For professional clients only

The Scottish Oriental
Smaller Companies Trust plc

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This is the twelfth 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 team, an autonomous investment management team within First Sentier Investors (formerly known as 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$5 billion, or the equivalent thereof, at the time of first investment.

We are conviction-based, bottom-up stock selectors who place 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.

Investor Note

August 2021

Risk Factors

This document is a financial promotion for The Scottish Oriental Smaller Companies Trust Plc for professional clients only in the UK and Switzerland and elsewhere where lawful. 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.
- **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.
- **Currency risk**: changes in exchange rates will affect the value of assets which are denominated in other currencies.
- **Smaller companies risk**: investments in smaller companies may be riskier and more difficult to buy and sell than investments in larger companies.
- **Leverage risk**: the Trust may be leveraged due to: i) borrowings; or ii) the use of derivatives to hedge currency exposure.

The amount of leverage employed is disclosed on the Trust's website from time to time. Higher leverage increases the potential risk of loss. Investment trust share prices 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 a full description of the terms of investment and the risks please see the Investor Disclosure Statement.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

Scottish Oriental - gearing

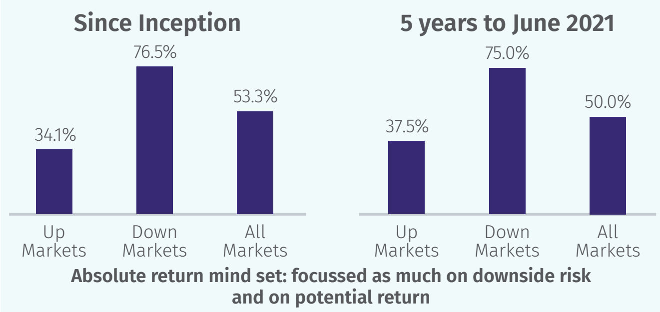
During the period, Scottish Oriental drew down £30m of borrowings at an interest rate of 2.75%, fixed for 20 years. In the past we have used debt sparingly in Scottish Oriental. While one of the great advantages of running an investment trust compared to an open ended fund is the ability to borrow, our emphasis on preserving capital has made taking on debt a debatable proposition for the Trust.

In 1999 and 2003 Scottish Oriental borrowed in Japanese Yen, both times at an interest rate that was fixed for four years. In 2011, US dollars were borrowed at an interest rate fixed for three years. And in 2014 sterling was borrowed for three years, again at a fixed interest rate. Only the proceeds of the 1999 borrowing was deployed in any meaningful way. The 2003 and 2014 borrowings were repaid early when we concluded that it was unlikely that markets would fall enough in the short term for us to wish to use the debt to buy stocks. And even if markets had fallen significantly, we would have had concerns about the remaining short tenure of the loan. Stocks tend to fall during a crisis and bankers tend to get very jittery about renewing debt facilities during crises. As the old adage goes, you should not ask to borrow an umbrella from a banker when it is raining.

The fall of interest rates in recent years has given Scottish Oriental an opportunity to take on more strategic gearing i.e. longer term debt. After discussion with the board of directors and pitches to several debt investors we opted to borrow for 20 years. This will allow us to invest these funds very much for the long term, as is our investment style, without fear of having to renew the facility at an inopportune time.

As at the end of June, Scottish Oriental had net assets of £333.5m and gross assets of £363.5m resulting in gross debt to equity of 9%. Having invested most of the proceeds of the debt issuance, net debt to equity is at 7.3%. This does not strike us as being onerous. The board of Scottish Oriental encouraged us to invest these funds asking us the simple question "do you think that the stocks you can buy will return more than 2.75% per annum over the next 20 years?" The answer to this question from us was a resounding yes! Since its inception in 1995 Scottish Oriental has produced double digit annualised returns. Therefore even if we feel that current market valuations are somewhat elevated because of the actions of central bankers we find it difficult to believe we cannot achieve much better than 2.75% per annum over the next 20 years.

