Investor note
August 2019

Scottish Oriental Smaller Companies Trust plc

This is the eighth semi-annual update on the Scottish Oriental Smaller Companies Trust plc ("The Trust" or "Scottish Oriental"). Our aim is to provide a general update on some of our current thoughts and views, insights about existing holdings, and changes to the portfolio over the period.

How we invest

Scottish Oriental is managed by the FSSA Investment Management team, an independent investment management team within First State Investments. The team manages a range of Asia Pacific equity strategies on behalf of institutional and wholesale clients globally, with offices in Hong Kong, Singapore and Edinburgh.

The Trust aims to achieve long-term capital growth by investing mainly in smaller listed companies across the Asia region; that is companies with market capitalisations of below US$3 billion, or the equivalent thereof, at the time of first investment.

We are conviction-based, bottom-up stock selectors with a strong emphasis on high quality proprietary research. Our investment approach adopts an absolute return mind-set and is inherently conservative, focusing on capital preservation as well as capital growth. By focusing on the potential downside (not just the upside) when making any investment decision, the risk to long-term client returns is significantly reduced. We are long-term investors and prefer to invest in quality companies that we can hold on to for many years.

The most significant source of investment ideas for the portfolio comes through country and company visits. As a team, we conduct more than a thousand direct company meetings throughout the year, seeking to identify a small sub-set of quality companies that meet our investment criteria. We place a clear emphasis on frequent visits to countries in the Asia region and on meeting the management of those companies in which the Trust is invested, or might invest.

While cultural, political, economic and sectoral influences play an important part in the decision-making process, the availability of attractively-priced, good quality companies with solid long-term growth prospects is the major determinant of Scottish Oriental's investment policy. Our country weightings bear no relationship to regional stock market indices and we do not consider ourselves obliged to hold investments in any individual market, sector or company. As a result, our asset allocation on a country and industry level is a residual of our stock selection process.

Return on Capital Employed and Gross Profits

We always end these notes soliciting feedback and suggestions on what might be of interest to Scottish Oriental's shareholders. Some time ago, one shareholder had asked us to look at gross profit and return on capital employed of the companies in the portfolio, but we had a few things we wished to cover first.

We should start with some definitions. Gross profit can be defined as the profit remaining after a company deducts the costs directly associated with making its products or providing its services. Dividing gross profit by revenues gives us gross margin, which can be used to compare companies. As a general rule, the higher the gross margin the better, but there is no definition of what a good or poor gross margin is.

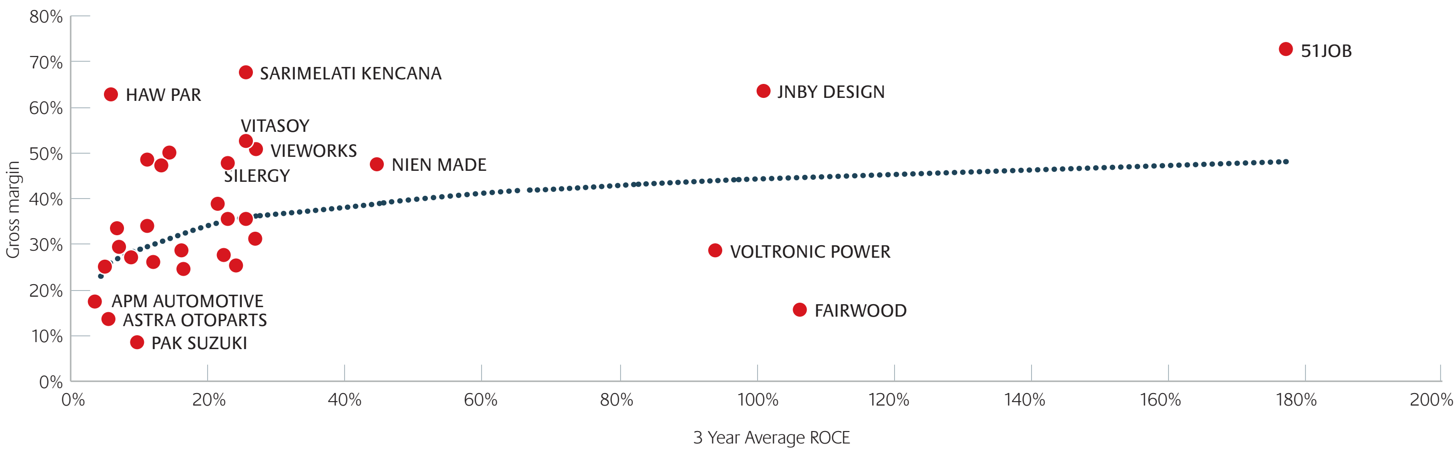
Return on capital employed (ROCE) is a more complicated metric. Simply put, it shows the success of a company's business model by dividing its operating profit (generally considered to be profit before interest expense and taxation) by the equity and debt capital it has utilised to generate these profits. There are many ways this can be calculated (we deduct estimated taxation from operating profits and net off cash against debt). Again, a higher ROCE is better than a low one. As a very general rule, we would tend to define a ROCE of less than 10% as being poor, although this depends on the country a company operates in. We would be much happier if a company we invest in earns a 10% ROCE in Hong Kong or Singapore than in Vietnam or Pakistan as we demand higher returns from riskier countries.

