Baillie Gifford™

European Growth Trust: manager insights

January 2024

Investment manager Chris Davies discusses performance, portfolio positioning and why the Trust continues to seek fast-growing companies that prioritise long-term growth over near-term profits. He also explains why the allocation to private companies is an important point of differentiation for the Trust.

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

Hi, my name is Chris Davies, and I'm one of the investment managers of the Baillie Gifford European Growth Trust. Conveying a message of optimism feels quite counter-cultural these days, but this is exactly what I want to do. In this short video, I will discuss performance, what we're seeing from companies, give an update on our private companies and finally explain why this environment suits us as growth investors.

Performance

2023 has been a poor performance year for us and our clients. Conditions have certainly not favoured our style of investment, with risk appetite at a low ebb and the feeling of uncertainty shortening investment horizons for many. This has led to several strongly negative reactions to company results for highly profitable companies with long growth runways, like Adyen in payments and Sartorius Stedim in bioprocessing, both selling off due to near-term disappointments.

We're much less worried. The portfolio has had longstanding exposure to fast growing companies which have prioritised long-term growth over near-term profits, which has sometimes detracted from performance, even as those companies have made material progress towards their goals.

In some cases, such as video games company Embracer and renewable investment company Aker Horizons, we have judged that the odds have been stacked against sustained progress by the shift in the economic environment and have sold them as a result. We will always make some mistakes.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

79756 10042649

But our mantra throughout this period for companies has been "don't waste a crisis", and what has been pleasing is that most companies in the portfolio certainly aren't. Operational performance has generally been good, and we are seeing many affirming signals that our companies are taking advantage of this environment, investing while peers retrench, carrying out acquisitions, and buying back shares.

For example Spotify, the audio streaming platform, has begun to reduce its costs, and is beginning to see the fruits of its investments of the past few years, something which we believe should result in higher profits – this ought to be a high return business given the lack of capital involved. Allegro, a Polish ecommerce marketplace, has been leveraging its scale and competitive edge by increasing prices for its services, while peers such as Shopee exit the market.

Meanwhile Topicus, a serial acquirer of vertical market software businesses, is continuing to spend almost all of its cash flow on acquisitions, generating high growth rates as it consolidates this very fragmented industry. Low-cost airline Ryanair is gaining share across the board and enjoying some of its best years. It even recently announced the introduction of an ordinary dividend, permitted by the company's tremendous cash generating capacity.

Now, stock markets have been volatile – far more volatile than the underlying fundamentals of companies. We've been taking advantage of such dislocations, making several opportunistic purchases of structurally advantaged growth companies trading at appealing valuations. These include French semiconductor business Soitec, whose performance engineered substrates are critical components for the semiconductors we need in our phones and electric vehicles, and German company Hypoport, whose mortgage origination platform, EUROPACE, is allowing mortgage brokers to gain share in the German mortgage market from traditional banks. We've also added luxury companies LVMH and Moncler, one stalwart and one upstart, which we believe should both be able to compound earnings at attractive rates for a long time.

Portfolio update

We think the portfolio is attractively positioned, something which bears out in the portfolio's characteristics. Based on consensus estimates at the end of October, the portfolio is expected to deliver over four times the revenue growth of our benchmark index over the next three years, while the portfolio's earnings growth over the same period is expected to be more than double that of the index. These levels of growth are not going to be generated via a debt binge either, with the portfolio's net debt-to-equity ratio standing at 0.3 times, versus 0.5 times for the index. Meanwhile, the portfolio's forward price-to-earnings multiple[1] has contracted from 32 times in December 2019 to 18 times in October [20]23. So, our companies have stronger growth prospects, stronger balance sheets and are trading at attractive valuations.

One of the biggest points of differentiation for our portfolio is the allocation to private companies which stands at around 11 per cent. We think giving investors low-cost access to

[1] The forward price-to-earnings ratio is a stock valuation metric. It divides the current share price of a company by the estimated future ("forward") earnings per share of that company.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

private companies that would otherwise be unavailable is an attractive proposition. Companies are staying private for longer, and many of them are in the fortunate position to be able to choose their investors.