Even if we are unfortunate with timing and markets were to take a turn for the worse, 20 years offers ample time for share prices to recover. It is also worth highlighting that historically we have survived better than most during down markets as can be seen in the below chart that shows the percentage of months that we beat or lagged the main Asian index. Most of the time when markets rise, we lag. But most of the time when markets fall we are defensive. The result is that during Scottish Oriental's history it has outperformed in just over half of all months but by focusing on capital preservation the cumulative returns have been strong with reduced volatility.



Data provided in GBP. These figures refer to the past. Past performance is not a reliable indicator of future results. The benchmark shown is the MSCI AC Asia(ex Japan) Index, on an income reinvested gross of tax basis. Sources: First Sentier Investors.

As Scottish Oriental's investors are aware, whilst the Trust has achieved positive absolute returns, the past five years have been a tough time for relative performance. Therefore we thought it would also be of interest to present the same chart for the last five years during which time Vinay Agarwal has run the Trust. These characteristics are almost identical. The portfolio has been run in a similar manner to how it was run for the prior 20 years.

Having raised £30m with a mandate to invest, the question then turned to where the proceeds should be deployed. This was a fairly easy question for us with the answer being that the majority of the proceeds has been invested into existing holdings. During the period Scottish Oriental also bought back almost 800,000 shares at a cost in excess of £8m. This has the effect of increasing the position sizes of all holdings in the portfolio. When we like a portfolio as much as we like Scottish Oriental's this seemed an excellent use of the Trust's cash.

Recent notable changes to the Scottish Oriental portfolio

Portfolio turnover reduced this period with five new investments made and ten positions sold. The bulk of the selling was following strong share price appreciation. We also added significantly to a number of our favoured holdings as we deployed the proceeds of the debt issuance. There are now 57 stocks held in the portfolio with Scottish Oriental being 107 per cent invested.

Country weightings (%)	30-Jun-21	31-Dec-20
China	10.2	11.0
Hong Kong	5.4	6.0
Taiwan	8.0	4.1
Greater China	**23.6**	**21.1**
Bangladesh	1.3	1.5
India	41.8	37.1
Pakistan	1.3	0.9
Indian subcontinent	**44.4**	**39.5**
Indonesia	16.9	16.9
Malaysia	0.9	1.3
Philippines	11.8	11.5
Singapore	2.9	2.4
Thailand	1.5	1.2
Vietnam	2.2	2.9
South East Asia	**36.2**	**36.2**
South Korea	3.1	1.8
Gearing	-9.0	0.0
Cash	1.7	1.6
Total	**100.0**	**100.0**

Source: First Sentier Investors as at 30 June 2021.

Greater China

We increased Scottish Oriental's exposure to Greater China over the period with the Taiwan weighting doubling. In Taiwan we bought one new holding, **Parade Technologies**. Parade Technologies is an integrated circuit design company that specialises in products that facilitate high-speed data transmission across PC's, mobile phones and servers. We have been impressed by how management have targeted fast growing niche segments allowing the company to lead the market in introducing new products with higher technological standards. This has resulted in high levels of profitability accompanying its growth. Growth is driven by the requirement for increasing data transmission speeds across electronic devices which we expect to continue for the foreseeable future. In Taiwan we also continued to build the position in retail chain **Poya International** and we took advantage of share price weakness to add to uninterruptible power supply maker **Voltronic Power**.

In China we sold online recruitment platform **51job** where management's response to a takeover approach in 2020 seemed peculiar with little in the way of updates offered to shareholders and an unwillingness to engage. Several months later, management joined the consortium to take the company private but only at a modest premium to where we had sold. We also reduced plastic pipe manufacturer **Zhejiang Weixing New Building Materials** follow strong share price appreciation. Exposure to China was maintained as we built up the Trust's position in **Beijing Capital International Airport** and we added to branded apparel retailer, **JNBY Design** where we found the valuation compelling given its resilience during 2020 although we were taking profits by the end of the period following strong share price appreciation.