Logically a company that makes a high gross profit margin should make a higher ROCE than a company that makes a low gross profit margin. However, nothing is quite this simple as companies that utilise a lot of assets tend to demand higher gross margins to compensate for this asset heavy business model.

Further, investing in high ROCE companies sadly does not guarantee strong returns, as these companies tend to be valued highly by the stock market. High valuations lead to the risk of significant share price declines should such a company disappoint. Therefore it is important to identify companies with sustainably high ROCE. Such opportunities tend to arise from high barriers to entry due to, for example, intellectual property, a strong brand or a difficult-to-replicate distribution network. Also, frequently the best investment returns come from companies that increase ROCE when the stock market was not expecting this to happen.

We calculated average ROCE over the last three years for Scottish Oriental's holdings and have plotted these against gross margins in Figure 1 with a dotted line that indicates the trend. This does not include all Scottish Oriental's holdings, as ROCE and gross margin as concepts don't apply to financial stocks; some of our holdings have negative ROCE (we will come back to this later) and many companies don't actually report gross profits. However, this data set shows that there is little correlation between high gross margins and high ROCE. We have highlighted the names of the companies that stand out. We will look at most of these later.

Figure 1

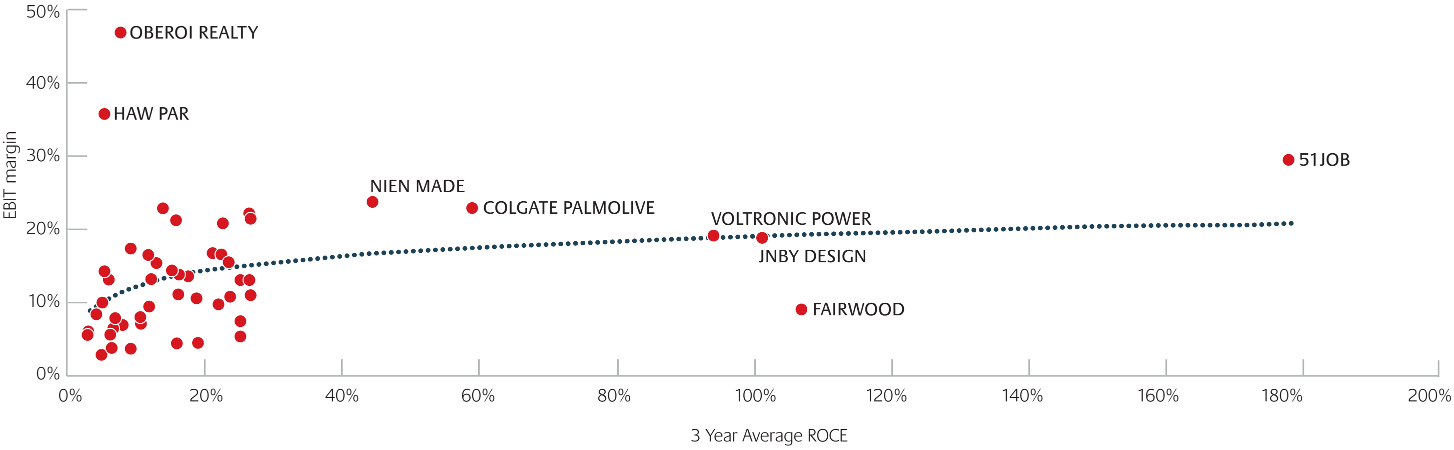


Source: Bloomberg, FSSA Investment Managers, as at 30 June 2019

Return on Capital Employed and Operating Profits

Companies typically have other significant expenses that still need to be deducted from gross profits. Deducting these expenses from gross profits arrives at operating profits, commonly referred to as EBIT (earnings before interest and tax). We would have imagined that there would be a better correlation between EBIT and ROCE. The correlation is marginally better but is far from perfect. Again, we have highlighted some of the more interesting data points with the company names.

Figure 2



Source: Bloomberg, FSSA Investment Managers, as at 30 June 2019

Outliers – high ROCEs or high EBIT margins

Looking at Figure 2, several stocks really stand out. Starting at the right hand side and working to the left; **51job** is a Chinese online recruitment platform and is a new holding for the Trust so we will provide greater detail on it later in this note. It makes very high margins and a massive ROCE. This is because of the platform nature of its business. Once you have made the investment in a successful internet platform, additional costs that come with additional revenues tend to be low, so scale brings outsized returns. This is a compelling proposition for investors, while it lasts. Our concern with such companies is that these outsized returns can attract attention from deep-pocketed competitors. Whilst we are optimistic about the prospects for Scottish Oriental's investment in 51job, we will need to watch the competitive environment closely.

Next is Hong Kong quick-service restaurant operator, **Fairwood**, which makes spectacular ROCEs despite unspectacular margins. It manages to generate such high returns as it doesn't need to deploy much capital in its business. It leases its stores and has "negative working capital". Typically Fairwood receives payment immediately but pays its suppliers much more slowly. As its sales are fresh food it carries little inventory, meaning that it can effectively use its suppliers' money to help fund its business. This means that little equity or debt capital is required.

