Hello and good afternoon. My name is Amy Maxwell, I'm from Citywire and I'll be presenting today's broadcast. Today, we'll be joined by our guest, Praveen Kumar, manager of the Baillie Gifford Shin Nippon Investment Trust. He'll be providing us with some fresh insights into what's really happening on the ground in Japan. Now all COVID restrictions have been lifted, there's plenty to update on the companies he's already invested in, as well as some new and exciting themes he's pursuing. We'll also touch upon valuations and the unique environment Praveen is witnessing right now. So, lots to talk about.

Welcome, Praveen. Thank you very much for joining me.

Hi Amy, thanks for having me.

So, you're just back from your second trip to Japan in six months. So, what was it like to be on the ground after a pandemic induced hiatus?

So, I was in Japan for two weeks in November last year and I was in Japan again, just a couple of weeks ago. So, in total in the span of six months, I've spent three weeks and over the course of these three weeks, I met no less than 54 companies. So quite a packed schedule, but it was interesting to draw some high-level observations from these meetings. So, the companies I was seeing were from a range of sectors. I would draw out three broad observations from my time spent in Japan meeting with these 50-odd companies. The first one, obviously, was as you mentioned in your introduction, all COVID restrictions have been dropped. Japan is open for business. It's open for tourism. It was interesting, I saw quite a lot of foreign tourists and by foreign, I mean non-Chinese.

So, still the recovery in Chinese tourism is taking a bit of time. So, we're still not seeing the floods of Chinese tourists that we used to see not too long ago. That's obviously a big opportunity for a number of our holdings. The second observation I would make is, speaking with the management teams, the companies and I was meeting a majority of the companies, with the presidents of these companies. The overall tone seemed to be one of cautious optimism. I certainly didn't see companies being worried about end-demand. They acknowledged some of the challenges in terms of geopolitics and what's been happening with central banks and interest rates. Across the piece, there was quite a strong sense of optimism.

Companies were busy adding capacity. In a lot of cases, there were companies complaining that the demand was just so strong for their products, that they were just not able to keep up with the demand. [overtalking 0:05:40] through examples of that. So, the overall sentiment I got was one where companies were generally cautiously optimistic in terms of the medium-term demand. The final point I thought about making, which again, is a slight difference from what we've heard and seen or at least, what I've heard and seen from Japanese companies in a long time is, this acknowledgement that the cost of capital has actually gone up because interest rates have gone up. So gone are the days where you could avail of cheap money and basically, engage in profitless growth almost.

There was a very strong acknowledgement that the companies do need to show that their business model works. They do need to start making a reasonably sustainable level of profits. Whilst not compromising on the growth. So, I think that last bit is perhaps, the most exciting insight for me, in terms of companies being able to show really rapid growth. At the same time, can grow their profits as well.

So really a changed dynamic in the few years in which you've been away. So, in terms of how the visits have shaped your investment thinking for your own portfolio, what are some of the companies-, can you give us a taste as to what some of the conversations you were having with current portfolios holdings and some updates there?

So, there are number of trends that are happening behind the scenes in Japan and because they tend to be quite slow burn trends, they don't really get that much airtime in western press. Frankly, they are a bit boring if you want to write and exciting article. So, an article title 'The Nikkei Hits an All-Time High at 3,100' will probably get a lot more hits than an article saying people's working habits have changed in Japan. There's a lot more acceptance of working remotely. That is exactly what we're seeing. A lot of companies that we were meeting, hardly 10% of the staff were in the office at the time.

Just to emphasise that, this is huge cultural shift for Japan. So, they should be huge headlines really, in terms of the impact it's having on culture.

It is. I think it hints at quite a significant change in mindset of corporate Japan. Where previously you would be required, as an employee, to come into work every day post the pandemic and report to your bosses. So very, very traditional mindset. These couple of visits in the last six months and just to be clear, this is not just a sentiment that I saw with some of the younger and more dynamic companies. So, I met a range of traditional manufacturers as well. Some of them, 70, 80-year-old companies. So even there, there was quite willing acceptance that people's expectations have changed. Employees expectations have changed and they were much more open to this idea of flexible working. What this change in mindset has done is it's created a huge opportunity for companies like Katitas, which is a current holding in Shin Nippon.

