) rose by 10.2%. In comparison, the net asset value ('NAV') of your Company rose by 10.8% to 901.1p per share. The share price did even better – rising by 15.1% to 800.0p, as the discount narrowed from 14.5% to 11.2%.

Over the course of the year the Euro (representing 58.4% exposure of the NAV at year end) rose 2.6% against Sterling but both the Swedish Krona and the Swiss Franc (combined 31.3% exposure of the NAV) declined against Sterling resulting in almost no overall currency effect on the net asset value. We do not hedge currencies.

Since the appointment of Montanaro Asset Management Limited ('Montanaro') in September 2006, the NAV per share has increased by 161.9% compared with an increase of 132.3% in the benchmark index (see the 'Key Performance Indicators' on page 13).

A review of the market, investment approach and an analysis of performance is set out in the Manager's Report together with more detail on the stocks in which the Company is invested.

Earnings and Dividends
Revenue earnings per share for the year were 9.5p (2017: 9.8p).

The Company's primary aim is to deliver capital growth to its shareholders. However, our substantial revenue reserve combined with the long-term growth in dividends of the companies in which we invest have allowed us to maintain a consistent and robust dividend payout. An interim dividend of 1.75p per share was paid on 5 January 2018. The Board recommends the payment of a final dividend of 6.75p per share payable on 3 September 2018 to shareholders on the register on 13 July 2018. Subject to shareholder approval, this would bring the total dividends for the year to 8.50p per share, an increase of 3.0% compared to the previous year.

Directors
Over the last few years, we have taken steps to refresh the Board. In the current year a recruitment process was undertaken by the Nomination Committee. On 8 November 2017, Caroline Roxburgh was appointed to the Board. Caroline Roxburgh is a Chartered Accountant with over 30 years' experience in finance and audit and was formerly a Partner at PricewaterhouseCoopers LLP until her retirement in 2016.

Bruce Graham and Alex Hammond-Chambers will retire following the conclusion of the Annual General Meeting on 29 August 2018. Bruce Graham (Chairman of the Audit Committee) and Alex Hammond-Chambers (Chairman of the Nomination Committee and Senior Independent Director) have served on the Board since 2003 and 2004 respectively and I would like to thank them both for their outstanding contribution and firm commitment to the Board. Following their retirement, Caroline Roxburgh will become Chairman of the Audit Committee, Richard Curling Chairman of the Nomination Committee and Merryn Somerset Webb the Senior Independent Director.

I have served on the Board since 1992 and as Chairman since 2004 and will also retire following the conclusion of the Annual General Meeting on 29 August 2018. I am pleased to report that the Board intends to appoint Richard Curling to succeed me as Chairman. Richard has over 30 years' experience as a fund manager with extensive experience of investment trusts and has made a significant contribution to the Company since he joined the Board in 2015. I know his counsel will serve the Company well.

The Nomination Committee is currently undertaking a further recruitment process with a view to appointing another non-executive director in the near future. This would bring the Board to four non-executive directors following these retirals.

Borrowings

The Board, in discussion with the Manager, regularly reviews the gearing strategy of the Company and approves the arrangement of any gearing facility. Gearing increases or decreases the returns from underlying profits or losses generated by the investment portfolio. This is a key feature of investment trusts that we believe offers a strong competitive advantage over alternative open-ended investment funds. Therefore, the Board strongly encourages the active use of gearing by the Manager.

The Board has set a maximum limit on borrowing, net of cash, of 30% of shareholders' funds at the time of borrowing. At the end of the fiscal year, the Company had borrowings, net of cash, of 0.6% compared to 7.3% at the beginning of the year, the decline being explained within the Manager's Report on page 7.

The Company currently has borrowings in the form of fixed rate loans totalling €25 million which are due to mature on 13 September 2018. It is the current intention of the Board to secure further borrowing at an appropriate level.

Treasury Shares

During the year, the Company did not buy back shares into or sell shares from Treasury. The Board's stated Treasury shares policy is included on page 24.

The Board will seek to renew the Company's share buyback and share issuance authorities at the forthcoming Annual General Meeting.

Annual General Meeting

The Annual General Meeting will be held on Wednesday 29 August 2018 at 12.30pm at the offices of BMO Global Asset Management, Quartermile 4, 7a Nightingale Way, Edinburgh. Shareholders are encouraged to attend the Meeting where there will be an opportunity to meet and ask questions of the Board and the Manager.

Outlook

We continue to believe that the fundamentals behind the market remain positive. Global economies are growing and monetary policy remains accommodative. However, it remains to be seen how markets respond to rising interest rates in the face of stronger economic growth, or indeed lower growth than expected.

Your portfolio consists of some of the highest quality companies in Europe. Their strong management teams, good growth prospects, sound balance sheets and cash generative business models should ensure that long-term returns will be attractive irrespective of short-term considerations.

A R IRVINE
Chairman
29 June 2018

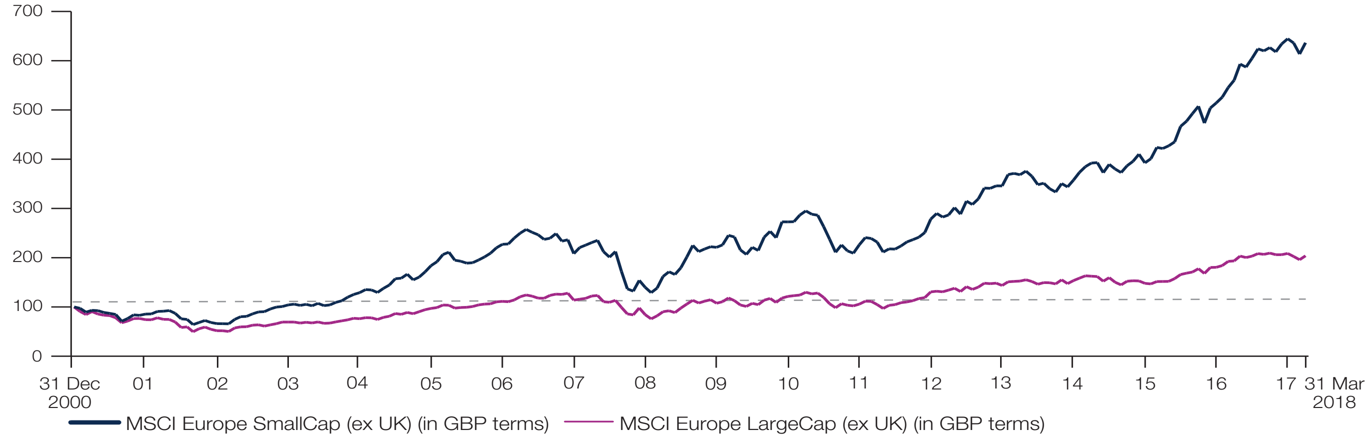
Forward-looking statements

This document may contain forward-looking statements with respect to the financial condition, results of operations and business of the Company. Such statements involve risk and uncertainty because they relate to future events and circumstances that could cause actual results to differ materially from those expressed or implied by forward-looking statements. The forward-looking statements are based on the Directors' current view and on information known to them at the date of this document. Nothing should be construed as a profit forecast.

Manager's Report

Continental European Small v. LargeCap

(MSCI Europe SmallCap (ex UK) v. MSCI Europe LargeCap (ex UK) indices, Net TR, GBP)
(rebased to 100 from 31 December 2000)



The Attractions of Quoted European Smaller Companies ('SmallCap')

The key attraction of investing in smaller companies is their long-term record of producing higher returns than large companies. In the UK, over the last 63 years, this has amounted to an average of 3.4% per annum ("the SmallCap Effect"). £1 invested in large companies in 1954 would now be worth £1,000, whereas the same £1 invested in smaller companies would now be worth over £7,200 – seven times more.

We have less data in Europe – it only goes back to 2000. But what data we have suggests that the SmallCap Effect is even more pronounced here: as can be seen in the chart above, European "small" companies have been outperforming large ones by over 7.1% per annum.

The market for European smaller companies is inefficient. While some large companies are analysed by over 50 sell-side research institutions, many smaller companies in Europe have little or no such coverage. Following MiFID II, research coverage for small companies may well decline even further. We believe that this makes it easier for those with a high level of internal research capability to find attractive, undervalued and unrecognised investment opportunities. This in turn makes it possible to deliver long-term performance over and above that of the index.

Montanaro

Montanaro was established in 1991. We have one of the largest and most experienced specialist teams in the UK dedicated exclusively to researching and investing in quoted smaller companies.

At 31 March 2018, Montanaro's assets under management stood at €2.8 billion.

Investment Process

Montanaro specialises in researching and investing in quoted smaller companies. We have a particular focus on those with a market value below €5 billion.

We have a disciplined, two-stage investment process. Initially, we identify good businesses within our investable universe – the very best go onto our approved list of stocks. In the second stage, we assess valuation and select the most attractive investments from the approved list for your portfolio.

We have an in-house team of eleven analysts who each focus on specific sectors. Utilising their specialist industry knowledge and a range of proprietary screens, they are continually on the lookout for new investment ideas. With around 4,000 companies to choose from, they can afford to be picky.

We look for high quality companies that have strong growth prospects. They must be profitable, have good and experienced management and deliver sustainably high returns on capital employed. We prefer those that can deliver self-funded organic growth without diluting their returns or straying from their areas of expertise. Conversely, we avoid those with stretched balance sheets, poor cash generation, incomprehensible accounts or structurally challenged business models. We also do not invest in companies that generate a significant proportion of sales from products with negative societal impacts such as tobacco, gambling, armaments or alcoholic drinks.

When we consider that we have identified a good company, it must still pass our stringent checklist and be approved by Montanaro's Investment Committee before it is added to our approved list. A stock cannot be considered for inclusion in your portfolio until it has passed this hurdle.

Once approved, we conduct a detailed analysis of a stock's valuation and will wait until there is adequate upside before building a position. While in the short-term the market is usually focused on how quarterly results compare to consensus expectations, we place particular emphasis on understanding the extent to which a company can compound its cashflows over the long-term. We are willing to pay more for high quality, growing businesses.

We believe that a deep understanding of a company's business model, drivers and the way it is managed is the most important way to manage risk and to add value. We therefore visit our investee companies on a regular basis. We place great emphasis on management and seek to gain an understanding of their goals and aspirations by seeing them operate in their own environment. Their track record is examined in detail along with board structure, the level of insider ownership and corporate governance policies. We seek to understand where a company will be in 5 – 10 years rather than the next quarter.

Once a stock has been added to a portfolio, our analysts update its checklist and their assessment of its value regularly. We will sell a holding if we believe that the company's underlying quality is deteriorating or if there has been a fundamental change to the investment case.

In summary, we invest in well managed, high quality, growth companies at sensible valuations. We keep portfolio turnover and transaction costs low and follow our companies closely over many years. We would rather pay a little more for a higher quality, more predictable company that can be valued with greater certainty. Finally, we align shareholders' interests with our own by investing meaningful amounts of our own money alongside yours.

Portfolio Construction

As discussed above, the portfolio is constructed by selecting stocks from our approved list. We believe the best form of risk management is investing in fundamentally good businesses, which this approach is designed to ensure. We also have a number of internal risk controls aimed at limiting our exposure to any individual company and ensuring liquidity is adequate for us to enter and exit a position if required.

We will generally hold between 40 and 60 companies in the portfolio. This means that our performance relative to the benchmark index can fluctuate. However, over the long-term, our fundamental, research-driven investment approach has delivered attractive absolute and relative returns.

Country and sector distribution within the portfolio is driven by stock selection. Overweight and underweight positions relative to those in the Benchmark are based on where the greatest value is perceived to be. We do not try to position the portfolio based on economic or political forecasts. Geographical and sector weightings are monitored and risk limits applied to ensure that your portfolio is not overly concentrated towards one specific macroeconomic outcome.

Our bottom-up, quality focused approach and aversion to macroeconomic predictions also tends to mean we have different weightings to certain sub-sectors compared to the index. For example, we do not hold any commercial banks or mining companies but we are significantly overweight in healthcare.

More broadly, our investment approach does lead us to be continually overweight in higher quality and growth companies. There are times when lower quality, "value" companies outperform and we will usually perform less well than the overall smaller companies market during such periods.

Performance Attribution

The year to 31 March 2018 again saw some strong performances from our largest contributors. Last year we discussed **Biotage**, which sells products for separation in analytical and organic chemistry applications, and **Nemetschek**, which provides software solutions to the construction industry. Holdings in these two companies were new additions to the portfolio and it was therefore pleasing to see both performing particularly well during the year on the back of rapidly expanding profits.

Another strong performer was **LEM Holding**, which makes current and voltage transducers: revenue growth accelerated due to stronger industrial end markets and investors began to see the potential for the company's products in the hybrid and electric vehicle space. Further contributions were made by longstanding portfolio holdings such as **Sartorius Stedim**, the developer of equipment used to manufacture biologic drugs, and **Rational**, the market-leading manufacturer of cooking appliances for commercial kitchens.

Manager's Report continued

Our largest detractor was **RaySearch Laboratories**, a developer of software used for treatment planning in radiation therapy. The company's sales continued to increase, but foreign exchange movements combined with significant investments for future growth caused operating profits to fall. While we reduced our position significantly ahead of the subsequent share price decline, this limited rather than removed the impact on the portfolio. We believe that the long-term prospects for the business remain strong. Last year, the holding in this company was the top contributor to performance.

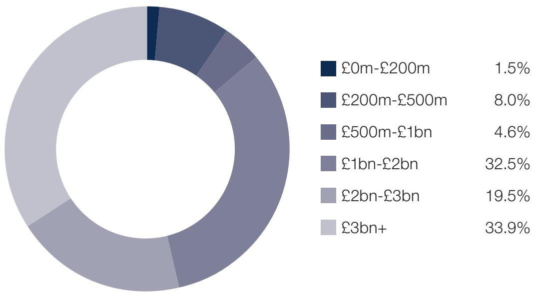
Less dramatic falls were seen from the Swiss wealth manager **VZ Holding** and Italian disc brake specialist **Brembo**. Nevertheless, both companies grew their revenues and profits in 2017 while simultaneously investing for future growth. We expect this to be the case in 2018 too and continue to hold the shares.

Portfolio Changes

We try to keep portfolio turnover as low as possible. Nonetheless, we typically make a few changes each year as we find new ideas that we believe will provide stronger long-term returns than existing holdings. Companies that become too large, get acquired or whose investment case deteriorates are also replaced with new stocks from our approved list.

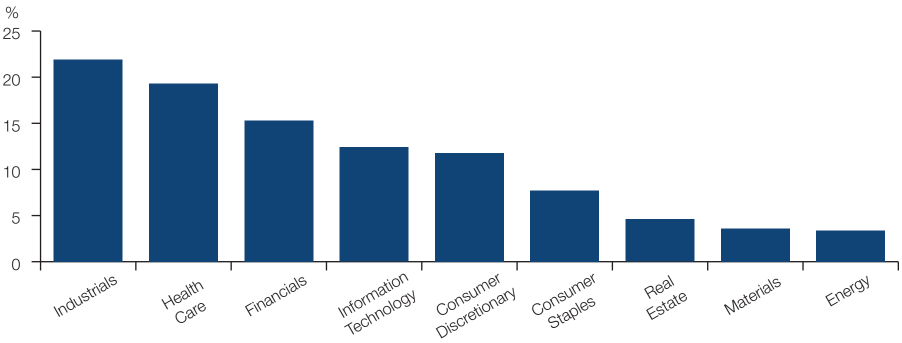
In the year to 31 March 2018, we sold positions in various holdings including that in **Virbac**, the animal health company, as the company's balance sheet deteriorated following a significant acquisition and we grew concerned by the impact of generic competition for one of their key

Market Capitalisation of Holdings by Value (31 March 2018)



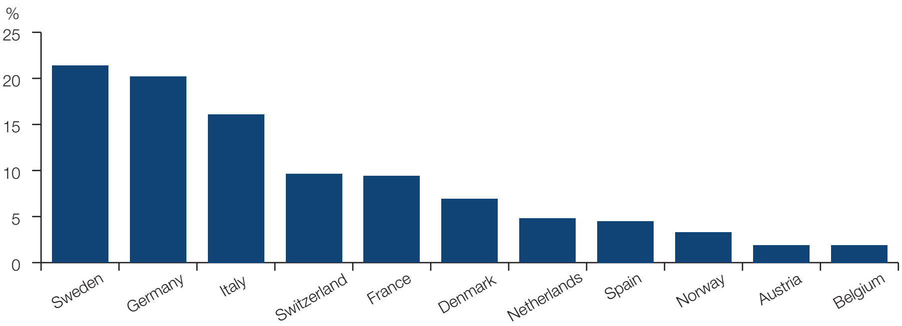
Source: Montanaro Asset Management Limited

Sector Distribution (31 March 2018)



Source: Montanaro Asset Management Limited

Geographical Analysis (31 March 2018)



Source: Montanaro Asset Management Limited products as well as a weakening new product pipeline. The holding in **Fielmann**, Europe's largest optician, was sold as we felt the valuation was too high given the company's long-term growth prospects; and we also removed the holding in asset manager **Azimut** as we did not like their increasingly acquisitive and unfocused approach to expansion.

New additions to the portfolio included investments in **Thule**, the global market leader in roof and bike racks; **Grenke**, which provides lease financing for IT equipment to small and medium sized businesses; and **Fortnox**, which provides cloud-based accounting systems to companies in Sweden.

At 31 March 2018, the portfolio consisted of 51 companies of which the top ten holdings represented 32.5% of the total net asset value.

Gearing

The Board determines levels of gearing following recommendation from the Manager. The Company ended the fiscal year with gearing of 0.6% (31 March 2017: 7.3%) – lower than both last year and the level that our existing loans allow for. This reflects our view that, while there are few signs of an imminent economic downturn, there are also fewer compelling investments available at the moment because valuations have risen and sentiment is strong. Nevertheless, we remain ready to increase our gearing as and when opportunities arise.

Outlook

Our long term outlook remains positive, reflecting our view that the companies in which we invest have all the ingredients necessary to grow their profits significantly and reinvest in their businesses at high returns on capital. Given valuations that are not obviously over-extended, this should deliver attractive long term returns to our investors.

MONTANARO ASSET MANAGEMENT LIMITED

29 June 2018

Twenty Largest Holdings
as at 31 March 2018

1. Sartorius Stedim
is a world leading supplier of equipment and technologies used to produce biopharmaceuticals.

2. Christian Hansen
is a global supplier of bioscience based ingredients to the food, health and animal feed industries.

3. MTU Aero Engines
manufactures and maintains aircraft engines and components.

4. Cerved Information Solutions
is Italy's dominant corporate credit bureau, used for assessing commercial counterparty risk. It is also one of the largest credit management platforms in Italy, helping banks to recover their non-performing loans.

5. CTS Eventim
is the market leading ticketing company in Europe, providing an online platform from which to sell tickets to a range of events such as operas and pop concerts.

6. SimCorp
provides integrated investment management software solutions to the world's leading asset managers.

7. IMCD
is one of the world's largest specialty chemical distributors.

8. Merlin Properties
is a real estate company with a focus on commercial property in Spain.

9. VZ Holding
is a Swiss independent financial consultant and wealth manager.

10. Industria Macchine Automatiche
develops and manufactures packaging machines for the food and pharmaceutical markets.

11. Avanza
is a Swedish online broker and pension provider. It offers its customers a platform to manage all of their savings under one umbrella.

12. Rational
is the global market leader in the field of advanced cooking systems for commercial kitchens.

13. Marr
is a leading distributor of food products to the foodservice sector in Italy.

14. Euronext
is a pan-European exchange, operating financial markets in Belgium, France, Ireland, the Netherlands, Portugal and the UK.