There are two additional companies that are not shown on Figure 2 because ROCE for them is negative. This is not because of negative operating profits, but because of negative capital employed. These two companies are convenience store operator, **Taiwan Familymart**, (which has similar working capital characteristics to Fairwood) and Pakistani auto manufacturer, **Indus Motors**. Indus Motors is interesting as its customers fund the company's capital requirements by placing significant cash deposits far in advance of taking delivery of a vehicle. In the long run we do not see this to be sustainable, as capacity will be added to the industry and supply will catch up with demand, but it does show the trust that customers place in the company and the desirability of its cars.

As a fashion retailer, **JNBY Design** has done very well to generate such high margins and ROCE. The nature of fashion is fickle, however, and its future success is dependent on whether it continues to get its designs and product mix right. A bad season could see it left with too much unsold inventory, which would tie up capital and lower margins as this inventory would likely be discounted to clear. We have therefore been very sensitive with the price we are willing to pay for this company.

Uninterruptible power supply maker, **Voltronic Power**, is a very different business. It is an asset-light manufacturer that has significant "know how". It produces reliable equipment and is gaining share from more expensive manufacturers. Window blind manufacturer, **Nien Made**, has similar characteristics. Quality is important for window blinds – its distributors do not want to buy from just anyone and it has managed to earn high margins as its major competitor is US based with a much higher cost structure. Tariffs on Chinese imports have hurt this company, though it also has manufacturing capacity in Cambodia and can switch manufacturing away from China in due course if need be.

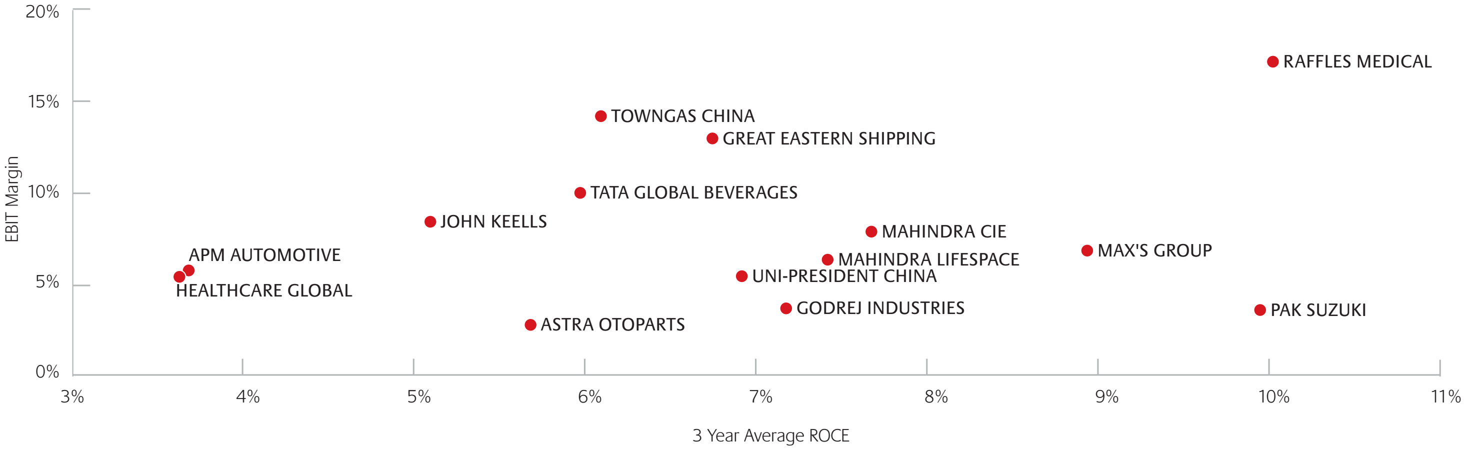
Finally for the very high ROCE companies, we have **Colgate Palmolive** India. Its well-known brands allow it to make superior margins which, when combined with predominantly outsourced manufacturing, see sustainably high ROCEs.

Two companies stand out as having very high EBIT margins but low ROCEs. These are **Oberoi Realty** and **Haw Par**. Oberoi is an Indian real estate developer selling quality properties, as well as developing and owning malls, offices and hotels. This requires a lot of capital. Its ROCE will never be high given the nature of its business but has been improving and we have seen successful counterparts in other more developed countries. Haw Par, on the other hand, is an accounting quirk. Its core Tiger Balm products generate high margins and high ROCE but it also has a very significant investment in Singaporean bank, UOB. The ROCE booked on this investment is effectively equivalent to the bank's dividend yield, which drags down Haw Par's overall ROCE.

Outliers – low ROCE companies

Given the highly populated cluster of less strongly performing companies at the bottom left of Figure 2, we have focused in on these in Figure 3:

Figure 3



Source: Bloomberg, FSSA Investment Managers, as at 30 June 2019

It could be said that we aren't entirely happy with the current performance of all of the companies in Figure 3, so we should explain why Scottish Oriental owns them, starting with the disappointments. Indian cancer centre specialist, **Healthcare Global Enterprise**, has not performed how we expected. What we believed to be a focused company has expanded aggressively and increasingly diversified away from its area of expertise, diluting returns from its more established cancer centres. This shows a scant regard for return on capital. We recently met with the founder and articulated our views, and are debating the best course of action. Malaysian auto component manufacturer, **APM Automotive**, has struggled given the poor operating environment in Malaysia but, rather than focus on putting its existing operations right, it has instead sought to expand. We have concerns that these investments will be unsuccessful and further impair returns, and are also considering our next steps. Indonesian auto components manufacturer, **Astra Otoparts**, and Pakistani auto manufacturer, **Pak Suzuki Motors**, have suffered from depressed returns resulting from downturns in their respective markets. However, we do have more faith in both sets of management teams doing the right thing here, and expect their operations to improve.