In Hong Kong we sold automotive steering system manufacturer **Nexteer Automotive Group** on valuation concerns following a sharp increase in its share price.

Indian Subcontinent

On a net basis the Trust was a seller of Indian stocks but strong share price performance from its holdings saw increased exposure to the country. Six positions were sold in India, all following strong share price appreciation leading to expensive valuations. These companies were **Ambuja Cements**, injectable drug producer **Gland Pharma**, operator of offshore vessels, tankers and bulk carriers **Great Eastern Shipping**, temporary staffing services provider **Quess Corp**, air-conditioning producer **Voltas**, and IT outsourcer **Zensar Technologies**. We also reduced the Trust's holdings in fast moving consumer goods company **Emami** and bearings manufacturer **SKF India** for the same reason.

Some of the proceeds of these sales were invested into two new Indian holdings. **Solara Active Pharma Sciences** produces the active ingredients for pharmaceuticals. Solara operates largely in developed markets which have high barriers to entry due to stringent quality requirements. There is also an increasing domestic market. The company has the opportunity to grow several times in the coming years as customers are increasingly seeking to reduce dependence on Chinese manufacturers who have historically dominated this industry. **Thermax** is a leading engineering company with a core product of industrial boilers. A new chief executive is reducing the company's exposure to poorly performing markets and the company is expanding its product range to clean energy, including waste-heat recovery, biomass and other new energy projects. Customer demand and profitability in these segments is strong.

In India we also continued to build the Trust's positions in wealth management platform **IIFL Wealth Management**, cable manufacturer **KEI Industries**, and city gas distributor **Mahanagar Gas**.

South East Asia

Scottish Oriental's overall South East Asian weighting was unchanged over the period. However, given the weak performance of the Trust's holdings in Indonesia and the Philippines, we had to commit further capital to maintain this exposure.

In Indonesia we purchased one new holding, **Arwana Citramulia**, which is a leading tile manufacturer. Several years ago, the Indonesian tile industry suffered from weak demand and over capacity. The company responded to this by reducing its operating expenses significantly and shifting its product mix in favour of higher-priced tiles. Arwana Citramulia is now entering the high-end glazed porcelain tile segment. Here it has much potential to gain market share from imports which dominate this segment. This should improve its profitability further and see growth accelerate in the coming periods. In recent years, the industry has been disciplined in adding new capacity, while consumer demand for tiles has grown consistently resulting in an attractive outlook for the company. In Indonesia we also added to home improvement store operator **Ace Hardware** and **Mitra Adiperkasa**, an operator of franchises in food & beverage, department stores, sportswear and fashion apparel. Both companies have seen their share prices weaken as government measures restricting movement have resulted in reduced customer footfall. But both companies have adapted to the current situation with an increased focus on online platforms and e-commerce and we believe they will emerge with a stronger competitive position following the disruption from Covid-19.

Elsewhere in South East Asia we reduced Malaysian home improvement store operator **Mr DIY** on strong share price performance. We added to convenience store operator **Philippine Seven** which has been badly impacted by lockdown measures in the Philippines but we have been impressed at management's plans to adapt the store formats to focus more on staples. In the Philippines we also added to branded food company **Century Pacific Food** where management's performance remains impressive. We continued to build up the position in Singapore-based credit reporting agency **Credit Bureau Asia** and Thai bank **TISCO Financial**. And in Vietnam we sold conglomerate **REE Corp** following strong share price performance.

South Korea

The Trust's exposure to South Korea increased over the period. We made one new investment in the country, **Zinus Holdings** which is the one of the leading global manufacturers of mattresses. The company is number one in the US online mattress market. Despite this, its market share is still low, at around 6%. Mattresses' bulky nature leads to high transportation costs but Zinus introduced the patented "Mattress In A Box" concept which allows it to sell at significantly lower prices than competitors. The company is widening its product portfolio as well as expanding into new markets through e-commerce channels to diversify its presence. Zinus has been growing at approximately 20% per annum and is expected to continue this level of growth in the coming years. Despite this level of growth it trades at 16x analysts' estimates for 2021 profits which appears very reasonable to us.

