Baillie Gifford

Positive Change
Q3 investment update

October 2023

Investment manager Lee Qian and investment specialist Nduka Amadi give an update on the Positive Change Strategy covering Q3 2023.

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

Nduka Amadi (NA): Welcome to the Positive Change Quarterly update. My name is Nduka Amadi. I'm an investment specialist on Positive Change. I'm joined today by Lee Qian, who's an investment manager and a decision-maker for Positive Change. As a reminder, Positive Change is an investment strategy which is focused on impact investing. We're looking really for a concentrated and actively managed portfolio which is interested in generating attractive long-term returns while contributing to a more sustainable and inclusive world.

Now, Lee, thank you for joining us. Today, we're going to talk through your view of the investment environment, get an update on the portfolio and hear what the team has been up to over recent months. So, starting with the market environment, it feels very different now, a couple of years on from the pandemic and those highs. How do you see the current investment environment?

Lee Qian (LQ): Yes. So, the last two years have definitely been a volatile period. We have seen geopolitical events. We have seen changes to the macro economy with higher inflation and higher interest rates. But in that context, the last few months have been a bit calmer. If we look at VIX, a measure of the volatility of [the] S&P 500, that has returned to pre-pandemic level. The IPO market seems to be opening up again.

So, whilst we cannot rule out another black swan event, if that doesn't happen, we are likely to return to a period of normality again, where excess returns will be driven more by the fundamental operating progress of the businesses rather than large swings in interest rates or inflation.

NA: Great. So I take from that that we're in a more stable, I suppose, relative period. And it's a little bit more like we're used to in terms of how we understand returns and what matters in terms of the companies we invest in.

Bearing the last couple of years in mind, do you see that there have been any changes in terms of how you've approached investing to respond to the environment?

LQ: So, we remain committed to our investment philosophy and to our true objective. We are committed to finding companies that are able to generate attractive long-term investment performance for shareholders by contributing towards a more sustainable and inclusive world.
We actually believe in the current environment of a more rational capital market, where financing is more constrained, and is likely to lead to more rational competition, companies are less likely to just raise cheap capital and burn cash to acquire users. So we should see companies with strong competitive advantage able to exploit that advantage and gain market share and generate superior profit and cash flow growth.

So, in this context, we think that looking for businesses with attractive long-term growth opportunities, strong competitive advantage, is going to be the more likely way to generate superior investment returns for clients. So we remain committed to our investment philosophy.

NA: Thank you. So that brings us nicely on to the company specifics. So why don't we talk a little bit about the portfolio? We can see that we've added a new company to the portfolio recently. Can you tell us a little bit about this?

Yes. We took a new holding in Wuxi Biologics. This is a company that provides outsourced research and development services for large pharma and small biotech. It’s based in China and is able to leverage on access to abundant labour and to provide cost-competitive services for global customers.

The company has performed very well. It has demonstrated strong execution over the last five years. Revenue has grown ninefold and net profit margin has reached 27 per cent in the most recent year. And so very strong operating progress, strong execution, and we think the opportunity in outsourced research and development will continue to increase, and markets in greater need for biologics, antibodies and treatments are going to increase as well. So this provides a nice tailwind for growth for Wuxi Biologics.

In terms of the impact, the company is able to help more businesses to be innovative, it's providing lower cost research and development activities. So, a smaller biotech with less capital is able to commercialise its idea. So Wuxi Biologics supports innovation in the broader biotech sector and helps to bring more treatments to more patients.

NA: Great. So that sounds like a really strong company in terms of the investment case. And it's very clear what the impact is - it's quite an enabler of innovation.

LQ: Yes.

NA: What about the rest of the portfolio? We can see that FDM has left. Could you explain why that has recently been sold?

LQ: Yes, of course. So FDM is a provider of training services to help people get on the career ladder. In particular, it focuses on people who might not have gone to a top-tier university, who might be the first person in their family to go get a degree or people who have left or are returning to the workforce after a period of absence. So, there's a very strong social mobility argument to what FDM is doing.

The challenge with FDM is it's a very people-intensive business. It requires people to go out and recruit people who are searching for job opportunities. It's people-intensive in terms of the provision of training for them, and then helping them to find a job with an employer as well. So, it's a relatively difficult business model to scale, and we have seen that the growth has been a little bit underwhelming. Our investment elsewhere in the portfolio, like in Coursera for example, shows that there are potentially more scalable options to provide training and upskilling services to people. So we think there are better investment opportunities elsewhere than FDM.

