

MUSCIT

Montanaro UK Smaller Companies Investment Trust

Quarterly review – Q3 2025



A tough quarter for UK Small & MidCap:

- UK SmallCap trailed LargeCap by ~7% amid rising gilt yields and continued outflows from the asset class *

Quality out of favour:

- Heading towards an “annus horribilis” for Quality, as the factor underperformed the overall UK market by c. -5% in Q3 and -9% YTD**

Takeovers continue apace:

- Heightened takeover activity and elevated bid premia underline the valuation opportunity in UK Small & MidCaps

Note: All returns are Total Returns in GBP.

**Based on the MSCI UK SmallCap vs LargeCap indices; ** based on MSCI UK Quality vs MSCI UK indies*

The third quarter of 2025 remained a challenging environment for our “Quality Growth” style of investing. Global equities continued to advance, led once again by speculative areas of US technology – quantum computing, bitcoin-linked equities and unprofitable growth names all delivered outsized gains.

Gold had another stellar quarter, the reasons explained by several factors:

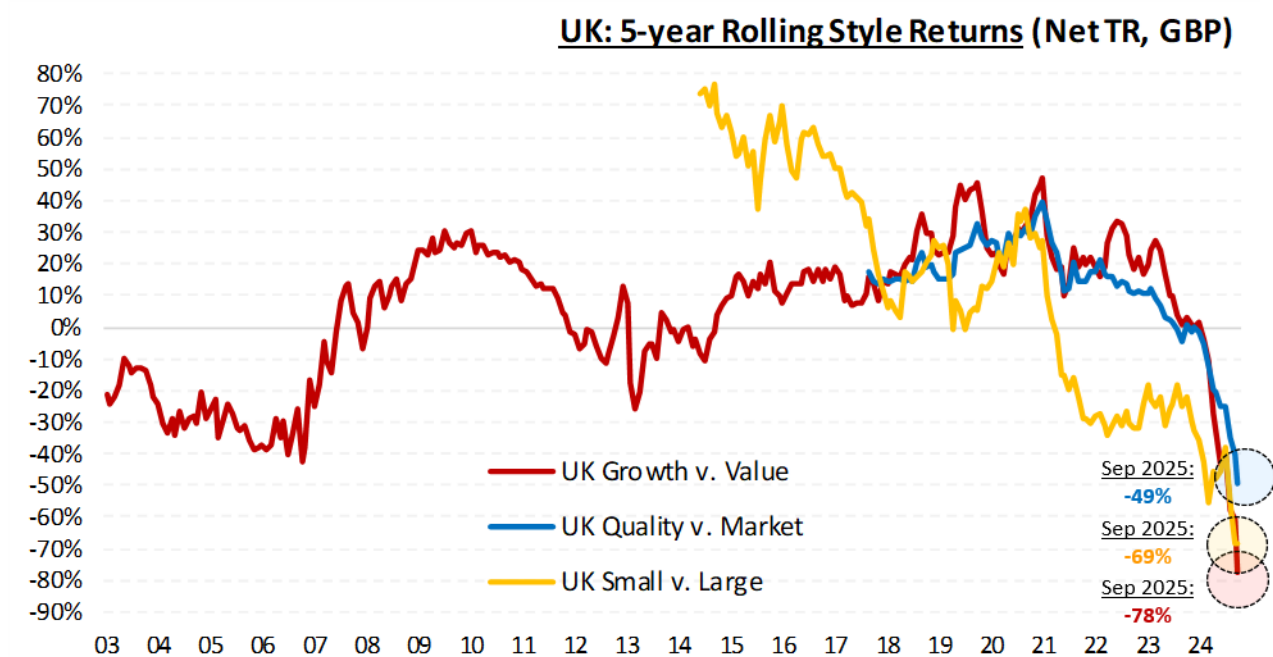
- 1) hedging versus a declining US dollar;
- 2) ongoing inflationary and macroeconomic concerns;
- 3) a “fear-of-missing-out”...