Several companies were purchased with what we considered to be depressed ROCEs and with an expectation of improvement. Noodle and beverage manufacturer, **Uni-President China**, Indian auto components manufacturer, **Mahindra CIE**, and Filipino restaurant operator **Max's Group** are all improving as anticipated. Sri Lankan conglomerate, **John Keells Holdings**, has been set back by this year's tragic Easter bombings. **Tata Global Beverages** and **Great Eastern Shipping** are new holdings and will be discussed later.

Two companies have low ROCE as a result of recent significant investments. Hospital operator, **Raffles Medical**, has invested significant amounts of capital in two Chinese hospitals which will leverage off the brand and experience of its flagship Singapore hospital. This has depressed its returns, but we expect things to improve notably over the next few years. Chinese gas distributor, **Towngas China**, has continued to invest in new and existing projects. Its mature projects perform better than its younger ones and we have seen over the decades with its parent company, Hong Kong and China Gas, how successful investment in this industry can be.

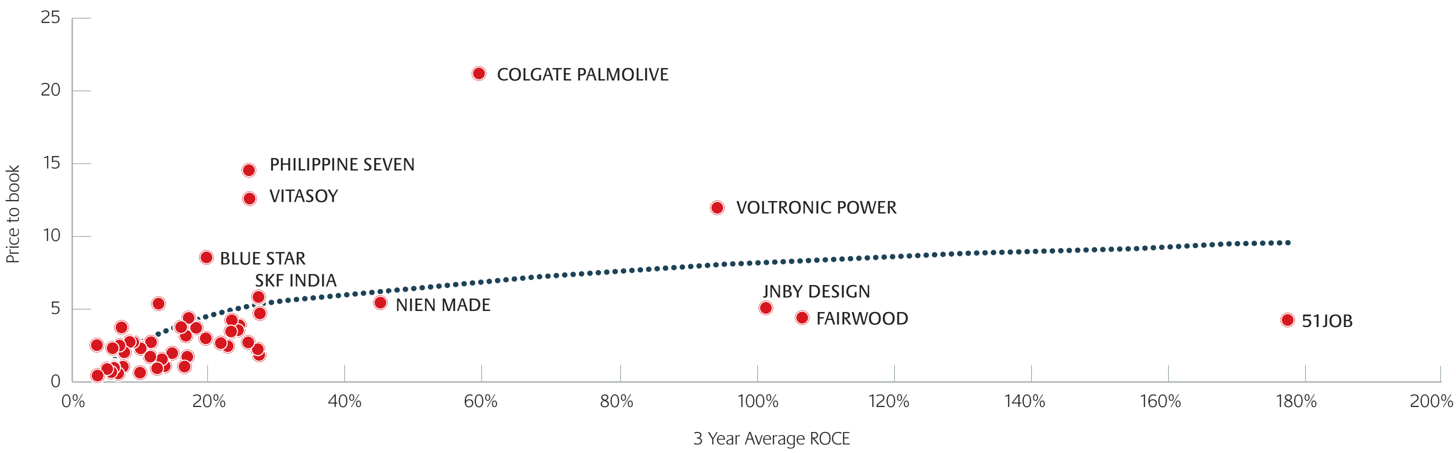
Conglomerate, **Godrej Industries**, and property developer, **Mahindra Lifespace**, have similar ROCE drivers as the former consolidates a property developer (Godrej Properties) into its accounts. We expect returns for the reputable developers in the Indian market to improve. Financing for small local developers is increasingly difficult and the result is less competition for quality plots of land. This is benefiting the likes of Mahindra Lifespace and Godrej Properties.

Finally we should mention Indonesian retail operator, **Hero Supermarket**. It has an average ROCE over the last three years of -12% and therefore does not appear anywhere on the chart. This has resulted from large losses it has booked in restructuring its underperforming supermarkets and hypermarkets. Hero is part of Hong Kong's Jardine Group, which we know well, and we believe is heading in the right direction.

Why not only invest in companies with high ROCE?

We would agree that, all being equal, it would be better to only own high ROCE companies in a portfolio. Sadly all is never equal. As we mentioned earlier, companies with high ROCEs tend to be valued highly. Figure 4 shows Scottish Oriental's holdings' ROCE compared to price to book. Price to book shows the value of a company ascribed by the stock market, divided by the book value of the company's net assets. There is a stronger correlation here:

Figure 4



Source: Bloomberg, FSSA Investment Managers, as at 30 June 2019

There is no "correct" price to pay for a company based on its ROCE. What matters most is the sustainability of a company's business model as well as the potential to grow its business, generating high ROCE on additional capital deployed. The most expensively valued companies in Scottish Oriental's portfolio when measured using price to book, such as Colgate Palmolive, Vitasoy and Philippine Seven, all have strong brands and a long runway for growth ahead of them. Given their superior ROCE, they should all be able to fund this growth without raising capital. This justifies such lofty valuations.

