Baillie Gifford™

Global Discovery manager update

September 2023

Head of Global Discovery Douglas Brodie joins investment specialist Bill Chater to discuss the drivers of recent performance, holdings' operational developments, portfolio positioning and outlook, and thoughts on economic areas witnessing structural change.

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

Bill Chater (BC): Hello. Thank you for joining this update on Global Discovery. The presentation will focus on the broader Global Discovery Strategy but will draw some specific examples from its associated pooled vehicles. Although these vehicles are all managed by the same team with the same approach, please bear in mind that not all vehicles may be available in all jurisdictions. Also, before we begin, please note that this session is being recorded. We run these update webinars every six months. The previous one took place with Svetlana Viteva in February. The recording of this is available on our website.

But for today's update, I'm delighted to be joined by Douglas Brodie, the head of the Global Discovery team. Over the next 45 minutes or so, we will provide an update on the strategy, focusing predominantly on recent performance, positioning, and our outlook from here. The body of the update will be around 25 minutes or so, leaving 20 minutes for audience question and answer. So, please submit your questions in the textbox at the bottom of the screen throughout.

So, as an introduction and a scene-setter, Douglas, could you please summarise Global Discovery in just a minute or two? Also, after a period of poor performance in which the environment has changed so much, whether it be inflation and aggressive rate cycle, concerns around deglobalisation, in light of all of this, what gives you the confidence to think that this approach remains relevant?

Douglas Brodie (DB): Good morning to everyone. So, maybe just to refresh, we set up the Strategy back in 2011, really with the aim of maximising the advantages of long-term investing lower down the market cap scale. And really, the driving force behind that was that the technology and innovation, they were driving a new wave of business creation and some fantastic growth opportunities for entrepreneurs to exploit. And we saw a swathe of digital technologies that were hitting, creating exciting opportunities in a real host of areas. And that's very much still alive, so that broadening of the frontiers of innovation, the deepening of the frontiers, that was present then when we set it up, and very much present now.

And really, the challenge for us, as it was then, was: could we build a portfolio that gave our investors really the ability to participate in that change? And I think, more explicitly, get into these dynamic companies when they were young, early on their path, and crucially retain them as they drove. So, for us, it was very much smaller company investing with a twist, and that twist was a very heavy transformational growth angle to how we grew those companies.

And ultimately, what we were trying to exploit, as we've pulled up on the slide here, is that extreme investment asymmetry that you can access as you come down that market cap scale. And in that time, in that intervening 12 years, we've stayed true to that path, and I think there's probably two key lessons and things that we've learned in that time that I'd be keen to highlight.

So, we now have a portfolio that I think is more seasoned. It carries a broader spread of maturities, and we've got greater examples now of where we've done very well in businesses, and we've recycled that capital back into earlier-stage ideas. And we have a whole swathe of learnings, both in terms of the companies themselves, the industries that they operate in, but also really how to analyse these companies, and how to crucially think about how they de-risk, and how they scale, and how to aggregate them into a portfolio.

And look, to your point of relevance, I get why people ask that, but absolutely, this is still relevant. We work in that sort of finance industry where everything is made up of different cycles, be it business cycles, economic cycles, interest rate cycles that people like to talk about at the moment, stock market cycles, growth versus value cycles, political cycles. And each of these has its own characteristics and its own duration that maybe lasts months to a couple of years. And most of them, frankly, they ebb and flow with the pace of activity in the broad economy in society at large, but I'd almost put them to one side.

And a strategy like ours is linked to what I think are the longest, most enduring of all these cycles, those that really result from technology and classic innovation, which I think is separate from invention, but innovation and ingenuity. This is the real driver, it's that problem-solving capability that is present in society at large, and the pace of that can oscillate, but it's always there. And so, as long as the world has problems to solve and there's entrepreneurial people out there willing to solve them, then yes, a strategy like this has relevance. And that relevance is reflected, I think, in the long-term returns that should endure, as well.

BC: Okay, thank you very much for that. So, let's now chat about recent performance. Douglas, could you just please share your thoughts on what's driven recent performance, I guess particularly since the beginning of 2023?