This is perhaps best illustrated by a statement from the Chief Strategist of a major bank: *“gold has become so big...that you cannot ignore it. There becomes a level when it becomes impossible not to own.”* A rally built on fundamentals it was not.

Small and MidCap companies lagged their LargeCap peers by -7% in the quarter, while defensive and higher-quality businesses also lagged as Value areas of the market rallied. Quality underperformed the UK market by -5% in Q3. These trends are a continuation of the environment seen in the UK over the past five years, namely that SmallCap, Quality and Growth have all been out of favour.

These factors – to which the Fund is heavily exposed – have underperformed by -69%, -49% and -78% respectively over the last 5 years. These are remarkable numbers as the chart below demonstrates. There is no doubt that investors prefer cyclical and short-term earnings leverage rather than companies with resilient profitability and strong balance sheets – i.e. Value stocks. Low-margin service companies, banks and gambling companies have all performed well this year – areas we avoid.

UK Quality, Growth and SmallCap all under immense pressure



Source: Internal, Factset, MSCI.

Indices used: MSCI UK Growth, MSCI UK Value, MSCI UK Quality, MSCI UK, MSCI UK Small Cap, MSCI UK Large Cap.

Nonetheless, we remain more confident than ever that the strong fundamentals of our investments in MUSCIT – high returns on capital and margins, robust balance sheets, strong structural growth – will ultimately be rewarded as market leadership normalises and sanity prevails.

Performance & Portfolio

During the quarter, MUSCIT's NAV declined by -2.8% compared to the benchmark which rose by +3% (the benchmark inclusive of AIM rose by +2.9%).

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

- **JTC:** the provider of fund, corporate and private client services - rose after revealing it was in discussions with two private equity firms about a possible takeover offer.
- **Alpha Group:** the financial services company specialising in foreign exchange and risk management - advanced amid improving investor sentiment, supported by strong operational momentum. The announced bid is expected to be completed soon.
- **MP Evans:** the producer of sustainable palm oil and tropical crops - gained after reporting strong first-half results, including higher operating profit and an increased dividend.

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

- **Hilton Foods:** the supplier of packaged and processed meats - drifted after UK seafood volumes were impacted by high white fish prices and capital expenditure increased at its Wal-Mart Canada facility.
- **Bytes Technology:** the UK provider of IT and software solutions - fell after issuing a profit warning as customer capital expenditure weakened and internal sales restructuring created short-term disruption.
- **XPS Pensions:** the provider of UK pensions consultancy and administration - declined after profit taking (despite no specific company news during the period).

Manager's comments

We look closely at the top five and bottom five performers each quarter as a sign of how well we have done overall. In this instance, the totals were +2.9% and -2.6% respectively (we received two take-over approaches for JTC and Alpha Group which helped). Normally we would have expected MUSCIT to have outperformed in a quarter that at first sight would appear to have been broadly flat. That we underperformed - and by quite a lot - reflects what we did not own (lower quality Value stocks) as opposed to what we do own. This also confirms the style headwinds that we have been facing for several years. Nonetheless, it came as a bit of a surprise.

For some, the Summer third quarter is a time for holidays and some peace and quiet. Not this year for us as six new companies were welcomed to the portfolio. As each requires approval by our Investment Committee and a lot of work by our Analysts, we have been busy. So here they are with a few comments:

1) **AG Barr:**

AG Barr has house-hold brands such as Boost energy drink; Rubicon and of course the famous “Irn-Bru” which has 12% of the market in Scotland (compared with just 2% in England and Wales). It has a long history which we like – founded in 1875, Irn-Bru was launched in 1901 with a secret recipe (known by only three people) and a memorable slogan “Made in Scotland from girders” and has become a beloved institution in Scotland out selling Coca-Cola. Apparently, 20 cans of Irn-Bru are sold every second. Crikey!

