Baillie Gifford™

UK Core
Q2 investment update

July 2024

Investment manager Iain McCombie and investment specialist Kathleen Hunter give an update on the UK Core Strategy covering Q2 2024.

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Kathleen Hunter (KH): Hello everyone, and welcome to our UK Equity Core update. My name is Kathleen Hunter, I'm an investment specialist with our UK Equity team and today I'm joined by Iain McCombie who is Head of our UK Equity team and lead portfolio manager on our UK Core Strategy. As a brief reminder, our UK Core Strategy is looking to identify some of the best growth businesses in the UK and then hold on to them over the long term. So at least five years.

So, Iain, shall we start with a bit of a scene-setter? The UK Core Strategy delivered a positive return over the quarter, but it was slightly behind the FTSE All Share. How would you characterise the market environment this quarter?

Iain McCombie (IM): Yeah, I think two things, Kathleen. I think we're still in a little bit of a holding pattern in terms of, you know, what's the next, what's going to happen next? There's still an element of wait and see. Now, we did have a pretty good result season in terms of companies who are reporting their kind of December year ends or just after, you know, January, February year ends. And the news has been actually pretty positive and companies are doing pretty well in a tough environment. And dare I say it with some of the trading updates we saw in the quarter, one or two possible green shoots, which I think is kind of interesting, but let's not get too carried away.

I think the other thing that obviously is politics. You know, we're recording this today. This is election day. So, you know, I don't know what's going to happen after that. But clearly the markets and all the pundits seem to be very unanimous that there's going to be a change of government. Now, what does that mean for us in our portfolio? I'm not sure it makes a lot of difference to most of our companies, but clearly that's a catalyst that people are kind of setting a lot of store on, but we'll have to wait and see.

KH: Okay, thank you.

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So you just mentioned the UK election taking place today. I appreciate you don't expect it to have a big impact on the overall portfolio, but are there any individual stocks that you're spending a bit more time thinking about?

IM: Yeah, the one that really stands out to me, Kathleen, is Trainline the ticketing app, and we did a visit down to their offices in London actually last month where we actually went to spend time with them but also particularly to kind of really drill into what do they see in terms of the potential issues with Labour potentially becoming the next government.

Now, Labour have been very clear that they would like to take control of the whole rail network at some point. But I think actually the meeting was actually kind of relatively reassuring. They did point out that actually Labour launched their transport policy from the Trainline offices in London. So there is a kind of relationship there. And I think it's almost one of the classic, you know, the devil is in the detail, that it's very easy to say things, but more likely it would be done over time rather than in a big bang for a lot of actually kind of fundamental operational reasons. And the actual positive thing is that they need something like Trainline because it is the number one ticketing app. And there's a lot of things that they are providing which are actually quite attractive to the government in terms of actually boosting revenues.

So that's very good for the government, but also from our perspective as shareholders, one of the things that they have quietly dropped and the current government have quietly dropped is trying to have a public version of Trainline to try and compete with it. They've quietly just dropped that. So what you're left with is Trainline, the dominant app in this area. So, on balance, we think that the risk reward is still attractive for us as shareholders.

KH: Okay, thank you.

So moving on to performance attribution, the two of the big contributors to performance this quarter were the savings platform Hargreaves Lansdown and the venture capital company Molten Ventures. Would you be able to talk us through what's been driving their share prices?

IM: Yeah, I mean, two very different businesses, Kathleen. Hargreaves Lansdown, the wealth managing platform, I'm sure a lot of people who are listening to this will know all about it. And they also know, frankly, it's been a very disappointing investment the last few years for us. We've gone through some pretty tough times. So I think the share price going up here is nice, but let's put it in context, it's been a tough investment for us. What's happened is that there's been a private equity bid, a potential bid, I should say, for Hargreaves. And at the moment, at the time of this recording, the board has asked for a bit more time for an offer to be finalised. So we'll have to wait and see what we're going to do there. But, as you said, the share price has gone up.

Molten Ventures, a very different business. As you said, it's a venture business. What that means is basically they're investing in early stage companies, mostly in the UK and a bit in Europe, too. So kind of businesses that haven't listed yet, predominantly in fast-growing technology areas. Now, the share price has done very poorly in the last two or three years in particular, but what is interesting is that the net asset value of these businesses hasn't held up relatively well. So what that means is that the discount that the share price is to the net asset value has ballooned out to 1.70 per cent, a 70 per cent discount.