This is a company that buys really old houses, typically 30, 35 years old, renovates them to a high standard and sells it to first-time buyers. Typically, a family of three where both the husband and wife are working. Now what we're seeing is because of this work from home option that a lot of people are getting, they're looking for slightly larger homes, maybe homes with a study as well and a lot of people are actually moving outside of Tokyo because it's very difficult to get those types of houses in Tokyo that are affordable.

Tokyo is known for space saving, so is there another big shift going on there as well?

You have these box sized apartments that are priced at an absolutely ridiculous level. So, we are seeing, I wouldn't say a massive shift, but there's a decent chunk of population that's gradually moving to the suburbs of Tokyo and that's where companies like Katitas actually operate. They're seeing quite strong demand for this type of cohort that's looking for a bit more space, but more affordable. [marker 0:10:00] It's actually cheaper to buy a Katitas house than to actually rent in Tokyo. So, it's a win-win situation for those types of families that are renting in Tokyo and what their own place with a bit of space to work from home.

You might see some change in the demographics, in the birth rate. It's known to have an aging population, maybe this is a shifting point.

That's a very interesting point you make, Amy because that's exactly my initial thought was obviously, the government is doing possibly, everything it can to try and boost the birth rate because obviously, we've known for years that Japan has had terrible demographics, but people have not really taken it that seriously. They've just kicked it in the long grass and taken the view that this is a problem for another day. That another day has come right now. The government is basically, coming up with a whole raft of measures. Trying to throw money at the problem, trying to encourage companies, encourage people. I think small things like these, as you rightly said, could actually be a small catalyst in trying to kickstart the whole birth rate resurgence. Now obviously, it takes quite a bit of time. So, we'll have to wait and see, but this is definitely a step in the right direction I would say.

Fantastic news. I understand there's also another theme you picked up during your visit was-, you touched upon it earlier on in our conversation, the inbound tourism, the return of it. GMO Financial Gate, do you want to talk to us a little bit about-, it's payment specialist, do you want to talk to us about how that's getting on and why it's still interesting to you in the portfolio?

GMO Financial Gate is probably one of the stocks that I'm most excited about. So, we've all known about online payments, ecommerce and one of our companies that we own, we've owned if for over ten years, is a company called GMO Payment Gateway. So, it's a different company. That company mainly does gateway services for online payments. Now, GMO Financial Gate, it's actually a subsidiary of the payment gate. It sounds confusing, but GMO Financial Gate, it does offline payments. By that what I mean is, if you go to a John Lewis and you buy an item and you pay using your credit card. So that's an offline transaction. Typically, you would either go through a Visa or Mastercard or American Express network, depending on which card you have.

What GMO Financial Gate have built is a completely new network that bypasses all these three networks. It's on average, about 20% t0 30% cheaper. As you know, there's been a lot of hue and cry, both in Europe and in the UK about credit card charges and how these companies are abusing their monopolistic position. So, this company has built a completely new, really fast, low-cost network that's bypassing the traditional Visa Mastercard network. Interestingly, what they've also done is, they sell you a terminal, which accepts over 30 different types of payments like QR codes, credit cards, debit cards, etcetera. Also, for the merchant, they can download apps from that terminal. Apps that help the merchant with their business. So, things like if you want to link the point-of-sale terminal with your inventory. So, you can download an app for that.

If you want to look at the time management. So, your employees swiping in, swiping out, how many hours people are putting in, you can download an app for that. So, all these apps, the majority of them are developed by third-party developers. So, it's almost a bit like an app store, Apple app store-like ecosystem. So really interesting business model and this company has been growing like an absolute weed. Well over 40%, 50% in terms of sales.

This insurgent, do you think it has potential to go beyond Japan or is it very much a Japanese story?