In South Korea we also added to payment gateway provider **NHN KCP** on share price weakness. We sold one holding, testing pin/socket manufacturer **Leeno Industrial**. Having initiated a small holding last year, the share price then performed strongly leaving little margin for error.

Top 10 holdings

Stock name	% of net assets
Godrej Industries	4.3
Century Pacific Food	3.7
Uni-President China	3.7
Mahindra CIE Automotive	3.4
Colgate-Palmolive India	3.2
Mitra Adiperkasa	3.1
Selamat Sempurna	3.0
Philippine Seven	2.6
Oberoi Realty	2.6
Blue Star	2.6
Total	**32.1**

Source: First Sentier Investors as at 30 June 2021.

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.

Annual Performance

Time Period	1yr to Jun 21	1yr to Jun 20	1yr to Jun 19	1yr to Jun 18	1yr to Jun 17
NAV %*	23.9	-16.8	0.8	-0.1	19.3
Asia Index** %	25.2	5.0	3.6	8.4	30.8
Small Cap Index*** %	45.4	-1.6	-4.2	5.2	19.3
Share price %	36.3	-19.4	1.0	-3.0	23.3

* Capital only return.
**MSCI AC Asia (ex Japan) Index
*** MSCI AC Asia (ex Japan) Small Cap Index

	3mth	6 mth	1 year	3 years	5 years	10 years
NAV	3.0	7.2	23.9	3.9	23.9	83.2
NAV – total return	3.5	7.6	25.2	7.4	30.6	106.0
Asia Index*	3.5	5.4	25.2	36.2	93.1	135.9
Small Cap Index**	9.5	18.8	45.4	37.0	71.9	100.6
Share Price	10.4	14.2	36.3	10.9	32.7	83.4
Share Price – total return	10.4	14.2	37.9	15.0	41.0	110.0

Source: First Sentier Investors. As at 30 June 2021.
* MSCI AC Asia (ex Japan) Index
** MSCI Asia (ex Japan) Small Cap Index

Six month performance

In the first half of 2021, Asian stocks rose, continuing their strong performance from 2020. Performance was mixed with Taiwan being the strongest market on continued demand for technology products. India also performed strongly, shaking off the severe impact that the second wave of Covid-19 had during the period. Increasing Covid-19 cases in Indonesia, Malaysia and the Philippines resulted in governments there imposing restrictions on movement. Those restrictions and a decreased propensity to consume saw these economies weaken and all three stock markets fell.

Scottish Oriental's holdings in China, India, Malaysia, Pakistan, Singapore, Taiwan and Vietnam produced strong returns. By contrast, Scottish Oriental's investments in Bangladesh, Hong Kong, Indonesia, the Philippines, South Korea and Thailand produced losses. The Trust's holdings in Indonesia were the biggest detractor from performance during the period. Whilst the situation with Covid-19 in Indonesia has clearly deteriorated, the companies that Scottish Oriental owns are leaders in their respective areas and we expect them to consolidate their leading positions and come out of this crisis stronger.

What helped

At a stock level, five of the top ten contributing stocks were Indian. The top contributor was conglomerate **Godrej Industries**. Having lagged its listed subsidiaries and associates recently, most of this performance was the company making up lost ground. However it also benefited from the announcement that the Godrej family would inject Godrej Housing Finance Limited into the company for a nominal consideration. Some Asian families look at their listed companies as a piggy bank to be raided when times are tough. The fact that the Godrej family are choosing to grow their housing finance business inside the listed vehicle and without taking advantage of minority shareholders as part of the transaction merely reiterates our view that the Godrej family are one of the best families to back for the long term in Asia. Property developer **Mahindra Lifespaces** was the second best contributor, announcing strong sales during the period. The three other Indian holdings in the top ten contributors were auto components manufacturer **Mahindra CIE** which rose as auto manufacturing normalised; bearings manufacturer **SKF India** which reported strong operating performance; and IT outsourcer **Mphasis** which has continued to grow impressively despite the pandemic.

