Baillie Gifford™

European Equities
Q2 investment update

July 2024

Investment manager Christopher Howarth and investment specialist Thomas Hodges give an update on the Europe ex UK and Pan Europe strategies covering Q2 2024.

Your capital is at risk. Past performance is not a guide to future returns.

Thomas Hodges (TH): Welcome to this quarterly update video covering the European Equity Strategy. My name is Tom Hodges, I'm an investment specialist covering the European team and I'm joined today by Christopher Howarth who is an investment manager on the European team. And today we're going to run you through performance and also what we've been doing in the portfolio.

So, kicking off with performance, you'll have noticed that we underperformed in the second quarter. And while this is disappointing, we have to reflect on how that's been driven. And it was driven by a few large holdings seeing some share price weakness. Those companies, which are Dutch payments company Adyen, Ryanair, the European airline, and Sartorius Stedim, which is a bioprocessing equipment manufacturer, whilst the guides that they made, the results that they issued have led to them seeing some share price weakness, we actually think that the outlook looks a lot brighter. And that's because, you know, we need to remember that the map is not the territory. Perceptions don't always equal reality. So, if you take Ryanair to begin with, Ryanair has issued a fairly soft summer fare growth outlook. But if you put this in the context of how fares have grown quite significantly since COVID, as you probably well know from booking flights, and how there is a real structural supply and demand imbalance in the airline industry at the moment. The outlook for Ryanair's pricing power looks very, very strong. And the fact that it's grown capacity since Covid should enable it to take market share. So this looks very strong in the short, the medium and the long term for Ryanair.

And if you take Adyen, which saw its take rate fall in its quarterly results, this was actually largely due to scaling up a new customer. So it actually reflects a business win, which will be supportive for volume growth. And over time, they will be able to continue to maintain their premium take rate just on the virtue of the fact that they have a really strong technology platform and they create a lot more value for the customers that they support.

And then in the case of Sartorius Stedim the long term looks really strong but in the near term they've seen some demand weakness and demand volatility so the orders that they were receiving haven't improved sequentially as the market would have liked after a really poor 2023. But the long term looks really strong because it's supported by the growth of the biologics drug industry. Biologics, which are more targeted, more personalized drugs, they're expected to outpace the growth of the broad pharmaceuticals industry quite significantly over the coming years. And in order to develop them, you need bioprocessing equipment, of which Sartorius Stedim is one of the leading producers, and therefore they should be a disproportionate beneficiary of this.

And of course, there were positives for the portfolio over the quarter. Spotify continues to perform really well. have noticed that they might have pushed through a price increase in your subscription. But the fact that they've done that without much attrition shows how strong the product is and how it's created a product that customers love. And the pricing power that they're starting to exhibit should support their progress towards becoming a profitable company. And then Hypoport, which is a German mortgage origination platform, that continues to perform well as we start to see German mortgage volumes tick up after a really weak period.

But probably one of the best ways to test whether perceptions meet reality is to get out there and to meet companies on the ground. That's exactly what Christopher has just been doing. Christopher, you've just come back from Poland. So maybe you can talk to us about your trip, the types of companies that you saw and your takeaways.

Christopher Howarth (CH): Yeah, so I went to Poland for about three days with a colleague from another team at Baillie Gifford. And over that time, I met a variety of different Polish businesses from a video gaming company to some construction businesses and to mines as well. So it was a real kind of mix of different companies. And one of the things that you immediately notice about Poland is how much construction work and how much general kind of progress it feels like there is taking place. Now Poland is a really remarkable country. It's grown at mid to high single digits since basically the fall of communism in the early 90s. And it's not a country which people often associate with growth stocks. Often we think of the industrials of Germany and Sweden or the luxury houses of France and Italy, but actually Poland has now got a growing group of very exciting businesses. So this was a really good opportunity to go out there and to meet businesses and to get insights that you wouldn't necessarily get from looking at a business's annual report.

TH: And I know you went and saw a company which is focused on groceries for rural Poland, which is quite niche. And it's a company you followed for quite some time.

CH: That's right. So this is probably one of the stranger investment trips I made was into rural Poland to visit and tour a range of discount supermarkets. So Dino Polska was a business which I first encountered a couple of years ago when screening for businesses with phenomenally high returns on capital. And what it does is it opens a new store almost every day. It generates incredible returns which it puts straight back into, reinvests into organic growth. It's a family-owned business and it is taking huge amounts of market share within Poland. So I met them, I met one of their leading competitors and at the same time there's been quite a, there's been a bit of fear in the market around deflation, which has suddenly hit Poland. And this has caused a lot of the stocks in the sector to derate. So this actually gave us a good opportunity to take a position in this company.