15. Brembo
manufactures high performance braking systems for cars, commercial vehicles and motorbikes.

16. Orpea
owns and operates nursing homes, rehabilitation facilities and psychiatric hospitals in Europe.

17. AAK
is an ingredients business with a focus on specialty vegetable oils and fats.

18. Elekta
develops equipment and software that is used in the delivery of radiation therapy.

19. Brunello Cucinelli
is a luxury goods company, known in particular for its high-end day wear and cashmere products.

20. Carl Zeiss Meditec
develops and sells surgical microscopes as well as systems and consumables for the treatment of ophthalmic diseases.

Holding	Country	**31 March 2018 Value £'000**	31 March 2017 Value £'000	31 March 2018 % of investment portfolio*	31 March 2018 % of net assets	31 March 2018 Market cap £m
Sartorius Stedim	France	**6,413**	5,403	4.2	4.2	6,609
Christian Hansen	Denmark	**5,509**	4,635	3.6	3.7	9,215
MTU Aero Engines	Germany	**5,409**	4,696	3.6	3.6	6,978
Cerved Information Solutions	Italy	**5,279**	4,613	3.5	3.5	1,963
CTS Eventim	Germany	**5,156**	4,808	3.4	3.4	3,621
SimCorp	Denmark	**4,938**	4,344	3.2	3.3	2,291
IMCD	Netherlands	**4,377**	3,921	2.9	2.9	2,630
Merlin Properties	Spain	**4,359**	2,687	2.9	2.9	5,802
VZ Holding	Switzerland	**3,856**	4,390	2.5	2.5	1,769
Industria Macchine Automatiche	Italy	**3,809**	4,565	2.5	2.5	3,078
Avanza	Sweden	**3,740**	2,714	2.5	2.5	1,265
Rational	Germany	**3,570**	4,651	2.4	2.4	5,833
Marr	Italy	**3,386**	3,994	2.2	2.2	1,613
Euronext	Netherlands	**3,385**	2,273	2.2	2.2	4,179
Brembo	Italy	**3,293**	5,101	2.2	2.2	4,124
Orpea	France	**3,165**	2,689	2.1	2.1	6,533
AAK	Sweden	**3,130**	2,636	2.1	2.1	3,004
Elekta	Sweden	**3,027**	3,135	2.0	2.0	3,311
Brunello Cucinelli	Italy	**3,012**	2,575	2.0	2.0	1,707
Carl Zeiss Meditec	Germany	**2,952**	2,737	1.9	2.0	4,606
Twenty Largest Holdings		**81,765**		**53.9**	**54.2**	

* Does not include cash of £20.6 million at 31 March 2018

A full portfolio listing is available on request from the Manager.

Analysis of Investment Portfolio by Sector
as at 31 March 2018

Sector	% of portfolio
Energy Equipment and Services	3.4
Energy	**3.4**
Chemicals	3.6
Materials	**3.6**
Machinery	7.9
Professional Services	3.8
Aerospace and Defence	3.6
Trading Companies and Distributors	2.9
Building Products	1.9
Commercial Services and Supplies	1.8
Industrials	**21.9**
Equity REITs	2.9
Real Estate Management & Development	1.7
Property	**4.6**
Textile Apparel and Luxury Goods	3.5
Media	3.4
Auto Components	2.2
Other	1.3
Household Durables	1.2
Consumer Discretionary	**11.6**
Food Products	5.5
Food and Staples Retailing	2.2
Consumer Staples	**7.7**
Health Care Equipment and Supplies	8.2
Life Sciences Tools and Services	3.2
Biotechnology	2.6
Health Care Technology	2.4
Health Care Providers and Services	2.1
Other	0.9
Health Care	**19.4**
Capital Markets	7.2
Diversified Financial Services	6.4
Other	1.8
Financials	**15.4**
Software	8.4
Electronic Equipment, Instruments and Components	2.1
Semiconductors and Semiconductor Equipment	1.9
Information Technology	**12.4**
Total	**100.0**

Business Model and Strategy

Our objective is to achieve capital growth for our shareholders by investing principally in Continental European quoted smaller companies. We seek to invest in well managed, high quality, growth companies. We keep portfolio turnover low and follow our companies closely over many years.

Introduction

The Company carries on business as an investment trust. Its Ordinary Shares are traded on the Main Market of the London Stock Exchange. The Company has no employees but contracts investment management and administration to appropriate external service providers, who are subject to oversight by the Board of Directors.

The principal service providers are:

– Montanaro Asset Management Limited ('Montanaro' or the 'Manager'), which was appointed as Investment Manager on 5 September 2006 and the Company's AIFM on 22 July 2014.

– F&C Investment Business Limited ('F&C') provides company secretarial and general administrative services.

In addition, the Company has appointed Equiniti Limited to act as Registrar and BNY Mellon Trust & Depositary Limited as Depositary.

Board of Directors

The Board of Directors is responsible for the overall stewardship of the Company, including investment and dividend policies, gearing, corporate strategy, corporate governance and risk management. Biographical details of the Directors, all of whom are independent and non-executive, can be found on page 19. The Board consists of four male Directors and two female Directors.

The Directors have considered their duties under section 172 of the Companies Act 2006 in promoting the success of the Company for the benefit of stakeholders. An important responsibility is the annual evaluation and appointment of the Manager, which also acts as the Alternative Investment Fund Manager ('AIFM'). The outcome of the evaluation in the current year is set out on page 21.

The Manager

Established in 1991, Montanaro is a highly experienced specialist investor in quoted smaller companies. It has one of the largest teams in the UK researching and investing exclusively in quoted smaller companies and currently manages approximately €2.8 billion, mainly on behalf of leading financial institutions. Montanaro's investment philosophy and approach is set out in the Manager's Report on pages 4 to 7.

Investment Strategy

The Company's investment strategy is set out in its objective and investment policy as set out below.

Objective

The Company's objective is to achieve capital growth by investing principally in Continental European quoted smaller companies.

The Company's benchmark index is the MSCI Europe SmallCap (ex UK) Index (in Sterling terms).

Investment Policy

The Company invests principally in quoted smaller companies within the European Union, Norway and Switzerland (but is not restricted from investing in smaller companies quoted on other European stock exchanges). In addition, the Company may invest in:

- Companies listed on non-European stock exchanges that derive significant revenues or profits from Europe.
- European securities, such as global depositary receipts, listed on other international stock exchanges.
- Debt issued by European governments or denominated in European currencies.

The Company's investment policy is flexible, enabling it to invest in all types of securities of companies, including (but not limited to) equities, preference shares, debt, convertible securities, warrants and other equity-related securities. The Company may also invest, where appropriate, in open-ended collective investment schemes and closed-ended funds that invest in Europe. It is not intended that the Company will acquire securities that are unquoted or unlisted at the time of investment (with the exception of securities which are about to be listed or traded on a stock exchange). However, the Company may continue to hold securities that cease to be quoted or listed if the Manager considers this to be appropriate.

Investment risk is diffused through holding a range of securities in different countries and industry sectors. Investments are not limited as to country or sector basis weightings, but no investment in the portfolio may exceed 10% of the Company's total assets at the time of investment. The Company may invest in derivatives, financial instruments, money market instruments and currencies solely for the purpose of efficient portfolio management (i.e. solely for the purpose of reducing,

Business Model and Strategy continued

transferring or eliminating investment risk in the Company's investments, including any technique or instrument used to provide protection against currency and credit risks).

The Company borrows funds for investment to enhance returns over the long-term and may borrow in Sterling, Euros or other currencies. The Board has set a maximum limit on borrowing, net of cash, of 30% of shareholders' funds at the time of borrowing. The Company's portfolio will normally be fully invested. However, during periods in which changes in economic conditions or other factors so warrant, the Company may reduce its exposure to securities and increase its position in cash and money market instruments.

The Company will not invest more than 10%, in aggregate, of the value of its total assets at the time of investment in other investment trusts or investment companies admitted to the Official List of the UK Listing Authority.

Investment of Assets

At each Board Meeting, the Board receives a detailed presentation from the Manager together with a comprehensive analysis of the performance of the Company and compliance with investment restrictions during the reporting period. An analysis of how the portfolio was invested as at 31 March 2018 is contained on page 10 and the 20 largest holdings are shown on pages 8 and 9.

Principal Risks

The Company's Principal Risks are set out in detail on pages 14 to 16.

Review of Performance and Outlook

The Company's performance in meeting its objectives is measured against key performance indicators ('KPIs') as set out on page 13. Reviews of the Company's returns during the financial year, the position of the Company at the year end, and the outlook for the coming year are contained in the Chairman's Statement on pages 2 and 3 and the Manager's Report on pages 4 to 7, both of which form part of this Strategic Report.

Dividend Policy

The Company's primary aim is to deliver capital growth to its shareholders, rather than dividend income. In determining dividend payments, the Board takes account of income forecasts, brought forward revenue reserves, the Company's dividend payment record and the Corporation Tax rules governing investment trust status. These rules determine the minimum level of dividend which must be paid in order to comply with Section 1158 of the Corporation Tax Act 2010 in respect of the retention of distributable income.

Dividends can also be paid from the Capital Reserve from any surplus arising from the realisation of any investment.

Taxation Policy

The Company complies at all times with Section 1158 of the Corporation Tax Act 2010 ("**Section 1158**") such that it does not suffer UK Corporation Tax on capital gains; and ensures that it submits correct taxation returns annually to HMRC and settles promptly any taxation due.

The Board is fully committed to complying with applicable legislation and statutory guidelines, including the UK's Criminal Finances Act 2017, designed to prevent tax evasion in the jurisdictions in which the Company operates.

Board Diversity

The Board is composed solely of non-executive Directors and has one third female representation. The Board's approach to the appointment of non-executive Directors is based on its belief in the benefits of having a diverse range of experience, skills, length of service and backgrounds, including gender. The Board will always appoint the best person for the job and will not discriminate on the grounds of gender, race, ethnicity, religion, sexual orientation, age or physical ability.

Key Performance Indicators

The Board recognises that it is long term share price returns that are most important to the Company's shareholders. They are largely driven by competitive portfolio returns and by keeping down the level of both the discount and ongoing charges.

The Board uses a number of key performance indicators to assess the Company's success in pursuing its objectives. They are as follows:

- NAV and share price returns, both absolute and against the benchmark.
- Discount of share price to NAV per share.
- Ongoing charges.

The NAV and share price returns against the benchmark index for the one, three, five and ten year period ended 31 March 2018 and for the period since Montanaro Asset Management Limited ('MAM') were appointed as Investment Manager are shown below. The historic discount and ongoing charges figures are included in the Historic Record below.

The Company's performance for the year against the key performance indicators, together with the outlook for the coming year, is reported within the Chairman's Statement on pages 2 and 3 and the Manager's Report on pages 4 to 7.

NAV and Share Price Return to 31 March 2018

	1 Year %	3 Year %	5 Year %	10 Year %	MAM* %
Montanaro European Smaller Companies Trust NAV	10.8	57.5	61.1	124.4	161.9
Montanaro European Smaller Companies Trust Share price	15.1	55.3	54.1	135.3	148.4
Benchmark-MSCI Europe SmallCap (ex UK) Index (in sterling terms)	10.2	48.6	93.4	114.4	132.3

* From 5 September 2006, when MAM were appointed as Investment Manager.

Historic Record

	Net assets £'000s	NAV per share	Ordinary Share price	Discount	Dividends per share	Ongoing Charges***
5 September 2006*	60,022	344.0p	322.0p	6.4%	n/a	1.6%
31 March 2007	74,447	426.7p	404.0p	5.3%	4.00p	1.8%
31 March 2008	69,061	401.6p	340.0p	15.3%	4.00p	1.8%
31 March 2009	42,653	257.4p	220.8p	14.2%	7.33p**	1.6%
31 March 2010	71,059	428.8p	373.0p	13.0%	4.50p	1.7%
31 March 2011	88,837	536.0p	467.0p	12.9%	4.50p	1.6%
31 March 2012	81,278	471.6p	405.0p	14.1%	5.50p	1.5%
31 March 2013	93,009	559.2p	519.3p	7.1%	6.75p	1.5%
31 March 2014	98,683	593.3p	540.0p	9.0%	7.00p	1.5%
31 March 2015	95,751	572.2p	515.0p	10.0%	7.50p	1.5%
31 March 2016	106,418	636.0p	540.0p	15.1%	7.50p	1.4%
31 March 2017	136,050	813.1p	695.0p	14.5%	8.25p	1.2%
31 March 2018	150,776	901.1p	800.0p	11.2%	8.50p	1.2%

* Date of commencement of current management arrangements.

** Includes special dividends of 2.83p per share.

*** Ongoing Charges. Refer to Alternative Performance Measures on page 62.

Business Model and Strategy continued

Principal Risks and Uncertainties and Risk Mitigation

The Board carefully considers the Company's principal risks and seeks to mitigate these risks through continued and regular review, policy setting, compliance with and enforcement of contractual obligations and active communication with the Manager, the Administrator and shareholders.

Most of the principal risks that could threaten the Company's objective, strategy, future returns and solvency are market related and comparable to those of other investment trusts investing primarily in quoted securities.

The Report of the Audit Committee on pages 28 to 30 summarises the Company's internal control and risk management arrangements. By means of the procedures set out in that summary, and in accordance with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, issued by the Financial Reporting Council, the Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. It has also regularly reviewed the effectiveness of the Company's risk management and internal control systems for the period.

The principal risks and uncertainties faced by the Company, and the Board's mitigation approach are described below.

Notes 15 to 20 to the accounts provide detailed explanations of the risks associated with the Company's financial instruments and their management.

PRINCIPAL RISKS	MITIGATION
Investment and strategic risk Inappropriate strategy, including country and sector allocation and stock selection could lead to poor returns for shareholders. *No change in overall risk in year*	At each Board Meeting the Manager discusses portfolio performance and strategy with the Directors and performance against the benchmark and the peer group is reviewed. The Manager also provides the Board with monthly reports. The portfolio is well diversified with typically 40-60 holdings, thereby reducing stock-specific risk. The Board formally reviews the performance of the Manager and its terms of appointment annually.
Gearing One of the benefits of an investment trust is its ability to use borrowings, which can enhance returns to shareholders in a rising stock market. However, gearing exacerbates movements in the NAV both positively and negatively and will exaggerate declines in NAV when share prices of investee companies are falling. *No change in overall risk in year*	The Board is responsible for setting the gearing range within which the Manager may operate and has set a maximum limit on borrowing, net of cash, of 30% of shareholders' funds at the time of borrowing. The Company currently has loans totalling €25 million that mature in September 2018 and it does not anticipate any difficulty extending or replacing these with an appropriate level of borrowing. The Board receives recommendations on gearing levels from the Manager, and monitors and discusses with the Manager the appropriate level of gearing at each Board Meeting.

PRINCIPAL RISKS	MITIGATION
Other financial risks The Company invests principally in Continental European quoted smaller companies and its principal risks are therefore market related with short term risk arising from the volatility in the prices of the Company's investments and foreign exchange. Events such as terrorism, disease, protectionism, inflation or deflation, changes in regulation and taxation, excessive stock market speculation, economic recessions, political instability and movements in interest rates and exchange rates could affect share prices in particular markets. As with all small company investment trusts, there is liquidity risk at times when the liquidity of the underlying portfolio is poor, such as when smaller companies are out of favour or during periods of adverse financial conditions. The portfolio is focused on investments in smaller European companies where the opportunities may be more attractive than in larger companies but where overall portfolio liquidity may be more challenging. This may result in difficulties in buying or selling individual holdings in difficult markets. In addition, illiquid stock markets may impact the discount of the Company's share price to the NAV per share. *No change in overall risk in year*	Portfolio diversification, both geographical and sectoral, can mitigate the consequences of such risky events and the Board reviews the portfolio with the Manager on a regular basis. However, it is not the Company's policy to hedge currency risk. The Board has also set investment restrictions and guidelines which are adhered to and reported on by the Manager. If required, it is also possible to raise the level of cash held, thereby reducing the risk of declining share prices and the effect of gearing on lower portfolio valuations. However, the portfolio's liquidity is not managed on the basis of timing short-term market fluctuations. One of the benefits of an investment trust is that the Manager is rarely forced to buy or sell individual holdings at inopportune times. The Manager constantly reviews the underlying liquidity of the portfolio, which is well diversified, and deals with a wide range of brokers to enhance its ability to execute and minimise liquidity risk. Further details on the financial risks arising from the Company's financial instruments, together with the policies for managing these risks are included in notes 15 to 20 to the accounts.
Discount volatility As with all small company investment trusts, discounts can fluctuate significantly both in absolute terms and relative to their peer group. *No change in overall risk in year*	The Board and Manager actively monitor the discount of share price to NAV per share and seek to influence this through liaising closely with the Company's Broker, share buybacks and effective marketing. The Board has stated its commitment to an active discount management policy, such 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 of time and is significantly wider than the average for similar trusts. Any such transaction must be value enhancing for shareholders and the Board will take into consideration the effect of the buyback on the liquidity of the Company's shares. The Board encourages the Manager to market the Company to new investors to increase demand for the Company's shares, which may help to reduce the discount.

Business Model and Strategy continued

PRINCIPAL RISKS	MITIGATION
Regulatory	
The Company carries on business as an investment trust and has been approved as such by HM Revenue & Customs subject to it continuing to meet eligibility conditions and ongoing requirements. As a result, it is not liable to corporation tax on capital gains. Breach of Section 1158 of the Corporation Tax Act 2010 could lead to the Company being subject to tax on chargeable gains. Breach of regulatory rules could also lead to suspension of the Company's Stock Exchange listing, financial penalties or a qualified audit report. *No change in overall risk in year*	The Administrator monitors the Company's compliance with Section 1158 of the Corporation Tax Act 2010 including revenue forecasts and the amount of proposed dividends to ensure the rules are not breached. The results are reported to the Board at each meeting. The Administrator monitors compliance with the Listing Rules of the UK Listing Authority and compliance with the principal rules is reviewed by the Directors at each Board Meeting. The Board and AIFM also monitor changes in legislation which may have an impact on the Company.
Operational	
In common with most other investment trust companies, the Company has no employees. The Company is therefore reliant on the services provided by third parties such as the Manager, the Administrator and the Custodian (as a delegate of the Depositary). Disruption or failure of the Manager's or Administrator's systems, or those of other third-party service providers could lead to an inability to provide accurate reporting and monitoring of the Company's financial position or a breach of regulatory and legal regulations. *No change in overall risk in year*	The Board and the Audit Committee receives regular reports on the operation of internal controls to mitigate against the risk of failure, including those at the Manager, the Administrator and the Custodian as explained in more detail within Risk Management and Internal Control on pages 28 to 29. These have been tested and monitored throughout the year which is evidenced from their control reports regarding their internal controls which are reported on by their reporting accountants. Quarterly reports are also received from the Depositary which is responsible for the safekeeping of all custodial assets of the Company.
Manager	
Should the Manager not be in a position to continue to manage the Company, performance may be impacted. *No change in overall risk in year*	Montanaro has one of the largest specialist teams in the UK focusing on quoted European smaller companies. Montanaro operates a team approach in the management of the investment portfolio which mitigates against the impact of the departure of any one member of the investment team. The Manager keeps the Board informed of developments within its business.

Viability Assessment and Statement

In accordance with the UK Corporate Governance Code, in order to assess the viability of the Company, the Board is required to assess its future prospects and has considered that a number of characteristics of its business model and strategy were relevant to this assessment:

- The Company's objective is to achieve capital growth.
- The Company's investment policy, which is subject to regular Board monitoring, means that the Company is invested principally in the securities of Continental European quoted smaller companies.
- The Company is a closed-end investment trust, whose shares are not subject to redemptions by shareholders.
- The Company's business model and strategy is not time limited.

