

# What is private company investing and why do we do it?

September 2023

Discover what private company investing is, and why our decades of institutional knowledge of exceptional growth companies gives us an advantage.

Your capital is at risk.

**BJ (Ben James):** Hello, and welcome to this series of films on investing in private companies at Baillie Gifford. We aim to give you everything you need to know. They're applicable to all clients that invest in our range of trusts and vehicles that hold private companies. I'm Ben James, an investment specialist director that looks after our US Equity Growth and Scottish Mortgage investment trusts, both of which hold significant numbers of private companies. I'm joined by James Yuill and Rachael Callaghan, both from the Private Companies Team.

James is the head of our operations and Rachael is a manager looking after investor relations. Welcome, guys.

**RC (Rachel Callaghan):** Hi, Ben.

**JY (James Yuill):** Hi, Ben.

**BJ:** Let's start with, why do we invest in private companies? Rachael, in the industry, there are loads of different definitions, venture capital, seed investing, angel investing, private equity. We call it private companies. Why do we do that?

**RC:** I think that's a great starting point, Ben. And largely, it's a case of semantics based on our investment philosophy. We call it private companies at Baillie Gifford because we are not just buying equity. We are investing in private companies and joining them on their

journey. We are looking for high-growth, transformational, disruptive companies that just happen to be private. And that means that their shares aren't traded on the public stock exchanges. They are held privately by founders, management teams and shareholders.

**BJ:** Why did we start investing in private companies in the first place? As we know, but our audience might not know, companies are staying private for longer. In the past, companies would list on the public stock exchange and be able to sell their shares to anyone around. And they would be about seven years old. They're now averaging about 12 years old. And some of our largest private companies at Baillie Gifford are over 20 years old. What happened was there was a lot of money that was allowed to go after private companies because they could hold more shareholders on their shareholder register after some regulation in the US.

And also because of technology, the Internet and so on, they didn't need as much money to grow significantly. Whereas in the past, that wasn't the case. And you see these companies becoming really big, many billions of dollars at a relatively early stage, but able to stay private because there's lots of money being able to invest in them.

**JY:** Absolutely. It's a whole new ecosystem for growth companies themselves.

**BJ:** That's right. And we were part of that. We started in 2012. And we were fortunate to realise that we have a range of investment trusts in the UK which are permanent pools of capital, which can hold private companies in them without the risk of a liquidity problem. They could hold them for a long time and support them. That's another reason why we do this, Rachael. And I think that we might have an edge in this. Can you talk about that?

**RC:** Yes. It's important to remember that at Baillie Gifford, we've been analysing growth companies for over a century. We were founded in 1908. And that gives us an intrinsic institutional heritage that a lot of people don't have. We have an edge in analysing high-growth, exceptional, innovative companies. And I don't just mean in terms of how they can improve profit margins or the business model development or product development plan or how they might expand into different geographies.

Of course, we take all of that into our analysis when we're looking at different investment cases. But there's also the intangible things, whether or not... It doesn't matter if you have all these great business models and spreadsheets if you don't have the willingness and the ability to execute on the business plans that you have. And we have this unfair advantage at Baillie Gifford where we have decades of institutional knowledge on what makes exceptional growth companies work, how they get to the next stage of their growth.

And that comes from strong cultures, good governance structures and really visionary founders and management teams that have the willingness and the ability to push forward into that next stage of growth.

**BJ:** One of the challenges we get from some clients is that if there's all this new money and a new ecosystem going after private companies, how do we get access? And James, you'll have seen, looking after the shareholder registers of these companies we invest in, that actually, we have quite a good reputation here and are able to get access. Can you talk about that a bit?

**JY:** Yes. The luxury a lot of these companies have is they can be selective on who is on that shareholder list. It's a much narrower list than you would see for a public company. And what they want is shareholders that are supportive, that are there for that long-term journey. And that doesn't stop when they become public. Having that reputation and knowing that we're long term, that gives the confidence to the companies that Baillie Gifford are a good shareholder to have.

**BJ:** And what about our structure then also is attractive to these founders in these companies? Because in traditional private equity, what happens when a private company goes to list on the market, goes to an IPO?

**JY:** It'd sell. Traditionally, either the vehicles don't allow them to hold listed equities for long...

**BJ:** The managers would sell it. The investors would sell it.

**JY:** Exactly. The managers will sell and cash out, really, when they become public. Whereas what we're looking to do is to hold them throughout that journey to the point where they've achieved a level of growth and transformation that we believe they can.