This is not a new company for us. We first invested in July 2006 at £10.65. There then followed several site visits to Milton Keynes. We came to know the Chief Executive Roger White well after numerous meetings. In September 2012, they announced a possible merger with Britvic which led to a review by the Competition Commission which ultimately approved the deal. Nonetheless, in July 2013, AG Barr announced that they would not proceed. We sold in December 2016 at a split-adjusted price of £29.04 or a return of 250%.

In May 2024, Roger retired after 22 years. We met his successor Euan Sutherland recently and were impressed not only by his outstanding background but also by his enthusiasm and vision for the future. In every meeting with a company we learn something unexpected: for me it was that in blind tastings consumers cannot tell the difference between Lucozade and Boost – but there is a big price difference: Boost Energy sells at £1.00 a bottle and Lucozade at £1.59 - £1.79. Makes you think ...

We will revisit companies if there is a change of management whom we have met and regard highly. It is also reassuring to invest in companies where he made good returns in the past (I hate revisiting those where we have not done so).

2) FRP Advisory:

A UK specialist advisory firm has a highly integrated model across 5 core pillars: Restructuring Advisory, Corporate Finance, Debt Advisory, Financial Advisory, and Forensic Services. But the core business remains Restructuring (70-80% of revenue) where they are market leader by number of appointments with a nationwide network.

We met Geoff Rowley over the Summer, joint founder of the business in 2001. A certified accountant (we like bean counters), he is also a Licensed Insolvency Practitioner with 35 years' experience. Over the past 14 years, revenues have grown by 16% CAGR and last year by 19% (of which 11% was organic). They have a leading mid-market position competing with the big four Auditors as specialists, conflict free with strong referral networks. A people-centric partnership model ensures that they retain the best talent through an Employee Benefit Trust (EBT), which holds some 23% of the equity. We too have an EBT.

We have a natural affinity with owner-led businesses with a strong focus on a family culture who look after their employees well. With cash on the balance sheet and a forward P/E of less than 10x, FRP should do particularly well if the UK economy has a tough time and there are more restructurings and bankruptcies. It has done well in good times too. This makes it a good diversifier for the overall portfolio, which generally benefits from a strong economy.

3) Mortgage Advice Bureau (MAB)

Another owner-led company, MAB was founded in 2000 by Peter Brodnicki who still owns around 18% of the Company. Floated in 2016, they are a [leading UK mortgage intermediary](#) with c. 8.5% market share of a fragmented market. They have a network of over 2,000 mortgage advisers with a highly [diversified customer base and enjoy strong relationships with estate agencies, new build and price comparison websites](#).

MAB believe their key differentiator is their MIDAS tech platform which enables efficiency and helps with customer acquisition and retention. AI is set to improve this further. To process a mortgage used to take ten hours – now it is seven ... and they are aiming to get down to just five hours by the end of this year. Improved efficiency translates into improved profitability. So, MAB is also a play on AI and should be a major beneficiary.

Peter has ambitions **to double the company in 5-6 years**, driven by organic growth and M&A. They have **excellent cash generation**, decent margins and a robust balance sheet. Each year, a large number of mortgages mature and have to be remortgaged, effectively providing high levels of reliable recurring revenues.

4) Pinewood.AI:

Pinewood describes itself *“as a leading automotive retail ecosystem, with purely cloud-based software designed around customers and hyperscale...active in 21 countries with over 35,000 users in the UK, Europe and Asia”*. In other words, they provide dealer management systems (DMS) to car salesmen to make the process fast and efficient.

Why they are not perhaps a household name lies in their history. The software capability was created when they were part of Pendragon until this was taken over by the US retailer Lithia Motors, when it was spun off and branded Pinewood.AI in October last year. This meant that, for the first time, they could market their software to those who were once competitors.