Also relevant were a number of aspects of the Company's operational arrangements:

- The Company retains title to all assets held by the Custodian under the terms of a formal agreement with the Depositary and Custodian.
- The borrowing facilities, which remain available until September 2018, are also subject to formal agreements, including financial covenants with which the Company complied in full during the year.
- Revenue and expenditure forecasts are reviewed by the Directors at each Board Meeting.

In considering the viability of the Company, the Directors carried out a robust assessment of the principal risks and uncertainties which could threaten the Company's objective and strategy, future performance and solvency, including the impact of a significant fall in equity markets or adverse currency movements on the Company's investment portfolio. These risks, their mitigations and the processes for monitoring them are set out on pages 14 to 16 in Principal Risks and Uncertainties and Risk Mitigation, pages 28 and 29 in the Report of the Audit Committee and in notes 15 to 20 of the accounts.

The Directors have also considered:

- The level of ongoing charges incurred by the Company which are modest and predictable and that these were covered approximately 1.7 times by investment income and total 1.2% of average net assets;
- Future revenue and expenditure projections;
- The Company's borrowing in the form of fixed rate loans totalling €25 million, which are due to mature in September 2018, noting that the Company has a large margin of safety over the covenants on this debt and does not anticipate any difficulty extending or replacing this facility. This loan was covered 7.9 times by the Company's total assets at 31 March 2018;
- Its ability to meet liquidity requirements given the Company's investment portfolio consists principally of Continental European quoted smaller companies which can be realised if required. It is estimated that approximately 95% of the portfolio could be liquidated under normal conditions within seven trading days;
- The ability to undertake share buybacks if required;
- That the Company's objective and investment policy continue to be relevant to investors; and
- The Company has no employees, having only non-executive Directors and consequently does not have redundancy or other employment related liabilities (including pensions) or responsibilities.

These matters were assessed over a three year period to June 2021, and the Board will continue to assess viability over three year rolling periods, taking account of severe but plausible scenarios. In the absence of any adverse change to the regulatory environment and to the treatment of UK investment trusts a rolling three year period represents the horizon over which the Directors do not expect there to be any significant change to the Company's principal risks or their mitigation and they believe they can form a reasonable expectation of the Company's prospects.

Based on their assessment, and in the context of the Company's business model, strategy and operational arrangements set out above, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the three year period to June 2021. For this reason, the Board also considers it appropriate to continue adopting the going concern basis in preparing the Report and Accounts.

The Chairman's Statement on pages 2 and 3, the Manager's Report on pages 4 to 7, the Twenty Largest Holdings on pages 8 and 9, and the Analysis of Investment Portfolio by Sector on page 10 all form part of this Strategic Report on pages 2 to 17, which has been approved by the Board of Directors.

By order of the Board

F&C INVESTMENT BUSINESS LIMITED
Company Secretary
Quartermile 4, 7a Nightingale Way
Edinburgh EH3 9EG
29 June 2018

Advisers

Investment Manager and Alternative Investment Fund Manager ('AIFM')
MONTANARO ASSET MANAGEMENT LIMITED
53 Threadneedle Street
London EC2R 8AR
Tel: 020 7448 8600
Fax: 020 7448 8601
www.montanaro.co.uk

Company Secretary, Administrator and Registered Office
F&C INVESTMENT BUSINESS LIMITED
Quartermile 4
7a Nightingale Way
Edinburgh EH3 9EG
Tel: 020 7628 8000
Fax: 0131 225 2375

Registrar
EQUINITI LIMITED
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA

Registrar's Shareholder Helpline
Tel: 0371 384 2030*

Registrar's Broker Helpline
Tel: 0906 559 6025

* Lines are open 8.30am to 5.30pm, Monday to Friday.

Stockbroker
CENKOS SECURITIES PLC
6.7.8 Tokenhouse Yard
London EC2R 7AS

Depositary
BNY MELLON TRUST & DEPOSITARY LIMITED
One Canada Square
London E14 5AL

Custodian
THE BANK OF NEW YORK MELLON SA/NV (LONDON BRANCH)
One Canada Square
London E14 5AL

Bankers
ING BANK N.V., LONDON BRANCH
60 London Wall
London EC2M 5TQ

Auditor
ERNST & YOUNG LLP
Atria One
144 Morrison Street
Edinburgh EH3 8EX

Solicitor
DICKSON MINTO W.S.
16 Charlotte Square
Edinburgh EH2 4DF

Montanaro European Smaller Companies Trust plc
Registered in Scotland No. SC074677

An investment company as defined under Section 833 of the Companies Act 2006.

Board of Directors

Andrew Irvine – Chairman

Andrew Irvine was appointed in 1992 and is chairman of Fidelity Special Values plc and a non-executive director of BlackRock North American Income Trust plc. He is a former Chairman of Celtic Rugby Limited and The British and Irish Lions and a past President of Scottish Rugby Union plc. Mr Irvine is an experienced investment company director and has considerable business experience.

Richard Curling

Richard Curling was appointed in 2015. He has over 30 years' experience as a fund manager and is currently an investment director at Jupiter Fund Management Plc with extensive experience of investment trusts.

Bruce Graham

Bruce Graham, who is a Chartered Accountant, was appointed in 2003 and was previously a partner at PricewaterhouseCoopers. Since leaving PricewaterhouseCoopers he has provided forensic accounting services to third parties. He is Chairman of the Audit Committee. Through many years of experience Mr Graham has significant knowledge of accounting, financial and business matters.

Alex Hammond-Chambers

Alex Hammond-Chambers was appointed in 2004. He is Chairman of the Nomination Committee and was appointed Senior Independent Director with effect from 11 May 2017. He is Chairman of Hansa Trust plc. As a former fund manager, director of a number of investment companies, and past Chairman of the Association of Investment Companies, Mr Hammond-Chambers has considerable experience of investment matters and of the investment company sector.

Caroline Roxburgh

Caroline Roxburgh was appointed in November 2017. Until recently she was a partner at PricewaterhouseCoopers and has over 30 years' business, finance and audit experience across a number of industries and sectors.

Merryn Somerset Webb

Merryn Somerset Webb was appointed in 2011. She is the Editor-in-Chief of UK personal finance magazine MoneyWeek, writes for the Financial Times and is a radio and television commentator on financial matters. She is also a director of Baillie Gifford Shin Nippon plc. She is Chairman of the Remuneration Committee. Mrs Somerset Webb has significant experience of financial matters.

Report of the Directors

The Directors submit the Annual Report and Accounts of the Company for the year ended 31 March 2018.

Statement Regarding Annual Report and Accounts

Following a detailed review of the Annual Report and Accounts by the Audit Committee, the Directors consider that taken as a whole it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy. In reaching this conclusion, the Directors have assumed that the reader of the Annual Report and Accounts would have a reasonable level of knowledge of the investment industry in general and investment trusts in particular. The outlook for the Company is set out in the Chairman's Statement on page 3. Principal risks can be found on pages 14 to 16 with further information in notes 15 to 20 to the accounts.

Results and Dividends

The results for the year are set out in the attached accounts.

An interim dividend of 1.75p per Ordinary Share was paid on 5 January 2018. The Board recommends a final dividend for the year of 6.75p per Ordinary Share payable on 3 September 2018 to shareholders on the register on 13 July 2018.

Principal Activity and Status

The Company is registered as a public limited company in Scotland (**registered number SC074677**) and is an investment company within the terms of Section 833 of the Companies Act 2006. Its shares are quoted on the Main Market of the London Stock Exchange.

The Company carries on business as an investment trust and has been approved as such by HM Revenue and Customs, subject to it continuing to meet the relevant eligibility conditions and ongoing requirements. The Company intends to conduct its affairs so as to enable it to comply with the requirements.

Disclosure of Relevant Information to the Auditor

Having made the requisite enquiries, so far as the Directors are aware, there is no relevant audit information (as defined by Section 418(3) of the Companies Act 2006) of which the Company's Auditor is unaware and each Director has taken all steps that ought to have been taken to make himself or herself aware of any relevant audit information and to establish that the Company's Auditor is aware of that information.

Re-appointment of Auditor

Ernst & Young LLP has expressed its willingness to continue in office as the Company's Auditor and resolutions proposing its re-appointment and authorising the Directors to determine its remuneration will be proposed at the Annual General Meeting. (Resolutions 7 and 8).

Further information in relation to the proposed re-appointment can be found on page 30.

Directors

Biographical details of the Directors, all of whom are independent and non-executive, can be found on page 19. Other than Mrs C A Roxburgh, who joined the Board on 8 November 2017, all Directors held office throughout the year under review.

Unless otherwise determined by ordinary resolution, the Company shall not have fewer than two or more than ten Directors (disregarding alternate Directors). The Company or the Board may appoint any person to be a Director and a Director is not required to hold any shares of the Company. Any Director appointed by the Board shall hold office only until the next annual general meeting and shall then be eligible for election.

In accordance with the Company's Articles (the "Articles"), Mrs C A Roxburgh will retire at the Annual General Meeting, being the first such meeting following her appointment and being eligible, offers herself for election (Resolution 4). Mrs C A Roxburgh whose biographical details are included on page 19, has extensive experience across a number of industries and sectors and the Board believes that it is in the interest of the shareholders that she be elected.

The Articles state that each Director must retire from office at the third Annual General Meeting after the Annual General Meeting at which he or she was last elected. However, as explained in more detail under the Corporate Governance Statement on page 25 the Board has agreed that all Directors will retire annually. Mr R B M Graham, Mr R A Hammond-Chambers and Mr A R Irvine are not standing for re-election and will therefore retire at the conclusion of the forthcoming Annual General Meeting. Accordingly, Mr R M Curling and Mrs M R Somerset Webb will retire at the Annual General Meeting and, being eligible, offer themselves for re-election (Resolutions 5 and 6). The Board confirms that, following formal performance evaluations, the performance of each of the Directors seeking election/re-election continues to be effective and demonstrates commitment to the role, and believes that it is therefore in the interests of shareholders that they are re-elected.

In addition to any power of removal conferred by the Companies Acts (the "Companies Acts"), the Company may by special resolution remove any Director before the expiration of his or her period of office. Furthermore, the office of a Director must be vacated if any of the circumstances set out in Article 98 of the Articles arise, for example if: (i) a Director resigns by notice in writing delivered to the registered office or tendered at a meeting of the Board; or (ii) by reason of a Director's mental health, a court makes an order which wholly or partly prevents that Director from personally exercising any powers or rights which that Director would otherwise have.

No Director has a contract of service with the Company and no Director has any material interest in any contract to which the Company is a party.

Directors' Indemnities

As at the date of this report, indemnities are in force between the Company and each of its Directors under which the Company has agreed to indemnify each Director, to the extent permitted by law, in respect of certain liabilities incurred as a result of carrying out his or her role as a Director of the Company. The Directors are also indemnified against the costs of defending any criminal or civil proceedings or any claim by the Company or a regulator as they are incurred provided that where the defence is unsuccessful the Director must repay those defence costs to the Company. The indemnities are qualifying third party indemnity provisions for the purposes of the Companies Act 2006.

A copy of each deed of indemnity is available for inspection at the Company's registered office during normal business hours and will be available for inspection at the Annual General Meeting.

Powers of the Directors

Subject to the provisions of the Companies Acts, the Articles and to any directions given by the Company in general meeting by special resolution, the business of the Company is managed by the Board, which may exercise all the powers of the Company whether relating to the management of the business of the Company or not. In particular, the Board may exercise all the powers of the Company to issue shares or other securities and to borrow money and to mortgage or charge all or any part of the Company's assets.

Conflicts of Interest

Each Director has a statutory duty to avoid a situation where he or she has, or could have, a direct or indirect interest which conflicts, or may conflict with the interests of the Company. A Director will not be in breach of that duty if the relevant matter has been authorised in accordance with the Articles.

The Board has approved a protocol for identifying and dealing with conflicts and has resolved to conduct a regular review of actual or possible conflicts and any authorised conflicts. No conflicts or potential conflicts were identified during the year.

Investment Management Arrangements

Montanaro provides investment management services to the Company and is the Company's AIFM. Under the terms of the investment management agreement, Montanaro is entitled to receive a management fee of 0.9% per annum of the Company's market capitalisation (payable monthly in arrears). Montanaro is also entitled to a fee of £50,000 per annum for acting as the Company's AIFM.

Montanaro's appointment may be terminated by either party giving to the other not less than six months' notice. The investment management agreement may be terminated earlier by the Company provided that a payment in lieu of notice, equivalent to the amount the Manager would otherwise have received during the notice period, is made.

Since the year end, the Remuneration Committee and the Board has reviewed the appropriateness of the Manager's appointment. In carrying out its review, the Board considered the skills, experience, resources and commitment of the Manager together with the investment performance during the year and since its appointment. It also considered the length of the notice period of the investment management agreement and the fees payable to the Manager. Following this review, it is the Directors' opinion that the continuing appointment of the Manager on the terms agreed is in the interests of shareholders as a whole.

Depositary and Custodian

BNY Mellon Trust & Depositary Limited acts as the Company's Depositary in accordance with the AIFM Directive. The Depositary's responsibilities include cash monitoring, segregation and safe keeping of the Company's financial instruments and monitoring the Company's compliance with investment limits and leverage requirements. The Depositary has delegated the custodian function to The Bank of New York Mellon SA/NV (London Branch).

Report of the Directors continued

Capital Structure

The Company's capital structure is composed solely of Ordinary Shares. The rights and obligations of shareholders are set out in the Articles (which can be amended by special resolution). All shares rank equally for dividends and entitlement to capital, and at a general meeting of the Company every shareholder who is present in person or by proxy or by a corporate representative shall have one vote for all of the shares of which he/she is the holder on a show of hands, and one vote for each share on a poll.

Unless the Board otherwise decides, no member is entitled in respect of any share held by him/her to vote (either personally or by proxy or by a corporate representative) at any general meeting of the Company if any calls or other sums presently payable by him/her in respect of that share remain unpaid or if he/she is a person with a minimum of 0.25% interest (as defined in the Articles) and he/she has been served with a restriction notice (as defined in the Articles) after failure to provide the Company with information concerning interests in those shares required to be provided under the Companies Acts.

Subject to the provisions of the Companies Acts, the Company may by ordinary resolution from time to time declare dividends in accordance with the respective rights of the members, but no dividend can exceed the amount recommended by the Board. Subject to the provisions of the Companies Acts, the Board may pay such dividends as appear to it to be justified by the financial position of the Company. The Board may deduct from any dividend or other moneys payable to a member by the Company on or in respect of any shares all sums of money (if any) payable by him/her to the Company on account of calls or otherwise in respect of shares of the Company. The Board may also withhold payment of all or any part of any dividends or other moneys payable in respect of the Company's shares from a person with a minimum of 0.25% interest (as defined in the Articles) if such a person has been served with a restriction notice (as defined in the Articles) after failure to provide the Company with information concerning interests in those shares required to be provided under the Companies Acts.

There are no restrictions on the transfer of shares of the Company, except that certain restrictions may from time to time be imposed by laws and regulations (for example, insider trading laws).

Substantial Interests in Share Capital

As at 31 March 2018, the Company had received notification of the following substantial holdings of voting rights (being only those received under the Financial Conduct Authority's Disclosure Guidance and Transparency Rules):

	Number of shares held	Percentage held
Wells Capital Management	1,808,275	10.8
East Riding of Yorkshire Council	1,775,000	10.6
Lazard Asset Management LLC	1,339,207	8.0
1607 Capital Partners LLC	865,674	5.2
Brewin Dolphin Limited	839,499	5.0
Montanaro Asset Management Ltd	600,000	3.6
Jupiter Asset Management Ltd	595,800	3.6

Since 31 March 2018, to the date of this report, the Company has received the following notification of voting rights: Brewin Dolphin Limited 820,197 Ordinary Shares (4.9%). The Company has not received any other notification of any changes in these voting rights and no other notifications of voting rights have been received since the year end.

Corporate Governance

Full details of the Company's corporate governance arrangements are given in the Corporate Governance Statement, which forms part of this Report of the Directors and can be found on pages 25 to 27.

Accounting and Going Concern

The financial statements start on page 41 and the unqualified Independent Auditor's Report on the financial statements is on pages 35 to 40. Shareholders will be asked to approve the Annual Report and Accounts at the AGM (Resolution 1). In assessing the going concern basis of accounting, the Directors have had regard to the guidance issued by the Financial Reporting Council and have undertaken a rigorous review of the Company's ability to continue as a going concern.

The Directors have taken into account the Company's investment policy, which is described on pages 11 and 12 and which is subject to regular Board monitoring processes and is designed to ensure that the Company is invested mainly in liquid, listed securities. The Company retains title to all assets held by its custodian, and has financial covenants relating to its bank borrowings with which it complied during the year.

As part of the going concern review, the Directors have also considered the current cash position of the Company, the availability of the fixed rate loans until 13 September 2018, compliance with their covenants and the ability to refinance them, the Company's other liabilities and forecast revenues.

Notes 15 to 20 to the accounts set out the financial risk profile of the Company and indicate the effect on its assets and liabilities of falls and rises in the value of securities, market rates of interest and changes in exchange rates.

The Directors believe, in light of the controls and review processes noted above and bearing in mind the nature of the Company's business and assets and liabilities, that the Company has adequate resources to continue in operational existence for a period of at least twelve months from the date of approval of the accounts. For this reason, they continue to adopt the going concern basis in preparing the accounts.

The Company's longer term viability is considered in the 'Viability Assessment and Statement' on page 17.

Future Developments of the Company
The outlook for the Company is set out in the Chairman's Statement on page 3 and the Manager's Report on page 7.

Greenhouse Gas Emissions
All of the Company's activities are outsourced to third parties. As such it does not have any physical assets, property, employees or operations of its own and does not generate any greenhouse gas or other emissions.

Financial Instruments
The Company's financial instruments comprise its investment portfolio, cash balances, bank debt and debtors and creditors that arise directly from its operations, such as sales and purchases awaiting settlement and accrued income. The financial risk management objectives and policies arising from its financial instruments and the exposure of the Company to risk are disclosed in notes 15 to 20 to the accounts.

Annual General Meeting
The notice of Annual General Meeting to be held on Wednesday 29 August 2018 is set out on pages 64 to 68.

Directors' Authority to Allot Shares (Resolution 9)
The Company's Articles empower the Directors to allot unissued shares. In accordance with section 551 of the Companies Act 2006, such allotments must be authorised by shareholders in a general meeting. Resolution 9 to be proposed at the forthcoming Annual General Meeting renews the Directors' authority, granted by shareholders at last year's Annual General Meeting, to allot new shares under section 551 of the Companies Act 2006. This authority will allow the Directors to allot shares up to an aggregate nominal amount of £836,500, representing an amount equal to approximately 10% of the Company's total issued ordinary share capital as at 29 June 2018 (being the latest practicable date before the publication of the Annual Report and Accounts) excluding shares held in treasury. This authority will expire at the conclusion of the Company's next Annual General Meeting, to be held in 2019 or, if earlier, on 30 September 2019.

Directors' Authority to Allot Shares other than on a Pre-emptive Basis (Resolution 10)
Resolution 10 to be proposed at the Annual General Meeting grants the Directors authority to allot new shares for cash and to dispose of treasury shares, up to an aggregate nominal amount of £836,500, representing an amount equal to approximately 9.6% of the Company's issued Ordinary Share capital (including treasury shares) as at 29 June 2018, without having to first offer such shares to existing shareholders pro rata to their existing holdings. The authority also allows the Directors to take such steps as they consider necessary in relation to the treatment of overseas shareholders, treasury shares and fractional entitlements on pre-emptive share issues. This authority will expire at the conclusion of the Company's next Annual General Meeting to be held in 2019 or, if earlier, on 30 September 2019 and will enable the Company to issue new shares and to dispose of treasury shares at any price for cash, including where shares are being issued from treasury at a price representing a discount to the NAV per share at the time of issue.

