THE SCOTTISH AMERICAN INVESTMENT COMPANY P.L.C – MANAGER INSIGHTS

Investment Manager Toby Ross gives an update on The Scottish American Investment Company P.L.C.

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A Key Information Document for SAINTS is available by visiting www.bailliegifford.com

Toby Ross: 2020 was a year that I think many of us will be only too happy to forget, especially those of us who live in countries like the UK, which were particularly badly hit by the pandemic. For lots of us, it's felt like something of a stress test.

In investment terms, it was also a challenging year, but looking back on it, it was a pretty good year, in investment terms, for SAINTS. In this short video today, I'll talk a little bit about how the trust performed during 2020, and some of the things that drove performance. But I'll also discuss with you, some of the things that we think are going to matter for long term income investors over the next five or ten years.

A look back at 2020: The Great Dividend Crisis

2020 was a brutal year for income investors, particularly those in markets like the UK, which has been very reliant on the income from some mature, high yielding companies, which in many cases, came under immense pressure during the pandemic. The dividend stream from the UK market as a whole, actually fell by between 40 and 50 per cent in 2020, while global equity market dividends fell by around 15 per cent, so a really drastic drop.

As managers of SAINTS, over the last few years, we've put enormous effort into really stress testing the dividends of the companies we invest in, so that we understand how they would perform when the going gets more difficult. We didn't know that there was going to be a pandemic in 2020 or anything like that. But we did know that understanding how resilient our holdings would be during a period of stress was going to be important, because at some stage, there'd be a crisis that our companies would have to respond to.

All of that work and stress testing really proved its worth in 2020, because many of our holdings were able to increase their dividends. In fact, nine of SAINT's ten largest holdings, at the start of last year increased their dividends over the course of 2020, so that was really helpful to us.

Companies like Roche, the Swiss diagnostics and pharmaceuticals business, they were quick out the gates with developing diagnostic tools for COVID. In fact, within a few months of the pandemic starting, they developed over a dozen different diagnostic tests that governments and healthcare systems around the world were using. And then, towards the end of the year, they had two really quite ground-breaking therapies on the market as well. Because of the speed with which they responded, they were able to sail through the pandemic, operationally.

In another continent, Brazilian stock exchange operator, B3 actually increased its dividend by over 90 per cent last year, and that growth was very helpful to us. Because of those two things, the resilience we saw from our largest holdings, as well as strong growth from some of our companies, SAINTS, as a whole, saw the income from its equity portfolio drop by only around 4 per cent. So, a much more robust performance than if we'd invested in global markets, as a whole, or particularly the UK market.

That covers the income side, but because our companies both were on the front foot, delivering growth and delivered resilient income streams, they were also rewarded well in capital terms. Over the year, the equity portfolio delivered just under 16 per cent as a total return, which was a bit ahead of equity markets.

That was particularly helped by strong growth delivered by some of our Asian holdings. Companies like TSMC, the Taiwanese semiconductor manufacturer, whose competitive position was vastly strengthened over the course of the year, or ANTA Sports, the Chinese sportswear business. In general, being exposed to Asia, where life was a bit quicker to get back to normal, that turned out to be very helpful last year.

SAINTS's equity portfolio represents over 90 per cent of their net asset value, so it's the main driver of returns over time. However, we can also invest in other income generating assets, and today the bulk of that is invested in a commercial property portfolio that's managed by a specialist in that area, called OLIM.

Now, OLIM have been doing exactly the same high grading work on the resilience of the portfolio that we've been doing on the equity portfolio. And because of that focus on really high-quality resilient tenants, we've avoided areas like offices or high street retail, that have really come under a lot of pressure during the course of the pandemic.

And generally, the rental experience has been good, and we benefit from having very long duration leases. Our average lease length is around 15 years, and many of those leases are inflation linked. Over the course of 2020, rental income actually rose by 2.7 per cent, and the capital value also increased modestly, which is in sharp contrast to many other parts of the commercial property market. Again, a very resilient performance from the property portfolio.

A resilient performance
It's really those two things, the strength of the equity portfolio and the resilience of the property portfolio, that mean in a challenging year, SAINTS's net asset value per share actually rose strongly by 13.9 per cent. And the earnings per share only fell by around 4 per cent to 11.4p.

