ScotGems plc
Managed by
Stewart Investors

ScotGems

Investment Update

November 2017

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- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- Currency risk: the Company invests in assets which are denominated in other currencies; changes in exchange rates will affect the value of the Company.
- Emerging market risk: Emerging markets may not provide the same level of investor protection as a developed market; they may involve a higher risk than investing in developed markets.
- Smaller companies risk: the Company invests in smaller company shares which can be more unpredictable and more difficult to sell than those of larger company shares.
- Concentration risk: the Company typically invests in a concentrated portfolio of investments and should a particular investment decline in value, this will have a pronounced effect on the overall value of the Company.
- The Company's share price may not fully reflect net asset value.

Reference to specific securities (if any) is included for the purpose of illustration only and should not be construed as a recommendation to buy or sell. Reference to the names of any company is merely to explain the investment strategy and should not be construed as investment advice or a recommendation to invest in any of those companies.

For an overview of the terms of investment, risks, returns and costs and charges please refer to the Prospectus and Investor Disclosure Document. **If you are in any doubt as to the suitability of the Company for your investment needs, please seek investment advice.**

The core of our investment philosophy is to find and then invest alongside capable business people who have a track record of sustainably growing the cash flows of their business, who share the rewards with all stakeholders in a fair manner, and who have survived a few down cycles without going bust. A combination of competence, honesty and conservatism is usually hard to find, but these are the qualities we believe are essential in the managements we choose to back.

Uni-President is a Taiwanese business group we have known for many years. We hold them in high regard for their integrity and long-termism in building new businesses. Philippine Seven, a chain of 7-11 convenience stores in the Philippines, was started almost 20 years ago by the family behind Uni-President, and is almost a replica of a similar business they had already built in Taiwan. The company, which is one of our top positions, is a high return business, which has steadily grown revenues at a CAGR[1] of 20%, and book and dividend per share at a CAGR of 16%.

LEENO Industrial, which was set up by an ex-LG group engineer in 1978 in Busan, South Korea, has remained focused on providing customised testing services to its clients for the last 27 years. Not only do we admire their intense focus on what they do; but also their willingness to turn down business which is not of sufficiently high quality or which could potentially dilute their profitability. As a result, they only have the best quality clients, a 'who's who' of technology companies from California to Taiwan, who all use LEENO for their latest cutting-edge products. The company has a very impressive financial track record, with book value[2] CAGR of 20% over the last 15 years. The company has not made a loss in the last 20 years and always has a net cash balance sheet.

Our focus on people means that we are happy to back business families with excellent track records in building something new, such as RCL Foods. On paper, RCL is largely a commodity business selling chicken, chicken feed and sugar with branded consumer products making up only 25% of earnings. However, it is majority-controlled by Remgro, a business group which wants to turn RCL into the leading consumer goods business in South Africa. Remgro in the past has built up Richemont, a leading global luxury goods company, First Rand, perhaps the best financial services firm in South Africa, and Mediclinic, one of the best-managed hospital chains in the country.

"Why can't others spot these opportunities? What is your edge?" You might ask.

Our most important edge is our long time horizon which enables us to focus on the people behind the business, beyond the short term prospects of business itself. Many investors still view RCL Foods as a commodity producer, while we value the stewardship of their major shareholder, high quality management team and a small, but rapidly growing, branded consumer business. LEENO's slow but steady growth is perhaps not exciting enough for many technology investors and Philippine Seven has such a loyal long-term shareholder base that its shares do not trade in sufficient quantities every day to make it attractive for investors looking to churn their portfolios.

"If the results from long-term investing are indeed as good, why can't others do it?"

While a long-term mindset is perhaps easy to develop, you need a similarly aligned long-term oriented investor base, an operating structure which supports long-term decision making and an investment culture which nurtures it. This requires a similar sense of stewardship in our own business which we demand of our investee companies; something which is easy in theory but difficult in practice.

We now have 17 positions in the trust which we are gradually building up. The majority of the portfolio is still held in cash. We do not take a view on the general market and we are certainly not market timers. But we do spend a lot of time thinking about valuations, and firmly believe that the price we pay for investments is one of the most important drivers of future returns. Valuations do not always remain high, and the market does present opportunities to buy at attractive prices from time to time. We are happy to run large cash positions and wait for such opportunities.

1 Compound Annual Growth Rate, this is a useful measure of growth.
2 The value of a security or asset as entered on a firm's balance sheet.

One of the reasons behind the long-term investment success of our team has been our ability to buy (and stay invested) in weak markets. This partly stems from the defensive way we run our portfolios, which means we tend to lose less than the index in down markets, providing us with resilience and courage to buy when others are selling. There is a significant opportunity-cost behind spending cash today. If you over-pay, not only do you lose money, you also forego the option of investing the same cash when valuations become attractive.

This does not mean that we stop looking. The team works hard whatever the state of the markets. But we prefer to remain inactive in terms of buying decisions. Learning not to do anything is one of the key elements of our jobs.

Ashish Swarup & Tom Allen

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Important information

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