Scottish Oriental's top ten holdings

Scottish Oriental's ten largest positions are shown in Table 1. We have only discussed three of them so far.

The reason for this is that most are not outliers. They generate healthy but not overtly high ROCEs from respectable EBIT margins. Their management teams are good allocators of capital and as a significant shareholder of these companies we believe Scottish Oriental should benefit from steady multi-year growth. We expect capital that is needed for growth to be retained but excess capital to be returned to shareholders in the form of dividends. This is what good companies do.

Table 1

	Net Assets 30/06/19 (%)	3 year average ROCE (%)	3 year average EBIT margin (%)	Price/book	Country	Sector
SKF India	3.8	27	13	5.8x	India	Industrials
Concepcion Industrial	3.8	23	16	3.5x	Philippines	Industrials
Haw Par	3.2	6	36	1.1x	Singapore	Health Care
Blue Star	3.2	20	4	8.6x	India	Industrials
Selamat Sempurna	3.0	27	22	4.7x	Indonesia	Consumer Discretionary
Mphasis	2.8	24	15	3.6x	India	Information Technology
Gujarat Gas	2.8	13	9	5.4x	India	Utilities
Towngas China	2.7	6	14	1.0x	China	Utilities
Raffles Medical Group	2.6	10	17	2.3x	Singapore	Health Care
Sinbon Electronics	2.6	24	11	3.9x	Taiwan	Information Technology

Source: First State Investments as at 30 June 2019.

Recent notable changes to the Scottish Oriental portfolio

This period we made nine new investments and completely sold out of eight positions. There are now 59 stocks in the portfolio.

Table 2

Country weightings (%)	30-June-19	31-Dec-18
China	8.8	8.7
Hong Kong	6.2	5.8
Taiwan	10.3	12.2
Greater China	**25.3**	**26.7**
Bangladesh	1.7	1.6
India	30.9	28.1
Pakistan	1.7	1.7
Sri Lanka	3.0	4.7
Indian subcontinent	**37.3**	**36.1**
Indonesia	10.5	8.0
Malaysia	0.9	2.0
Philippines	10.2	9.4
Singapore	5.8	5.2
Thailand	0.0	2.1
Vietnam	1.9	1.7
South East Asia	**29.3**	**28.4**
South Korea	0.9	1.9
Cash	7.2	7.0
Total	**100.0**	**100.0**

Source: First State Investments as at 30 June 2019.

Greater China

Scottish Oriental's overall exposure to Greater China was stable during the period. Despite this, we generated some strong ideas and initiated four new positions:

51job is the largest online recruitment platform in China. As the penetration level and prices of online recruitment services increase in China, the company has solid growth potential. Management is focused on expanding its service offering and improving its client mix. It offers new services such as background checks and training for prospective employees, which is expected to improve the retention rate of its clients. It consistently generates free cash flow, resulting in net cash accounting for over 20% of its market capitalisation. However, the company does not yet pay dividends. We are engaging on this issue with its management.

ASM Pacific Technology is the world's leading manufacturer of back-end semiconductor and surface mount technology equipment, used in manufacturing electronic chips. Higher penetration of electronics across automotive, industrial and consumer applications should drive consistent growth in the sales of its equipment over the long-term. A global slowdown in demand across its end-user industries, such as consumer electronics, has led to attractive valuations for the company. It has maintained a net cash balance sheet, which supports a healthy dividend yield.

Nexteer Automotive Group is a leading global automotive steering system manufacturer. The Aviation Industry Corporation of China (AVIC) acquired a majority stake in the company in 2011 from General Motors, which had previously been its parent for over 100 years. Nexteer has consistently gained market share since the change in its ownership, from 5% in 2012 to 12% currently. This trend should continue, as it builds a stronger position in the Chinese market by setting up new joint-ventures with its automotive customers. The introduction of new technologies such as electric vehicles and Advanced Driver Assistance Systems (ADAS) will create opportunities for the company to introduce new products. The downturn in the global automotive cycle has led to attractive valuations, allowing us to initiate a position for the Trust. The company generates free cash flow consistently. This has led to a net cash balance sheet and supports a dividend yield of 2.5%.

Nissin Foods is the leading noodle brand in Hong Kong. The company has a dominant franchise in Hong Kong, with over 60% market share in noodles. Its operations in Hong Kong are growing, as the company launches new products and increases its control over its distribution channels. However, it has a much larger growth opportunity in China, where it has 20% market share in the premium noodle segment. Nissin has built a strong brand in China, based on its portfolio of healthier and higher quality products compared to its peers. Customer preferences are steadily shifting in favour of premium noodles. Nissin Foods is likely to be among the key beneficiaries of this premiumisation trend. Net cash on its balance sheet comprises one third of the company's market capitalisation.

In addition, we added to the Trust's holding in traditional Chinese medicine company, **Tong Ren Tang Technologies**, where we believe management have made improvements to its sales and distribution structure. We added significantly to Chinese branded apparel retailer, **JNBY Design**, at the start of the period, continuing to build up the position we initiated last year. However, strong share price performance saw us start to take profits by the end of the first half.