DB: It's been a challenging time for us. I think it's been a challenging time for lots of growth investors, and plainly that isn't what we hope for, and we recognise very much that's difficult for clients that have backed us with that. But maybe if we reflect upon the last 18 to 24 months, clearly the big headwind has been inflation, interest rates, and that sort of narrative that I think has dominated stock markets. We've discussed that before, so I'll keep my comments on that relatively brief in this context.

And I don't want to gloss over it too readily, but frankly, a lot of that feels in the rear-view mirror. The distortions to supply chains largely washing through, inflation we think broadly trending down, central banks having restored elements of their credibility, etc. But I think the market really struggles to shake that off as the dominant theme that it really wants to dance to here, so you're in this weird sort of paradoxical situation at the moment where bad economic statistics, be it jobs-related, GDP-related, is almost treated with glee by markets. It means rates might come down faster, and the confidence of that is true. Good economic data is treated badly. And for me, that almost just in a snapshot captures just how far fundamentals have fallen off the radar.

And I think when the stock market is almost forced to look on a bottom-up basis and really get back to companies and their prospects, the time horizons here have been so condensed down to the short term. So, as growth investors, what really excites us is where these companies that we invest in will get to on a minimum three- to five-year view. Frankly, that's where we earn our crust, is: can we see things out on a timeframe that people don't like to conventionally go through? But what you tend to find at the moment is in so many cases that we see, it's the next 18 months that is viewed as being of paramount importance. And anything that works to a timeline that we're consistently working to just, quite frankly, doesn't get much airtime, doesn't get much agenda in terms of the debate.

And we see that time and time again, and to pick out Ocado towards the start of the year in terms of that. We've seen that more recently with Novocure. And in many ways, that has lots of ways in which it manifests to us, and probably the easiest one to see would just be the heightened volatility, the dispersion of returns that we've seen in the portfolio between the winners and the losers feels particularly extreme. It's an environment of quite exaggerated reactions. I think there is a heavy skew towards retail and trading flows in many of these businesses, and I think a broad sense that a lot of institutional money is just riding this volatility out, but really isn't driving it or really contributing to it.

BC: Okay. So, if that's the broader context, then, you've mentioned a couple of holdings in that last answer, but I wonder if we could just delve a little bit deeper into that, and you could outline what you're seeing and hearing from the portfolio holdings. And within that, if you have a feeling about how the aggregate portfolio is performing operationally, and then if there's any holdings which have surprised either to the up[side] or the downside since the turn of the year.

DB: Yes, sure, I'll happily try and do that. So, in general, we feel good about the portfolio in aggregate positioning. And if you look at that very high-level in terms of some of the metrics that we could talk about here, for me, the growth outlook is impressive. I think there is a marked step up in projected profitability. And some of that we always see, that's just the natural flow of these businesses as they progress, as they grow. In many cases, some of these companies have used the current environment to get fitter, to get leaner. And these businesses, for us, they tend to have very high gross margin structures. They skew towards companies with strong recurring revenue dynamics, they are intrinsically scalable, they have very robust balance sheet positioning. So, if you factor that in alongside the growth, we think these valuations in aggregate look undemanding for where we are on the quality companies that we've got access to.

And while that data is helpful in itself, that's projecting out three years, and that notional three-year period, yes, it's important, but where we think these companies can get to beyond that is probably equally, if not more, important for us. But to your point around picking out a few names, strong performers year-to-date, I'd highlight Schrödinger, actually, in that regard. So, Schrödinger is a relatively new position for us. We're really attracted to their core offering around computational small molecule drug design, really taking the core principles of physics around how atoms and bonds behave and co-defining that into predictive software that can design molecules. And the fidelity with which they can do that, I think, is staggering.

And when you combine that now with the scalability of machine learning and just being able to chuck multiple structures through this, it's really impressive. And the business, frankly, has gone [from] strength to strength. We see that reflected in the growth of their own pipeline, more interest from pharmaceutical partners who they either develop drugs for or sell software to. But fundamentally, I think this boils down to mounting evidence that using these in silicone techniques, you can design better, cheaper drugs, and personally I've been staggered as to how that area has moved, and quite so quickly. Myself and my colleague visited the company earlier in the year, furthered our understanding of that one, and we subsequently added to the shares. I think they've doubled year-to-date or so.

