ScotGems plc
Managed by
Stewart Investors

ScotGems

Investment Update

September 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.**

Stepping in during tough times

The long term success of ScotGems depends on our ability to identify high quality smaller companies at reasonable prices. We are looking for companies with honest owners and robust business models that can grow through economic cycles. Such companies remain expensively valued in our view, and as a result ScotGems cash position remains significant.

Cash has been split evenly between three currencies; Pounds Sterling, Singapore Dollars, and United States Dollars, via short term treasury bills. As bottom up[1] stock pickers we do not wish to take a view on any one single currency, so have instead chosen to diversify our risk.

We have twenty-two companies in ScotGems one year after the launch of the Trust, with an average market capitalisation[2] in the region of $1bn US Dollars. We can add to almost all of these positions as and when valuations become more attractive but for now we see a benefit to remaining patient.

The reality is that emerging markets are prone to political and economic uncertainty which often translates into stock market turbulence.

As long-term investors we consider these volatile periods to offer opportunities to invest in high quality companies at more reasonable valuations.

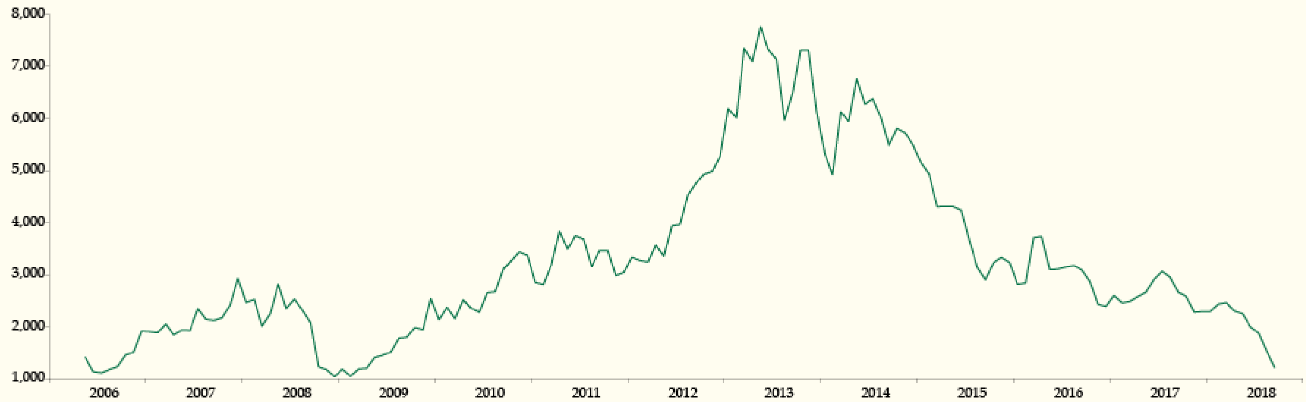
Recent developments in Turkey provide a case in point. Investor sentiment and the Turkish currency have weakened in unison, and equity valuations have become extremely attractive. This led us to build up a position in Coca-Cola Icecek (CCI) after the period end.

CCI bottles and distributes Coca-Cola's products in Turkey, and further afield in Central Asia and Pakistan. The business was formed in the 1990s as a joint venture between Coca-Cola and the Anadolu Group, an honest and politically neutral local business house.

In the context of Turkey, where the political landscape is increasingly authoritarian and volatile, it is especially important that the Anadolu Group built their business ethically and continue to operate through honest means. We also take comfort that they operate in areas of the economy, like food and beverages, that are less susceptible to government attention and political interference.

With Turkey and Pakistan's economies suffering CCI has become extremely unpopular. The dollar value of the company has fallen by two-thirds in the last year and it is now worth the same price as when it listed in 2006.

Coca-Cola Icecek Market Capitalisation (USD)[3]



1 Analysis of a company focused principally on its management, franchise and financials rather than the broader industry in which it operates, or macroeconomic factors.
2 Market capitalisation is the value of a company that is traded on the stock market, calculated by multiplying the total number of shares by the present share price.
3 Source: Capital IQ.

It is during tough times that our patience and time horizon becomes an advantage. We have the conviction to step in when sentiment is weak and others are selling. This conviction has been reinforced over years, observing how the business and its management team have behaved in times of stress.

Looking past the short-term noise there is a long-term structural growth story for CCI. The markets in which the company operates are under penetrated by global standards and consumption per capita remains low. The business in Pakistan, where CCI only commenced operations in 2008 and continues to grow market share, is especially interesting.

The point about long-term structural growth is worth re-iterating because it is a key tenet of all ScotGems investments. We are attempting to identify well-managed cash generative franchises that can survive difficult periods in order to become much larger businesses over time. We are not interested in speculative investments where we lack conviction in the quality of a franchise and its management team.

In the case of CCI we are buying a well-run company led by a capable local management team that continues to invest in the long-term health of the business. The management team has experienced periods of uncertainty before, and still the franchise has continued to prosper. CCI's operating income has compounded in dollars at a high-single digit rate since it went public in 2006.

We also like that the Coca-Cola Company in Atlanta is placing a stronger emphasis on developing less sugary drinks which are healthier, and its new management team has prioritised profits over volume growth.

Our biggest concern with CCI is the company's balance sheet, which carries significant dollar debt. Foreign currency debt becomes a more sensitive issue when the local currency depreciates, as has been the case with the Turkish Lira in recent weeks.

The majority of ScotGems' portfolio companies are debt free. However, we understand that certain businesses operating in sectors such as manufacturing require regular investments in new capacity, which need to be funded by debt or equity, in order to expand. Turkey's debt markets are relatively small and immature, so companies are forced to borrow in foreign currency.

We take comfort that CCI's debt is very long-term and also from management's long standing relationship with Coca-Cola, which has experienced turbulent conditions before.

In terms of portfolio construction, these factors mean that CCI could never be a large position. However, having sat on the side-lines for several years, we have become comfortable that at current valuations the potential reward is sufficiently attractive.

We have been cautious in investing cash since the launch of the Trust. It's not for lack of ideas. Instead we prefer to wait for opportunities like CCI to emerge. There is huge value in having cash available to invest when markets correct and sentiment is weak. This may detract from performance in the short-term, as it has done for the first year of the Trust, but we believe this approach is the best way to deliver long-term returns for our shareholders.

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