I think for GMO Financial Gate, in particular, just the scale of the opportunity in Japan is so massive. If you think about the offline retail, that's easily worth, you know, a few trillion yen. GMO Financial Gate is only just starting. It's got a single digit billion-yen sales. Obviously, growing quite rapidly. So, I would almost be tempted to say that overseas is likely to be a distraction for this company, simply because the opportunity in Japan itself is so massive. Interestingly, no company has attempted what GMO Financial Gate is attempting to do, simply because Visa, Mastercard, American Express, they've had such a stranglehold on the market, that companies have just felt it's not worth their while trying to take share from those big US companies, but this one company is trying to do exactly that. I think the opportunity in Japan itself is quite massive.

So far, we've got a changing culture in terms of living. A changing culture in terms of-, well, a disruptor from the traditional ecosystem, retail, consumer ecosystem. Now, did your trip spur any new ideas in terms of obviously, you can't name names if you haven't invested yet, but in terms of the themes in which you've picked up on, is there some exciting information you could impart there?

The most recent trip, I was there for five days and in five days I came back with four new ideas, which I think is a pretty significant return on investment I would say. When I saw four ideas, I just don't mean ideas where I would have to do a bit more work. These are four solid new ideas. It's quite interesting how different these four ideas are. So, one of them is an artificial intelligence company. Now in Japan, there are a whole host of artificial intelligence companies. We've spoken to at least five or ten of them in the last three, four years. We know the whole area of artificial intelligence can be hugely disruptive, especially in a very, very traditionally minded, very slow-moving economy like Japan.

Unfortunately, we've not found any interesting investments, simply because the artificial intelligence companies or the AI companies we've spoken to so far, they've not really had a robust revenue model. It's all been product based. So, a client would come to you and say, can you solve this problem for me and the company would develop an AI model, software and give it to them and that's it. So, there's no concept of a recurring revenue or anything like that. This one company that we met, actually, it's run by a husband-and-wife duo from Taiwan. Only about 20% of the staff are Japanese, the rest are all Taiwanese from Southeast Asia, got quite a few western employees as well. Very international business already, only about 20% of sales come from Japan and it's growing quire rapidly.

What they've done differently is, their AI software, it helps retailers and other vendors to improve their customer targeting abilities. So basically, trying to increase the lifetime value of customers. Helping these retailers find out who are the customers they should be targeting. Obviously, all of this is done with the consent of the end-user. Their software, very cleverly, works out if you target this person with X percent discount offer, they're surely going to buy it, for example. So really very precise targeting. Their model is based on the success of the clients. They don't charge a fixed fee.

So, they make money only if their clients make money, which I think is quite an interesting way of even validating a business model. Their sales are growing at about 30%. They have over a 90% retention rate. That means nine out of ten customers keep using their software every single year.

I imagine that level of intelligence is probably invaluable for many retailers to tinker with their offering and to know that they're targeting the right people.

Exactly. I'll give you a very simple example. Let's say you put a few things in your shopping basket and before you press 'buy' you go to run off on an urgent errand and you come back, you forget about it. Now what this company allows that retailer to do is basically, give you message on your phone or on your tablet saying, "Hi me, there are these things in your basket, are you still interested and by the way, we can give you 10% off." So, it's a really granular level of targeting and for some it might seem a bit scary as well. Obviously, it's all done with the consent of the customer.

The double pincer with the discount.

Exactly. So very interesting and it's actually, I almost think it's a Taiwanese company. They're headquartered in Tokyo, but all intents and purposes it seems like a Taiwanese company that happens to be listed in Japan. So very interesting.

Keeping in the area of technology, the semiconductor space is another area where you found some interesting insight and some companies of note.

Yes, and it's quite topical because as some of your readers may have seen today, one of the largest US semiconductor companies called Nvidia had some extremely good results and more semiconductor names are pretty strong on the back of those results. Broadly speaking, I think, over the years one very significant shift that's been missed by most people is, Japanese manufacturers have moved away from making these big, visible [marker 0:20:00] products like the Sony's of the world, Hitachi's of the world, the Toyota's of the world. Over the years they've established quite strong, really critical positions in large, systemically important supply chains like semiconductors and these are very small companies providing very mission critical kit without which the whole supply chain would basically collapse.