I've been meaning to pick out a few others. Encouraging progress at Zillow, actually. I know a lot of people ask about Zillow. They are taking significant share in that real estate marketplace in what are undeniably tough markets. And I think that the bit that people are missing with that, they are making great progress of really adding in value-added services across that whole flow chain of transacting in houses, and really enforcing that. And so, very interesting monetisation opportunities for them in time.

I'd also pick out some companies where we've actually been incredibly impressed with how they've used this difficult environment to get operationally fitter, to improve their metrics, to improve their cash flow. Exact Sciences stands out in that regard. More recently, I'd actually put Upwork in that category, as well. But again, we have some companies that kind of dance to their own tune in terms of their end demand dynamics. And yesterday we had AeroVironment reporting, one of our larger positions, they do unmanned drones primarily for a sort of military surveillance opportunity, and here the demand for their product has been stellar, and you're looking at a company that's got the most exciting order book and product development pipeline it's had in a long time.

You know, we have had some negatives. I think some of them are fairly obvious. Probably the most high-profile one would be Novocure, where we've had a real mixed bag of clinical data from them. So, Novocure is the company that does the device for slowing down and arresting cancer cell development. And maybe save aspects of this for the Q&A if people want to get into the details of it, but it's one where we've seen some real intriguing evidence around how their technology recently combines with immuno-oncology drugs.

And just a bit of context around that, immuno-oncology drugs, the likes of Keytruda, etc, have become one of the biggest-selling categories of drugs. In many cancer types, they form the first line of treatment. And what we've seen with Novocure is, their device deeply synergises with that. There are commercial near-term challenges around how they actually get that to market, which patients groups they go into. That's where I referred to a mixed bag in terms of some of the data. But to a long-term investor here, the de-risking that we're seeing with that one feels very, very worthy. Now, proving up new modalities is hard, especially when it's cancer, and frankly, that is just not one disease. So, these products have to find their positioning in each of these cancer types and really work out where they fit into that treatment paradigm. But in a snapshot with that one, it's just indicative of how unforgiving the stock market is at the moment for any company that has even a minor blemish in terms of what it wants to achieve.

Other disappointments, I'd pick out Codexis as being disappointing for us. So, their core business, generating custom enzymes primarily for a pharmaceutical customer base, that has underwhelmed, ditto their aspirations in therapeutic enzymes, and it's sort of necessitated a period of rationalisation and focusing down on a narrower set of opportunities.

We had high hopes for STAAR Surgical with their Implantable Collamer Lenses for vision correction. And don't get me wrong, we still do, but the near-term ambition for them is to get that product into the US market. Historically, the vast market of where they've sold that has been Asia, and particularly China. The US approvals came through. Early attempts at commercialising that have hit what a lot of companies hit when they try and go into the US market. It's the perverse incentives, it's the challenges and the inertia. And I'd say we're comfortable with the progress that they're making to address that, and I think they are taking the right steps to get that.

BC: Okay, thank you. I wonder if I might ask you a bit of a broader question. In the recent period, we clearly acknowledged that we've made mistakes in elements of our research and decision-making. But in the spirit of continuous improvement and evolvement, Douglas, what learnings are you taking from that? And have there been any adjustments to the approach or the process to protect from something similar happening again, and better position us for the future?

DB: Yes, we never shy away from the fact that we will get individual stock calls wrong sometimes. It goes with the nature of the territory, particularly when you are looking at younger, less developed companies. It is the reason why we run a diversified portfolio. It's the reason why we talk about that asymmetry, that profile. But clearly, you don't come through a period like the last three to four years without quite deep reflections on what you could have done better, what did we as a team miss, what parts of our process and decision-making could we have had more robust? I think one that I've highlighted in the past, which is the difficulty in trying to predict some of these secondary and tertiary effects of the pandemic, and really having to very actively just weigh up so many different scenarios and just be open to some of those things.

I think one of the more interesting newer reflections for me, we were discussing this as a team recently, I think it relates to growth pressures that many of these companies were almost placing themselves under. It did have that era of abundantly available capital, stock markets that were very much actively rewarding risk-takings, almost like gung-ho investments by companies. And I think in some cases that led to growth initiatives in some business, some of which we owned, that ultimately failed to come through.