Now, one of the benefits that SAINTS has as an investment trust is that it can accumulate revenue reserves in the good times, and use them to support the dividend stream when the going gets more challenging. And that's exactly what the board did during 2020. The board was able to use some of the revenue reserves, and pay an increased dividend of 12p, so that's an increase of just ahead of inflation, of around 1.1 per cent.

And even having done that, we still have very strong reserves set aside for future years, so the revenue reserves today are equal to around seven months of dividend payments. So, we're still in a very strong position to keep on growing the dividend, ahead of inflation over time.

Questions for the next 5-10 years

So that's 2020, but where should our attention focus looking forwards? The experience of investing through the pandemic has really brought home to us, the importance of investing for long term income, not for short term yield. What do we mean by that? Well, lots of the companies that income investors have traditionally turned to, so the high yielding, more mature businesses, they've really struggled during this environment, and we think will continue to do so.

Often asking the question, what's the yield on this stock going to be this year, just isn't the right question. You need to be looking forwards to, how well is this company going to be positioned in five- or ten-years' time? To do that, there are three questions that we think are really worth long-term income investors asking themselves.

Firstly, is this a company of the future? Is it a company like Novo Nordisk, which is in our portfolio, which is one of the leading diabetes treatment manufacturers, but it's also pioneering a new generation of anti-obesity drugs that could help millions and millions of people in the future? Really pioneering in that space.

Or Albemarle, which is one of the leading producers of Lithium, which is going to be an absolutely vital commodity for the transition to electric vehicles. We think investors are much better off in these companies of the future than they are in companies that are struggling to deal with the legacies of their past.

Secondly, is the company led by a dynamic, adaptable management team? Again, we saw during the pandemic, what a difference it makes to have a driven management team at the top, who are nimble and can adjust to changes in the environment quickly, and deal with an uncertain time. Companies like ANTA Sports, the Chinese sportswear manufacturer, where they were able to bounce back from the pandemic really much more quickly than their competitors.

Finally, is this company capable of paying truly sustainable dividends? And by that, we think investors need to look a bit more broadly than just at some of the narrower financial metrics that they've looked at, and consider, does this business have big inherent sustainability challenges that are baked into their business model, that the company's going to have to address? Because often, if it does, then it's just not going to be a sustainable dividend pay-out over the long run.

We saw that last year, with companies like BP and Shell, that are having to make big pivots in their business model. We think that's going to be a theme that comes up again and again over the coming years.

So, those are three questions we're asking ourselves for both our existing holdings and the many new ideas we look at in any year.

These are some of the questions that we're asking both of SAINTS's existing holdings and the many new ideas that we discuss every year. We're excited by many of the opportunities that we're finding, and we look forward to telling you much more about the companies that we think are going to underpin dividend growth at SAINTS for the next decade.

Hopefully, we'll be able to do that in person, but until then, thank you again for the time today, and for the trust you've placed in SAINTS, and we hope you and those close to you stay well.

Share Price Performance to 31 December each year

	2016	2017	2018	2019	2020
Scottish American Investment Company P.L.C	28.7	17.2	-1.6	25.1	12.0

Source: Baillie Gifford & Co, Morningstar and underlying providers.

Dividend Performance to 31 December each year

	2016	2017	2018	2019	2020
Total dividend per ordinary share (net) – (pence per share)	10.825	11.10	11.50	11.875	12.00

Source: Baillie Gifford & Co, Morningstar and underlying providers.

Past performance is not a guide to future returns.

SAINTS invests in overseas securities and changes in the rates of exchange may also cause the value of your investment (and any income it may pay) to go down or up.

The trust invests in emerging markets where difficulties in dealing, settlement and custody could arise, resulting in a negative impact on the value of your investment.

SAINTS has some direct property investments, which may be difficult to sell. Valuations of property are only estimates based on the valuer's opinion. These estimates may not be achieved when the property is sold.

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The trust can borrow money to make further investments (sometimes known as "gearing" or "leverage"). The risk is that when this money is repaid by the trust, the value of the investments may not be enough to cover the borrowing and interest costs, and the trust will make a loss. If the trust's investments fall in value, any invested borrowings will increase the amount of this loss.

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