We have completely sold out of two stocks so far this year. Automobile body part manufacturer, **Minth**, was, at one point, Scottish Oriental's largest holding. However it was disposed of after our meetings with the company raised concerns of several of the top management team leaving the firm. Given these departures, we are concerned that Minth may struggle to manage the current downturn in the global automotive cycle. We also sold Chinese sportswear brand, **Li Ning**. This company had only been purchased in the previous period, following the changes its founder had made on being reappointed as CEO. The share price of Li Ning has more than doubled so far in 2019, and the company's valuations became too expensive for us.

In addition we significantly reduced the Trust's position in non-alcoholic beverage producer, **Vitasoy**, on continued strong share price performance. Its valuation is now highly expensive but we are maintaining a small position given the strength of its franchise.

Indian Subcontinent

Scottish Oriental's exposure to the Indian subcontinent inched up over the period. As would be expected given the breadth of its stock market, most of the Trust's notable transactions were in India, with four new positions bought and three completely sold. The four new holdings are:

Colgate-Palmolive India is the listed subsidiary of Colgate Palmolive Company. It has operated in India since 1937 and its parent owns a 51% stake in the company. Colgate has been the market leader in the Indian oral care industry for decades. Its market share of toothpaste has increased from 49% to 52% over 10 years. Per capita consumption of toothpaste in India is less than half of the average of other developing countries. Colgate will benefit from higher per capita consumption and the shift towards premium oral care products. In recent years, the company has focused on gaining share in the fast growing "natural" segment of the industry. Its parent also has a large portfolio of personal care, home care and pet care products, which the company is likely to introduce in India as per capita incomes grow. Valuations for Colgate are expensive, however the opportunity of increasing per capita consumption, further strengthening its market position and introducing new products, should allow Colgate to become a much bigger business over the long-term.

Edelweiss Financial Services is a diversified financial services firm with operations including credit, asset/wealth management and life insurance, as well as running India's largest asset reconstruction company. The growth opportunity for non-bank finance companies (NBFCs) in India is large. The market is underpenetrated and 70% of lending is done by state-owned banks which are inefficient. However, NBFCs have faced a severe liquidity crunch since 2018 following a major default in the sector. The industry is likely to consolidate among higher quality firms which survive this crisis. Edelweiss has made several changes to improve the quality of its business over the last year. Management has shifted its funding mix towards longer term and more reliable sources. Reputed global investors have invested equity in some of its key businesses. Poor performing managers as well as unprofitable businesses have been cut. The focus of its lending business has also shifted towards retail loans, which have lower risk than large ticket wholesale loans. These changes should help Edelweiss emerge stronger from the current crisis and build a large business over the long-term.

Great Eastern Shipping is an operator of offshore vessels, tankers and bulk carriers. It is managed by the Sheth family who founded the business over 70 years ago and own a 30% stake. The management has a strong track record of acting counter-cyclically. The business cycle has been unfavourable in recent years. In 2018, the company suffered its first net loss in over 30 years. The management has been using this cyclical downturn to add capacity at attractive prices. As environmental regulations related to the shipping industry become increasingly stringent, higher operating costs are leading to higher rates of ship scrapping. This is expected to improve the industry's demand-supply balance, and lead to higher charter rates.

Tata Global Beverages operates leading tea and coffee brands in India and certain international markets such as the United Kingdom. The company's market leading positions in the tea and coffee categories in India has led to a steadily growing and cash generative domestic franchise. However, sub-optimal capital allocation decisions in the past led to poor performing international operations which depressed its overall returns on capital employed. There have been several encouraging changes to the company's culture and capital allocation under its new Chairman, Mr. Natarajan Chandrasekaran. The company has hired high quality professionals from multinationals including Glaxosmithkline, Diageo and Coca-Cola in recent years. Reputed independent directors from larger consumer companies have also joined its board. Management has shut down or sold its loss making international operations in regions such as Russia and Eastern Europe, to increase focus on the profitable tea and coffee brands in India. Recently, the Tata Group decided to merge all its food businesses into Tata Global Beverages, including brands in pulses, spices and salt. As the products share a common distribution network, this should provide increased scale and bargaining power with distributors. Tata Global Beverages also operates a joint-venture with Starbucks in India, with 150 stores currently. Given strong consumer demand and improving profitability, its store expansion is expected to accelerate. This could emerge as a large and profitable business for the company over the long term. The company's net cash balance sheet positions it well to fund its growth.

We exited three Indian holdings during the period. **Linde India** was sold as the share price rose significantly after its parent announced its intention to privatise the company. The privatisation was to be conducted via a process whereby shareholders tendered their shares to establish an offer price which Linde India's parent could accept or counter. We felt that the expectations in the market were unrealistic and chose to sell the Trust's holdings in the market instead of tendering. India's leading cinema operator **PVR** was only purchased last period but strong share price performance saw valuations become too rich for us, so we banked Scottish Oriental's profits. Department store group **Shoppers Stop** was sold following poor engagement from the new management team of the company, which is looking to invest aggressively, resulting in increased debt.

