ScotGems plc
Managed by
Stewart Investors

ScotGems

Investment Update

March 2018 | For Institutional and Retail Investors in the UK

This document is a financial promotion for ScotGems plc (the "Company") only for those people resident in the UK for tax and investment purposes. Investing involves certain risks including:

- **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.**

Philippine seven

The long term investment opportunity for ScotGems is significant. We believe that we can identify promising smaller companies near the start of their journey to become larger and prosperous businesses.

These companies will typically be controlled and run by responsible stewards and effective management teams who have evidenced a track record of sustainable cash flow growth, balance sheet conservatism, and a respect for all stakeholders. We aim to align ourselves with capable business people who share our attitude towards risk.

Our process for identifying promising smaller companies relies on our willingness to back owners and management teams to grow their businesses over the long term. On their journey these businesses, and the economies to which they are exposed, will inevitably experience difficult periods. During such times of stress, many corporates will adopt sharp and dishonest practices which threaten the interests of other stakeholders including minority investors. The history of emerging markets is littered with such examples. To minimise the risk to our clients' capital we believe it is paramount that the reputation and integrity of the businesses owners, which we choose to back, is beyond question. We will end up overlooking some impressive operators on corporate governance grounds but we believe this is necessary in order to protect client capital.

ScotGems owns shares in a company called Philippine Seven, which operates a chain of convenience retail stores in the Philippines under the 7-Eleven brand. There are a number of almost identical businesses across South East Asia owing to the attractiveness of the business model which is highly scalable, cash generative, and favourable to the first mover[1]. The quality of Philippine Seven's franchise is obvious but it is not the primary reason for our investment. We have invested because we trust the Company's owners and management team to work effectively to build a successful and sustainable business without taking governance shortcuts along the way.

One of the first things we do when assessing a company is to consider its history as far back as records allow. We do this to discover whether the owners built their business by honest means or not. We avoid business people who have compromised themselves in any way. This laborious process to discover honesty is necessary because the markets in which we invest experience regular and volatile political changes, which consistently expose those whose businesses were born through, or relied on, political patronage, to retrospective scrutiny.

Philippine Seven was founded in the early 1980s by former civil servant Vincente Paterno and his brother-in-law Jose Pardo. The fact that Vincente Paterno had been a state bureaucrat during the time of kleptocrat[2] Ferdinand Marcos was on the surface alarming and warranted scrutiny. On this occasion we were happy to learn that despite ties to the Marcos regime, Vincente Paterno had a reputation for being a principled government employee. He was the only technocrat[3] to join the anti-dictatorship movement, having resigned from office in 1982 in response to the assassination of opposition leader Ninoy Aquino. Furthermore, there is no evidence of political favour in the awarding of the franchise concession nor the means which the business was funded. Indeed the founders showed no clear signs of political links and worked hard to support local communities.

Understanding the origins of Philippine Seven helps us as stewards of our clients' capital. If we believe the founding family is honest and aware of the interests of its stakeholders then the chances of them abusing their status and becoming a political target reduces significantly. The fact that the Group has kept a low profile and remained apolitical over thirty years is especially important in the current circumstances with the Philippines experiencing political change.

Applying this same philosophy and focus on reputation we concluded that the people behind the 7-Eleven franchises in Malaysia and Thailand are not of investible quality, despite their business operations being just as impressive in terms of financial metrics.

1 A first mover is a business with a competitive advantage having brought a product or service to the market before others.
2 A kleptocrat is a ruler who uses power they possess to exploit resources of their own territory for their own personal gain.
3 A technocrat is a member of a technically skilled elite (for example engineer or scientist) who holds a level of political power as well as technical knowledge.

The 7-Eleven franchises in Malaysia and Thailand are similar to each other in the sense they enjoy dominant market share and benefit from relaxed tobacco advertising laws. Both companies are owned by successful business groups who are known for their close political associations. Even though the convenience retail industry rarely suffers from political interference, we still worry that those with close political ties can occasionally become targets when regimes change. This is the primary reason we are not invested in the 7-Eleven franchises in Malaysia and Thailand.

