

ScotGems

Investment Update

January 2019 | For Institutional and Retail Investors in the UK

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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.
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- The Company’s share price may not fully reflect net asset value.

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Youngone (South Korea)

Assessing the key decision maker is especially important in smaller companies. More often than not this individual is the founder of the company, which means he or she sets the tone for the organisation's strategy and culture.

We lack the conviction to invest alongside business owners and managers who do not display certain qualitative characteristics. We are looking for evidence of integrity, conservatism, and competence.

Because we are looking for such traits, many of the individuals that we follow keep a low profile, which means they typically shun the media spotlight in favour of quietly focusing on their businesses.

This makes the challenge of assessing qualitative characteristics even more difficult. It can take a long time, sometimes years, to build relationships that enable us to form opinions. In this context, our time horizon becomes an advantage.

Our investment in Youngone is an example of this process in action. It is a Korean company focused on the manufacturing of outdoor apparel, operating primarily in Bangladesh.

The company's financials reflect decisions taken by the founder decades ago. He chose to focus on higher value outdoor garments which were less price sensitive and therefore less dependent on unskilled labour. At the same time he said no to low end work. His decision to prioritise pricing discipline over revenue growth has translated into consistent profit margins.

His focus has attracted leading global brands such as North Face, Nike, and Patagonia. High quality customers such as these have made Youngone's business more sustainable, as has the company's reputation within the local community. Youngone has historically been the largest foreign investor in Bangladesh and a pioneer in employing female workers in the garment industry, which has had long term socio-economic benefits for the country.

Our initial assessment of Youngone suggested a high degree of stewardship; an owner manager who possibly possessed the qualitative characteristics that we look for. To test this thesis and better understand the company's ethics and values, we had to get to know its owners and managers.

Korea's business community is hierarchical and opaque which makes it difficult for foreign investors like ourselves to access company management teams. It took numerous visits to Korea and Bangladesh over a period of years to build an accurate picture. We were gradually able to gain access to senior management before eventually meeting the founder Mr. Sung.

Mr Sung explained how Youngone came to find itself operating in Bangladesh, and how the company continues to interact with its various stakeholders. Since entering Bangladesh in the 1970s he has stuck to a belief that social responsibility helps build brands and makes his business sustainable. He has helped develop much needed infrastructure and services in Bangladesh, whilst at the same time providing jobs for 60,000 local women. He has fostered an image as a force for good in the country and has a reputation for uncompromised ethics.

No company is perfect though. On a visit to Bangladesh we noted that the industrial park on which Youngone's manufacturing site is located contains a golf course to entertain visiting executives. Although this is not an ideal arrangement, we feel that the founder's record of acting with integrity means that we can give the company the benefit of the doubt. It was only by meeting Mr. Sung that we were able to test a range of issues and form a view on his attitude towards business, workers, and the local community in Bangladesh. Developing such relationships with business owners requires time and patience, but without these relationships we risk not knowing whether business owners are taking shortcuts which invariably show up long term in the financial results of a company.

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Contact details

Edinburgh

Stewart Investors

23 St Andrew Square
Edinburgh EH2 1BB
United Kingdom
e. info@stewartinvestors.com
t. +44 (0) 131 473 2900
stewartinvestors.com

London

Stewart Investors

Finsbury Circus House
15 Finsbury Circus
London EC2M 7EB
United Kingdom
e. info@stewartinvestors.com
t. +44 (0) 207 332 6500
stewartinvestors.com

Singapore

Stewart Investors

58 Duxton Road
2nd & 3rd Floor
Singapore 089522
e. info@stewartinvestors.com
t. +65 680 59670
stewartinvestors.com

Sydney

Stewart Investors

Suite 10, Level 3
13 Hickson Road
Dawes Point
Sydney NSW 2000
e. info@stewartinvestors.com
t. +61 2 8274 8000
stewartinvestors.com