The Directors will only allot new shares pursuant to the authorities proposed to be conferred by Resolutions 9 and 10 if they believe it is advantageous to the Company's shareholders to do so and in no circumstances, would result in an overall dilution of the NAV per share. The Board's policy regarding the issue of shares from treasury is described on page 24. The Directors consider that the authorities proposed to be conferred by Resolutions 9 and 10 are necessary to retain flexibility, although they do not have any intention of exercising such authorities at the present time.

Directors' Authority to Buy Back Shares (Resolution 11)
The Company did not buy back any Ordinary Shares during the year.

Report of the Directors continued

The current authority of the Company to make market purchases of up to 14.99% of the issued Ordinary Shares expires at the end of the Annual General Meeting and Resolution 11, as set out in the notice of the Annual General Meeting, seeks renewal of such authority. The renewed authority to make market purchases will be in respect of a maximum of 14.99% of the issued Ordinary Shares of the Company as at the date of the passing of the resolution, excluding treasury shares (approximately 2.5 million Ordinary Shares). The resolution specifies the minimum and maximum prices which may be paid for any Ordinary Shares purchased under this authority. This power will only be exercised if, in the opinion of the Directors, a purchase would result in an increase in the NAV per share and be in the best interests of the shareholders as a whole.

The Board's intention is to apply an active discount management policy, and to 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 of time and is significantly wider than the average for similar trusts. Any such transaction must be value enhancing for shareholders and the Board will take into consideration the effect of the buyback on the liquidity of the Company's shares.

Treasury Shares

Shares which are bought back by the Company pursuant to the share buyback authority may be cancelled or held by the Company in treasury and subsequently re-issued. It is the Board's intention that any further shares bought back by the Company will be held in treasury. Shares held in treasury will not carry any voting rights, dividends payable in respect of them will be suspended and they will have no entitlements on a winding-up of the Company.

It is the Board's policy that shares will only be re-issued from treasury either at a price representing a premium to the NAV per share at the time of re-issue, or at a discount to the NAV per share provided that such discount is lower than the weighted average discount to the NAV per share when they were bought back by the Company.

It is also the Board's policy that shares may be held in treasury indefinitely.

The Board believes that the treasury shares policy will improve liquidity in the shares and help to maintain the size of the Company. Furthermore, the Board believes that the re-issuance of shares from treasury at a discount to the NAV per share within the parameters described above will, in conjunction with the Company's share buyback policy, ensure that the overall effect of the 'round trip' of repurchasing shares and subsequently re-issuing them from treasury will be an enhancement to the NAV per share.

As at 29 June 2018, being the latest practicable date before the publication of the Annual Report and Accounts, there were 17,448,260 Ordinary Shares in issue, including 715,000 Ordinary Shares held in treasury (which represented 4.3% of the total issued Ordinary Share capital (excluding treasury shares) as at 29 June 2018).

Recommendation

The Directors consider that the passing of each of the resolutions to be proposed at the Annual General Meeting is in the best interests of the Company and its shareholders as a whole and they unanimously recommend that all shareholders vote in favour of these resolutions.

Individual Savings Accounts ('ISAs')

The Company's shares are qualifying investments as defined by HM Revenue & Customs' regulations for ISAs. It is the current intention of the Directors that the Company will continue to conduct its affairs to satisfy this requirement.

By order of the Board

F&C INVESTMENT BUSINESS LIMITED
Company Secretary
Quartermile 4
7a Nightingale Way
Edinburgh EH3 9EG
29 June 2018

Corporate Governance Statement

Introduction

Arrangements in respect of corporate governance, appropriate to an investment trust, have been made by the Board. Except as disclosed below, the Company complied throughout the year with the relevant provisions of the UK Corporate Governance Code issued by the Financial Reporting Council ('UK Code'), which can be found at www.frc.org.uk.

The Board has also taken into account the recommendations of the AIC Code of Corporate Governance ('AIC Code') which can be found at www.theaic.co.uk.

Since all the Directors are non-executive, the provisions of the UK Code in respect of the role of the chief executive are not relevant to the Company and, likewise, the provisions of the UK Code relating to Directors' remuneration are not relevant except in so far as they relate specifically to non-executive Directors. For the reasons set out in the preamble to the UK Code, the Board considers that these provisions are not relevant to the Company, being an externally managed investment trust. The Company has therefore not reported further in respect of these provisions.

With effect from 11 May 2017, Mr R A Hammond-Chambers was appointed Senior Independent Director as recommended by provision A.4.1 of the UK Code.

In view of its non-executive nature and the requirements of the Articles of Association, that all Directors are subject to retirement by rotation, the Board does not consider it appropriate for the Directors to be appointed for a specified term as recommended by provision B.2.3 of the UK Code. The Articles of Association require the Directors to retire by rotation at least every three years. However, in accordance with the recommendations of the UK Code and the AIC Code, the Board has agreed that all Directors will retire annually and, if appropriate, seek re-election.

The Board

The Board consists solely of non-executive Directors. Mr A R Irvine is the Chairman and with effect from 11 May 2017, Mr R A Hammond-Chambers is the Senior Independent Director. All Directors are considered by the Board to be independent of the Manager. Under the requirements of the Articles of Association, Directors are subject to election at the first Annual General Meeting after their appointment. New Directors receive an induction from the Manager and Company Secretary on joining the Board, and all Directors are encouraged to attend relevant training courses and seminars.

Individual Directors may, at the expense of the Company, seek independent professional advice on any matter that concerns them in the furtherance of their duties. The Company maintains appropriate directors' and officers' liability insurance.

Mr R B M Graham, Mr R A Hammond-Chambers and Mr A R Irvine are not standing for re-election and will therefore retire at the conclusion of the forthcoming Annual General Meeting.

The Board's policy on tenure is that continuity and experience are considered to add significantly to the strength of the Board and, as such, no limit on the overall length of service of any of the Company's Directors, including the Chairman, has been imposed.

Mr R M Curling has primary responsibility for the investment management of a holding representing 3.6% of the Company which is held by Jupiter Asset Management, on behalf of their clients. Any potential conflicts of interest which arise as a result would be disclosed. Notwithstanding this connection, the Board considers Mr R M Curling to be independent in character and judgement.

The basis on which the Company aims to generate value over the longer term is set out in the Business Model and Strategy on pages 11 to 17.

The Company has no executive Directors or employees. An investment management agreement between the Company and the Manager sets out the matters over which the Manager has authority and the limits beyond which Board approval must be sought. All other matters, including strategy, investment and dividend policies, gearing, risk management and corporate governance procedures, are reserved for the approval of the Board of Directors.

The Board currently meets at least four times a year and, in addition, informally on a frequent basis. It receives full information on the Company's investment performance, assets, liabilities and other relevant information in advance of Board meetings.

Corporate Governance Statement continued

The following table sets out the number of scheduled Board and Committee meetings held during the year ended 31 March 2018 and the number of meetings attended by each Director.

No. of meetings	Board of Directors 4	Audit Committee 3	Remuneration Committee 1	Nomination Committee 4
A R Irvine	4	3	1	4
R M Curling(1)	4	n/a	1	4
R B M Graham	4	3	1	3
R A Hammond-Chambers	4	3	1	4
C A Roxburgh(2)	2	2	–	–
M R Somerset Webb	4	3	1	4

In addition to the above meetings, the Board met informally on a number of occasions during the year. With the exception of R A Hammond-Chambers and C A Roxburgh (see note 2 below), all Directors attended the Annual General Meeting in July 2017.

(1) R M Curling is not a member of the Audit Committee.
(2) Appointed as a Director on 8 November 2017.

Board Effectiveness

During the year the performance of the Board, Committees and individual Directors were evaluated through an interview based process led by the Chairman. The performance of the Chairman was evaluated by the other Directors. This process involved completing a questionnaire designed to suit the nature of the Company, discussions with individual Directors, individual feedback from the Chairman to each of the Directors and discussion of the points arising amongst the Directors.

Following this process it was concluded that the performance of each Director, the Chairman, the Board and its Committees continues to be effective and each Director and the Chairman remain committed to the Company.

Voting Policy on Portfolio Investments

The Manager, in the absence of explicit instructions from the Board, is empowered to exercise discretion in the use of the Company's voting rights. Environmental, social and governance factors are, taken into account by the Manager as part of its investment analysis and decision-making processes. The Board notes the Manager has been a signatory of the UK Stewardship Code, since its publication in 2010 and its statement can be found on its website www.montanaro.co.uk.

Committees

Throughout the year a number of committees have been in operation, namely the Audit Committee, the Remuneration Committee and the Nomination Committee. The full terms of reference for each Committee are available on request from the Company.

Audit Committee

The Report of the Audit Committee is included on pages 28 to 30 and forms part of this statement.

Remuneration Committee

The Remuneration Committee, chaired by Mrs M R Somerset Webb, comprises the full Board and reviews the appropriateness of the Manager's continuing appointment together with its terms and conditions thereof on a regular basis. The Remuneration Committee also determines the level of Directors' fees. The Directors' Remuneration Report on pages 31 to 33 provides information on the remuneration arrangements for the Directors of the Company.

Nomination Committee and Board Diversity

The Nomination Committee, chaired by Mr R A Hammond-Chambers, comprises the full Board and is convened for the purpose of considering the appointment of additional Directors as and when considered appropriate. The Board is composed solely of non-executive Directors and has one third female representation. In considering appointments to the Board, the Nomination Committee takes into account the ongoing requirements of the Company and the need to have a diverse balance of relevant skills, experience, independence and knowledge of the business generally and of the Company specifically within the Board. The Board complies with the UK Corporate Governance Code in appointing appropriately diverse, independent non-executive directors who set the standards of the Company. The Board will always appoint the best person for the job and will not discriminate on the grounds of gender, race, ethnicity, religion, sexual orientation, age or physical ability. The Company's Board diversity policy is shown on page 12. The Directors have not set any measurable objectives in relation to the diversity of the Board.

During the year a recruitment process, which did not involve an external search agency, was undertaken by the Nomination Committee. Subsequently, the Board approved a recommendation from the Nomination

Committee and effective 8 November 2017, Mrs C A Roxburgh was appointed to the Board.

As explained in the Chairman's Statement, the Nomination Committee is undertaking a further recruitment process in order to appoint another non-executive Director in the near future.

Relations with Shareholders

The Company welcomes the views of shareholders and places great importance on communication with its shareholders. The Manager holds meetings with the Company's largest shareholders and reports back to the Board on these meetings. The Chairman and other Directors offer to meet with significant shareholders every year and are available to meet other shareholders if required. The Annual General Meeting of the Company provides a forum, both formal and informal, for shareholders to meet and discuss issues with the Directors and the Manager of the Company. The Annual Report and Accounts (which includes the Notice of Annual General Meeting) is sent to shareholders at least 20 working days before the Annual General Meeting.

Risk Management and Internal Controls

Details of the principal risks and internal controls applied by the Board are set out on pages 14 to 16 and pages 28 and 29 respectively.

Share Capital and Companies Act Disclosures

Details of the Company's share capital structure and other Companies Act 2006 Disclosures and details of substantial interests is set out on page 22.

By order of the Board

F&C INVESTMENT BUSINESS LIMITED
Company Secretary
Quartermile 4
7a Nightingale Way
Edinburgh EH3 9EG
29 June 2018

Report of the Audit Committee

Composition of the Committee

The Board recognises the requirement for the Audit Committee as a whole to have competence relevant to the sector in which the Company operates and at least one member with recent and relevant experience.

The Audit Committee is chaired by Mr R B M Graham a Chartered Accountant, who has recent and relevant financial experience, operates within clearly defined terms of reference and comprises all the Directors except Mr R M Curling. Mrs C A Roxburgh is also a Chartered Accountant with over 30 years' finance and audit experience. These Directors have a combination of financial, investment and business experience and specifically with respect to the investment trust sector.

Role of the Committee

The duties of the Audit Committee include reviewing: the annual and interim financial statements; the system of internal controls; and the terms of appointment and remuneration of the Auditor, Ernst & Young LLP ('EY'), including its independence and objectivity.

The Audit Committee met on three occasions during the year including two meetings with EY. The attendance of each of the members is set out on page 26. In the course of its duties, the Committee had direct access to EY, F&C Investment Business Limited (the 'Administrator') and Montanaro Asset Management Limited (the 'Investment Manager and AIFM'). Amongst other things, the Audit Committee considered and reviewed the following matters and reported thereon to the Board:

- The annual and half-yearly reports and accounts and results announcements;
- The accounting policies of the Company and the allocation of management expenses and interest costs between capital and revenue;
- The principal risks faced by the Company and the effectiveness of the Company's internal control and risk management environment including consideration of the assumptions underlying the Board's Viability Statement;
- The effectiveness of the audit process and related non-audit services and the independence and objectivity of EY, its re-appointment, remuneration and terms of engagement;
- The policy on the engagement of EY to supply non-audit services and approval of any such services;
- The implications of proposed new accounting standards and regulatory changes;
- The need for the Company to have its own internal audit function;
- The receipt of AAF (01/06) and ISAE 3402 reports or their equivalent from the Manager, Administrator, Custodian and other service providers; and
- Whether the Annual Report and Accounts is fair, balanced and understandable.

Risk Management

The Board has established an ongoing process designed to meet the particular needs of the Company in managing the risks to which it is exposed, consistent with the related guidance issued by the Financial Reporting Council.

Montanaro's Compliance and Risk department and F&C's Business Risk department provide regular control reports to the Audit Committee and the Board covering administration, risk and compliance matters.

A key risk summary is produced to identify the risks to which the Company is exposed, the controls in place and the actions being taken to mitigate them. The Board has a robust process for considering the resulting risk matrix and reviews the significance of the risks and reasons for any change.

The Company's principal risks and their mitigations are set out on pages 14 to 16 with additional information provided in notes 15 to 20 to the accounts.

The integration of these risks into the consideration of the Viability Assessment and Statement on page 17 was also fully considered.

Internal Control

The Board is responsible for the Company's systems of internal controls and for reviewing their effectiveness.

The Audit Committee has reviewed and reported to the Board on these controls which aim to ensure that the assets of the Company are safeguarded, proper accounting records are maintained and the financial information used within the business and for publication is reliable.

The key procedures which have been established to provide an effective internal control environment are as set out below:

- Investment management services are provided by Montanaro, which is regulated by the Financial Conduct Authority. At each Board Meeting the Board monitors the investment performance of the Company in comparison to its stated investment objective, the benchmark index and comparable investment trusts. The Board also reviews the Company's activities since the last Board Meeting to ensure that the Manager adheres to the agreed investment policy and approved investment guidelines. On an annual basis, Montanaro produces an AAF 01/06 Report on internal controls, which is reviewed by a firm of independent reporting accountants, for consideration by the Audit Committee. Montanaro is also the Company's AIFM and in this capacity provides a quarterly report to the Board.

- F&C Investment Business Limited ('FCIB' or the 'Administrator') is responsible for the provision of company secretarial, accounting and administration services to the Company. On an annual basis, FCIB produces an AAF 01/06 Report on internal controls, which is reviewed by a firm of independent reporting accountants, for consideration by the Audit Committee.
- The Bank of New York Mellon SA/NV (London Branch) is responsible for the custody of the Company's investments. Lists of investments held are reconciled to the Company's records on a regular basis and a report on controls, which is reviewed by a firm of independent reporting accountants, is produced annually for consideration by the Audit Committee.
- The Board reviews contracts with other third party service providers, including the standard of services provided, on a regular basis.
- Board procedures are set within clearly defined parameters.
- At every Board meeting the Directors review financial information prepared by the Administrator, including management accounts and forecasts of income and expenditure.
- BNY Mellon Trust & Depositary Limited, as the Company's Depositary provides quarterly reports to the Board and carries out daily independent checks on cash and investment transactions.

A formal annual review of these procedures is carried out by the Audit Committee. The review meeting is attended by the Company's Auditor. During the year, the Committee receives updates on any material changes in the risk environment and the action taken.

These procedures have been in place throughout the year and up to the date of approval of the Annual Report and the Board is satisfied with their effectiveness. The procedures are designed to manage rather than eliminate risk and, by their nature, can only provide reasonable, but not absolute, assurance against material misstatement or loss.

The Board has reviewed the need for an internal audit function. It has decided that the systems and procedures employed by the Manager and the Administrator, including their risk management and internal audit functions, provide assurance that a sound system of internal control, which safeguards shareholders' investment and the Company's assets, is maintained. In addition, reporting is also provided by the Depositary with respect to their monitoring and oversight of the Company. An internal audit function, specific to the Company, is therefore considered unnecessary.

External audit process and significant matters considered by the Audit Committee

As part of its review of the scope and results of the audit, during the year the Audit Committee considered and approved EY's plan for the audit of the financial statements for the year ended 31 March 2018. At the conclusion of the audit EY did not highlight any issues to the Audit Committee which would cause it to qualify its audit report nor did it highlight any fundamental internal control weaknesses. EY issued an unqualified audit report which is included on pages 35 to 40. The significant issues considered by the Audit Committee are discussed in the table on page 30.

Non-audit Services

The Committee regards the continued independence of the auditor to be a matter of the highest priority. The Company's policy with regard to the provision of non-audit services by the external auditor ensures that no engagement will be permitted if:

- the provision of the services would contravene any regulation or ethical standard;
- the auditor is not considered to be an expert provider of the non-audit services;
- the provision of such services by the auditor creates a conflict of interest for either the Board or the Manager; and
- the services are considered to be likely to inhibit the auditor's independence or objectivity as auditor.

In addition to statutory audit fees, EY received fees for non-audit services of £nil during the year (2017: £14,000). In the prior year this related to the provision of tax compliance and advisory services for the year ended 31 March 2016 and advice in relation to the recovery of overseas taxation. The Audit Committee did not consider that the provision of such non-audit services was a threat to the objectivity and independence of the conduct of the audit as these services were provided by teams wholly independent from that of the audit.

As the Company is a Public Interest Entity listed on the London Stock Exchange, with effect from 1 April 2017, under EU legislation, prohibitions of certain services and a cap on the level of fees incurred for permissable non-audit services now applies and by year four, should not exceed 70% of the average audit fee for the previous three years.

To adhere to these new rules, KPMG LLP provides corporate tax compliance and other tax services to the Company.

In particular, the Committee has a policy, with effect from 1 April 2017, that the accumulated costs of all non-audit services sought from the auditor in any one year should not exceed 30% of the likely audit fees for that year.