**BJ:** It's quite appealing for founders and people running companies for us to hold it to and through IPO?

**JY:** Exactly.

**RC:** Yes.

**BJ:** And the third reason is because it helps us understand, therefore, how the world's changing. And also, the fourth reason that I will always talk about is the fact that previously, decades ago, it was quite hard to access these great companies. But because

of the vehicles that we use to invest in them, we can democratise access to these world-leading private growth companies.

Let's summarise it up. The reason why we do this is companies just staying private for longer. It gives us access to some of the most innovative companies and leaders in the world and improves our networks. It helps us understand where the world's changing and therefore, what we need to invest in and what that might mean for our public companies. And it democratises access to these great private companies for everyone.

**RC:** Yes, exactly.

**JY:** Absolutely.

**BJ:** Thanks for watching this film and look out for other films in the series on investing in private companies at Baillie Gifford.

# What are the myths of private company investing?

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September 2023

**Baillie Gifford's Ben James, James Yuill and Rachel Callaghan pull apart three myths of private company investing that could be skewing your view of what it is.**

## Your capital is at risk

**BJ (Ben James):** Hello, and welcome to this next film in the series on investing in private companies at Baillie Gifford. This film is about myth-busting and we're going to bust three big myths about investing in private companies. The first one, Rachael, is we invest in really early-stage, high-risk, seed capital companies. Do we do that?

**RC (Rachel Callaghan):** I think it's worth setting the scene a little bit. Back in 2008, there were only 18 companies that had a valuation of a billion dollars or more, so-called the unicorns. In today's world, there is over 1,200 of these companies. These companies are established businesses with clear revenues or pathways to revenues, profitability or, again, pathways to profitability. They are looking for additional capital to really help grow or unlock that next stage of transformational growth.

**BJ:** I think it's really important for context to give the audience an idea of some of our largest companies. Let's look at the largest five private companies we invest in. SpaceX, the rocket company, ByteDance, the owner of TikTok, Epic Games, which essentially runs the engine for the likes of Fortnite, Northvolt, the European battery maker, and Stripe, the payments company. Let's look at those. SpaceX and ByteDance, they are both valued well north of \$100 billion. They are generating cash.

And then if you bought anything online recently and paid for it, it's likely that Stripe will have powered that. If your kids play on Fortnite or if indeed you play on Fortnite, James, no judgement here, it'll have been powered by Epic Games. And Northvolt has \$60 billion of orders on its orderbook. And if they were public companies, they'd be in the FTSE 100. They'd be big enough to be in the FTSE 100.

**RC:** Yes.

**JY (James Yuill):** Exactly.

**RC:** It is important to recognise that that inflection point does change per company. For some companies, it might be \$150 billion and they're looking for the next stage of investment. Some of these companies are extremely capital-intensive. They need multiple rounds of support. And for some companies, they might be pre-revenue and they're just looking for that next stage of investment for certain R&D, research and development projects. And they might need capital too. It just depends per company.

If you look at the dollar failure rate for a series A company, that's slightly earlier on in the journey, it's north of 16 per cent. Whereas when you get to series D, E and F, where Baillie Gifford tends to participate, you're into the low single digits then for failure rate. But a lot of the upside, a lot of the growth still remains for these companies because of the kind of companies that we invest in that are changing industries or creating new ones entirely.

**BJ:** That leads me on to myth number two, investing in private companies means you need to have a seat on the board, you need hundreds of people going in and helping them set up their processes or shifting or pivoting the business model. And we don't do that, James?

**JY:** No, that's right. Often, private equity can mean going and taking a majority stake trying to turn around a business. Whereas what we're trying to do, we're stage-appropriate investors. We're taking minority positions in these companies, in companies that we believe in the management that's there and the ideas that they're fostering. We're not taking on that risk. We're not trying to turn them around and change what they're doing. We support the ideas that they already have.

**BJ:** They're pretty mature companies that essentially need a different skill set, whether that be supporting them on the road to IPO and beyond or connecting them with other people. But they don't need us to change their business. They're already well-functioning businesses?

**JY:** Exactly. And I think the important part there as well is we're not pressuring them to list as well. We're about supporting the ideas and developing their business. As and when they do list, we'll be there to support them. But because we can be agnostic about that means we don't need to pressure them.

