

Discovery

Q2 investment update

July 2024

Investment manager Douglas Brodie and investment specialist Bill Chater give an update on the Discovery Strategy covering Q2 2024.

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

Bill Chater (BC): Welcome to the Q2 2024 update on the Discovery Strategy. As a reminder, Discovery invests in a diversified portfolio of initially immature companies seeking to disrupt and transform attractive growing end markets. I'm Bill Chater, investment specialist for the strategy, and I'm joined by Douglas Brodie, lead fund manager and head of the Discovery Investment Team. Today, we'll update you on the portfolio, including notable developments at significant holdings and changes within it. But I think we should start with performance. Returns over the quarter have been muted and slightly disappointing. We've spoken about in the past the environment being quite unsupportive of our style of investing.

And Douglas, I wonder if you would be able to talk a little bit more about that, if there's been any changes over the quarter, and just really how you're kind of thinking about that in general?

Dougald Brodie (DB): Yeah, sure. I'd say markets are still in a state of flux. We're still in that sort of weird waiting game in terms of interest rates. You've got general elections in various countries around the world, and that's sort of dominating bits of attention. And I'd say there's some very dominant themes at play in equity markets. And those themes are kind of sucking in a lot of air and a lot of attention. And in certain areas, they're sucking in a lot of what I would call risk capital. And we see that very clearly in terms of some of the AI stocks, in terms of some of the healthcare GLP-1 driven stocks. So yes, it still remains a difficult environment for what we do.

And as a reminder, we look for these interesting, innovative, high growth businesses. And it's kind of weird to say it, but for me, that feels a very contrarian thing to be doing at the moment. That instinctively feels very wrong. We don't exactly know when that will turn, but we sense we're getting closer to that shift in the backdrop, partly because I think some of these themes have been pushed

very far, but also we're starting to see evidence of M&A (Mergers & Acquisitions) and big companies sniffing around these interesting smaller businesses that are largely ignored.

BC: Now, even within that environment, we've seen some really exciting, encouraging updates from our holdings. I just think it's worth you stepping through some of those.

DB: Yeah, happy to do that. And really just to sort of emphasise that that's what we believe is the long-term driver here. And as much as we can sort of hint around sentiment, it's the delivery by the companies. And one particularly close to my heart would be a company called Alnylam, which we've owned for a good number of years now. And we're really attracted to the real power potential of them to use their technology to turn down genes in the context of driving disease. And we had a very significant readout this quarter in one of their very high-profile trials where they were using that technology to turn down a gene that is a key driver in a particular form of cardiovascular heart failure that unfortunately impacts about over 300,000 people around the world. And they produced really stellar data in terms of that technology. Really, I think, making a very robust case that this should become the standard of care in that very underserved critical patient group. And the commercial dollars that we think will flow from that, we're talking multiple billions of revenue here. So that's really interesting in the context of Alnylam, but it's really that sort of, it's the confidence that it now gives them, the cash flows that it will give them to power forward with what we think is one of the most interesting pipelines out there.

I would also pick out American Superconductor, a smaller holding for us, but it's done really well. They are active in the area of helping companies and aspects of infrastructure tap into the grid from an electrical supply context. They do that with sort of wind turbines, with marine systems. You also see them do that in terms of critical infrastructure and tapping into that grid. It's very much in play with that renewables theme.

Other companies that have done very well would be Twist Bioscience, the maker of synthetic DNA. The cost and the speed with which they can produce that is allowing them to take outsized share. And TransMedics is another very interesting business that's really on a really sort of fundamental role in terms of the performance that they've driven. Very interesting organ perfusion technology to keep organs alive and building a sort of system and a service that's very market expansive. Better outcomes for patients and actually market expansive in terms of transplantation.

BC: Okay. Now, conversely, as will be the case anytime in a portfolio of, or within a portfolio context, there's other holdings which have hit speed bumps or have had challenges. I wonder if you could just talk about a couple of those that have occurred in the quarter, and particularly whether it impacts your longer-term investment thesis for those companies.