You could cite Zillow in terms of that, all the iBuying and open Zillow Offers business that they got. I think you could probably put Teladoc into that aspect, as well, with big Mergers & Acquisitions in a difficult Covid-type environment and trying to integrate businesses. Is there, in some of cases, maybe almost that ambition running ahead of the ability to execute? So, I think for us, the lessons around just being more questioning, what do companies' actions signal, and what's the motivating factor behind what they're doing? As opposed to just capturing it as growth, and growth is good. Be a bit deeper into the reasons of some of these things.

As you might expect, we field lots of questions about sell discipline, and I would say there was a recognition that we need to be more rigorous with enforcing risk-reward upside, especially when that risk-reward changes very quickly, as it did do for many of the stocks over that past two- to three-year period, either through rapid price appreciation or very big changes in the backdrop for those companies. And look, that would always be challenging for a strategy like ours. We are open-ended in terms of the growth we want from these businesses with classic blue-sky scenarios. We want to invest in companies where we will make multiple times our money.

So, risk-reward assessment is always dynamic in that regard, but typically in the past we've done that on an ad-hoc basis. As some of our businesses progress, we delve in. We did this multiple times with Tesla, running the risk-reward at various points in the ten years or so that we owned it. But could there be almost more formal points, more trigger points around when we intervene and run a formal review? Seeking to add more rigour to what is undeniably a hard exercise, but I think doing it in a way that retains the improvement behind the philosophy in why we own these businesses.

So, in the past, I actually think we've had a quite good valuation self-discipline, but that relates to businesses that historically have been further down their path of commercialisation. Businesses like Tesla, like Dexcom, which we've both moved on from, probably two of our most successful investments, frankly. And almost at that point where growth becomes linear, more able to be extrapolated, and the path to the end goal becomes more visible, can we take some of that rigour and bring that earlier into our process?

We're also introducing more stock-specific challenge from our internal risk team into our portfolio discussion meetings. We're engaging with them about holding sizes. So, yes, there's lots of work going on in that, and we are genuinely open to always improving what we do, and you learn lots in this business about the companies, how the world works, and you are constantly learning about how to manage portfolios.

BC: That's really great to hear. Another question that kind of almost tries to tie together quite a lot of what we've spoken about so far, just to put it bluntly, what do you think the market is getting wrong about Discovery? Or maybe if I phrase it slightly differently, what are you seeing in the portfolio, in the companies, that you think the market is missing, and gives you the confidence, then, that this can turn around?

DB: Yes, there have been multiple shocks to the system over the past three or so years. We all know what they are. It's been a difficult time to be an investor, to be a company, frankly. And I think to some extent, elements of that have impacted on broad investor psychology, somewhat understandably, maybe. Successful long-term investing is about tolerating periods of uncertainty, having an approach that at its core is optimistic, in its refinement has to be critical, it has to be sceptical, is has to be questioning, but it can never be cynical. It's very hard to be a cynical long-term investor.

And if you think about where markets are at the moment, there's very little tolerance of uncertainty. There's very little optimism, and what optimism there is feels very herded into a handful of tiny themes and companies. And frankly, there was a highly cynical attitude to companies wanting to build, wanting to transform. And almost as you come down that market cap scale, that becomes even more magnified. So, growth company investing is sort of what we do. It feels odd to even say this, but it feels kind of contrary at the moment. And given everything that we've seen, what's happening in technology, our observations of markets over multiple decades, that feels wrong.

So, what I think the stock markets overlooks with a portfolio like ours is, really, it's the long-term relevance of these companies. It's almost at the moment, it can be somewhat blindsided by the craving for near-term predictability. I think it gives scant regard to the deep scalability of these companies. They have a real recurring revenue asset-like model that repeats across our portfolio, and many platform-based companies with that intrinsic scalability. Now, I cannot in all honesty sit here and say when that prevailing rather toxic market psyche will change. Frankly, I'm not sure anyone can predict a timing point around market events like that and market psyche, but it will ultimately change. And in the intervening time, it will be the progress of these companies, the de-risking that they go through, that drives the portfolio forward. And that's frankly where we feel good.