Report of the Audit Committee continued

Significant Issues Considered by the Audit Committee in Relation to the Financial Statements

Matter	Action
Investment Portfolio Valuation The Company's portfolio is invested in the shares of European quoted smaller companies. Errors in the portfolio valuation could have a material impact on the Company's net asset value per share.	The Board reviews a full portfolio valuation at each Board meeting and, since the implementation of the AIFM Directive in July 2014, receives quarterly reports from the AIFM and the Depositary. The Audit Committee reviewed the Administrator's annual internal control report, which is reported on by independent external accountants, and which details the systems, processes and controls around the daily pricing of securities, including the application of exchange rate movements.
Misappropriation of Assets Misappropriation of the Company's investments or cash balances could have a material impact on its net asset value per share.	The Audit Committee reviewed the Administrator's annual internal control report, as referred to above, which details the controls around the reconciliation of the Administrator's records to those of the Custodian. The Audit Committee also reviewed the Custodian's annual internal control report, which is reported on by independent external accountants, and which provides details regarding its control environment. As stated above, since the implementation of the AIFM Directive in July 2014, the Board receives quarterly reports from the AIFM and the Depositary.
Income Recognition Incomplete or inaccurate income recognition, including allocation between revenue and capital, could have an adverse effect on the Company's net asset value and earnings per share and its level of distributable revenue.	The Audit Committee reviewed the Administrator's annual internal control report, as referred to above, which details the systems, processes and controls around the recording of investment income. It also compared the final level of income received for the year to the budget which was set at the start of the year and considered the accounting treatment of all special dividends received with the Manager.
Annual Report and Accounts Ensuring the Annual Report and Accounts is fair, balanced and understandable.	The Audit Committee read and discussed this Annual Report and Accounts and advised the Board that it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Auditor assessment, independence and re-appointment
The Audit Committee reviews the reappointment of the auditor every year. As part of this year's review of auditor independence and effectiveness, EY has confirmed that it is independent of the Company and has complied with relevant auditing standards. In evaluating EY, the Audit Committee has taken into consideration the standing, skills and experience of the firm and the audit team. The Audit Committee, from direct observation and enquiry of the Administrator, remains satisfied that EY continues to provide effective independent challenge in carrying out its responsibilities. EY's fee for the audit was £21,000 (2017: £20,500).

Under mandatory audit rotation rules, the Company will be required to put the external audit out to tender at least every ten years. Given the EU regulations and transitional provisions, as EY has been the Company's auditor for more than twenty years, then rotation is required at the latest, following the year ended 31 March 2021 audit. Following professional guidelines, the audit partner rotates after five years. The year ended 31 March 2018 is Caroline Mercer's first year as audit partner. On the basis of this assessment, the Audit Committee has recommended the re-appointment of EY to the Board. EY's performance will continue to be reviewed annually taking into account all relevant guidance and best practice.

R B M Graham
Chairman of the Audit Committee
29 June 2018

Directors' Remuneration Report

The Board consists solely of independent non-executive Directors. The Company has no executive Directors or employees. The level of Directors' fees is determined by the Remuneration Committee within the limits defined in the Articles of Association and approved by shareholders.

Full details of the Company's policy with regards to Directors' fees, and fees paid during the year ended 31 March 2018, are shown below and on page 32. This shows all major decisions on Directors' remuneration and any substantial changes made during the year relating to Directors' remuneration, including the context in which any changes occurred.

Under company law, the Auditor is required to audit certain disclosures provided. Where disclosures have been audited they are indicated as such. The Auditor's opinion is included in its report on pages 35 to 40.

Remuneration Committee

The Remuneration Committee consists solely of independent non-executive Directors and determines the level of the Directors' fees in accordance with the UK Code. The Administrator provides information on comparative levels of Directors' fees to the Remuneration Committee in advance of each review.

The Remuneration Committee consists of all six non-executive Directors and it is chaired by Mrs M R Somerset Webb. As the Company has no executive Directors, the Committee meets at least annually to determine the level of Directors' fees.

Directors' Remuneration Policy

The Company's policy is to remunerate Directors exclusively by fixed fees in cash at a rate which should reflect the responsibilities of being a non-executive Director, including the potential liabilities associated with the position, and the time committed by them to these responsibilities including, where appropriate, Board Committee duties. There were no changes to the policy during the year.

The Company has not received any views from its shareholders in respect of the levels of Directors' remuneration. It is intended that the policy will continue for the three year period ending at the AGM in 2020.

The fees for the non-executive Directors are determined within the limits set out in the Company's Articles of Association. The present limit is £200,000 in aggregate per annum and may not be changed without seeking shareholder approval at a general meeting. There is no performance related remuneration scheme and therefore non-executive Directors are not eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits.

Directors do not have service contracts, but new Directors are provided with a letter of appointment. These letters of appointment are available for inspection at the Company's registered office. The terms of Directors' appointments provide that they should retire and be subject to election at the first Annual General Meeting after their appointment. Under the terms of the Company's Articles of Association, Directors are obliged to offer themselves for re-election by shareholders by not later than the third Annual General Meeting after they were last elected. However, the Board has agreed that all Directors will retire annually and, if appropriate, seek re-election. There is no notice period and no provision for compensation upon early termination of appointment.

Voting at Annual General Meeting on Directors' Remuneration Policy

The Directors' Remuneration Policy was last approved by shareholders at the Company's Annual General Meeting, held on 27 July 2017. 99.7% of votes were in favour of the resolution and 0.3% of votes were against.

It is the Board's intention that the Directors' Remuneration Policy will be put to a shareholder vote again at the Annual General Meeting in 2020.

Annual Statement

As Chairman of the Remuneration Committee, I confirm that effective 1 April 2017, the Chairman's fee increased to £32,000 per annum, the Audit Committee Chairman's fee increased to £27,000 per annum and other Directors' fees increased to £23,000 per annum.

Future Policy Table

Following a review of the level of Directors' fees, the Remuneration Committee concluded that the amounts paid to Directors should remain unchanged. The current fees were last increased with effect from 1 April 2017, and it is anticipated that these fees will remain unchanged at least until 31 March 2020.

Based on these fees, Directors' fees for the forthcoming financial year would be as follows:

	31 March 2019 £	31 March 2018* £
Chairman	32,000	32,000
Audit Committee Chairman	27,000	27,000
Director	23,000	23,000

*Actual fees for the year ended 31 March 2018.

Directors' Remuneration Report continued

Annual Report on Directors' Remuneration

Directors' Emoluments for the Year (audited)

The Directors who served during the financial year received the following amounts for services as non-executive Directors for the years ended 31 March 2018 and 2017 as well as reimbursement for expenses necessarily incurred. No other forms of remuneration were paid during the year.

Fees for services to the Company (audited)

	Fees (audited)		Taxable Benefits* (audited)		Total (audited)	
	2018 £	2017 £	**2018 £**	2017 £	**2018 £**	2017 £
A R Irvine (Chairman)	**32,000**	28,500	**–**	–	**32,000**	28,500
R M Curling	**23,000**	19,000	**2,914**	1,239	**25,914**	20,239
R B M Graham (Audit Committee Chairman)	**27,000**	23,000	**–**	–	**27,000**	23,000
R A Hammond-Chambers(1)	**23,000**	19,000	**–**	98	**23,000**	19,098
C A Roxburgh(2)	**9,116**	n/a	**–**	n/a	**9,116**	n/a
M R Somerset Webb	**23,000**	19,000	**–**	42	**23,000**	19,042
Total	**137,116**	108,500	**2,914**	1,379	**140,030**	109,879

(1) Includes fees of £13,000 (2017: £13,000) paid to a company called Alex Hammond-Chambers and Company.
(2) Appointed 8 November 2017.
* Comprises amounts reimbursed for expenses incurred in carrying out business for the Company, which have been grossed up to include PAYE and NI contributions.

Relative Importance of Expenditure on Pay

As the Company has no employees, the table above represents the total remuneration costs and benefits paid by the Company. To enable shareholders to assess the relative importance of expenditure on Directors' remuneration, the table below shows the actual expenditure during the year in relation to Directors' remuneration (excluding taxable benefits), other operating expenses and shareholder distributions:

	2018 £	2017 £	Change %
Aggregate Directors' Remuneration	**137,116**	108,500	+26.4
Management and other operating expenses*	**1,930,000**	1,520,000	+27.0
Dividends paid to shareholders	**1,381,000**	1,255,000	+10.0

* Includes Directors' remuneration.

Directors' Shareholdings (audited)

The Directors who held office at the year end and their interests in the shares of the Company were as follows:

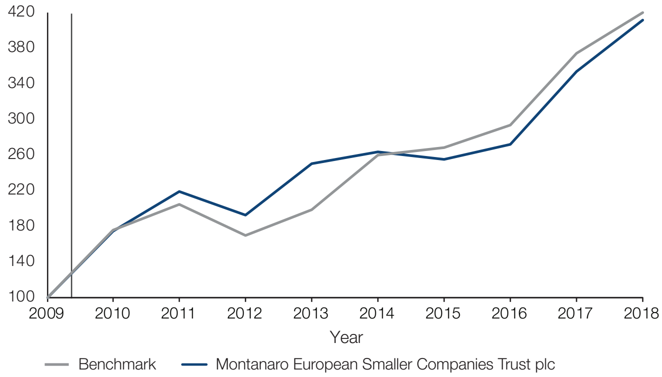
		2018 Ordinary Shares	2017 Ordinary Shares
A R Irvine	Beneficial	**65,000**	65,000
R M Curling	Beneficial	**5,000**	nil
R B M Graham	Beneficial	**34,600**	34,600
R A Hammond-Chambers	Beneficial	**25,000**	25,000
C A Roxburgh		**nil**	n/a
M R Somerset Webb	Beneficial	**3,802**	3,802

There have been no changes in the Directors' interests in the shares of the Company between 31 March 2018 and 29 June 2018.

Company Performance

The Board is responsible for the Company's investment strategy and performance, although the management of the Company's investment portfolio is delegated to Montanaro through the investment management agreement, as referred to in the Report of the Directors on page 21. The graph below compares, for the nine financial years ended 31 March 2018, the share price total return (assuming all dividends are reinvested) to shareholders compared to the return from the benchmark index. An explanation of the performance of the Company for the year ended 31 March 2018 is given in the Chairman's Statement and the Manager's Report.

Share Price Total Return vs Benchmark*
(rebased from March 2009)



* From 5 September 2006: MSCI Europe SmallCap Index. The benchmark was changed on 1 June 2009 to the MSCI Europe SmallCap (ex UK) Index (in Sterling terms).

Voting at Annual General Meeting on Annual Report

At the Company's last Annual General Meeting, held on 27 July 2017, shareholders approved the Annual Report on Directors' Remuneration for the year ended 31 March 2017. 99.7% of votes were in favour of the resolution and 0.3% were against.

An ordinary resolution for the approval of this Annual Report on Directors' Remuneration will be put to shareholders at the forthcoming Annual General Meeting.

On behalf of the Board

M R SOMERSET WEBB
Director
29 June 2018

Management Report and Directors' Responsibilities Statement

Management Report

Listed companies are required by the Financial Conduct Authority's Disclosure Guidance and Transparency Rules (the 'Rules') to include a management report in their annual financial statements. The information required to be in the management report for the purpose of the Rules is included in the Chairman's Statement (pages 2 and 3), the Manager's Report (pages 4 to 7), Twenty Largest Holdings (pages 8 and 9), Analysis of Investment Portfolio by Sector (page 10), the Business Model and Strategy (pages 11 to 17) and the Report of the Directors (pages 20 to 24). Therefore a separate management report has not been included.

Directors' Responsibilities Statement in Relation to the Financial Statements

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union. The Directors are also required to prepare a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement.

Under company law the Directors must not approve the financial statements unless they are satisfied that they present a fair, balanced and understandable report and provide the information necessary for shareholders to assess the Company's performance, business model and strategy. In preparing the financial statements the Directors are required to:

- select suitable accounting policies in accordance with IAS 8: '*Accounting Policies, Changes in Accounting Estimates and Errors*' and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance;
- state that the Company has complied with IFRS, subject to any material departures disclosed and explained in the financial statements;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on a going concern basis unless it is inappropriate to assume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Responsibility Statements under the Disclosure Guidance and Transparency Rules

Each of the Directors confirms that to the best of his or her knowledge:

- the financial statements, prepared in accordance with IFRS as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company;
- the Strategic Report (comprising the Chairman's Statement, Manager's Report, Twenty Largest Holdings, Analysis of Investment Portfolio by Sector and Business Model and Strategy) and the Report of the Directors include a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that it faces;
- taken as a whole, the Annual Report and financial statements are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy;
- the financial statements include details on related party transactions; and
- having assessed the principal risks and other matters discussed in connection with the Viability Statement, it is appropriate to adopt the going concern basis in preparing the financial statements.

On behalf of the Board

A R IRVINE
Director
29 June 2018

Independent Auditor's Report

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MONTANARO EUROPEAN SMALLER COMPANIES TRUST PLC

Opinion

We have audited the financial statements of Montanaro European Smaller Companies Trust plc (the 'Company') for the year ended 31 March 2018 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 22, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRS') as adopted by the European Union.

In our opinion, the financial statements:

- give a true and fair view of the Company's affairs as at 31 March 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 14 to 16 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 17 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on pages 22 and 23 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 17 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Independent Auditor's Report continued

Overview of our audit approach

Key audit matters	• Incorrect valuation and defective title of the investment portfolio • Incomplete or inaccurate revenue recognition through failure to recognise proper income entitlements or apply appropriate accounting treatment
Materiality	• Overall materiality of £1.51m which represents 1% of shareholders' funds (2017: £1.36m)

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Incorrect valuation and defective title of the investment portfolio (as described on page 30 in the Report of the Audit Committee). The valuation of the assets held in the investment portfolio is the key driver of the Company's net asset value and total return. Incorrect asset pricing or a failure to maintain proper legal title of the assets held by the Company could have a significant impact on the portfolio valuation and the return generated for shareholders. Listed investments are valued at fair value, which is deemed to be bid value or the last traded price depending on the convention of the exchange on which the investment is listed. The valuation of the portfolio at 31 March 2018 was £151.73m (2017: £145.99m) consisting of listed equities.	**We performed the following procedures:** Obtained an understanding of the Manager's and Administrator's processes and controls surrounding investment pricing and trade processing and also performed a walkthrough to evaluate the design and effectiveness of controls. For all listed investments in the portfolio, we compared the market values and exchange rates applied to an independent source. We agreed the Company's investments to the independent confirmation received from the Company's custodian/depositary as at 31 March 2018.	**The results of our procedures are:** We noted no issues when obtaining an understanding of the Manager's and Administrator's processes and controls surrounding investment pricing and trade processing. For all listed investments, we noted no material differences in market value or exchange rates when compared to an independent source. We noted no differences between the custodian/depositary confirmation and the Company's underlying financial records

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Incomplete or inaccurate revenue recognition though failure to recognise proper income entitlements or apply appropriate accounting treatment (as described on page 30 in the Report of the Audit Committee). The investment income receivable by the Company during the year directly affects the Company's ability to make a dividend payment to shareholders. The investment income received for the year to 31 March 2018 was £3.09m (2017: £2.98m). Special dividends by their nature require the exercise of judgement as to whether the income receivable should be classified as 'revenue' or 'capital'. During the year, the Company received 6 special dividends with an aggregate value of £0.18m. These special dividends were all treated as revenue. Realised and unrealised profits or losses contribute to a significant portion of the capital returns in the Statement of Comprehensive Income. There is a risk that these are not calculated correctly which could lead to the capital returns being materially misstated.	**We have performed the following procedures:** Obtained an understanding of the Manager's and Administrator's processes and controls surrounding revenue recognition and allocation of special dividends and also performed a walkthrough to evaluate the design and effectiveness of controls. We agreed a sample of dividend receipts to the corresponding announcement made by the investee company, recalculated the dividend amount received and agreed cash received to bank statements. We agreed a sample of investee company dividend announcements from an independent source to the income recorded by the Company. We confirmed that there were no accrued dividends as at the year end. We reviewed the income report and the acquisition and disposal report to identify special dividends greater than our testing threshold received in the year. We reviewed the treatment of all special dividends greater than our testing threshold based on the underlying motives and circumstances for the payment and considered the treatment of the classification of these dividends as either revenue or capital. We agreed a sample of key transaction details (e.g. units, trade date) of purchases and sales recorded to contract notes, agreeing the cost and proceeds to bank statements. We agreed the realised gains and losses arising on a sample of disposals. We recalculated the unrealised gains in total as at the year end.	**The results of our procedures are:** We noted no issues when obtaining an understanding of the Manager's and Administrator's processes and controls surrounding revenue recognition and allocation of special dividends. We noted no issues in agreeing the sample of dividend receipts to an independent source, recalculating these amounts and agreeing them to the bank statements. We noted no issues in agreeing the sample of investee company announcements to the income entitlements recorded by the Company. We noted no issues in agreeing the accounting treatment adopted with respect to each special dividend receipt reviewed. We noted no issues in agreeing a sample of transaction details to contract notes and bank statements. We noted no issues in recalculating a sample of realised gains and losses and recalculating the unrealised gains in total as at the year end.

Independent Auditor's Report continued

There has been one change to the areas of key focus raised in the above risk table from the prior year; the inclusion of the risk of incomplete or inaccurate revenue recognition though failure to recognise proper income entitlements or apply appropriate accounting treatment. This has been identified as a key audit matter due to the proportion of audit time spent and the judgement involved in the allocation of special dividends.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls and changes in the business environment when assessing the level of work to be performed.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Company to be £1.51m (2017: £1.36m) which is 1% of shareholders' funds. We believe that shareholders' funds provides us with materiality aligned to the key measurement of the Company's performance.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 75% (2017: 75%) of our planning materiality, namely £1.13m (2017: £1.02m). We have set performance materiality at this percentage due to our past experience of the audit that indicates a lower risk of misstatements, both corrected and uncorrected.

Given the importance of the distinction between revenue and capital for the Company we also applied a separate revenue tolerable threshold of £0.09m (2017: £0.10m) for the revenue column of the Statement of Comprehensive Income, being 5% of the revenue profit before taxation.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.08m (2017: £0.07m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- **Fair, balanced and understandable set out on page 20** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting set out on page 28** – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 25** – the parts of the directors' statement required under the Listing Rules relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' reports have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 34, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Independent Auditor's Report continued

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and determined that the most significant are IFRS, the Companies Act 2006, the Listing Rules, the UK Corporate Governance Code and Section 1158 of the Corporation Tax Act 2010.
- We understood how the Company is complying with those frameworks through discussions with the Audit Committee and Company Secretary and review of the Company's documented policies and procedures.
- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur by considering the key risks impacting the financial statements. We identified a fraud risk with respect to the incomplete or inaccurate income recognition through incorrect classification of special dividends. Further discussion of our approach is set out in the section on key audit matters above.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved review of the reporting to the directors with respect to the application of the documented policies and procedures and review of the financial statements to ensure compliance with the reporting requirements of the Company.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- Following the recommendation of the Audit Committee, we were appointed by the Company to audit the financial statements for the period ended 31 March 1982 and subsequent financial periods. Our appointment was subsequently ratified at the annual general meeting of the Company on 22 June 1982.

  The period of total uninterrupted engagements including previous renewals and reappointments is 37 years, covering the periods ending 31 March 1982 to 31 March 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

CAROLINE MERCER
(Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
Edinburgh
29 June 2018

Notes:

1. The maintenance and integrity of the Montanaro European Smaller Companies Trust plc web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement of Comprehensive Income
for the year ended 31 March 2018

	Notes	2018 Revenue £'000	2018 Capital £'000	2018 Total £'000	2017 Revenue £'000	2017 Capital £'000	2017 Total £'000
Capital gains on investments							
Gains on investments held at fair value	9	**–**	**15,962**	**15,962**	–	31,339	31,339
Exchange losses		**–**	**(284)**	**(284)**	–	(1,133)	(1,133)
		–	**15,678**	**15,678**	–	30,206	30,206
Revenue							
Investment income	2	**3,094**	**–**	**3,094**	2,978	–	2,978
Total income		**3,094**	**15,678**	**18,772**	2,978	30,206	33,184
Expenditure							
Management expenses	3	**(442)**	**(821)**	**(1,263)**	(340)	(631)	(971)
Other expenses	4	**(667)**	**–**	**(667)**	(549)	–	(549)
Total expenditure		**(1,109)**	**(821)**	**(1,930)**	(889)	(631)	(1,520)
Profit before finance costs and taxation		**1,985**	**14,857**	**16,842**	2,089	29,575	31,664
Finance costs	5	**(179)**	**(333)**	**(512)**	(174)	(323)	(497)
Profit before taxation		**1,806**	**14,524**	**16,330**	1,915	29,252	31,167
Taxation	6	**(223)**	**–**	**(223)**	(280)	–	(280)
Total comprehensive income		**1,583**	**14,524**	**16,107**	1,635	29,252	30,887
Return per share	8	**9.5p**	**86.8p**	**96.3p**	9.8p	174.8p	184.6p

The total column of this statement represents the Company's Income Statement and Statement of Comprehensive Income, prepared in accordance with IFRS. The supplementary revenue return and capital return columns are both prepared under guidance published by the Association of Investment Companies.