I'll give you an example. One of the companies that I saw and quite interesting is, it basically makes these huge metal tanks that are lined with a special chemical. These tanks are used to store all the gases in semiconductor manufacturing process. There are a number of gases that are used for different purposes and these tanks are used to store them and because these gases are so toxic, hazardous and corrosive, you need the tanks to be almost bulletproof and that's what the lining actually achieves. It keeps everything absolutely sealed shut. This company is one of three manufacturers globally, of these tanks and it's about five to ten times larger than the other two players. It is the only supply of these tanks to TSMC, the big foundry based in Taiwan, Taiwan Semiconductor Manufacturing Corporation.

So not a lot of people, even in Japan, have heard of this company. There are numerous examples like this company where you look at them and say they've got such an important position in the supply chain, without which you really can't see the whole thing working.

The ownership of these companies, are they family owned? They seem to be quite small, under the radar companies, but how is it to get in to speak to them and how is the corporate structure of those in terms of investment potential?

I think the majority of them do tend to be owned by families and the founding families tend to have reasonably large stakes. You also get a few manufacturing businesses where the family have, perhaps, exited a long time ago and now, it's run by a professional management team. So, this tank company is an example of the latter, I suppose. What's interesting is, for a lot of these companies, that doesn't tend to be the starting point. They will have started making something completely different. It's just that over the years and this is a 70-plus year-old company, this tank manufacturer. Over the years, they would have built enough expertise and knowledge in those specific niches, that they're then able to use that library of skills and suddenly, come up with a killer product that's applicable to a completely different industry.

So, this tank manufacturer, it didn't start out as a manufacturer of tanks. It started out making seals that go into containers that are used in factories, petrochemical plants. That sealing technology, they got so good at it that then they saw the semiconductor industry that was using these really toxic gases. Then they came up wit this idea, why don't we use our sealing technology and see if we can apply that to the semiconductor industry. We've seen so many examples of companies that are able to do that.

That reputation Japan has for manufacturing and precision manufacturing is still there. It hasn't lost its way, which many people would say so. It's under the radar, as you say, producing mission critical equipment for really, really important industries.

This phrase that's used most of the time, in Japan, in terms of the lost decade or whatever. Actually, I think that gets a lot of air time. If you see what's happened in the last whatever decade that this lost decade is referring to, the reality is actually quite different, yes, there wasn't that level of growth in the economy per se, but the economy is different from the stock market. I think that's an important distinction and what we've seen companies achieve in that so-called lost decade is just a relentless focus on getting brutally cost competitive. Building more and more of these libraries of technologies and in the last ten, 15 years, what we've seen is literally an emergence of these businesses. Using those technologies that they've built over the years to suddenly come up with a product that's become the go-to product in quite important global supply chains.

Which is why in this whole talk about geopolitics and things, Japan is such a crucial part of that conversation. Simply because you have this entire army of equipment suppliers without which, as I said earlier, supply chains wouldn't work.

It's an interesting dynamic in that growth stocks globally, have struggled so much. This almost feels like a backdoor to that growth story, without potentially, so much volatility.

I think what's happened is, is there's been a wholesale selloff of anything with a G in it [overtalking 0:28:16]. People have not stopped to actually take a step back and to actually look at what the business is doing. I'll give you an example. One of the stocks we own in the portfolio is a company called GA Technologies, which is an online real estate platform that's looking to disrupt the traditional high street type real estate model. That is a business that is only about eight to nine years old and it's already got to sales of over Y100 billion, which is quite remarkable for such a young company and it is making profits. Based on historic growth forecasts and next years forecasts, it's maintaining a very fast pace of growth.

You look at the rating on the company, price to sales or price to earnings, it's trading as if it was an ex-growth company. So, there are these extreme disconnects that we're seeing right across the portfolio across different sectors, which are making me quite enthusiastic to be honest, at the moment.

It's been reported extensively in the last year, this idea of overseas investors coming back to Japan. So, this person [marker 0:30:00] has a question that says, "What is going on in the small-cap space? In particular, with overseas investors."