**RC:** I think a big part of the role that Baillie Gifford plays is the continuity of capital and the well-aligned shareholder, the well-aligned supportive voice that we provide to the management team. Because we have this institutional understanding that we talked about in our earlier video, we know what it takes to be a great growth business. And that doesn't happen overnight. These companies need that support. They don't necessarily need us to come in and change things. They just need capital to execute on the ideas that they already have.

**BJ:** Myth number three, private company valuations are stale. We don't think ours are, but can you just give us a bit of a colour on that, James?

**JY:** I think historically, the reporting frequency when it comes to the private equity space is lesser. And that can lead to this notion that valuations are left untouched for long periods.

**BJ:** How often would a traditional private equity fund revalue their companies?

**JY:** They tend to report quarterly. But what they're more focused on will be the annual.

**BJ:** Maybe once a year, they change the value?

**JY:** In times gone by, I think that that's certainly been the case. And that impression is still there. Whereas we don't have that luxury where we hold these assets and vehicles, like Scottish Mortgage, that are pricing daily. We need to be on top of our valuations. The way we deal with valuations looks to almost mark to market to be able to react and look at what's happening in the broader markets, whether that's company-specific or volatility in the broader markets and what that might mean for private companies.

**BJ:** We're pretty confident that we have amongst the most robust and diligent valuation processes for private companies in the business, but I think that's a whole film in itself. If you want to watch that film, please check out the other films in this series, including the one on valuations.

# What's the valuations process?

September 2023

**Baillie Gifford's Ben James, James Yuill and Rachel Callaghan describe who and what is involved in the firm's robust approach to valuing private companies.**

**Your capital is at risk.**

**BJ (Ben James):** Hello, and welcome to this film on valuing private companies. It's a really important topic, James, and it's your area of expertise. Where do we start?

**James Yuill (JY):** Sure. I think when it comes to valuing private companies, there's three key things we're thinking about. The first of those is the resource that we put to it and the governance around it. The second is the frequency and how often do we deal with valuations and factor market volatility. And then the third is the modelling itself. What's actually driving the numbers in the end?

**BJ:** I think it's a really important topic. And I want to reassure the audience about how robust our process is. Let's bring those three points to life by taking a private company through the journey of valuation. Private company A, where do we start?

**JY:** Sure. I think that point of transaction, the point of investment is always going to be your starting point. We want to make sure that we're comfortable it's arm's length, who is involved, the quantum. A lot of these companies are at later stage. It's substantial rounds with numerous investors, which helps with that. And then from there, we want to build it into our valuations schedule. And that's where we start to bring in our independent external input through S&P.

**BJ:** What is our schedule for valuing private companies?

**JY:** The fundamental is always that we will value everything at least once per quarter.

**BJ:** Every private company?

**JY:** Every private company, at least once per quarter. And S&P will come into that. They will review it all once per quarter.

**BJ:** Who's S&P? What do they do?

**JY:** They're an external firm. They're a financial firm that provide numerous services, but valuations is one of them. They look at equity valuations for numerous people, including for us. They will



assess all of our holdings.

**BJ:** They send in a list of valuations for our private companies and then your team steps in and starts their work?

**JY:** Exactly. We'll scrutinise everything we get from them. We'll challenge the approach, but also we're double-checking all the data, everything that's actually driving that end result.

**BJ:** Who's on your team that does this, by the way?

**JY:** In the operational team, we've got a number of analysts and the manager that look through all those reports that come from financial background too that have a lot of experience in looking at these valuations.

**BJ:** And are the investment managers those who make the decisions part of that team?

**JY:** No. That's the important part around not marking our own homework. We keep that separate. We're completely independent from the investment floor. We will liaise with them to make sure we have all the news from these companies and that we understand what's going on. But other than that, the valuations are driven separately.

**BJ:** S&P Global give you a valuation for company A. You then check against your own thinking about company A. And what happens when you disagree?

**JY:** We'll put our challenge to S&P and whether it be data-related or approach-related, they can rebut that and challenge. Or they may take on board what we've said and change it, but only if they are comfortable. Fundamentally, this is their opinion.

**BJ:** How do you come up with a valuation? What things do you look at?

**JY:** It's all really around the fundamentals of the company. Performance, the financials, what's actually happening, but the milestones as well. Are they achieving the things we thought they would or have they missed deadlines? There are key factors, as is the broader external markets. Looking at a peer set, looking at the listed markets, what's changed in terms of market sentiment?