NA: Thank you, Lee. So, to summarise, it's sold on investment grounds. We like its impact, but we can see that there are more scalable opportunities out there with some of the names like Coursera, and Duolingo, which are still in the portfolio, addressing that social mobility and education challenge.

LQ: That's right.

NA: Great. So we've heard about the new name, we've heard about the company that has left. Can we learn a little bit more about the significant developments across the other names in the portfolio?

LQ: Yes. So overall, the companies in the portfolio have performed well, and in particular over the long term, businesses have demonstrated good operating progress.

I'll start off with one of our recent investments, Remitly, this is a mobile remittance business. So instead of having to go to offline agents, like a Western Union, to send money back home to family and friends, people can now do everything on their mobile phone. It's much more convenient, it's cheaper and it's a faster way to send money home to family and friends.

Remitly has performed very well. It has achieved product market fit and has seen very fast user growth and revenue growth. So in the most recent quarter, it now has 5 million active customers. And since its IPO in 2021, the business has grown revenue by at least 40 per cent per year every single quarter. So very consistent and strong performance since IPO. So, that's a business which has shown very good operating progress.

Another company is Dexcom. So this is a business that provides continuous glucose monitoring devices. Positive Change has invested in the business since the inception of the strategy over six years ago. And over that period, Dexcom has compounded revenue at more than 30 per cent per year and continues to maintain a very healthy level of growth in the most recent quarter.

The business has also demonstrated operating progress and went from a negative operating margin to positive 14 per cent operating margin in the most recent year. So, very strong performance both at the top line and the bottom line.

NA: Great. So it's good to see those two examples, one that's been in the portfolio for a much longer time, both making really good progress. But can you tell us about some of the names that have faced a more recently challenging time?

LQ: Yes, there have been a couple of companies where the near-term operating progress has been more challenging. One example is Illumina, the leading provider of genomic sequencing and devices. The business, we are still excited about the long-term opportunity, in particular in the greater use of genomic data, to help us diagnose and treat a wide range of these diseases.

But in the near term, the growth in the market seems to have stagnated and the company has also faced some issues around corporate governance and its acquisition of GRAIL, which have received a lot of regulatory scrutiny. So, it's a business we are actively monitoring. It has a new CEO, so we are looking forward to the opportunity to engage with the new management team and understand the long-term strategy for the business going forward. But we remain excited about the growth opportunity and the company is still the largest provider of genomic sequencing equipment.

NA: Okay. Thank you, Lee. That's a good comprehensive look at what's happening with the portfolio in terms of those really strong performing companies, and those where perhaps we're watching to see what happens over time. But a takeaway is that, over the long term, we still see that growth opportunity and the impact that they can have.

Great. So now we're done with the update on the portfolio, it would be great to hear about what the team has been up to. What is in the pipeline and what are people excited about over the coming months?

LQ: Yeah, there are many areas of research which we find fruitful and exciting over the long term. Members of the team have also been out on the road to see companies as well.

So, for example, Thaiha has been to the US to visit a number of healthcare businesses, and Kate has been to China to look at a number of companies around clean energy and clean tech. And a member of the team has also been to India to look at a range of businesses helping people in emerging markets.

At a thematic level, we do think climate and energy is going to be a big area of investment over the long term, and the pace of climate change is not slowing down, if anything it’s probably picking up, so more investment and more innovation is needed in this area if we are going to mitigate the worst impacts of climate change.

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And we are seeing exciting businesses, exciting technology here, and we are optimistic [that] over the next couple of years there will be new companies working in this area that will be investable and will make their way into the portfolio.

Another area is around healthcare, in particular around genomics. We are confident of the greater use of genomic data to help guide in diagnosis and treatment of diseases. And so we think there will be more investment opportunity there as well.

And those are just two examples. But there are other areas that the team is working on and are excited about, too.

NA: Great, it definitely sounds like there's a wide range of opportunities coming, and that's a really optimistic note on which to end. Lee, thank you very much for your time and for providing us with this update.

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Positive Change

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

	2019	2020	2021	2022	2023
Positive Change Composite	-6.8	80.9	41.5	-42.7	15.7
MSCI ACWI	1.95	11.0	28.0	20.3	21.4

Annualised returns to 30 September 2023 (net%)

	1 year	5 years	Since inception*
Positive Change Composite	15.7	9.6	16.6
MSCI ACWI	21.4	7.0	9.0

*Inception date: 3 January 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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