Obviously, there's been a lot of headlines in the FT, etcetera, about foreigners rushing in and certainly, we're seeing quite a lot of interest in Japanese equities. For us, sitting here and engaged in investing in high growth businesses, it actually doesn't feel like that. I'll explain the reason for that, the reason for that is because a lot of the foreigner overseas interest that we've seen, it's largely concentrated on stocks that are not really geared for growth. So, the large part of the interest has been in companies where there's some change in terms of corporate governance where shareholder returns are perhaps there' s a change in view in terms of shareholder returns, dividends, share buybacks.

So, it's really that segment and it's a very large segment, to be fair, it's that segment of somewhat old-style Japanese companies that seem to be having a change of heart, that are seeing quite a lot of interest. We've not yet seen the same level of interest trickle down into the real growth companies, the businesses of tomorrow. The really dynamic businesses. I almost think it's a matter of time because with the former group of companies, these are companies that are just looking to survive, not looking to grow. So, I'm pretty sure the interest in those companies is likely to win and that's when you get this trickle down effect where people start looking at some of the more dynamic growth businesses.

Businesses that are expanding globally, exposed to some of these long-term structural trends like EVs or semiconductors that will start looking a lot more interesting for overseas investors. So that's what I suspect will happen in due course.

"What's the percentage indirect exposure of the portfolio to China?" So, I would say there's quite a lot of geopolitics to touch upon there was well, which maybe you could elaborate on.

We don't really tend to calculate the exact percentages in terms of the China exposure. Obviously, we do have quite a few manufacturing businesses and areas like factory automation, semiconductors as well, that have a decent level of sales in China, for instance. Again, it's quite difficult to calculate these percentages precisely, simply because quite often, companies will classify sales quite differently. So, to give you an example, you have numerous Japanese manufacturers where the manufacturing happens in Japan, but the product is shipped to China, but the sales are recorded as Japanese sales if you see what I mean. So sometimes, you can get quite confusing, not like-for-like numbers. I would say in terms of our direct exposure to China, it would mostly be parts of the niche manufacturers as one of the key thematic buckets that we classify the portfolio.

So, we would have some exposure there. In terms of global brands as well, there are a couple of stocks that have a reasonable business in China. I think overall, a lot of these businesses, they're just continuing to perform as usual. Certainly, we're not seeing or heard anything to suggest that the Chinese businesses are being disrupted. It also helps to be not really the top tier in terms of the Toyotas of the world. It helps if you're under the radar. You're not really seen as something that's too systemic of easy to attack in some ways. So overall, we remain fairly comfortable in terms of direct China exposure.

Do you want to touch upon the geopolitical situation? With US and China hostilities and again, the Russia and Ukraine situation, there is significant impact on supply chains, for which the mechanics

and some of the companies you've spoken about are integral to. So, could we have a brief overview of how those tensions could impact the portfolio?

This is definitely an issue that we just can't ignore, saying that it'll go away with time. Japan unfortunately, tends to find itself squeezed between two great superpowers. So, at one hand obviously, in terms of the whole culture, the democratic system, the long-standing relationship to the US. So, Japan wants to be closely aligned with the US. When it comes to more pragmatic concerns like business and the corporate sector, obviously, China is a very, very important trading partner. In aggregate, the Japanese exposure to China in terms of sales, is reasonably high. So, it's quite a delicate balancing act that the Japanese have really mastered over the years. If you can imagine, this is something that's not just come up all of a sudden.

You always had the US China tensions, a flare up from time-to-time. Japan has, so far, been quite masterful at navigating the middle part. Not getting on the wrong side of China, but at the same time, taking a stand on what they see as the right thing and supporting the US. Having said that, a few companies, especially within the semiconductor space, because I think that's seen as quite an important systemic, critical industry, a few companies from what they were saying, there is a sense that they need to somewhat diversify away from China. Diversify is not the right term. I suppose, de-risking is the right team. So, give you an example of what that means in practice is, some of the companies are now looking at adding the new production, incremental new production in the US.