I think another thing to flag would be, many of our companies feel like they've almost been through a period of consolidation, perhaps almost regrouping, building for the next wave to come, adapting to that new environment. I think many of them, personally, I think feel primed for interesting developments where almost like the market expectations are low, and frankly outdated in many cases. I pick Teladoc into that, actually. They've emerged now with a more unified offering. They've got the chronic care opportunity developing very nicely. Close to home, we have Ocado, so you've got the next-generation robotics about to hit. There's everything that they could potentially do now in non-grocery, which is the other 50 per cent of retail.

A company that we don't talk about that much, but I think is very interesting in that regard, would be LiveRamp. So, they provide identification solutions largely to digital media and the advertising industry, helping people get personalised ads, frankly. And you've had a huge explosion in the amount of data out there, but also the fragmentation of that data, especially customer-centric data, and that really creates a huge opportunity for a business like LiveRamp to help companies stitch that together, and really do that in a way where their core identification and authentication really shines through.

BC: Thank you. Now, one final question from me before we go toward an audience Q&A, a bit of a change of focus. One of the topics which has been a source of optimism, I think, and has really captured the market's imagination this year, has been AI (artificial intelligence). Many of the portfolio's holdings have referenced the impact of this new technology on their business, both in a positive way and also a negative way. I wonder if you could just talk about the work the team has done in this area, and how that's influenced your approach to these positions.

DB: Yes, it's definitely a hot topic, and I think rightly so. So, maybe just stepping back from it slightly, we've had multiple companies in our portfolio for years that have used AI in various contexts. So, the topic in and of itself isn't new. The new bit is these generative AI forms, particularly these local language models, and it's the ability to train these predictive engines on huge data sets, be it around languages, the knowledge implicit in the internet, on broad video content. So, as a result, you've seen this transition where AI has gone from being a narrow tool to use in very specific ways, to this huge general-purpose tool which has generated really novel outputs. That could be code, that could be novel digital media, it could be working entire workflows within businesses. And in the form of those local language models, the ChatGPT that I'm sure many people have played around with, it can create this sort of freakishly relatable user interface.

So, in that sense, I'd say general-purpose tools, they tend to accrue benefits to multiple players. They're available to everyone, so everyone gets to use them. In theory, these things, I think, should be quite impressive at raising the average productivity of a typical employee within a business. These things really are that good. But frankly, as stock pickers, I think the more relevant debate for us is around how these change competitive dynamics in industries. Who can use these tools to really drive their offering to the next level? And conversely, who is at risk from competitors stealing a bit of a march on them?

So, in that regard, I would view these generative forms of AI almost as an amplifier of competitive strengths, that those forward-thinking companies that have built deep, robust competitive advantages, that have mastered digital technologies, they will be the ones that are readily positioned to incorporate this. They will be the ones with modern, nimble architecture. They will be the ones that have been collecting the right data to train these models. And frankly, they'll be ones with the willingness and the capital to invest in them. So, I think that applies across many software companies, marketplace companies. Conversely, it'd be the companies that are poorly positioned that will be the ones that those dynamics work against them.

And we've been engaging with our companies to better understand the impact of this on them. And frankly, it is early days in terms of that. Some businesses, I think in the past we've probably discussed Chegg as almost being in the crosshairs of how these sort of dynamics play. But for many companies, it's actually very nuanced. So, I'd pick out examples where we can see clear additive benefits of this to our holding. So, we own a business called Appian, which has got a very strong position in automating complex mission-critical workflows with its customers. And we see great potential for them to embed all these forms of AI in that we need to understand context and generate high-quality responses, going from something that's semi-automated now, something that could in theory be fully automated. And, crucially for them, doing that in a way where a corporate doesn't risk the integrity and the security of their data. And I think that is actually something that's often mis-looked in how companies will have to engage with this.

We also own a business called Upwork, which is one of the leading providers of freelance talent, and it's interesting to see how generative AI and different forms of AI interact with that company. So, actually, one of the biggest bottlenecks in these forms of AI is accessing talent. One of the fastest-growing categories for them on their freelance platform is around AI expertise, particularly in that ChatGPT-trained area, but also you could think more broadly than that. They have thousands of freelancers across multiple product categories. How can Upwork introduce all these productivity tools into that base of freelancers, and then drive their offering to the next level?