Elsewhere in India we continued to build up the Trust's holding in real estate developer, **Oberoi Reality**. We also added significantly to IT outsourcer, **Mphasis**, where meetings with management increased our conviction in the company's ability to adapt towards digital and cloud based applications faster than its larger counterparts. We considerably reduced the Trust's stake in fast moving consumer goods company, **Jyothy Laboratories**, where we were disappointed at the company choosing to appoint the Chairman's daughter as its next CEO.

Outside India the only transactions of note were in Sri Lanka. We exited conglomerate, **Hemas Holdings**, where we were disappointed at management's perseverance with poorly performing businesses, such as hotels we had hoped they would divest. We added to **Hatton National Bank** following poor share price performance, resulting in low valuations.

South East Asia

There was little overall change to Scottish Oriental's South East Asian weighting but some change of note at a country level.

Exposure to Indonesia increased following the completion of the purchase of **Sarimelati Kencana**, the exclusive franchise operator of Pizza Hut in Indonesia. The company operates the leading pizza chain in Indonesia with over 450 stores, compared to 130 stores for its next largest competitor. Management is focused on accelerating the expansion of smaller "Pizza Hut Delivery" stores. As the food delivery segment is growing rapidly in highly congested cities such as Jakarta, the company's investments in building its delivery network should help it strengthen its market position further. It has also received incentives such as lower royalty and store opening fees from its principal, Yum! Brands, for this expansion. These incentives should help Sarimelati improve its profitability.

Exposure to the Philippines also increased. We initiated a position in **Philippine Seven Corporation**, the dominant convenience store operator in the Philippines, with the exclusive right to use the 7-Eleven brand. President Chain Store of Taiwan owns a majority stake of 52%. Management is led by its CEO, Victor Paterno, who owns a 7% stake and is from the 2nd generation of the company's founding family. The company is the undisputed market leader in convenience stores due to its first mover advantage. It has over 2,000 stores, compared to 500 for its next largest competitor. As the company has gained scale, its bargaining power with suppliers has increased. This has led to an improvement in its profitability and higher free cash flow generation as well. The increased cash generation is being used to fund an acceleration in its store network rollout, which will strengthen its market position further.

We also further added to casual dining restaurant operator, **Max's Group**, following positive meetings with the company's management. We discussed cement producer **Cemex Holdings** in our previous note. Despite the losses we made for the Trust with this stock we decided to exit the company following engagement with the company about the alignment of its parent company with minority shareholders, and concerns on the significant increase in leverage that will be needed to set up new capacity.

We sold **Delta Electronics**, a producer of power supplies and associated components, leaving no holdings in Thailand. The company was disposed of during a tender offer by its controlling shareholder. Our recent engagement with the company indicated that our alignment of interest with the controlling shareholder was deteriorating. The company's business outlook is also challenging, following a slowdown in demand across several of its business segments.

Scottish Oriental investment performance

We invest with a long-term, that is, a three-to-five year mind-set, if not longer, and we hope to be measured over a similar time period. However, we are aware that the long-term is made up of several short- and medium-terms and sometimes it can be helpful to look at what has driven recent performance.

Table 3

	3 mth	6 mth	1 year	3 years	5 years	10 years
NAV	1.7	7.5	0.8	20.2	38.3	265.1
NAV – total return	2.3	8.2	2.2	24.4	46.7	311.7
Asia Index*	1.8	10.9	3.6	46.8	72.6	183.8
Small Cap Index**	-0.6	5.4	-4.2	20.2	38.0	133.4
Share Price	1.5	5.3	1.0	20.8	23.5	253.7
Share Price – total return	1.5	5.3	2.3	25.3	31.9	307.4

Annual Performance

	1yr to Jun 19	1yr to Jun 18	1yr to Jun 17	1yr to Jun 16	1yr to Jun 15
NAV %*	0.8	-0.1	19.3	8.3	6.3
Asia Index** %	3.6	8.4	30.8	3.9	13.2
Small Cap Index*** %	-4.2	5.2	19.3	0.4	14.4
Share price %	1.0	-3.0	23.3	4.5	-2.2

These figures refer to the past. Past performance is not a reliable indicator of future results. For investors based in countries with currencies other than the share class currency, the return may increase or decrease as a result of currency fluctuations

Performance figures have been calculated since the launch date. Performance data is calculated on a net basis by deducting fees incurred at fund level (e.g. the management and administration fee) and other costs charged to the fund (e.g. transaction and custody costs), save that it does not take account of initial charges or switching fees (if any). Income reinvested is included on a net of tax basis. Source: Lipper IM / First State Investments (UK) Limited.

Source: First State Investments. As at 30 June 2019.

* MSCI AC Asia (ex Japan) Index

** MSCI Asia (ex Japan) Small Cap Index

*** MSCI AC Asia (ex Japan) Small Cap Index

Six month performance

During the first half of 2019, concerns regarding the US-China trade war drove stock market performance. Markets started the year strongly on evidence of improving relations but this changed abruptly in early May with the threat of increased trade tariffs by the US President and the subsequent imposition of these tariffs, prompting a global equity selloff. Markets then recovered during June on the expectation that the G20 summit in Osaka would result in an improvement in relations between the US and China. Scottish Oriental outperformed the smaller companies' index over the first half of the year but underperformed the main Asian index.