DB: Yeah, sure. As you say, you tend to get these from time to time. One I'd put in that sort of speed bump category would be Sprout Social. They do a suite of software to help companies with their social media presence across all the different big social platforms. And I think there's a couple of

aspects that have impacted on growth. And we're still talking a business that's growing comfortably north of 20 per cent here. But some of the changes that they've made in terms of price points and moving to bigger customers, the execution around that has been a little bit skewwhiff, frankly. And we think they're navigating those changes. So I'd put that in the sort of speed bump category.

Another one where I'd put in the sort of soggy share price camp would be Exact Sciences. And I think that that's more to do with fears of competitors entering into their core franchise of colon cancer screening, we've done a lot of engagement with Exact Sciences around this, and we're very much of the view that the quality and the cost of their test, combined with their extensive market reach, gives them a very robust franchise to defend from.

BC: Okay. If we change focus slightly, even within the context of our low turnover approach, there's been some changes within the portfolio. I see that there's been a handful of new ideas entered in over the quarter that look really, really interesting and exciting.

I wonder if you could just talk through some of the changes that you've made with a particular focus on a couple of those new ideas.

DB: Yeah, I guess I hinted earlier on that we've had a little bit of M&A (Mergers & Acquisitions) involving our companies. We had inbound interest for HashiCorp from IBM and Shockwave Medical from Johnson & Johnson. We've sold both those positions. We've also exited a number of holdings where I would say we had concerns about maturity and sort of lacklustre growth profiles for businesses like MonotaRO and M3, Stratasys and Chegg. We've been recycling that capital into, as you say, interesting new ideas. And first up, we have a business called Sweetgreen, a very high potential salad rollout chain, primarily focused on the US, where we think the product innovation, the rollout potential and the margin potential within this business really makes it stand out amongst a host of competitors.

I would also pick out a business called Raspberry Pi, close to home here in the UK, a very recent IPO. And the attractions there really come from their low-cost processing computer chips that they provide. Now, typically they've provided those to almost like the hobbyist and education type market, but those people eventually migrate and work in industry, in commercial settings. And they're taking this knowledge of this kit and embedding it in various industrial processes, almost the kind of processing brains behind various bits of equipment that you might see out in the real world or on the factory floor. And the ability also to embed within that sort of AI capabilities, tapping into that theme of internet of things, edge-based AI, we really think they're a very interesting business at the forefront of doing that.

BC: Fascinating. Now, final question from me. If we step back, frankly, it's been a frustrating period for performance. What's giving you optimism that this will soon reverse?

DB: I would echo back to what I was saying earlier on. This is a very distorted market as we see it. We think those distortions will not persist. We think there will be greater breadth to investor interest in where change is happening and which companies are driving that change. And we think history is on our side in terms of that.

I would also echo back to what I'm saying in terms of the companies, that's where we take our enthusiasm from. Everything that I'm saying in terms of Alnylam and the potential there, everything in terms of the new ideas that we're seeing and talking about. You know, we recently engaged with businesses like Zillow and PeptiDream, where, again, we're getting reinforced just the strength and the potential to build great businesses here is really being discounted quite heavily by the equity markets, and that feels wrong.

BC: Thank you, Douglas.

So, in closing, we acknowledge that recent returns have been disappointing, but we are seeing tremendous potential for the strategy. We have existing holdings making stellar progress with both accelerating portfolio growth and noticeable developments prompting a re-rating of holdings. Additionally, we're finding multiple intriguing and exciting investable opportunities for the strategy.

Finally, we just want to thank you for your time today and your continued support of the Discovery Strategy. Thank you. Goodbye.

Discovery (representing Global Discovery and Worldwide Discovery strategies)

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

| | 2020 | 2021 | 2022 | 2023 | 2024 |
|-------------------------------|------|------|-------|------|-------|
| Worldwide Discovery Composite | 32.4 | 43.3 | -53.1 | 0.4 | -10.0 |
| MSCI ACWI Small Cap Index | -5.1 | 54.7 | -21.5 | 13.6 | 11.2 |

Annualised returns to 30 June 2024 (net%)

| | 1 year | 5 years | 10 years | Since inception |
|--------------------------------|--------|---------|----------|-----------------|
| Worldwide Discovery Composite* | -10.0 | -4.3 | N/A | 3.2 |
| MSCI ACWI Small Cap Index | 11.2 | 7.8 | N/A | 7.1 |

*Inception date: 30 June 2017.

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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