Yes, so, there's a couple, but frankly, AI is a very interesting theme, and I genuinely believe that, but there's so many interesting themes in the portfolio at large. You could think about everything that's going on in areas of genomics. We've got companies that have the ability to write, read, edit DNA. There's everything that's going on from a genomics perspective. We've gone into therapeutics with Alnylam, one of our biggest positions, from a diagnostics perspective with Exact Sciences. There'd be another very strong theme around automation. I've mentioned Ocado and their environment in the past. They would fit into that. Multiple companies [are] attached to multiple interesting themes, and that's how we think about the portfolio at large.

BC: Super. So, we'll move on to the audience Q&A, and a question has come in to do with the funding of the companies within the portfolio. So, the question is, with the funds now significantly down from its peak and flows slowing, are the managers concerned about being able to provide funding to early-stage businesses which may be in a more embryonic point of development? And I guess, Douglas, if I can just broaden that out, I know you and the team have been conducting more analysis of the holdings' balance sheet strength and financial resiliency, so I wonder if this is a good opportunity to talk about that, also.

DB: Yes, I think it is. I've even got a slide, actually, that might help with some of that. So, we've been thinking about that portfolio at large from a resilience perspective. And this has been a very interesting, I think, piece of work for us to do, and I think it's also helped people understand aspects of our portfolio, because they'll often hear me or my colleagues talk, and they think that everything that we own is very early stage, deeply uncertain, high potential, but really risky. And people hear less that we like to own these business as they de-risk, as they grow, and as they thrive, and as they progress from being highly immature along that spectrum of maturity.

I guess we've always known that on the team, and a slide like this, I think, begins to evidence that. So, this is looking at the portfolio largely from an income cash-flow perspective, so we've tried to segment out the 60-plus per cent of the portfolio which we would say is further along that maturity spectrum, so having progressed to either earnings positive [or] free cash flow positive. These would be businesses where you could take that as a proxy for those companies being at their self-sustaining point.

We then have about 30 per cent-ish of the portfolio that would not be able to make that claim yet, but where we feel the underlying unit economics of these businesses are very much proven. And what they are doing is investing, often at scale, in either sales and marketing, or R&D initiatives, to really make good on that opportunity. So, at that point, yes, they are genuinely well-capitalised to do that, and companies where the unit economics are proven and the growth just has to be funded to get it to deliver, don't really feel in the crosshairs for that.

Where you do have exposure in this fund would be to what we call here the fledglings. These would be the companies generally earlier in that sort of prove-themselves-up stage, and that perspective where ultimately some of them will be dependent upon funding, but many of these companies are actually very well cashed up to deliver upon that, because you kind of break that out in the stats at the bottom there. So, it's really just to sort of ram home that message of there is a spectrum of maturities here, and yes there are some early-stage businesses, but we feel very comfortable with them being able to deliver upon that long-term potential.

BC: The next question is about M&A activity, and just whether you're seeing increased amounts of either Venture Capital or Private Equity firms looking to deploy capital into what now may be quite undervalued listed opportunities. And I guess the follow-through of that would be, is that impacting the opportunity set more broadly, or the portfolio as it has been?

DB: Yes, I think you are starting to see more of that. Valuations clearly have rebased, and there will undoubtedly be an element of private equity that seeks to exploit that sort of time dichotomy that stock markets are working to an 18-month agenda, and people with long-term capital to deploy can think longer-term than that. We've had a couple of our businesses being taken over year-to-date, both in that healthcare-related area, a business called Chinook Therapeutics, and Tabula Rasa [HealthCare]. Earlier in the year we had iRobot, as well. So, you are starting to see either strategic capital or venture capital come into these areas.

Personally, for me, I wouldn't point to that as something that I particularly like. It's a consequence of valuations having rebased, and perhaps opportunistic investing by others, and it's exploiting the aspect around stock markets that personally is quite frustrating. We don't buy our businesses and own them and retain them, keeping our fingers crossed that someone takes them out. It tends to mean the real long-term reason for owning that business, the benefit of it frankly will accrue to someone else, and that's generally not a good thing.