All revenue and capital items in the above statement derive from continuing operations.

No operations were acquired or discontinued in the year.

The accompanying notes are an integral part of the financial statements.

Balance Sheet
as at 31 March 2018

	Notes	2018 £'000	2017 £'000
Non-current assets			
Investments held at fair value through profit and loss	9	**151,728**	145,989
Current assets			
Trade and other receivables	10	**578**	524
Cash and cash equivalents	10	**20,574**	11,144
		21,152	11,668
Total assets		**172,880**	157,657
Current liabilities			
Trade and other payables	11	**(201)**	(272)
Interest-bearing bank loans	12	**(21,903)**	–
		(22,104)	(272)
Non-current liabilities			
Interest-bearing bank loans	12	**–**	(21,335)
Total liabilities		**(22,104)**	(21,607)
Net assets		**150,776**	136,050
Capital and reserves			
Called-up share capital	13	**8,724**	8,724
Share premium account		**5,283**	5,283
Capital redemption reserve		**2,212**	2,212
Capital reserve		**130,916**	116,392
Revenue reserve		**3,641**	3,439
Shareholders' funds		**150,776**	136,050
Net asset value per share	14	**901.1p**	813.1p

The financial statements on pages 41 to 58 were approved by the Board of Directors and authorised for issue on 29 June 2018 and signed on its behalf by:

A R IRVINE
Director

The accompanying notes are an integral part of the financial statements.

Statement of Changes in Equity
for the year ended 31 March 2018

	Notes	Share Capital £'000	Share Premium Account £'000	Capital Redemption Reserve £'000	Capital Reserve £'000	Revenue Reserve £'000	Total £'000
Balance at 1 April 2017		8,724	5,283	2,212	116,392	3,439	136,050
Total comprehensive income		–	–	–	14,524	1,583	16,107
Dividends paid	7	–	–	–	–	(1,381)	(1,381)
Balance at 31 March 2018		**8,724**	**5,283**	**2,212**	**130,916**	**3,641**	**150,776**

	Notes	Share Capital £'000	Share Premium Account £'000	Capital Redemption Reserve £'000	Capital Reserve £'000	Revenue Reserve £'000	Total £'000
Balance at 1 April 2016		8,724	5,283	2,212	87,140	3,059	106,418
Total comprehensive income		–	–	–	29,252	1,635	30,887
Dividends paid	7	–	–	–	–	(1,255)	(1,255)
Balance at 31 March 2017		**8,724**	**5,283**	**2,212**	**116,392**	**3,439**	**136,050**

The accompanying notes are an integral part of the financial statements.

Cash Flow Statement
for the year ended 31 March 2018

	Notes	2018 £'000	2017 £'000
Cash flows from operating activities			
Profit before finance costs and taxation		**16,842**	31,664
Investment gains		**(15,962)**	(31,339)
Exchange losses		**284**	1,133
Withholding tax		**(325)**	(457)
Investment income		**(3,094)**	(2,978)
Dividends received		**3,142**	2,913
(Decrease)/increase in payables		**(71)**	82
Purchases of investments		**(26,404)**	(31,123)
Sales of investments		**36,627**	35,210
Net cash inflow from operating activities		**11,039**	5,105
Cash flows from financing activities			
Dividends paid	7	**(1,381)**	(1,255)
Interest paid		**(478)**	(461)
Net cash outflow from financing activities		**(1,859)**	(1,716)
Net increase in cash and cash equivalents		**9,180**	3,389
Exchange gains		**250**	429
Increase in cash and cash equivalents		**9,430**	3,818
Cash and cash equivalents at beginning of year		**11,144**	7,326
Cash and cash equivalents at end of year	10	**20,574**	11,144

The accompanying notes are an integral part of the financial statements.

Notes to the Accounts
for the year ended 31 March 2018

1 Accounting Policies

A summary of the principal accounting policies is set out below.

BASIS OF ACCOUNTING

The financial statements of the Company have been prepared in accordance with the Companies Act 2006, International Financial Reporting Standards ('IFRS'), which comprise standards and interpretations approved by the International Accounting Standards Board ('IASB'), and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee ('IASC') that remain in effect, and to the extent that they have been adopted by the European Union.

The principal accounting policies adopted are set out below. Where presentational guidance set out in the Statement of Recommended Practice ('SORP') for investment companies issued by the Association of Investment Companies ('AIC') is consistent with the requirements of IFRS, the Directors have sought to prepare the financial statements on a basis compliant with the recommendations of the SORP.

The functional and presentational currency of the Company is Pounds Sterling and has been determined on the basis of the currency of the Company's share capital and the currency in which dividends and expenses are paid.

The valuation of financial assets held by the Company at the year end have been derived from active, liquid markets. Risks relating to the valuations are disclosed in note 16.

In assessing the going concern basis of accounting, the Directors have given due regard to the guidance issued by the Financial Reporting Council. After making enquiries, and bearing in mind the nature of the Company's business and assets, the Directors consider that the Company has adequate resources to continue in operational existence for a period of at least twelve months from the date of approval of the financial statements. For this reason, they continue to adopt the going concern basis in preparing the financial statements. Further detail is included in the Report of the Directors on pages 22 and 23.

The accounting policies adopted are consistent with those of the previous financial year, except that the following amendments to IAS 7 has been adopted in the current year:

- The IASB issued amendments to IAS 7 '*Statement of Cash Flows'* as part of its Disclosure Initiative and these require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amendments do not prescribe a specific format to disclose financing activities; however, an entity may fulfil the disclosure objective by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. On initial application of the amendments, entities are not required to provide comparative information for preceding periods. The adoption of these amendments did not have any impact on the current period or any prior periods other than those disclosed in note 12.

The following new standards have been issued but are not effective for this accounting period and have not been adopted early:

- In July 2014, the IASB issued the final version of IFRS 9 '*Financial Instruments*' which reflects all phases of the financial instruments project and replaces IAS 39 '*Financial Instruments: Recognition and Measurements*'. The standard introduces new requirements for classification and measurement of financial instruments, a new expected credit loss model for calculating impairment on financial assets, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required with some exceptions. The adoption of IFRS 9 is unlikely to have a material effect on the Company's financial assets or financial liabilities, which will continue to be classified as fair value through profit or loss and held at amortised cost respectively.

Notes to the Accounts continued
for the year ended 31 March 2018

1 Accounting Policies continued

- IASB has issued a new standard for the recognition of revenue, IFRS 15 '*Revenue from Contracts with Customers*'. This will replace IAS 18 which covers contracts for goods and services. The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards.

  The standard permits a modified retrospective approach for the adoption. Under this approach entities will recognise transitional adjustments in retained earnings on the date of initial application (e.g. 1 April 2018), i.e. without restating the comparative period. They will only need to apply the new rules to contracts that are not completed as of the date of initial application.

  The standard will be effective for annual periods beginning on or after 1 January 2018. It is currently anticipated that this standard will not have any impact on the Company's financial statements as presented for the current year, as the Company's income is predominantly dividend income and fair value gains which are not accounted for under IFRS 15.

OPERATING SEGMENTS
The Board has considered the requirements of IFRS 8 '*Operating Segments*'. The Board is of the view that the Company is engaged in a single segment of business, of investing in European quoted smaller companies, and that therefore the Company has only a single operating segment. The Board of Directors, as a whole, has been identified as constituting the chief operating decision maker of the Company. The key measure of performance used by the Board to assess the Company's performance is the total return on the Company's net asset value, as calculated under IFRS, and therefore no reconciliation is required between the measure of profit or loss used by the Board and that contained in the financial statements.

PRESENTATION OF STATEMENT OF COMPREHENSIVE INCOME
In order to better reflect the activities of an investment trust company and in accordance with guidance issued by the AIC, supplementary information which analyses the Statement of Comprehensive Income between items of a revenue and capital nature has been presented alongside the Statement of Comprehensive Income. The net revenue return is the measure the Directors believe appropriate in assessing the Company's compliance with certain requirements set out in Section 1158 of the Corporation Tax Act 2010.

INCOME
Dividends are recognised as income on the date that the related investments are marked ex-dividend.

Dividends receivable on equity shares where no ex-dividend date is quoted are recognised when the Company's right to receive payment is established. The treatment of special dividends is disclosed on page 49.

Where the Company has elected to receive its dividends in the form of additional shares rather than cash, the amount of the cash dividend foregone is recognised as income.

Interest income is accounted for on an accruals basis.

EXPENSES AND FINANCE COSTS
All expenses and finance costs are accounted for on an accruals basis and are charged against revenue, except where incurred in connection with the maintenance or enhancement of the value of the Company's assets and taking account of the expected long-term returns as follows:

– finance costs payable are allocated 35% to revenue and 65% to capital.

– management expenses payable are allocated 35% to revenue and 65% to capital.

1 Accounting Policies continued

TAXATION

The tax expense represents the sum of the tax currently payable and movements in deferred tax. Tax payable is based on the taxable profit for the year and withholding tax payable. Taxable profit differs from profit before tax as reported in the Statement of Comprehensive Income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

In line with the recommendations of the SORP, the allocation method used to calculate tax relief on expenses presented against capital returns in the supplementary information in the Statement of Comprehensive Income is the 'marginal basis'. Under this basis, if taxable income is capable of being offset entirely by expenses presented in the revenue return column of the Statement of Comprehensive Income, then no tax relief is transferred to the capital return column.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the Statement of Comprehensive Income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Investment trusts which have approval under Section 1158 of the Corporation Tax Act 2010 are not liable to taxation on capital gains.

INVESTMENTS

Investments are recognised and derecognised on the trade date where a purchase or sale is under a contract whose terms require delivery within a timeframe established by the market concerned, and are initially measured at fair value being consideration paid. Investments are classified as fair value through profit or loss. As the Company's business is investing in financial assets with a view to profiting from their total return in the form of dividends or increases in fair value, listed equities are designated as fair value through profit or loss on initial recognition.

The Company manages and evaluates the performance of these investments on a fair value basis in accordance with its investment strategy, and information about the investments is provided internally on this basis to the entity's key management personnel.

Financial assets designated at fair value through profit or loss are measured at subsequent reporting dates at fair value, which is the bid price or the last traded price depending on the convention of the exchange on which the investment is listed.

Where securities are designated upon initial recognition as fair value through profit or loss, gains and losses arising from changes in fair value and investment realisations are included in the net profit or loss for the period as a capital item.

All investments for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy in note 15, described as follows, based on the lowest significant applicable input:

Level 1 reflects financial instruments quoted in an active market.

Notes to the Accounts continued

for the year ended 31 March 2018

1 Accounting Policies continued

Level 2 reflects financial instruments whose fair value is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables includes only observable market data.

Level 3 reflects financial instruments whose fair value is determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable market transactions in the same instrument and not based on available observable market data.

For investments that are recognised in the financial statements on a recurring basis, the Company determines whether transfers have occurred between levels in the hierarchy by re-assessing the categorisation (based on the lowest significant applicable input) at the date of the event that caused the transfer.

CASH AND CASH EQUIVALENTS

Cash comprises bank balances and cash held by the Company. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

INTEREST-BEARING BORROWINGS

All borrowings are initially recognised at cost, being fair value of the consideration received. After initial recognition, all interest-bearing borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any loan arrangement costs.

RESERVES

(i) **Share Premium Account**

The following are included in this reserve:

- the surplus of net proceeds received from the issue of new Ordinary Shares over the par value of such shares.
- surplus arising on the sale of Ordinary Shares from treasury.

(ii) **Capital Redemption Reserve**

The nominal value of Ordinary Shares bought back for cancellation is added to this reserve. This reserve is non-distributable.

(iii) **Capital Reserve**

The following are included in this reserve:

- gains and losses on the realisation of investments.
- increases and decreases in the valuation of investments held at the year end.
- exchange differences of a capital nature.
- special dividends of a capital nature.
- expenses and finance costs, together with the related taxation effect, charged in accordance with the above policies.
- cost of purchasing Ordinary Shares to be held in treasury or cancelled.
- proceeds from the issue of Ordinary Shares held in treasury equivalent to the original cost of the repurchase.

In addition, the Company's Articles of Association permit it to distribute from the Capital Reserve any surplus arising from the realisation of its investments.

(iv) **Revenue Reserve**

The net profit arising in the revenue column of the Statement of Comprehensive Income is added to this reserve. Dividends paid during the year may be deducted from this reserve.

1 Accounting Policies continued

FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are recognised on the Balance Sheet of the Company when the Company becomes a party to the contractual provisions of the instrument. The Company shall offset financial assets and financial liabilities if it has a legally enforceable right to set off the recognised amounts and intends to settle on a net basis.

FOREIGN CURRENCIES

Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date. Non-monetary items expressed in foreign currencies held at fair value are translated into sterling at rates of exchange ruling at the date the fair value is measured. Transactions in foreign currencies are converted to sterling at the rate ruling at the date of the transaction. Exchange gains and losses are taken to the Statement of Comprehensive Income as a capital or revenue item depending on the nature of the underlying item.

Exchange gains and losses on investments are included within 'Gains on investments held at fair value' and are taken to the Capital Reserve. Exchange differences on other financial instruments are included in the Statement of Comprehensive Income as 'Exchange losses'.

Rates of exchange (per Pound Sterling)	**31 March 2018**	31 March 2017	Change %
Danish Krone	**8.50**	8.69	–2.2
Euro	**1.14**	1.17	–2.6
Norwegian Krone	**11.01**	10.74	2.5
Swedish Krona	**11.75**	11.16	5.3
Swiss Franc	**1.34**	1.25	7.2

USE OF JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The presentation of the financial statements in accordance with accounting standards requires the Board to make judgements, estimates and assumptions that affect the accounting policies and reported amounts of assets, liabilities, income and expenses. Estimates and judgements are continually evaluated and are based on perceived risks, historical experience, expectations of plausible future events and other factors. Actual results may differ from these estimates.

The areas requiring the most significant judgement and estimation in the preparation of the financial statements are: recognising and classifying unusual or special dividends received as either revenue or capital in nature and setting the level of dividends paid and proposed to adhere to Investment Trust status rules under Section 1158 of the Corporation Tax Act 2010.

Dividends received which appear to be unusual in size or circumstance are assessed on a case-by-case basis, based on interpretation of the investee companies' relevant statements, to determine their allocation in accordance with the SORP to either the revenue account or capital reserves. Dividends which have clearly arisen out of the investee company's reconstruction or reorganisation are usually considered to be capital in nature and allocated to capital reserves. Investee company dividends which appear to be paid in excess of current year profits will still be considered as revenue in nature unless evidence suggests otherwise.

Notes to the Accounts continued
for the year ended 31 March 2018

2 Income

	2018 £'000	2017 £'000
Investment income		
Overseas dividend income	**3,094**	2,978
Total	**3,094**	2,978

3 Management Expenses

	2018 Revenue £'000	2018 Capital £'000	2018 Total £'000	2017 Revenue £'000	2017 Capital £'000	2017 Total £'000
Investment management fee	**424**	**789**	**1,213**	322	599	921
AIFM fee	**18**	**32**	**50**	18	32	50
	442	**821**	**1,263**	340	631	971

Details of the management fee arrangements during the year are contained within the Report of the Directors on page 21 and details of fees owed to the Manager at the balance sheet date are included in note 11.

4 Other Expenses

	2018 Revenue £'000	2018 Capital £'000	2018 Total £'000	2017 Revenue £'000	2017 Capital £'000	2017 Total £'000
Directors' fees	**137**	**–**	**137**	109	–	109
Auditor's remuneration for:						
– statutory audit	**21**	**–**	**21**	21	–	21
– tax advisory services	**–**	**–**	**–**	8	–	8
Secretarial and administration fees	**129**	**–**	**129**	125	–	125
Legal, professional and advisory fees	**24**	**–**	**24**	6	–	6
Custody and depositary fees	**87**	**–**	**87**	77	–	77
Bank charges – negative interest	**121**	**–**	**121**	52	–	52
Other	**148**	**–**	**148**	151	–	151
	667	**–**	**667**	549	–	549

5 Finance Costs

	2018 Revenue £'000	2018 Capital £'000	2018 Total £'000	2017 Revenue £'000	2017 Capital £'000	2017 Total £'000
Interest payable on bank borrowings	**179**	**333**	**512**	174	323	497

6 Taxation

	2018 Revenue £'000	2018 Capital £'000	2018 Total £'000	2017 Revenue £'000	2017 Capital £'000	2017 Total £'000
Overseas tax	**223**	**–**	**223**	280	–	280

As at 31 March 2018, the Company had unutilised management expenses for taxation purposes of £24,666,000 (2017: £22,545,000). A deferred tax asset of £4,193,000 (2017: £3,833,000) has not been recognised on the unutilised expenses as it is unlikely that there will be suitable taxable profits from which the future reversal of the deferred tax could be deducted.

6 Taxation continued

FACTORS AFFECTING TAX CHARGE FOR THE YEAR

The tax charge for the year is lower than the standard rate of corporation tax in the UK for an investment company. The differences are explained below:

	2018 £'000	2017 £'000
Profit on ordinary activities before taxation	**16,330**	31,167
Corporation tax at standard rate of 19% (2017: 20%)	**3,103**	6,233
Effects of:		
Non-taxable gains on investments	**(3,033)**	(6,268)
Movement in unutilised expenses	**443**	404
Non-taxable overseas income	**(564)**	(596)
Exchange losses	**54**	227
Overseas tax	**241**	282
Overseas tax expensed	**(4)**	–
Adjustment to provision for prior years	**(17)**	(2)
Total tax charge for the year	**223**	280

7 Dividends

	2018 £'000	2017 £'000
Final dividend for the year ended 31 March 2016 of 5.75p per share	**–**	962
Interim dividend for the year ended 31 March 2017 of 1.75p per share	**–**	293
Final dividend for the year ended 31 March 2017 of 6.50p per share	**1,088**	–
Interim dividend for the year ended 31 March 2018 of 1.75p per share	**293**	–
	1,381	1,255
Amounts relating to the year but not paid at the year end:		
Final dividend for the year ended 31 March 2017 of 6.50p per share	**–**	1,088
Final dividend for the year ended 31 March 2018 of 6.75p per share*	**1,129**	–
	1,129	1,088

The Directors have proposed a final dividend in respect of the year ended 31 March 2018 of 6.75p per share, payable on 3 September 2018 to all shareholders on the register on 13 July 2018. The final dividend is subject to approval by shareholders at the Annual General Meeting.

The attributable revenue and the dividends paid and proposed for the purposes of the income retention test for section 1159 of the Income and Corporation Tax Act 2010, are set out below:

	2018 £'000	2017 £'000
Revenue attributable to equity shareholders	**1,583**	1,635
Interim dividend for the year ended 31 March 2017 of 1.75p per share	**–**	(293)
Final dividend for the year ended 31 March 2017 of 6.50p per share	**–**	(1,088)
Interim dividend for the year ended 31 March 2018 of 1.75p per share	**(293)**	–
Proposed final dividend for the year ended 31 March 2018 of 6.75p per share*	**(1,129)**	–
Revenue reserve transfer	**161**	254

* Based on 16,733,260 Ordinary Shares in issue at 29 June 2018.