**BJ:** You have a list of similar companies or related companies in the public space that are listed companies and see how they've moved. What if private company A doesn't have a peer in the public market?

**JY:** And that's often the case. And that's where the challenge comes in. And that's about thinking outside the box, looking for companies that overlap in specific ways. They might not be exactly the same, but do they have the same growth trajectory? Do they have the same margins? Are they operating in the same industry? And building a set that overall captures all of those elements. And you have the market sentiment influencing from different angles.

**BJ:** You and S&P Global have now agreed in the price. Then what happens?

**RC (Rachel Callaghan):** Then it comes to the Private Companies Valuations Committee, which is part of the internal valuations process and governance structure at Baillie Gifford. Again, this is an entirely independent function within the valuations process. None of the valuations committee are on the investment floor. It's another arm's length independent scrutiny and challenge of both S&P's work, but also the internal valuations work that James' team does. And the Valuations Committee has to then further rubberstamp and approve all of the valuations that come past the group.

And we meet monthly to interrogate and challenge those valuations that we see and provide different insight from our roles around Baillie Gifford.

**BJ:** That's it then. We get to that point and that's the valuation done. Company A is worth X billion dollars?

**JY:** If only. There's then further levels to the governance, which is an important part of the process and something we take a lot of confidence from. The fact a lot of these companies are held by investment trusts, you've then got two further layers of governance really there. You've got your boards, independent boards that each of these trusts have. Completely external to Baillie Gifford itself. They will review all of these valuations every six months. They will see everything we see.

They see the full reports, any backup they want. And they'll challenge the valuations themselves. That then goes through audit. Each of those trusts, there's different auditors involved. We've got four different external firms.

**BJ:** Like PWC, KPMG, etc., those big...?

**JY:** Yes, three of the Big Four and different teams from within them as well. And I think importantly, also at different times in the year. The year ends for our trusts are many and varied. We have a lot of investments, some of the examples you named earlier. A lot of our investments are held in numerous portfolios. They're being scrutinised by boards and different boards and have different auditors looking at them at multiple points in the year.

**BJ:** Company A could be held in four or five different investment trusts and vehicles which look at it in their year ends, whether that's March, April, June, August, September. And they do that twice a year because they do half-years as well. And they're having different auditors, which then also look at it. And can they challenge and change the valuation as well?

**JY:** Absolutely. The boards, they have to be comfortable with the valuations. If they're not, then they can change the valuations to what they see is appropriate. And that's what the auditors will then sign off on.

**BJ:** That happens as a standard, once every quarter. But what about in really volatile or the periods

or if news comes in just after you value private company A, what happens then that changes that thought?

**JY:** That's where the frequency and the modelling is key. We think about trigger events. We're always monitoring within the team to see, has an event happened that might shift the value of a company? Financial performance outside the expectations, milestones being hit or market volatility. The comparable companies, have we seen an upward or a downward shift since we last valued? And making sure that we're reflecting that in the valuation and updating in as close to real time as we can.

**RC:** Have you marked your own homework at any point? And how accurate are you with your valuations process?

**JY:** Yes. What we've essentially had is the market marking our homework. We've had these price discovery events. And by that, we mean, effectively, transactional activity. A company raises new equity. It's acquired. It might be listing. Either way, the market has attached a value to the company.

**BJ:** If somewhere in the public, away from us, a company has raised money or it's been acquired and the price has been publicly stated, this is worth this?

**JY:** Exactly. Whenever that happens, we'll look at the valuations we have in place. How is it trending? Where were we before that happened? To see how we fared. And importantly, what we want to see is a mix. You're never going to get valuations perfect. They are estimates. But sometimes you want to see it go up a bit, sometimes down a bit. If you're always going up or you're always going down, that's a sign of bias in your process. You might always be too aggressive or you might always be too conservative.

And that's what we've seen. If we take the last 15 transactions or price discovery events that we've seen, we've had ten we've had to mark up a little bit and five we've had to mark down. And the average movement we've seen across all the 15 is about a 10 per cent uplift following a price discovery event. And that gives us confidence that the process has balanced, that we're not always going one way or the other. And we'll always be doing that back testing to make sure that that hasn't crept in.

**BJ:** Thanks. It's a really important topic. We could talk about it for a long time. If you want any more information, viewers, please go to our website to look at our policies and so on. But thanks for watching this film and look out for other films in the series on investing in private companies at Baillie Gifford.

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