BC: Yes, Now, there's been a few questions coming in about valuations. I'm trying to group them together. I think people are having questions about the impact of rising rates and valuations within the portfolio, and whether that's prompted you to exit any of these positions, whether you sense there are areas of opportunity from it. And then people are also asking if it's adjusted how the team is conducting valuation within the process, and then also if that's an area that you are considering for making any alterations or changes.

DB: Having run this strategy for 12-plus years, we never built it around a view on interest rates. We are trained financial analysts. We get that discount rates set the value of future cashflows; equity values are linked to discounted values of future cashflows. The theory is sound, we get that, but trying to predict interest rates as value-added insight onto equity analysis is tough. And we've always taken a view [that], quite frankly, it's tough for people that specialised in fixed income instruments, and it's tough for central bankers. Everyone gets that stuff wrong, and then plays catch-up with it.

Us, our skillset is understanding growth. We are trying to invest in companies where the quantum of growth can be huge. Interest rates, look, I get that they flex models around valuation in the here and now. And I've always pleaded, with the time horizon like us, our holding period here is a decade, and I think people who invest in this fund need to be in a similar timeframe, minimum five years, how you think about these things.

And I've always said, if you can tell me the interest rate in ten years' time when I might choose to sell this business because it's delivered on its operational growth, at that point I'll bother to build deeply detailed models around interest rate sensitivity, and I'll finesse valuation models accordingly. But people can't do that, and the whole world of interest rates and fixed income genuinely just takes the here-and-now and deploys that with a bit of finessing as to what's the long-term assessment. We kind of see that, like with the US 10-year being a decent proxy for that.

So, yes, we don't flex the portfolio around that. I think where we are a little bit more conscious of it is almost like the hurdle rate around which you'd expect companies to deliver operationally is, I think, a bit higher. The appetite to fund businesses that would be very early and require multiple rounds of funding to get to a point where you could say, look, this is really working, that feels lower. That's more adapting to an environment which, yes, probably to some extent is influenced by interest rates, but frankly, I would get worried if around the team we started discussing interest rate policy and all these things that we don't bring directly into our process and seek to add value on.

BC: Now, the next question has been around competitive dynamics, and specifically how you decide between the different competitors within an industry, and how you do that in new industries that might be just forming or themselves emerging. I wonder if you could talk through that and how the team thinks about competitive dynamics.

DB: The topic of competitive edge is vast, and trying to, frankly, distil that down to two or three minutes is probably quite a challenge. Because companies, the really strong ones, they will build multiple layers into their competitive advantage. And almost as you think about how a company evolves, a very nascent company that has an idea, I think it has a solution to a problem that is going to resonate with the market. Can it find that initial product market fit? And frankly, in the early days, that will probably be determined by [the] quality of the vision, the quality of the management, the ability to access early funding. And it will be wrapped up, frankly, in can they get to that point of, can the product find market fit. And it will be a very product-centric service offering.

What you then tend to find, and I think where, as a long-term investor, you have to pay more attention, is to how is that product fit going to morph into a genuine business with long-term competitive advantage. Because someone can always come along, try and out-compete you on product, but can they come and out-compete you on your business and all its broader strengths? So, that will factor in aspects around [the] commercial model, can they build a platform, can they genuinely show network effects, can they develop a consumable business model here around a razorblade thing, can they lock customers in? There's a whole host of more commercial developments that come on the back of product-centric competitive advantage.

So, really, yes, across that whole thing, you're trying to go product and commercial advantage, wrap it up in a cultural advantage. And all of that, frankly over multiple years watching a business, allows you to build a real impression of a company's competitive strength.

BC: Now, I'm very conscious of time, but I'm going to try and squeeze one [more] question in, one final question if I can. And it's a stock-specific one of a company I know that you're very enthused by. One of the attendees has asked if you can provide an update on Oxford Nanopore.

DB: Yes, sure. So, again, just a little bit of context here, we own Oxford Nanopore in our team as a private investment in the Edinburgh Worldwide Investment Trust. So, we have followed this business closely since 2014/15, that sort of timeframe. We participated in the IPO when it listed. So, yes, we've got a pretty good timeline around this one, and the developments that they've done. Look, stepping back from share prices and IPOs and all that, almost just distil it down to, here is a foundational technology that can read DNA or RNA at any length in real-time. And it can decode that from a base perspective, and it can decode it in terms of all the methylation signals. It's an area of epigenetics that some people would talk about. There isn't a technology out there that can hit all these briefs at the price points that Nanopore can offer in that.