Notes to the Accounts continued
for the year ended 31 March 2018

8 Return Per Share

	2018 Revenue	2018 Capital	2018 Total	2017 Revenue	2017 Capital	2017 Total
Basic	**9.5p**	**86.8p**	**96.3p**	9.8p	174.8p	184.6p

Basic total return per Ordinary Share is based on the total comprehensive income for the financial year of £16,107,000 (2017: £30,887,000) and on 16,733,260 (2017: 16,733,260) Ordinary Shares, being the weighted average number of Ordinary Shares in issue during the year, excluding those shares bought back and held in treasury.

Basic revenue return per Ordinary Share is based on the net revenue return on ordinary activities after taxation of £1,583,000 (2017: £1,635,000), and on 16,733,260 (2017: 16,733,260) Ordinary Shares, being the weighted average number of Ordinary Shares in issue during the year, excluding those shares bought back and held in treasury.

Basic capital return per Ordinary Share is based on the net capital return for the financial year of £14,524,000 (2017: £29,252,000), and on 16,733,260 (2017: 16,733,260) Ordinary Shares, being the weighted average number of Ordinary Shares in issue during the year, excluding those shares bought back and held in treasury.

9 Investments at Fair Value Through Profit and Loss

	2018 £'000	2017 £'000
Opening cost	**89,157**	81,719
Holding gains	**56,832**	36,661
Opening fair value	**145,989**	118,380
Purchases at cost	**26,404**	30,963
Sales – proceeds	**(36,627)**	(34,693)
– gains on sales	**14,589**	11,168
Holding gains	**1,373**	20,171
Closing fair value	**151,728**	145,989
Closing cost	**93,523**	89,157
Holding gains	**58,205**	56,832
Closing valuation	**151,728**	145,989

Net gains on the realisation of investments during the year represents the difference between the net proceeds of sale and the book cost of investment sold.

Movement in fair value represents the increase in the difference between book cost of investments held and their market value at 31 March 2018 compared with the difference between the book cost of investments held and their market value at 31 March 2017.

TRANSACTION COSTS

The Company incurred transaction costs on the purchase of investments of £20,000 and sale of investments of £26,000 (2017: £30,000 on purchases and £32,000 on sales).

	2018 £'000	2017 £'000
Gains on sales	**14,589**	11,168
Increase in holding gains	**1,373**	20,171
Gains on investments held at fair value	**15,962**	31,339

10 Current Assets

	2018 £'000	2017 £'000
Prepayments and accrued income	**6**	54
Overseas tax recoverable	**572**	470
	578	524

The carrying value of the balances above approximates to fair value. There are no amounts which are past due or impaired at the year end (2017: £nil).

CASH AND CASH EQUIVALENTS

These comprise bank balances and cash held by the Company. The carrying amount of these assets approximates to their fair value.

	2018 £'000	2017 £'000
Cash at bank and on hand	**20,574**	11,144

11 Current Liabilities

	2018 £'000	2017 £'000
Investment management and AIFM fee	**105**	178
Other creditors	**96**	94
	201	272

The carrying value of the balances above approximates to fair value.

12 Interest-Bearing Bank Loans

	2018 £'000	2017 £'000
Opening balance	**21,335**	19,738
Amortisation of set-up costs	**34**	34
Non-cash foreign currency movements	**534**	1,563
Closing balance	**21,903**	21,335

On 11 September 2013, the Company entered into a five year secured €15 million loan at a fixed rate of 2.90% per annum. This loan will mature on 13 September 2018. On 23 February 2016, the Company entered into a secured €10 million loan at a fixed rate of 0.9275% per annum. This loan will mature on 13 September 2018.

Under the bank covenants relating to the loans, the Company is to ensure that at all times the total borrowings of the Company do not exceed 40% of the Adjusted Net Asset Value (as defined in the loan agreements) and that the Adjusted Net Asset Value does not fall below £45 million (2017: £45 million). The Company met all covenant conditions during the year.

The fair value of the fixed rate €15 million term loan, on a marked to market basis, was £13,223,000 at 31 March 2018 (2017: £13,071,000). The fair value of the fixed rate €10 million term loan, on a marked to market basis, was £8,779,000 at 31 March 2018 (2017: £8,587,000). The fair value is calculated using a discounted cash flow technique based on relevant current interest rates.

Notes to the Accounts continued
for the year ended 31 March 2018

13 Share Capital

	Listed		Held in Treasury		In Issue	
	Number	£'000	Number	£'000	Number	£'000
Allotted, issued and fully paid:						
Ordinary Shares of 50p each						
Balance at 1 April 2017	17,448,260	8,724	(715,000)	(357)	16,733,260	8,367
Balance at 31 March 2018	17,448,260	8,724	(715,000)	(357)	16,733,260	8,367

During the year the Company sold no Ordinary Shares (2017: nil).

CAPITAL MANAGEMENT
The Company's capital is represented by the issued Share Capital, Share Premium Account, Capital Redemption Reserve, Capital Reserve, Revenue Reserve and external debt financing. Details of the movement through each reserve are shown in the Statement of Changes in Equity. The Company is not subject to any externally imposed capital requirements.

The Company's capital is managed in accordance with its investment policy, in pursuit of its investment objective, both of which are detailed in the Business Model and Strategy. The Company's capital structure is also explained in the Report of the Directors on page 22.

14 Net Asset Value per Ordinary Share

	Net asset value per share		Net asset value	
	2018 p	2017 p	**2018 £'000**	2017 £'000
Net asset value per Ordinary Share	**901.1**	813.1	**150,776**	136,050

The net asset value per share is based on net assets at the year end and on 16,733,260 (2017: 16,733,260) Ordinary Shares, being the number of Ordinary Shares in issue at the year end, excluding those shares bought back and held in treasury.

15 Financial Instruments
The Company's financial instruments comprise its investment portfolio, cash balances, bank loans, and debtors and creditors that arise directly from its operations. As an investment trust the Company holds a portfolio of financial assets in pursuit of its investment objective. The Company makes use of borrowings, as detailed in note 12 and the Chairman's Statement, to achieve improved performance in rising markets. The downside risk of borrowings may be reduced by raising the level of cash balances held.

The Company's principal risks are described in the Business Model and Strategy on pages 14 to 16.

Financial risks arising from the Company's financial instruments are:

(i) market price risk, being the risk that the value of investment holdings will fluctuate as a result of changes in market prices caused by factors other than interest rate or currency rate movements;

(ii) interest rate risk, being the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates;

(iii) foreign currency risk, being the risk that the value of investment holdings, investment purchases, investment sales, bank loans and accrued income will fluctuate because of movements in currency rates;

15 Financial Instruments continued

(iv) credit risk, being the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Company; and

(v) liquidity risk, being the risk that the Company may not be able to liquidate quickly its investments to meet obligations associated with its financial liabilities.

FAIR VALUE HIERARCHY

IFRS 13 requires disclosures relating to fair value measurements using a three-level hierarchy (see definitions on pages 47 and 48). The level within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement. Assessing the significance of a particular input requires judgement, considering factors specific to the asset or liability.

The Company held the following categories of financial instruments as at 31 March 2018:

	Level 1 £'000	**Level 2 £'000**	**Level 3 £'000**	**2018 Total £'000**	Level 1 £'000	Level 2 £'000	Level 3 £'000	2017 Total £'000
Financial instruments								
Investments	**151,728**	**–**	**–**	**151,728**	145,989	–	–	145,989
Loans*	**–**	**(22,002)**	**–**	**(22,002)**	–	(21,658)	–	(21,658)

* Excludes amortised costs.

There were no transfers between levels in the fair value hierarchy in the year ended 31 March 2018 (2017: none).

Listed fixed asset investments held (see note 9) are valued at fair value through profit or loss. For listed securities this is either bid price or the last traded price depending on the convention of the exchange on which the investment is listed. The interest-bearing bank loans are recognised in the Balance Sheet in accordance with IFRS. The fair value of the loans are calculated using a discounted cash flow technique based on relevant current interest rates compared to its value as stated on the Balance Sheet at amortised cost of £21,903,000 (2017: £21,335,000). The fair value of all other financial assets and liabilities is represented by their carrying value in the Balance Sheet shown on page 42.

16 Market Price Risk

Mitigation of market price risk is part of the fund management process and is typical of equity investment. The portfolio is managed with an awareness of the effects of adverse price movements through detailed and continuing analysis with an objective of maximising overall returns to shareholders. Further information on the investment portfolio is set out on pages 8 to 10.

If the investment portfolio valuation had fallen by 10% (2017: 10%) at 31 March 2018, the impact on the profit or loss and the net asset value would have been negative £15.2 million (2017: negative £14.6 million). If the investment portfolio valuation had risen by 10% (2017: 10%) at 31 March 2018, the impact on the profit or loss and the net asset value would have been positive £15.2 million (2017: positive £14.6 million). The calculations are based on the portfolio valuation as at the respective balance sheet dates.

17 Interest Rate Risk

FIXED RATE

The Company has two fully drawn fixed rate term loans with ING Bank N.V., one of €15 million, with a Sterling equivalent of £13.2 million as at 31 March 2018 (2017: £12.8 million), at a rate of interest of 2.90% per annum and one of €10 million with a Sterling equivalent of £8.8 million as at 31 March 2018 (2017: £8.6 million), at a rate of interest of 0.9275% per annum. An interest rate sensitivity analysis has not been performed as the Company has borrowed at a fixed rate of interest.

Notes to the Accounts continued
for the year ended 31 March 2018

17 Interest Rate Risk continued
FLOATING RATE

When the Company retains cash balances, the cash is primarily held in accounts at the custodian. Interest received or paid on cash balances and bank overdrafts is at market rates and is monitored and reviewed by the Investment Manager and the Board. As at 31 March 2018, the cash position of the Company was £20.6 million (2017: £11.1 million).

If interest rates had increased by 1.0%, the impact on the profit or loss and the net asset value would have been positive £206,000 (2017: positive £111,000). If interest rates had decreased by 1.0%, the impact on the profit or loss and the net asset value would have been negative £206,000 (2017: negative £111,000). The calculations are based on the floating rate balances as at the respective balance sheet dates.

18 Foreign Currency Risk
The Company invests in overseas securities and holds foreign currency cash balances and foreign currency borrowings which give rise to currency risks. It is not the Company's policy to hedge this risk.

Foreign currency exposure:

2018	**Investments £'000**	**Trade and other receivables £'000**	**Cash £'000**	**Trade and other payables £'000**	**Loans £'000**	**Net exposure £'000**
Danish Krone	**10,446**	**65**	**56**	**–**	**–**	**10,567**
Euro	**89,390**	**312**	**20,333**	**(26)**	**(21,918)**	**88,091**
Norwegian Krone	**4,976**	**14**	**–**	**–**	**–**	**4,990**
Swedish Krona	**32,411**	**–**	**85**	**–**	**–**	**32,496**
Swiss Franc	**14,505**	**181**	**–**	**–**	**–**	**14,686**
Total	**151,728**	**572**	**20,474**	**(26)**	**(21,918)**	**150,830**

2017	Investments £'000	Trade and other receivables £'000	Cash £'000	Trade and other payables £'000	Loans £'000	Net exposure £'000
Danish Krone	8,978	91	–	–	–	9,069
Euro	90,875	295	11,003	(27)	(21,384)	80,762
Norwegian Krone	3,932	–	–	–	–	3,932
Swedish Krona	25,442	2	41	–	–	25,485
Swiss Franc	16,762	128	–	–	–	16,890
Total	145,989	516	11,044	(27)	(21,384)	136,138

If the value of Sterling had weakened by 5% (2017: 5%) against each of the currencies in the portfolio, the impact on the profit or loss and the net asset value would have been positive £7,986,000 (2017: positive £7,165,000). If the value of Sterling had strengthened by 5% (2017: 5%) against each of the currencies in the portfolio, the impact on the profit or loss and the net asset value would have been negative £7,225,000 (2017: negative £6,483,000). These calculations are based on the foreign currency exposure balances as at the respective balance sheet dates.

19 Credit Risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Company. The Company has in place a monitoring procedure in respect of counterparty risk which is reviewed on an ongoing basis. The carrying amounts of financial assets best represent the maximum credit risk exposure at the balance sheet date.

The Company had the following categories of financial assets exposed to credit risk as at 31 March 2018:

	2018 £'000	2017 £'000
Cash and cash equivalents	**20,574**	11,144
Prepayments, accrued income and overseas tax recoverable	**578**	524
	21,152	11,668

Credit risk arising on transactions with brokers relates to transactions awaiting settlement. Risk relating to unsettled transactions is considered to be small due to the short settlement period involved and the financial stability and credit quality of the brokers used, which are monitored on an ongoing basis by the Manager. The Manager also monitors the quality of service provided by the brokers used to further mitigate this risk.

There were no significant concentrations of credit risk to counterparties at 31 March 2018 or 31 March 2017. No individual investment exceeded 4.2% of the investment portfolio at 31 March 2018 (2017: 3.7%).

A significant majority of the assets of the Company, including those that are traded on a recognised exchange, are held in segregated accounts on behalf of the Company by The Bank of New York Mellon SA/NV (London Branch), the Company's custodian. Bankruptcy or insolvency of this or other custodians may cause the Company's rights with respect to securities held by the custodians to be delayed. The Board monitors the Company's risk by reviewing the custodian's internal control reports.

20 Liquidity Risk

The Company does not hold unlisted securities (2017: £nil). The Company's listed securities are considered to be readily realisable.

However, as with all smaller company investment trusts, there are times when the liquidity of the underlying portfolio is poor, such as when smaller companies are out of favour or during periods of adverse economic conditions. The Manager focuses on smaller companies where the opportunities may be more attractive but this can decrease overall underlying liquidity. This may result in the Manager being unable to buy or sell individual holdings within the portfolio. The Manager constantly reviews the underlying liquidity of the portfolio and deals with a wide range of brokers to enhance its ability to execute transactions and minimise liquidity risk. The Company's overall exposure to liquidity risks is monitored on a regular basis by the Board.

Liquidity risk is mitigated as the Company maintains sufficient cash to pay accounts payable and accrued expenses. As at 31 March 2018, the cash position of the Company was £20.6 million (2017: £11.1 million).

CONTRACTUAL MATURITY ANALYSIS FOR FINANCIAL LIABILITIES

As at 31 March 2018	**Within one month £'000**	**Between one and three months £'000**	**Between three and twelve months £'000**	**Between one and five years £'000**	**Total £'000**
Current liabilities:					
Other creditors	**110**	**65**	**26**	**–**	**201**
Interest-bearing bank loans	**–**	**–**	**22,158**	**–**	**22,158**
Total liabilities	**110**	**65**	**22,184**	**–**	**22,359**

Notes to the Accounts continued
for the year ended 31 March 2018

20 Liquidity Risk continued

As at 31 March 2017	Within one month £'000	Between one and three months £'000	Between three and twelve months £'000	Between one and five years £'000	Total £'000
Current liabilities:					
Other creditors	182	63	27	–	272
Non-current liabilities:					
Interest-bearing bank loans	–	–	433	21,617	22,050
Total liabilities	182	63	460	21,617	22,322

21 Related Parties and Transactions with the Manager
The following are considered related parties: the Board of Directors and Alex Hammond-Chambers and Company. The Directors of the Company received fees for their services and dividends from their shareholdings in the Company. As disclosed on page 32, fees for consultancy services were also paid to a company called Alex Hammond-Chambers and Company, which is owned by one of the directors Mr R A Hammond-Chambers. Further details are provided in the Directors' Remuneration Report on pages 31 and 32.

Transactions between the Company and the Manager are detailed in note 3 on management fees and note 11 on fees owed to the Manager at the balance sheet date. The existence of an independent Board of Directors demonstrates that the Company is free to pursue its own financial and operating policies and therefore, under the AIC SORP, the Manager is not considered to be a related party.

22 Securities financing transactions ("SFT")
The Company has not, in the year to 31 March 2018 (2017: same), participated in any: repurchase transactions; securities lending or borrowing; buy-sell back transactions; margin lending transactions; or total return swap transactions (collectively called SFT). As such, it has no disclosure to make in satisfaction of the EU regulations on transparency of SFT, issued in November 2015.

AIFM Disclosures

Alternative Investment Fund Managers ('AIFM') Directive ('AIFMD')

In accordance with the AIFMD, information in relation to the Company's leverage (as defined on page 63) and the remuneration of the Company's AIFM, Montanaro Asset Management Limited, is required to be made available to investors. Detailed regulatory disclosures including those on the AIFM's remuneration policy are available on the Company's website or from Montanaro Asset Management Limited on request. The Company's maximum and actual leverage levels at 31 March 2018 are shown below:

Leverage exposure	Gross method	Commitment method
Maximum limit	200%	200%
Actual	101%	114%

For the purposes of the AIFMD, leverage is any method which increases the Company's exposure, including the borrowing of cash and the use of derivatives. It is expressed as a percentage of Company's exposure to its net asset value and is calculated on both a gross and commitment method.

Under the gross method, exposure represents the sum of the Company's positions after deduction of cash and cash equivalents, without taking account of any hedging or netting arrangements. Under the commitment method, exposure is calculated without the deduction of cash and cash equivalents and after certain hedging and netting positions are offset against each other.

The leverage limits are set by the AIFM and approved by the Board. The AIFM is also required to comply with the gearing parameters set by the Board in relation to borrowings. Detailed regulatory disclosures to investors in accordance with the AIFMD are contained on the AIFM's website.

Shareholder Information

Annual General Meeting
The Annual General Meeting of Montanaro European Smaller Companies Trust plc will be held at the offices of BMO Global Asset Management, Quartermile 4, 7a Nightingale Way, Edinburgh EH3 9EG, on Wednesday 29 August 2018 at 12.30pm.

Key Dates

31 March 2018	Company year end
29 August 2018	Annual General Meeting
3 September 2018	Payment of final dividend
November 2018	Interim results announced
January 2019	Payment of expected interim dividend

Dividends
Shareholders who wish to have dividends paid directly into a bank account rather than by cheque to their registered address can complete a Mandate Form for this purpose. Mandates can be obtained from Equiniti Limited on request at the address shown on page 18.

Change of Address
Communications with shareholders are mailed to the address shown on the share register. In the event of a change of address or other amendment this should be notified to Equiniti Limited under the signature of the registered holder.

Frequency of NAV Publication
The Company's NAV is released to the London Stock Exchange on a daily basis.

ISA Status
The Company's shares are fully eligible for inclusion in ISAs.

AIC
The Company is a member of the Association of Investment Companies ('AIC').

Share Savings Scheme
UK residents can invest in the Company's shares through savings plans which are administered by Alliance Trust Savings Limited ('ATS'). ATS provides and administers a range of self-select investment plans, including tax-advantaged ISAs, JISAs and SIPPs, and First Steps, an investment plan for children. More information can be obtained by contacting ATS on 01382 573 737 or visiting www.alliancetrustsavings.co.uk.

Sources of Further Information
The Company's share price is listed in the *Financial Times* under Investment Companies, and in other newspapers. Information on the Company is also available on the Manager's website: www.montanaro.co.uk.

Data protection
The Company is committed to protecting and respecting the confidentiality, integrity and security of the personal data it holds. For information on the processing of personal data, please see the privacy policy on the website at www.montanaro.co.uk.

Warning to Shareholders – Beware of Share Fraud

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment.

If you receive unsolicited investment advice or requests:

- Check the Financial Services Register at **www.fca.org.uk** to see if the person or firm contacting you is authorised by the Financial Conduct Authority ('FCA').
- Call the FCA on 0800 111 6768 if the firm does not have contact details on the Register or you are told they are out of date.
- Search the list of unauthorised firms to avoid at **www.fca.org.uk/scams**.
- Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme.
- Think about getting independent financial and professional advice.