Since then, they have gained Lithia UK as a client (perhaps unsurprisingly) and also their largest ever contract with Global Auto Holdings and a five-year contract with Marshall Motors Group in October 2024. They claim to have among the best software capability and functionality on the market that should be attractive to the car dealers in the US, Europe, Japan and all over the world.

Bill Berman, the charismatic and larger than life Chief Executive, has great ambitions for the company and a repertoire of great stories. Bearing in mind their technological excellence, they were bemused to find that Japanese car dealers are still completing deals by fax! As an aside, Trevor Finn, former CEO of Pendragon, once considered joining the Board of MUSCIT as a non-executive director back in the day (over 20 years ago).

5) Cohort:

Cohort specialises in electronic warfare in three main areas:

- 1) sensor capabilities (threat detection of various electromagnetic spectra from sea, land, air, space and cyber domains - or a mixture);
- 2) accurate and real-time interpretation and data analysis, and
- 3) clear communications up and down the chains of command with appropriate battlefield responses. Of the traditional defence arenas of land, sea, and air, Cohort

is particularly strong in naval applications. Their simulation products help the UK MoD to train the next generation of electronic warfare and cyber security specialists.

Stanley Carter and Nick Priest (former CEO of Alvis land vehicles whom we knew then) created Cohort in 2006 and listed on AIM with the ethos of *“a group of like-minded technology companies operating in the defence and security markets... Subsidiaries operate with a significant degree of autonomy, enabling decision-making agility within a rigorous financial and strategic control regime”*. The strategy remains unchanged today.

The management team have been patiently, tactically, and quietly amassing key pieces of electronic warfare assets at reasonable prices. To date, they have spent almost £200 million on acquisitions that have added different skillsets to their capabilities:

2006	MASS:	Electronic warfare data analysis and simulation
2007	SEA:	Naval systems (sonar, countermeasures and launchers)
2010	Abacus:	Electronic warfare consultancy
2014	J+S:	Sonar and launch systems
2014	MCL:	Technical equipment in communications and surveillance
2016	EID:	Naval, tactical command, control and communications
2018	Chess:	Fire control and tracking sensors systems
2020	ELAC:	Sonar/hydroacoustic products, underwater communication
2025	EM Solutions:	Satellite communications for naval and other defence customers

Space has increasingly become a domain of key interest to all countries. Cohort's latest addition to the family, EM Solutions, should be able to enhance their capabilities in the space domain awareness. Their naval strength has come in good stead as most countries have primarily focused on aerial responses and underinvested in naval products over the last two decades. The only exception is China, which has not gone unnoticed by its Asian neighbouring countries. A strong, record order underpins growth for the next 3-4 years. It does not look as though peace is about to break out all around the world any time soon.

6) Volution Group:

Volution is a leading provider of energy-efficient ventilation solutions that improve indoor air quality and comfort. Its product range spans from basic extractor fans to advanced whole-building Mechanical Ventilation Heat Recovery systems (MVHR), hybrid ventilation, and fan coils. Awarded The Green Economy Mark in 2021, ~71% of Volution's revenue is

generated from low-carbon products.

The Group operates across the UK (37%), Continental Europe (31%) and Australasia (32%), with a healthy combination of organic and inorganic growth. It serves both Residential (73%) and Commercial (27%) markets; revenues split of ~65% RMI and ~35% New Build.

What makes it exciting? It is “Best-In-Class” (something we always look for) and has a consistent track record of outperforming peers and indices, with only one earnings downgrade in its history (COVID-related). The market is structurally growing: regulation changes and an increasing focus on indoor air quality are highly supportive of ventilation and this is being adopted across all geographies. The Group was established in 2002 following a management buyout of Smiths Group’s air movement and cable management divisions. It listed on the London Stock Exchange in June 2014.