So, when you think about it in the round, where it got to, and this business has had to work at that. You don't flick a switch and get to that position. The R&D that has gone in here has developed the product and the capability that is increasingly finding relevance. And I think we saw that yesterday in the results from the company. They are getting real traction here at these high end-users. Everyone tends to default to Oxford Nanopore thinking about this little MinION device the size of a stapler, and that gets a lot of airtime, but where you're building your franchise here is around bigger higher-performance machines sold to labs that do lots of sequencing and are exploring what they can do with even more sequencing and all this extra data. There's a very obvious bridge for Nanopore to get into now, much more clinical applications.

I know they're hosting a capital markets day later in the year, and I'd be fascinated to see where they've got to with some of these developments. But yes, from a science perspective and a commercial perspective, I've been impressed with where they've got to and where I think they can get to.

BC: Thank you. Well, we've now run out of time, so we'll leave it there for today. I'll just thank everyone who's joined us for doing so, and Douglas, thank you for your time, as well. I wonder if you have any final comments or messages just to leave the audience with.

DB: Yes, it's really just to say thank you for your time, for your interest in the product. I fully appreciate this has been a difficult time but hoping in the context of that 45 minutes or so I've managed to convey the excitement around what we see out there, and how, given what's happened in markets, I think now feels an interesting time to explore some of these businesses.

BC: Very good. Well, that's a good note to end on. Thank you again, everyone. Enjoy the rest of your day and take care. Okay, bye-bye.

DB: Bye.

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

	2019	2020	2021	2022	2023
Global Discovery Composite	10.4	35.9	30.9	-46.7	-7.2
S&P Global Small Cap Index	1.8	-2.8	36.8	-11.3	8.2
MSCI ACWI Small Cap Index	1.1	-2.3	38.3	-10,7	8.5

Annualised returns to 30 June 2023 (net %)

	1 year	5 years	10 years
Global Discovery Composite	-7.2	-0.6	9.4
S&P Global Small Cap Index	8.2	5.4	9.7
MSCI ACWI Small Cap Index	8.5	5.8	10.0

Source: Baillie Gifford & Co and underlying index providers. Pounds sterling. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.

Past performance is not a guide to future returns.

Risk factors

This communication was produced and approved in September 2023 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact, nor should any reliance be placed on them when making investment decisions.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research but is classified as advertising under Art 68 of the Financial Services Act (‘FinSA’) and Baillie Gifford and its staff may have dealt in the investments concerned.

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

The images used in this communication are for illustrative purposes only.

Important information

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Person's resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Financial intermediaries

This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe

Baillie Gifford Investment Management (Europe) Limited provides investment management and advisory services to European (excluding UK) clients. It was incorporated in Ireland in May 2018. Baillie Gifford Investment Management (Europe) Limited is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. Baillie Gifford Investment Management (Europe) Limited is also authorised in accordance with Regulation 7 of the AIFM Regulations, to provide management of portfolios of investments, including Individual Portfolio Management ('IPM') and Non-Core Services. Baillie Gifford Investment Management (Europe) Limited has been appointed as UCITS management company to the following UCITS umbrella company, Baillie Gifford Worldwide Funds plc. Through passporting it has established Baillie Gifford Investment Management (Europe) Limited (Frankfurt Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in Germany. Similarly, it has established Baillie Gifford Investment Management (Europe) Limited (Amsterdam Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in The Netherlands. Baillie Gifford Investment Management (Europe) Limited also has a representative office in Zurich, Switzerland pursuant to Art. 58 of the Federal Act on Financial Institutions ("FinIA"). The representative office is authorised by the Swiss Financial Market Supervisory Authority (FINMA). The representative office does not constitute a branch and therefore does not have authority to commit Baillie Gifford Investment Management (Europe) Limited. Baillie Gifford Investment Management (Europe) Limited is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited, and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

Baillie Gifford™

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

10036772 59715