Now, the net asset value has gone down because, as you can imagine, in a tougher environment for growth companies, the valuation metrics have got tougher for those businesses. But the good news is that the growth in a lot of those businesses has been really strong. So, there's been a bit of a derating, but the fundamentals of the businesses keep improving. So actually what that means is that the NAV (net asset value) has fallen a bit, but far less than some people had feared. And what we saw in the quarter is that they had their results. There was a kind of reassurance from that and the share prices started to respond very strongly. So the fact that this kind has narrowed, but it's still very material and that's why we continue to want to own it.

KH: Okay, thank you.

So sticking with performance attribution, after a very strong period the biggest detractor last quarter was the money transfer company Wise. Has anything sort of fundamentally changed with this business that's driving those share prices?

IM: [The] short answer is no. But I think the point that you raise, I think is actually a great one because it's a difference between long-term investing and short-term investing. You correctly highlighted it's been a great investment for us in the last year or so. But in this quarter, it wasn't. Now, what happened? Well, they had their financial results for the year, which were very strong, much better than expected. But they also said at the same time, we think growth will not be as high as some people had thought. And some people were disappointed by that, the short-term investors and the shares kind of traded off on the back of that.

Now, we stood back and said, well, hold on a second. You've had really strong growth and you're still talking about 15 to 20 per cent top-line growth for the next two years. And those are numbers to die for, frankly. But it didn't meet those kind of short-term unresolved expectations. But does it change the long-term disruptive element of growth that this company is delivering? Absolutely not. This is a great growth business and we're very happy to own it. And you get that short-term volatility, we're quite happy we can manage our way through that.

KH: Okay great, thank you. And moving on to portfolio activity, turnover has remained low but you have made a couple of changes to the portfolio this quarter. Would you be able to talk us through your new holding in Shaftesbury Capital?

IM: I'd love to, Kathleen. Now, Shaftesbury Capital is a product of a merger of two property companies, Shaftesbury and Capital. They both owned very attractive West End properties in London or areas in London, we call it States. So what we have now with this business, it owns pretty much all of Covent Garden. It owns all of Chinatown. It owns all of Carnaby Street and some other bits and bobs elsewhere. That's a fantastic portfolio of assets. For people at home, this is almost like playing Monopoly in real life, that you dominate these parts of the world, of the West End.

Now, what we've got with the management team, it's predominantly capital people. And what they've done, they used to own Covent Garden and they've really turned that around. It used to be a fairly, I'd say, not really fulfilling its potential. Now they've turned it into a real destination. If you ever go there at the weekend, it's very busy. There's really a lot of high-end shops, all the shops, turnover is very strong. You've got very attractive food and beverage outlets there.

What we're excited about is that they can turn that kind of capability into what they're doing in the old Chastity portfolio, particularly things like Carnaby Street and the Seven Dials, where we think there's a lot of potential to get them back to their glory days of, you know, a few years ago. And, you know, we've met them, we've actually walked the streets with them to understand what they're doing there. And some of it will take a few years, but there are also kind of, you know, fixes they can do to turn it around, I think, quicker than you might expect. And the best thing of all, Kathleen, is you're getting this at a 30 discount to NAV, so we're really excited about that holding.

KH: Excellent, sounds very interesting. So just very briefly, any final messages that you would like to leave us with today?

IM: We still see an abundance of growth opportunities in the UK and you're also getting them at attractive valuations. Now, that to us is still a very powerful combination. The reason why our portfolio turnover remains low is because we're really backing our portfolio. The fundamentals are good. We want to keep backing that. So we're very happy with where we are at the moment.

KH: Great. Well, thank you very much for your time today, Iain. And thank you, everyone, for joining us.

IM: Thank you.

UK Core

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

	2020	2021	2022	2023	2024
UK Equity Core Composite	-13.8	39.1	-24.8	14.8	8.4
FTSE All Share Index	-15.5	35.8	-10.6	12.9	12.3

Annualised returns to 30 June 2024 (net%)

	1 year	5 years	10 years
UK Equity Core Composite	8.4	2.3	2.0
FTSE All Share Index	12.3	5.4	2.8

Source: Baillie Gifford & Co and FTSE. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.

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