In fact, some of them are even bringing production back to Japan, which is fantastic news for the local suppliers and all these small-cap suppliers. So, we are seeing a few moves of that sort, but obviously, I'm not saying that they're completely abandoning the China manufacturing or not investing there at all. That's continuing to happen, but at the margin we are seeing tentative steps of just trying to de-risk some of the China exposure. That's where we are at the moment.

We've got a question here, in regards to the metrics you're using. "I wanted to know what metrics you're watching or which feedback from management are you counting on to assess if these companies will become profitable in the near future?" We've had a similar question that maybe you could answer at the same time. "What percentage of your portfolio is invested in companies which are currently unprofitable?" So, I suppose, it's a question about how do you balance the opportunities and who's going to win out and who do you back and do you drop at what point?

The percentage of the portfolio that's in loss making businesses. Independently, how would you define loss making businesses? So, I always think of it in two ways. The first category would be businesses that have been making losses for a number of years. Five to ten years, for example. So consistent perennial lossmakers. The other category would be businesses that have had a one-off issue, maybe a big impairment or a write down because in a specific year they make a loss, but they've not been lossmaking on an ongoing basis. So that's a second category. In terms of the first category, I would say only about 1% to 2% of the portfolio would be in those types of stocks that have been making losses every single year.

There are specific issues as to why they've been making a loss and I'm actually positive that they'll soon turn profitable. So that's the first category, this 1% to 2%. The second category of companies where because of a one-off issue, they're expected to make a loss in a single year. Again, I would guess is probably no more than 5%, maybe even lower. So, in aggregate, we're talking of 5%-ish of the portfolio and 95% of the portfolio is in companies that are profitable on a sustainable, ongoing basis and expected to make profits. In terms of what metrics we look at, we try and keep things simple. So, the two metrics that for me are the most important ones, the most important one is sales growth. The second equally important one is operating profit margin. So, we just try and keep things simple and focus on the OP margin.

The operating profit market, we feel, is a much more reliable indicator because it has less one-offs and it's quite difficult to fiddle around with an operating profit margin ratio. It also gives you a sense of, at an operating level, how a company is performing really. So, these are the two metrics that I keep an eye on.

We've got a question here around, "To what extent does Shin Nippon support, advise, finance its investee companies?"

That's a very, very interesting question. This is something that I've done in the last six, seven years where in my view, [marker 0:40:00] as a small-cap manager, especially in a country like Japan that's never really supported its small-caps in any shape or form, along with investing for our shareholders and trying to generate an attractive return over the long-term, I almost feel that we can play a bit of a part in terms of shepherding some of these companies. Whenever I've got the opportunity, I've tried to engage with companies and give them some kind of high-level advice. Not really trying to be activist or telling them how to run their business because that's not my place. Just to give you an example, one of the companies that I've engaged with in the past is a holding called Raksul. So, it's an online printing business that also has a pretty fast-growing advertising business as well.

This is a very young company, less than ten years old and in the past, they've asked me from advice on things like how should they think about the balance sheet given their stage of growth? Should they be issuing equity? Should they look at debt financing? Those types of high-level questions.

Also, some of the engagements I've had with companies have been at a more strategic level in terms of if a company is thinking of entering a particular area. How would we feel about that? Does it make sense for us? One of the main reasons why I'm able to engage at such a high level, usually with the founders and presidents, is simply because when we invest in a company, we spend a lot of time doing fundamental research.

Talking to suppliers, vendors, various management teams and trying to form as comprehensive a view. Obviously, you can't learn everything about a company, it's an ongoing process. When we do invest, over time we end up taking quite a significant position in the company. So, this company, Raksul for example, we own about 9% of the company. So, when you have a very supportive, long-term shareholder with a big shareholding, it becomes easier for us to get access. Also, companies listen to what we're saying. Whether they take it or leave it, that's up to them, but as someone looking at up and coming businesses, I think that's a good opportunity for us to try and engage with them and advise on certain matters, where we might have a helpful view.

"In the past 12 months were there any investments which you deem to be mistakes or are no longer invested?"