The charismatic Ronnie George joined Volution in 2008 as MD of Vent-Axia and became CEO in 2012 upon leading the management buy-out. He has transformed the business from a UK-centric provider of air quality solutions into a globally diversified organisation with 22 market leading brands in 17 countries. Volution is now a global leading ventilation company. The following is why what they do matters ... and why indoor air quality matters (“the Silent Killer”) ...

Ella Kissi-Debrah was born in Lewisham hospital in 2004; lived in south-east London; and from an early age was a Millwall fan. A healthy happy baby and a fun-loving toddler, just before her seventh birthday she became unwell. She had a chest infection that turned into a persistent cough which was diagnosed as asthma. One day, Ella coughed so much that she blacked out, caused by a lack of oxygen to the brain. She was admitted to hospital and released the following day, but a week later it happened again. This time she was put into a medically induced coma at Great Ormond Street Hospital. After repeated hospitalisations, Ella passed away at the tender age of just 9 years old, becoming the first person to have “*air pollution*” listed as the cause of death. Air pollution isn’t just an outdoor problem... 5.4 million people in the UK are asthmatic, 1.1 million of them being children. Now that makes you think...

In 2020, two-year-old Awaab Ishak tragically died due to mould in a poorly ventilated council flat. The coroner stated that ventilation was not effective: “*this was a direct contributing factor in the development of the mould ... a more proactive response should have been taken to treat the mould*”.

The family fought this case and gained a lot of publicity. It has now become known and led

to the introduction of “*Awaab's law*”, which comes into effect this month. Landlords are now mandated to monitor ventilation - a driver of growth for Volution and hopefully an improvement for us all in health/daily life. No young boy should die from poor ventilation/mould, especially in the UK ... shocking.

Outlook

Despite the headwinds we have faced, the Portfolio looks in good shape to us. Balance sheets across our holdings - over 55% of companies hold net cash - and operational performance continues to meet or exceed expectations. Where share prices have de-rated, we see growing valuation support.

Markets today are being driven less by fundamentals and more by momentum, hype and fear of missing out. Investor psychology has tilted towards chasing what has worked, regardless of valuation. The rally in AI-related equities is a case in point. Jeff Bezos recently remarked that we are in a cycle where *“every [AI] experiment is being funded... investors are having a hard time distinguishing between the good ideas and the bad ideas.”* He drew a parallel with the biotech bubble of the 1990s, when exuberant funding produced many poor investments but also delivered enormous societal benefit through accelerated innovation.

Sam Altman, the chief executive of OpenAI, struck a similar balance, observing: *“Are we in a phase where investors as a whole are overexcited about AI? My opinion is yes. Is AI the most important thing to happen in a very long time? My opinion is also yes.”* His words capture the paradox: valuations may be stretched, but the underlying technology could indeed be transformative.

In the UK, the valuation gap between Quality Growth and Value has reached historic, unprecedented levels. Many of the companies in which we invest trade on depressed multiples despite delivering consistent earnings and also dividend growth. Meanwhile, the broader market continues to see elevated takeover activity and a surge in share buybacks, evidence that corporate buyers and Boards recognise the disconnect between price and intrinsic value.

After a challenging quarter, we remain focused on our core areas of expertise. We have

continued to strengthen our investment process in recent years, tightening risk management, refining portfolio construction and ensuring that our Analysts and Fund Managers spend as much time as possible engaging directly with company management teams. This is made possible by having one of the largest specialist SmallCap teams. We remain convinced that investing in high-quality, growing businesses that increase their dividends and generate cash is the best way to compound capital over the long term.

Markets are fickle. Sentiment changes when investors least expect and the catalyst is seldom obvious at the time. Already, October has brought early signs of a more favourable environment for Quality and SmallCap investors - but let's not get carried away. When this shift truly takes hold, we believe our disciplined process and long-term focus will leave us well placed to benefit. We will never change our investment approach. Eventually, "Quality Growth" investors like us, although battered, bruised and humbled at the moment, will have their time in the sun once again.

Charles Montanaro
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