Thailand and Hong Kong were the strongest performing markets – the former on a more certain political situation and the latter on hopes for improved US-China relations. China, the Philippines and Singapore also produced double digit returns when measured in sterling. Pakistan was the worst performing market, with its prime minister forced to ask the IMF for a bailout as the country's foreign reserves dwindled. Sri Lanka was also weak following April's Easter bombings.

Scottish Oriental's holdings in China, Hong Kong, the Philippines, Singapore, Taiwan and Vietnam produced strong returns. The Trust's investments in South Korea and Sri Lanka produced negative returns. The Trust's investments in India, Malaysia and Pakistan were also relatively weak. In the past 18 months Indian smaller companies have significantly underperformed their larger counterparts with this pattern holding true in the first half of 2019. The result is increasingly attractive investment opportunities for the Trust in India.

What helped

At a stock level, there was little underlying theme to the best contributing stocks. The top contributor was Vitasoy, which performed exceptionally strongly following its previous period's results and on "index-led buying", where passive fund buying creates strong demand driving share prices up. This phenomenon makes little sense to us but is definitely real. Second best was Taiwanese cable and connector manufacturer, **Sinbon Electronics**, which saw revenues and profits grow from higher customer demand in areas such as wind energy and medical equipment. Third was Indian city gas distributor, Gujarat Gas, which is benefiting from increased demand for gas in one of its key operating regions after a coal ban for industrial users.

Air conditioning and refrigeration companies, **Blue Star** and **Concepcion Industrial**, both performed strongly for Scottish Oriental as they continued to gain market share in India and the Philippines respectively. Singapore's Haw Par continued to grow its Tiger Balm franchise and paid a substantial special dividend during the period. We have already mentioned the importance of **JNBY** getting its product right and its results indicated it has continued to do so, with correspondingly strong share price performance. **Heidelbergcement India** benefited from improving cement prices in its target markets; **Uni-President China** saw improving margins on falling raw material costs; and Taiwanese analogue integrated circuit designer, **Silergy**, saw a sharp appreciation in its share price in June as it was expected to benefit from increased demand from Chinese companies as they seek to avoid US-made products.

What hurt

Companies in the Indian subcontinent were the biggest detractors from performance with a Sri Lankan company, a Pakistani company and five Indian companies in the bottom ten.

The largest detractor from performance was **Jyothy Laboratories**. The company reported weak revenue growth and contracting margins during the period. **Healthcare Global Enterprises** was also weak, with results negatively impacted by its significant debt-funded expansion, resulting in high interest expense and losses from its new centres. **Shoppers Stop** was weak on concerns over falling footfall at department stores and changes in e-commerce regulations before we sold the company. **Mahindra CIE** produced acceptable results but the share price lagged on concerns over the global autos slowdown. **Godrej Industries** was impacted by the performance of its key holding, Godrej Consumer Products, which, like Jyothy Laboratories, suffered from weak revenues. Unlike Jyothy Laboratories, we believe the Godrej Group have the management team in place to succeed in the long run.

Hatton National Bank reported much higher provisioning, resulting from the weak economic environment in Sri Lanka and saw weakness in its share price. Taiwanese networking equipment manufacturer, **Wistron NeWeb**, reported a fall in its profits as the company incurred costs to relocate its production capacity in response to the global trade war. **Tong Ren Tang Technologies** was weak this period for no fundamental reason. As mentioned earlier, we have added to the Trust's position. **Indus Motors'** share price was weak when converted to sterling, as the Pakistani rupee fell further during the period, given the country's woes. The company has a track record of passing on the impact of currency depreciation to its customers and maintaining its profitability across business cycles. Also, **Raffles Medical's** share price fell as the launch of its new hospitals in China is leading to lower profitability in the short-term as operations ramp up. However, expansion into the large Chinese market provides higher growth potential over the long-term.

Outlook and conclusion

Over the last six months the performance of Asia's stock markets has predominantly been driven by US-China trade tensions. We have never been ones to try to forecast economic growth, finding it difficult enough analysing the earnings prospects for companies we invest in. With the economic outlook now dependent, to a significant extent, on the egos of Presidents Trump and Xi, we feel it is best to continue focusing on our companies and will leave economics to the experts.

We remain positive about the prospects for Scottish Oriental's companies. Most of the Trust's holdings produce ROCE in double digits, with the opportunity to reinvest profits for further growth in their core businesses. And those companies with lower ROCEs are, on the whole, improving. A few of the Trust's companies have been directly impacted by the US-China trade war. Most have not. And those companies that have been impacted by it remain profitable and should not need to significantly change their business models.

The positioning of Scottish Oriental's portfolio is broadly unchanged with significant investments in India, Indonesia and the Philippines as well as holdings in companies based in several other countries with large domestic markets and attractive demographics. We feel the portfolio is well-positioned to flourish over the long-run.

As has been the case for some time we would prefer if our companies were more cheaply valued. The volatility over the last six months afforded us some opportunities to pick up some reasonably valued companies with strong prospects. However, it also allowed us to sell some stocks where prospects were not so strong at an acceptable price, leaving cash levels unchanged. As always we are being patient in investing the Trust's cash to give the best possible chance of making positive returns for Scottish Oriental's shareholders.

We trust this update has given you a better understanding of the companies that Scottish Oriental invests in. We would welcome feedback on whether it has been helpful as well as what you would be interested in reading about in the future.

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