TH: And that becomes our second Polish holding.

CH: That's right. So we currently own another business called Allegro, which is sometimes described as the Polish Amazon. It's an e-commerce marketplace which about 53 per cent of Polish households use regularly. And Allegro has demonstrated surprising resilience in the face of competition from the likes of Amazon, from Temu, the Chinese retailer. And Allegro has managed to really entrench its position in the Polish market. And we're confident that it will continue to hold its own over the next few years.

TH: But changing tack very significantly to another company that we've owned, it's quite high profile, it's in the news, it's on the podcast, it's everywhere. We've taken a position in Novo Nordisk, so perhaps you could take us through why we've decided to take a position at this time.

CH: So Novo Nordisk is a fantastic business. It's undoubtedly one of Europe's finest pharmaceutical companies. Taking a position is a somewhat bittersweet moment for us, given that this is a company which we have historically owned over many years, and we finally decided to sell it several years ago over concerns around insulin pricing, amongst other things. In the intervening period, Novo Nordisk has surprised investors by revealing that one of its primary diabetes drugs also happens to be an incredible treatment for obesity, which has opened up an entirely new market and paved the way for many more years, potentially decades of growth to come. So while this does mean buying back into a stock which has gone up, which is always a very painful experience, we believe that actually the fundamentals of the investment case have changed and there's very material upside to come. Now, while the stock has re-rated, we believe that actually it's in the 30s as a price earnings multiple, but actually growing in the double digits. I think over 20 per cent earnings growth, it doesn't take many years for that multiple to come down significantly. So we believe that there is still plenty of upside on the table.

TH: And to fund these purchases, we've made some sales over the quarter. Adidas and Delivery Hero.

CH: That's right. So Adidas has been a stalwart of the portfolio for many years. It's had a few tough years recently, partly relating to Russia, partly relating to their partnership with Kanye West, but the new CEO has led a remarkable turnaround and the recovery in share price has given us a good opportunity to take some money off the table. Delivery Hero has unfortunately been a disappointing investment. We had high conviction in the success of food delivery, which is a consolidator of food delivery apps. Unfortunately, that hasn't played out as planned, and their competitors have shown a willingness to throw cash at taking market share, even when this has destroyed value for the industry. So we've decided that we're going to exit this position and put the money into other ideas.

TH: Well, thank you, Christopher. And if we're just to sum up quickly, whilst we underperformed over the quarter, we still think that there's reassuring signs of a really much brighter outlook for the companies which drove underperformance. We've taken new positions in companies like Dino Polska and Novo Nordisk, and we've sold positions like Adidas and Delivery Hero. But we'd like to really re-emphasize that we think that European growth investors are in a really strong position currently. We have secular growth continuing throughout the portfolio, whether that's the growth of biologics drugs, which we mentioned earlier, whether that's the semiconductor cycle beginning to pick up again. But we also have more cyclical tailwinds with optimism returning to the European economy and that really filtering through into company results. And this is all happening at the same time that valuations, we think, remain quite attractive. So all three aligning at the same time, we think makes for a really potent mix and we're feeling incredibly optimistic for the future. So with that, we would like to thank you for your time and we hope for you to join us next time.

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European Equities (including Europe ex UK Equities and Pan European Equities strategies)

Annual past performance to 30 June each year (net%)

	2020	2021	2022	2023	2024
Europe ex UK Equities Composite	21.4	51.5	-46.1	-17.6	6.3
Pan European Equities Composite	9.8	49.8	-46.5	19.1	4.6
MSCI Europe ex UK Index	-2.3	37.1	-20.7	25.6	12.3
MSCI Europe Index	-6.3	35.8	-17.0	22.6	12.4

Annualised returns to 30 June 2024 (net%)

	1 year	5 years	10 years
Europe ex UK Equities Composite	6.3	4.4	4.9
Pan European Equities Composite	4.6	1.9	2.8
MSCI Europe ex UK Index*	12.3	8.4	5.5
MSCI Europe Index	12.4	7.8	4.8

*FTSE World Europe ex UK prior to 31 December 2016.
Source: Baillie Gifford & Co and MSCI. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.

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