If you are approached by fraudsters please tell the FCA by using the share fraud reporting form at **www.fca.org.uk/scams** where you can find out more about investment scams. You call also call the FCA Consumer Helpline on **0800 111 6768**. If you have already paid money to share fraudsters you should contact Action Fraud on **0300 123 2040**.

Alternative Performance Measures (“APMs”)

The Company uses the following APMs:

Discount (or Premium)
If the share price of an Investment Trust is less than its Net Asset Value per share, the shares are trading at a discount. If the share price is greater than the Net Asset Value per share, the shares are trading at a premium.

Gearing
Unlike open-ended investment companies, Investment Trusts have the ability to borrow to invest. This term is used to describe the level of borrowings that an Investment Trust has undertaken, and is stated as a percentage of shareholders’ funds. The higher the level of borrowings, the higher the gearing ratio. Gearing is calculated as total liabilities less current assets divided by net assets.

Ongoing Charges (expressed as a percentage)
All operating costs expected to be incurred in future and that are payable by the Company expressed as a proportion of the average Net Assets of the Company over the reporting year. The costs of buying and selling investments are excluded, as are interest costs, taxation, non-recurring costs and the costs of buying back or issuing Ordinary Shares.

Ongoing charges calculation

		31 March 2018 £’000	31 March 2017 £’000
Total expenditure		**1,930**	1,520
Less negative interest (see note 4)		**(121)**	(52)
Less non-recurring costs		**–**	(4)
Total	(a)	**1,809**	1,464
Average daily net assets	(b)	**151,110**	121,349
Ongoing charges (c = a/b)	(c)	**1.2%**	1.2%

Glossary of Terms

AIFMD
Alternative Investment Fund Managers Directive. Issued by the European Parliament in 2012 and 2013, the Directive requires that all investment vehicles in the European Union, including Investment Trusts, must, with effect from 22 July 2014, appoint a Depositary and an Alternative Investment Fund Manager (**AIFM**). The Board of Directors of an Investment Trust, nevertheless, remains fully responsible for all aspects of the Company’s strategy, operations and compliance with regulations.

Association of Investment Companies (‘AIC’)
The Association of Investment Companies is the trade body for Closed-end Investment Companies (www.theaic.co.uk).

Benchmark
This is a measure against which an Investment Trust’s performance is compared. The benchmark of the Company is the MSCI Europe SmallCap (ex UK) Index (capital return in Sterling terms). The index averages the performance of a defined selection of companies listed in European smaller company stock markets and gives an indication of how those markets have performed in any period.

Closed-end Investment Company
A company, including an Investment Trust, with a fixed issued ordinary share capital which is traded on an exchange at a price not necessarily related to the Net Asset Value of the company and where shares can only be issued or bought back by the company in certain circumstances. This contrasts with an open-ended investment company, which has units not traded on an exchange but issued or bought back from investors at a price directly related to the Net Asset Value.

Custodian
A specialised financial institution responsible for safeguarding, worldwide, the listed securities and certain cash assets of the Company, as well as the income arising therefrom, through provision of custodial, settlement and associated services. The Company’s Custodian is The Bank of New York Mellon SA/NV (London Branch).

Depositary
Under AIFMD rules applying from 22 July 2014, the Company must appoint a Depositary, whose duties in respect of investments, cash and similar assets include: safekeeping; verification of ownership and valuation; and cash monitoring. The Depositary has strict liability for loss of any investments or other assets where it has safekeeping duties. The Depositary’s oversight duties include, but are not limited to, oversight of share buybacks, dividend payments and adherence to investment limits. The Company’s Depositary is BNY Mellon Trust & Depositary Limited.

Dividend
The income from an investment. Some Investment Trusts pay dividends on a quarterly or monthly basis. Montanaro European Smaller Companies Trust plc currently pays dividends twice a year.

IFRS
International Financial Reporting Standards as adopted by the European Union.

Investment Trust
A Closed-end Investment Company which satisfies the requirements of Section 1158 of the Corporation Tax Act 2010. Companies which meet these criteria are exempt from having to pay tax on the capital gains they realise from sales of the investments within their portfolios.

Leverage
As defined under the AIFMD rules, Leverage is any method by which the exposure of an AIF is increased through borrowing of cash or securities or leverage embedded in derivative positions. Leverage is broadly equivalent to Gearing, but is expressed as a ratio between the assets (excluding borrowings) and the net assets (after taking account of borrowings). Under the gross method, exposure represents the sum of the Company's positions after deduction of cash and cash equivalents, without taking account of any hedging or netting arrangements. Under the commitment method, exposure is calculated without the deduction of cash and cash equivalents and after certain hedging and netting positions are offset against each other.

Manager
The Company's investment manager, which is Montanaro Asset Management Limited. The responsibilities and remuneration of the Manager are set out in the Business Model and Strategy on page 11 and in the Report of the Directors on page 21.

Marked to Market
Accounting for the fair value of an asset or liability that can change over time and reflects its current market value rather than its book cost.

Market Capitalisation
The stock market value of a company as determined by multiplying the number of shares in issue, excluding those shares held in treasury, by the market price of the shares.

Net Assets (or Shareholders' Funds)
This is calculated as the value of the investments and other assets of an Investment Trust, plus cash and debtors, less borrowings and any other creditors.
It represents the underlying value of an Investment Trust at a point in time.

Net Asset Value ('NAV') per Ordinary Share
This is calculated as the net assets of an Investment Trust divided by the number of shares in issue, excluding those shares held in treasury.

Ordinary Shares
The main type of equity capital issued by conventional Investment Trusts. Shareholders are entitled to their share of both income, in the form of dividends paid by the Investment Trust, and any capital growth. Montanaro European Smaller Companies Trust plc has only Ordinary Shares in issue.

Share Price
The value of a share at a point in time as quoted on a stock exchange. The shares of Montanaro European Smaller Companies Trust plc are quoted on the Main Market of the London Stock Exchange.

SORP
Statement of Recommended Practice "Financial Statements of Investment Trust Companies and Venture Capital Trusts" issued by the AIC.

Total Assets
This is calculated as the value of the investments and other assets of an Investment Trust, plus cash and debtors.

Total Return
The return to shareholders calculated on a per share basis by adding dividends paid in the period to the increase or decrease in the Share Price or NAV. The dividends are assumed to have been re-invested in the form of Shares or Net Assets.

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of Montanaro European Smaller Companies Trust plc (the 'Company') will be held at the offices of BMO Global Asset Management, Quartermile 4, 7a Nightingale Way, Edinburgh EH3 9EG, on Wednesday 29 August 2018 at 12.30pm for the purposes of considering and, if thought fit, passing the following resolutions, of which resolutions 1 to 9 will be proposed as ordinary resolutions and resolutions 10 and 11 will be proposed as special resolutions.

Ordinary Resolutions

RESOLUTION 1 – ANNUAL REPORT AND ACCOUNTS

That the Annual Report and Accounts of the Company for the year ended 31 March 2018 be received.

RESOLUTION 2 – ANNUAL REPORT ON DIRECTORS' REMUNERATION

That the Annual Report on Directors' Remuneration for the year ended 31 March 2018 be approved.

RESOLUTION 3 – FINAL DIVIDEND

That a final dividend of 6.75p per Ordinary Share be declared.

RESOLUTION 4 – ELECTION OF DIRECTOR

That Mrs C A Roxburgh, who retires at the first Annual General Meeting following her appointment, be elected as a Director.

RESOLUTION 5 – RE-ELECTION OF DIRECTOR

That Mr R M Curling, who retires annually, be re-elected as a Director.

RESOLUTION 6 – RE-ELECTION OF DIRECTOR

That Mrs M R Somerset Webb, who retires annually, be re-elected as a Director.

RESOLUTION 7 – RE-APPOINTMENT OF AUDITOR

That Ernst & Young LLP be re-appointed as the Company's auditor, to hold office until the conclusion of the next general meeting at which accounts are laid before the Company.

RESOLUTION 8 – AUDITOR'S REMUNERATION

That the Directors be authorised to determine the auditor's remuneration.

RESOLUTION 9 – AUTHORITY TO ALLOT SHARES

That, in substitution for any existing authority but without prejudice to the exercise of any such authority prior to the date of the passing of this resolution, the Board of Directors of the Company (the 'Board') be and is hereby generally and unconditionally authorised pursuant to and in accordance with section 551 of the Companies Act 2006 to exercise all the powers of the Company to allot shares in the Company and to grant rights to subscribe for or to convert any security into shares in the Company up to an aggregate nominal amount of £836,500, provided that this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2019 or, if earlier, on 30 September 2019 save that the Company may before such expiry make an offer or enter into an agreement which would or might require shares to be allotted, or rights to subscribe for or to convert securities into shares to be granted, after such expiry and the Board may allot shares or grant such rights in pursuance of such an offer or agreement as if the authority conferred hereby had not expired.

Special Resolutions

RESOLUTION 10 – AUTHORITY TO ALLOT SHARES OTHER THAN ON A PRE-EMPTIVE BASIS

That, subject to the passing of resolution 9 set out in the notice of the Annual General Meeting of the Company convened for 29 August 2018 and in substitution for any existing authority, but without prejudice to the exercise of any such authority prior to the date of the passing of this resolution, the Board of Directors of the Company (the 'Board') be and is hereby generally empowered pursuant to sections 570 and 573 of the Companies Act 2006 (the 'Act') to allot equity securities (within the meaning of section 560 of the Act) (including the grant of rights to subscribe for, or to convert any securities into, ordinary shares of 50 pence each in the capital of the Company ('Ordinary Shares')) wholly for cash either pursuant to the authority conferred on them by such resolution 9 or by way of a sale of treasury shares (within the meaning of section 560(3) of the Act) as if section 561(1) of the Act did not apply to any such allotment or sale, provided that this power shall be limited to the allotment of equity securities and the sale of treasury shares:

(i) in connection with a rights issue, open offer or other pre-emptive offer in favour of the holders of Ordinary Shares who are on the register of members on a date fixed by the Board where the equity securities respectively attributable to the interests of all such holders are proportionate (as nearly as may be practicable) to the respective numbers of Ordinary Shares held by them on that date (subject to such exclusions or other arrangements in connection with the rights issue, open offer or other offer as the Board deem necessary or expedient to deal with shares held in treasury, fractional entitlements to equity securities and to deal with any legal or practical problems or issues arising in any overseas territory or under the requirements of any regulatory body or stock exchange); and

(ii) otherwise than pursuant to sub-paragraph (i) above, up to an aggregate nominal amount of £836,500,

and shall expire (unless previously renewed, varied or revoked by the Company in general meeting) at the conclusion of the Annual General Meeting of the Company to be held in 2019 or, if earlier, on 30 September 2019 save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Board may allot equity securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired. This power shall authorise the Board to issue equity securities at such issue price as the Board may determine (including, without limitation, where equity securities are being issued from treasury at a price below the net asset value per Ordinary Share of the Company at the time of the relevant issue).

RESOLUTION 11 – AUTHORITY TO BUY BACK SHARES

That, in substitution for any existing authority but without prejudice to the exercise of any such authority prior to the date of the passing of this resolution, the Company be and is hereby generally and unconditionally authorised for the purposes of section 701 of the Companies Act 2006 (the 'Act') to make one or more market purchases (as defined in section 693(4) of the Act) of ordinary shares of 50 pence each in the capital of the Company ('Ordinary Shares') on such terms and in such manner as the Board of Directors may determine provided that:

(i) the maximum aggregate number of Ordinary Shares which may be purchased is 2,508,315 (or if less, 14.99 per cent of the number of Ordinary Shares in issue (excluding treasury shares) immediately prior to the passing of this resolution);

(ii) the minimum price which may be paid for an Ordinary Share is 50 pence (exclusive of associated expenses);

(iii) the maximum price which may be paid for an Ordinary Share (exclusive of associated expenses) is the higher of: (a) 105 per cent of the average of the market value of an Ordinary Share for the five business days immediately preceding the day on which the Ordinary Share is purchased; and (b) the value of an Ordinary Share calculated on the basis of the higher price quoted for (i) the last independent trade of; and (ii) the highest current independent bid for any number of Ordinary Shares on the trading venue where the purchase is carried out; and

Notice of Annual General Meeting continued

(iv) unless previously renewed, varied or revoked, this authority shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2019 or, if earlier, on 30 September 2019 save that the Company may before such expiry enter into a contract to purchase Ordinary Shares which will or may be completed wholly or partly after such expiry and a purchase of Ordinary Shares may be made pursuant to any such contract.

By order of the Board

F&C INVESTMENT BUSINESS LIMITED
Company Secretary
Quartermile 4
7a Nightingale Way
Edinburgh EH3 9EG
29 June 2018

Notes

1. Attending the Annual General Meeting in Person

If you wish to attend the Annual General Meeting in person, you should arrive at the venue for the Annual General Meeting in good time to allow your attendance to be registered. It is advisable to have some form of identification with you as you may be asked to provide evidence of your identity to the Company's registrar, Equiniti Limited (the 'Registrar'), prior to being admitted to the Annual General Meeting.

2. Appointment of Proxies

Members are entitled to appoint one or more proxies to exercise all or any of their rights to attend, speak and vote at the Annual General Meeting. A proxy need not be a member of the Company but must attend the Annual General Meeting to represent a member. To be validly appointed a proxy must be appointed using the procedures set out in these notes and in the notes to the accompanying proxy form.

If members wish their proxy to speak on their behalf at the meeting, members will need to appoint their own choice of proxy (not the Chairman of the Annual General Meeting) and give their instructions directly to them.

Members can only appoint more than one proxy where each proxy is appointed to exercise rights attached to different shares. Members cannot appoint more than one proxy to exercise the rights attached to the same share(s). If a member wishes to appoint more than one proxy, they should contact the Registrar on 0371 384 2030. Lines are open from 8.30am to 5.30pm, Monday to Friday excluding UK public holidays. If calling from overseas please call +44 121 415 7047.

A member may instruct their proxy to abstain from voting on any resolution to be considered at the meeting by marking the 'Abstain' option when appointing their proxy. It should be noted that an abstention is not a vote in law and will not be counted in the calculation of the proportion of votes 'For' or 'Against' the resolution.

The appointment of a proxy will not prevent a member from attending the Annual General Meeting and voting in person if he or she wishes.

A person who is not a member of the Company but who has been nominated by a member to enjoy information rights does not have a right to appoint any proxies under the procedures set out in these notes and should read note 8 below.

3. Appointment of a Proxy Using a Proxy Form

A proxy form for use in connection with the Annual General Meeting is enclosed. To be valid, any proxy form or other instrument appointing a proxy, together with any power of attorney or other authority under which it is signed or a certified copy thereof, must be received by post or (during normal business hours only) by hand by the Registrar at FREEPOST RTHJ-CLLL-KBKU, Equiniti, Aspect House, Spencer Road, Lancing, BN99 6DA no later than 48 hours (excluding non-working days) before the time of the Annual General Meeting or any adjournment of that meeting.

If you do not have a proxy form and believe that you should have one, or you require additional proxy forms, please contact the Registrar on 0371 384 2030. Lines are open from 8.30am to 5.30pm, Monday to Friday excluding UK public holidays. If calling from overseas please call +44 121 415 7047.

4. Appointment of a Proxy Through CREST

CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual and by logging on to the following website: www.euroclear.com. CREST personal members or other CREST sponsored members, and those CREST members who have appointed (a) voting service provider(s), should refer to their CREST sponsor or voting service provider(s) who will be able to take the appropriate action on their behalf.

In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with Euroclear UK & Ireland Limited's specifications, and must contain the information required for such instruction, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy, must in order to be valid, be transmitted so as to be received by the Registrar (ID RA19) no later than 48 hours (excluding non-working days) before the time of the Annual General Meeting or any adjournment of that meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Application Host) from which the Registrar is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.

CREST members and, where applicable, their CREST sponsors or voting service provider(s) should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member, or sponsored member, or has appointed a voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

5. Appointment of Proxy by Joint Holders

In the case of joint holders, where more than one of the joint holders purports to appoint one or more proxies, only the purported appointment submitted by the most senior holder will be accepted. Seniority is determined by the order in which the names of the joint holders appear in the Company's register of members in respect of the joint holding (the first named being the most senior).

6. Corporate Representatives

Any corporation which is a member can appoint one or more corporate representatives. Members can only appoint more than one corporate representative where each corporate representative is appointed to exercise rights attached to different shares. Members cannot appoint more than one corporate representative to exercise the rights attached to the same share(s).

7. Entitlement to Attend and Vote

To be entitled to attend and vote at the Annual General Meeting (and for the purpose of determining the votes they may cast), members must be registered in the Company's register of members at 6.30pm on 27 August 2018 (or, if the Annual General Meeting is adjourned, at 6.30pm on the day two days prior to the adjourned meeting). Changes to the register of members after the relevant deadline will be disregarded in determining the rights of any person to attend and vote at the Annual General Meeting.

Notice of Annual General Meeting continued

8. Nominated Persons

Any person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 (the '2006 Act') to enjoy information rights (a 'Nominated Person') may, under an agreement between him/her and the member by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the member as to the exercise of voting rights.

9. Website Giving Information Regarding the Annual General Meeting

Information regarding the Annual General Meeting, including information required by section 311A of the 2006 Act, and a copy of this notice of Annual General Meeting is available from www.montanaro.co.uk.

10. Audit Concerns

Members should note that it is possible that, pursuant to requests made by members of the Company under section 527 of the 2006 Act, the Company may be required to publish on a website a statement setting out any matter relating to: (a) the audit of the Company's accounts (including the Auditor's report and the conduct of the audit) that are to be laid before the Annual General Meeting; or (b) any circumstance connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the 2006 Act. The Company may not require the members requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the 2006 Act. Where the Company is required to place a statement on a website under section 527 of the 2006 Act, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the Annual General Meeting includes any statement that the Company has been required under section 527 of the 2006 Act to publish on a website.

11. Voting Rights

As at 29 June 2018 (being the latest practicable date prior to the publication of this notice) the Company had 17,448,260 Ordinary Shares in issue, including 715,000 Ordinary Shares held in treasury. Each Ordinary Share (other than those held in treasury) carries one vote. The total voting rights in the Company as at 29 June 2018 were 16,733,260 votes.

12. Notification of Shareholdings

Any person holding 3 per cent or more of the total voting rights of the Company who appoints a person other than the Chairman of the Annual General Meeting as his proxy will need to ensure that both he, and his proxy, comply with their respective disclosure obligations under the UK Disclosure Guidance and Transparency Rules.

13. Further Questions and Communication

Under section 319A of the 2006 Act, the Company must cause to be answered any question relating to the business being dealt with at the Annual General Meeting put by a member attending the meeting unless answering the question would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information, or the answer has already been given on a website in the form of an answer to a question, or it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.

Members who have any queries about the Annual General Meeting should contact the Company Secretary at Quartermile 4, 7a Nightingale Way, Edinburgh EH3 9EG.

Members may not use any electronic address provided in this notice or in any related documents (including the Annual Report and Accounts and proxy form) to communicate with the Company for any purpose other than those expressly stated.

14. Documents Available for Inspection

The following documents will be available for inspection at the registered office of the Company during normal business hours on any weekday (Saturdays, Sundays and English public holidays excepted) from the date of this notice until the conclusion of the Annual General Meeting:

14.1 copies of the Directors' letters of appointment; and

14.2 copies of the Directors' deeds of indemnity.

Montanaro European Smaller Companies Trust plc
53 Threadneedle Street
London EC2R 8AR

Tel:	020 7448 8600
Fax:	020 7448 8601
E-mail:	enquiries@montanaro.co.uk
Website:	www.montanaro.co.uk