So, in the past 12 months we have sold a few stocks. Again, they were a combination of a loss of faith in management's ability to grow the business or respond to competitive pressures. Also, it's been a case of where the company has actually become quite successful. So much so that it's become a larger business now and where the growth from this point onwards, we felt is perhaps less exciting. So, one example would be Japan's largest online adverting company called CyberAgent, which we invested when it was a small-cap. Since then, it's been a phenomenal performer. It's become a large-cap and we're happy to run our winners, but in CyberAgent's specific case, we were not confident that the online advertising industry is going to grow at the same rate as it did in the last five, ten years.

We felt that CyberAgent has already become too big within the online advertising space and growth from here onwards is likely to be a bit of a hard slog. We might be wrong, but that's the view that we build having looked at recent results, spoken to management, etcetera. So, it's usually those types of reasons why we end up selling a stock., where we lose faith in management really.

We've got a broader question here. Somebody would like a recap on the portfolio, in terms of its volume and nature. So, if you could give us the birds eye view of what our viewers should be categorising the trust as.

On a very high level, Shin Nippon is explicitly a high growth portfolio. If someone is looking at Shin Nippon as a way of diversifying risk or as a steady portfolio, this is probably the wrong portfolio for you. This is explicitly a growth focused portfolio investing in the companies of tomorrow and not in the companies of yesterday. At a very high level, at the moment we have pretty close to 80 stocks. I think 79 stocks. We can own up to 80 stocks, so we have 79 at the moment. The makeup of the portfolio is we have about a quarter of the portfolio roughly in what we call as the online disrupters. So, these are companies that have been a favourite hunting ground over long periods of time. Disruptive, fast-growing businesses across a number of sectors. Usually, online-based business models. So again, quite young businesses.

Then we have maybe another 30%, 35% of the portfolio in what we call the niche manufacturers and these are the companies that I've been talking about in terms of the global hidden champions. The smid tank manufacturer, for instance, would be an example of a niche manufacturing company. Although, we don't yet own this stock. These niche manufacturers, again, are spread across a number of sectors. So, autos, industrials, factory automation, healthcare even. So that comprises about 30%, 35% of the portfolio. The rest of the portfolio is made up of a combination of global brands. So, companies like Descente, which is a very, very high-end clothing brand for skiing and golfing and they have a very, very fast growing business in China. It's a very, very popular brand in China.

Pigeon, which is again, a very popular brand in China for baby bottles and accessories. So we have a few of such global brands. Yonex, another example. The world's leading badminton brand. We also have a few healthcare names, outsourcing and services. So, a few staffing companies, given Japan's labour shortage. I think these companies should do really well in this kind of an environment, especially with wages going up as well. We've got a few niche financials. So that's the rough makeup of the portfolio. So very, very diversified portfolio. It's not exposed to a single area or a single type of company. We have very, very decent levels of diversification. The one common thing that ties virtually every single stock is that these are businesses which we believe are likely to grow their sales or profits or both, at a much, much higher pace than what the market thinks or than what you would get with a benchmark on an index, for instance, but that's the common theme that ties all our holdings.

"What discount rate are you using for valuing a typical company in your portfolio?" and secondly, "Are you seeing many opportunities within the private markets and you could you talk around the current private companies you own and how these deals are sourced?"

I personally rarely do any discounted cashflows where you use discount rates. That's partly for the reason discounted cashflow models can be very sensitive. This is true perhaps, across Baillie Gifford, we try and do a lot more scenario analysis where after our rigorous research, we bring all of that together in trying to contract a base-case scenario which is like the bare minimum return that we will expect. A bull-case scenario, which would be the more optimistic take and a bear-case scenario, which would be quite a pessimistic scenario. In general, for every stock, before we make an investment, we will expect at least a doubling of the share price on a five-year view in our base-case scenario. So, a bare minimum, we would expect a doubling of the share price.

If we are really struggling to build a scenario where we can see that happening, then that becomes less interesting for us from an investment point of view. A bull case scenario would be where we have a more optimistic outcome, were we're not talking of five times or ten times return, but almost like 20 times return. So, what needs to happen for the share price to go up 20-fold in a five or a ten-year view. A bear-case scenario is where you take the most pessimistic assumption, plug it into sales, into profit margin and see what comes out. Do you lose all of your money or do you lose 80% of your money? So that's the bear-case scenario. So, we try and do a lot more of these types of scenario analysis, rather than using models or using discount rates.