Vietnamese IT outsourcing and fixed line telecommunications operator **FPT Corp** was the third best contributor to performance and also the best performing stock in terms of absolute share price performance. The company's information technology business continues to grow strongly and this has seen the share price re-rate upwards. Branded food company **Century Pacific Food** also healthily grew profits during the year. The company is gaining market share in its dairy business and is expanding into new segments. Also in South East Asia, Indonesian retailer **Hero Supermarket** rose sharply after announcing it will shut down its lossmaking Giant Hypermarket brand focusing on the profitable IKEA, Guardian pharmacy and Hero supermarket formats.

Chinese branded apparel retailer **JNBY Design** also performed very well for Scottish Oriental as its improving growth outlook was incompatible with its cheap valuation. The final stock in the top ten contributors was Taiwanese connector manufacturer **Sinbon Electronics** where continued strong customer demand saw it again report excellent results.

What hurt

The biggest detractor from performance was Scottish Oriental's holdings in Indonesia with **Mitra Adiperkasa**, and **Ace Hardware** being the two largest detractors as the delta variant of Covid-19 impacted heavily on the country. Pizza Hut franchisee **Sarimelati Kencana** also performed poorly for the same reason.

The Philippines has also been suffering from Covid-19 and convenience store operator **Philippine Seven** continues to struggle under the resulting constraints on its business. Consumer Staple company **Universal Robina** was also weak as customers were less likely to make impulse purchases of its snacking products.

Other companies that were hurt by the pandemic were South Korean payment gateway provider **NHN KCP** which reported weaker sales in its offline business because of social distancing regulations; Chinese airport operator **Beijing Capital International Airport** which unsurprisingly reported significantly lower revenues in the period – however we were pleased with the cost reductions management have achieved; and Hong Kong-listed non-alcoholic beverage producer **Vitasoy** was weak as sales declined in Hong Kong as a result of the various restrictions in place.

Only two of the bottom ten detractors fell for reasons other than Covid-19. India's **Kansai Nerolac Paints** was weak following the announcement that a large industrial group was seeking to enter the paint industry. And Chinese white goods manufacturer **Hisense Home Appliances** suffered from inflationary cost pressures which have impacted margins.

Outlook and conclusion

In the past we have written about "free money" and how since the Global Financial Crisis of 2007-2008 the policy response to any crisis is now money printing. The level of stimulus has been massive resulting in interest rates that are near an all-time low. We have chosen to take advantage of these interest rates by locking in long term debt at favourable rates. The board of Scottish Oriental has encouraged us to invest this borrowed money on the basis that likely returns for Asian equities should comfortably exceed the interest cost on this debt over the next 20 years. Therefore approximately 107 per cent of the Trust's net assets is now invested in stocks.

The additional cash raised could have allowed us to recalibrate the portfolio. This optionality was valuable to us as it allowed us to reappraise Scottish Oriental's holdings almost as if we had a blank sheet of paper. The conclusion we reached was that we were, and are, incredibly happy with the portfolio's positioning and therefore we chose to add to some of our favoured companies where valuations were most reasonable and also to buy back shares in Scottish Oriental, in effect adding to each holding in the portfolio.

More than 70% of the Trust's net assets are invested in three countries - India, Indonesia and the Philippines. Companies in the former country have performed strongly for shareholders and we have been taking money out of that market. Despite this, India's weighting has increased because of this strong investment performance. The Trust's investments in Indonesia and the Philippines have performed poorly. Having been left behind when excess liquidity fuelled a global stock market rally, both countries are now suffering from high levels of Covid-19 cases and the resulting restrictions on movement have led to weakening economies. However the companies that Scottish Oriental owns in these markets have robust franchises and we have every confidence in the ability of their management teams. We expect them to emerge from this crisis even stronger. We have strong conviction in the portfolio.

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.

Important Information