We think our reputation as long-term growth investors, and our ability to invest in both private and public markets, mean we are advantaged when it comes to accessing companies. As a result, we've been able to invest in some of Europe's fastest growing, innovative private companies, such as Northvolt, Europe's battery champion which is rumoured to be turning public in 2024, sennder, a digital road freight forwarder, and most recently, Bending Spoons, an Italian software company with a unique approach to monetising apps. We're excited to be able to offer investors exposure to these companies which have exceptional potential payoffs.

Outlook

We have underperformed over the past two years – this is irrefutable. Interest rates have risen, and valuation multiples have fallen – this has hurt us. While we continually ask ourselves what we could have done differently, Baillie Gifford has been managing European portfolios since 1985 and has experienced poor performance before. Many of our most successful companies have been through similarly difficult bouts. Just as those companies did, we emerged from each one in a stronger position.

Looking to the past is for learning lessons while looking to the future helps us grasp opportunities, and with that perspective, we are in a bullish mood. The companies we invest in typically grow faster than the index and we would expect this to continue for far longer than five years because of the secular growth trends they benefit from.

We believe that they are of higher quality, have unique corporate cultures, have a preference for low or no debt, and are run by some of the best capital allocators in Europe, which makes them both resilient and opportunistic in difficult times. This, to our minds, makes for an attractive combination and puts the Trust in a strong position to deliver the returns its shareholders would expect of it over the long term.

Annual past performance of The Baillie Gifford European Growth Trust to 31 December each year (net %)

	2019	2020	2021	2022	2023
Share Price	16.9	64.8	4.2	-41.4	10.4
Net Asset Value	15.0	45.4	13.4	-35.2	8.4
FTSE Europe ex UK Index	21.3	7.8	17.6	-9.4	15.7

Source: Baillie Gifford, Morningstar and FTSE. Total return, Sterling.

Past performance is not a guide to future returns.

Important information and risk factors

This film was produced and approved in January 2024 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

This communication does not constitute, and is not subject to the protections afforded to, independent research. Baillie Gifford and its staff may have dealt in the investments concerned. The views expressed are not statements of fact and should not be considered as advice or a recommendation to buy, sell or hold a particular investment.

The investment trusts managed by Baillie Gifford & Co Limited are listed UK companies and are not authorised or regulated by the Financial Conduct Authority. The value of their shares, and any income from them, can fall as well as rise and investors may not get back the amount invested.

Baillie Gifford & Co and Baillie Gifford & Co Limited is authorised and regulated by the Financial Conduct Authority (FCA).

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The specific risks associated with the **European Growth Trust** include:

- The Trust invests in overseas securities. 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.

- Unlisted investments such as private companies can increase risk. These assets may be more difficult to sell, so changes in their prices may be greater.

- 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.

- Market values for securities which have become difficult to trade may not be readily available and there can be no assurance that any value assigned to such securities will accurately reflect the price the Trust might receive upon their sale.

- The Trust's risk is increased as it holds fewer investments than a typical investment trust and the effect of this, together with its long term approach to investment, could result in large movements in the share price.

- The Trust can make use of derivatives which may impact on its performance.

- Share prices may either be below (at a discount) or above (at a premium) the net asset value (NAV). The Company may issue new shares when the price is at a premium which may reduce the share price. Shares bought at a premium may have a greater risk of loss than those bought at a discount.

- The Trust can buy back its own shares. The risks from borrowing, referred to above, are increased when a trust buys back its own shares.

- The aim of the Trust is to achieve capital growth. You should not expect a significant, or steady, annual income from the Trust.

Further details of the risks associated with investing in the Trust, including a Key Information Document and how charges are applied, can be found in the Trust specific pages at **www.bailliegifford.com**, or by calling Baillie Gifford on **0800 917 2112**.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com