With a best will in the world, these things are a bit of a finger in the air stuff. You can plug-in whatever discount rate you want and get whatever number you want. We believe in more qualitative type research we spend a lot more time doing that and then filtering the key aspects of that into our valuation work. The second question in terms of private companies. We've been looking at this market since 2017 and so far, we've only made four investments, which perhaps, gives you an idea of how underdeveloped the market is. So, the four companies we own. The first one is Moneytree, which is the first company we instead in. It's an artificial intelligence company for the banking sector. So quite ahead of its time. We invested in that company in 2017. Potentially, quite an exciting business given AI seems to be coming to the fore.

The next one we invested in is a company [marker 0:50:00] called Gojo, which is quite a unique company. There's nothing like it in Japan. Small-cap, large-cap or mid-cap in the listed world. It's a microfinance holding company. It has stakes in a lot of smaller micro-finance businesses across Asia. In India, in Sri-Lanka, frontier markets. So, it's a way of getting access to some of the fastest growing regions in the world, by investing in Japan. It in itself, operates as a holding company. So quite an interesting business. The third one is Spiber, which is again, a synthetic biology company. Quite different. No other business like it in Japan at least.

They basically studied how spiders make silk. What kind of proteins [overtalking 0:50:42]. They've used that knowledge, used some clever AI stuff and they've built a technique where they can now basically, on an industrial scale, generate any material you want. Whether it's fake cashmere or fake leather or whatever, which actually is pretty close to the real thing. They're using the same proteins.

Real life spidermen.

Yes. They've got a very large commercial grade plant in Thailand that's just started production. So, they're focusing on a lot of brands and car interior manufacturers for instance. You know, all your leather seats and fur coat and mink coats, you'll seen be wearing those without having to actually having to kill all those animals.

I imagine the ESG potential in that is huge as well.

Exactly, yes, huge. The most recent one we invested was a company called JEPLAN, which was last year. So, this is a company that's developed a very clever, environmentally friendly way of recycling plastic. They're using the same methodology, same technology to try and recycle apparels. So really, a potentially interesting business with a global appeal. Of late we've not spent as much time looking at private companies, simply because the opportunities in the listed space itself is so exciting and so significant. We have been looking at names that are quite unique, similar to these four names that I mentioned. So that's an ongoing process.

"Did you get that lovely bonsai plant behind you from Japan?"

This has been set up to look nice and cheerful. No, unfortunately not. It was quite nice to get back to Japan last year first time and this year there was quite a noticeable difference. A lot more relaxed. In November when I went, all the management teams were wearing masks. This time, nine out of ten were without a mask. So, there was a noticeable relaxed feel to almost all of the meetings I would say. It was nice for things to get back to normal in Japan.

From your perspective, managing the fund, it's nice to really kick the tyres as they say in the investment community and really get a feel for what's going on, on the ground. After such a long time it must have been really great trip.

Perhaps for me, more exciting was finding those new ideas. When things are not going well for you, the danger is you withdraw and start focusing on the wrong things. I think what we try and do is, keep things simple, focus on things that we can control. Obviously, we can't control what the interest rates do or what politicians do in the US, but focus on things that we can control and try and be consistent in our approach and continue doing what's actually worked for a very long period of time and not try and chop and change things simply because the environment has changed. We're really playing the very long game here. So that's parting message from me, I suppose.

Thank you very much for sharing all of your newly found insights, Praveen, it's been great talking to you. That's all we have time for.

Annual Past Performance to 31 March Each Year (Net %)

	2019	***2020***	***2021***	***2022***	***2023***
Baillie Gifford Shin Nippon PLC	*-5.0*	*-21.2*	*68.8*	*-25.2*	*-14.0*
MSCI Japan Small Cap Index	*-4.8*	*-6.2*	*24.4*	*-7.7*	*5.4*

Source: Morningstar, MSCI. Share price, total return in sterling.