Our assessment of a company's reputation is ongoing. There is no such thing as a perfect company but we try to find businesses with a patient long term shareholder, a competent management team, and a credible independent board of directors.

In the case of Philippine Seven its founding families needed capital to grow in the 1990s, and invited President Chain Stores, owner of the 7-Eleven franchise in Taiwan, to become the company's majority shareholder. President Chain Stores has not sold a share since, and we see their presence, as one of the most honest and competent retailers in Asia, as being extremely positive. We also admire the major shareholder's understanding of the need for local managers, hence their continued partnership with the founding Paterno family. Second generation Jose Victor Paterno is CEO and is credited with rolling out the Company's successful franchisee model. Finally, we take comfort from the presence of reputable independent directors.

ScotGems will only invest in companies whose owners and managers exhibit similar characteristics to Philippine Seven in terms of honest beginnings and a visible commitment to all stakeholders. Six months after the fund's launch we have invested in seventeen such companies.

We see an opportunity cost to deploying cash today, so have been investing gradually. If we over-pay now we risk not only losing money but we forgo the option of investing the same cash when valuations become more attractive. The long term driver of returns for this strategy will not be short-term wins but rather our ability to deploy capital and remain invested during tougher times. With valuations of companies today especially high it is even more important that we remain patient.

Stewart Investors

Important information

This document has been prepared for informational purposes only and is only intended to provide a summary of the subject matter covered and does not purport to be comprehensive. The views expressed are the views of the writer at the time of issue and may change over time. It does not constitute investment advice and/or a recommendation and should not be used as the basis of any investment decision. This document is not an offer document and does not constitute an offer or invitation or investment recommendation to distribute or purchase securities, shares, units or other interests or to enter into an investment agreement. No person should rely on the content and/or act on the basis of any material contained in this document.

This document is confidential and must not be copied, reproduced, circulated or transmitted, in whole or in part, and in any form or by any means without our prior written consent. The information contained within this document has been obtained from sources that we believe to be reliable and accurate at the time of issue but no representation or warranty, express or implied, is made as to the fairness, accuracy, or completeness of the information. We do not accept any liability whatsoever for any loss arising directly or indirectly from any use of this information.

References to "we" or "us" are references to Stewart Investors. Stewart Investors is a trading name of First State Investments (UK) Limited and First State Investments International Limited.

In the UK, issued by First State Investments (UK) Limited which is authorised and regulated by the Financial Conduct Authority (registration number 143359). Registered office Finsbury Circus House, 15 Finsbury Circus, London, EC2M 7EB number 2294743.

ScotGems plc ("Company") is an investment trust, incorporated in England and Wales with registered number 10755475, whose shares have been admitted to the Official List of the London Stock Exchange plc. The Company is an alternative investment fund for the purposes of the Alternative Investment Fund Managers Directive. The Company has appointed First State Investments (UK) Limited as its alternative investment fund manager, and First State Investments International Limited has been appointed as investment manager. Further information is available from Client Services, Stewart Investors, 23 St Andrew Square Edinburgh, EH2 1BB or by telephoning 0800 587 4141 between 9am and 5pm Monday to Friday or by visiting www.scotgems.com. Telephone calls with Stewart Investors may be recorded.

First State Investments (UK) Limited and First State Investments International Limited are part of Colonial First State Asset Management ("CFSGAM") which is the consolidated asset management division of the Commonwealth Bank of Australia ABN 48 123 123 124. CFSGAM includes a number of entities in different jurisdictions, operating in Australia as CFSGAM and as First State Investments elsewhere. The Commonwealth Bank of Australia ("Bank") and its subsidiaries do not guarantee the performance of any investment or entity referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of the Bank or its subsidiaries, and are subject to investment risk including loss of income and capital invested.

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