Baillie Gifford™

Japan Growth
Q1 investment update

April 2025

Investment manager Donald Farquharson and investment specialist Alison Henry give an update on the Japan Growth Strategy covering Q1 2025.

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

Alison Henry (AH): Hello, and welcome to the Japan Growth Q1 update. I'm Alison Henry, an investment specialist, and I'm joined today by Donald Farquharson, head of the Japan Team and lead manager on the Japan Growth Strategy. As a reminder, we take a flexible approach to investing in a concentrated portfolio of the best growth companies in Japan. The plan for today is to talk about performance, portfolio positioning and outlook. But before we get into that, I'd like to start with the very topical macro. So, Donald, Q1 has been very much dominated by actions from the US. What are the implications of the tariffs on the Japan growth portfolio?

Donald Farquharson (DF): Well, I seem to end every quarter by saying that there are a lot of uncertainties and complexities. But that seems to be true, particularly now. Tariffs can be imposed, and then countries will react to it. And it's very hard as a portfolio manager to know what sort of action, other than to be quite calm in this type of environment. Quite apart from the fairness and proportionality of the US actions on the tariffs that it has imposed. In terms of the sectors that are most in the front line of this, the automotive, sector is the largest contributor to the trade surplus. We don't own any of the Japanese car manufacturers. So that's a good thing.

The second largest contributor are machinery companies. Now, this is an area where the portfolio does have quite a lot of exposure, principally in factory automation. And the US wants to attract a lot of capital. How is it going to be able to deliver that without Japanese factory automation companies? They are really the only or certainly the dominant providers in most instances.

And the third largest area is medical equipment. And there we think at a stock level, our companies are quite well positioned in that generally they are producing locally to sell locally. So the portfolio positioning vis-a-vis [with regards to] US tariffs looks OK. But of course, country responses make that very unpredictable. So at a stock level, what we're concentrating on is the durability of growth and operational and financial resilience.

AH: Thank you. So, moving on to stock specifics, the portfolio marginally underperformed over the period. One of the biggest attractors was Disco, which makes equipment for the semiconductor industry. Can I have your thoughts on the exposure to semiconductors more broadly in the portfolio?

DF: At a total portfolio level, what is categorised as being semiconductor is only a little over 3 per cent, so it's perhaps not huge. But there are a lot of other companies that we own, component makers that form a part of a semiconductor, or companies that make components which go into semiconductor production equipment, which aren't listed. So, it's complicated. There are a lot of different exposures across the portfolio, but more narrowly, as you say, that semiconductor area has been coming under pressure. Disco is the largest company or the largest single investment within that. Last year, we did actually halve the size of that holding. So, we've substantially reduced our exposure to that company. And the reason we continue to hold it and the reason we continue to like it, it makes dicing and grinding equipment and typically it has a 70 to 80 per cent market share in each of the segments in which it operates. So it has a very dominant position. It also sells a lot of downstream consumables which means that even if it's not selling the equipment, it will still be selling the consumables for as long as the equipment's being operated. So it's quite a resilient business.

AH: Moving on to contributors, both Sony and Nintendo did well over the period, they outperformed. Any correlation between the two entertainment names?

DF: Well, there is an obvious correlation between the two in that they both make console games. Taking Sony first, and I've been a long-term admirer of the company, I think that the the senior managers, Kenichiro Yoshida and Hiroki Totoki, are among, if not the best managers of any Japanese enterprise. And what they have succeeded in doing is repositioning the company from consumer electronics towards content- game content, music content, and pictures. And it is the former two, games and music, that have been doing extremely well and have been driving the share price to all-time highs.

And Nintendo has also been hitting all-time highs. It's a bit different, but there it's been on the back of the huge success of the Switch and the attention that is now falling on the successor console and on the software game pipeline.

AH: Talking of gaming, you sold Mixi over the quarter. Can you give us your reasons for that exit?

DF: So Mixi makes slightly different games, mobile games, and it had, about seven years ago, a huge hit in a game called Monster Strike. And we bought the shares shortly after that, when actually the share price had been quite weak. concern over what the successor would be. And part of the problem is there hasn't been a successor. So, at the same time, the shares ironically did quite well. And we had been reducing the holding. More recently, some governance concerns, also the way in which the business was repositioning towards more volatile, less predictable areas, we just decided we'd sell it.

AH: And what did you use the proceeds to go into? I know you made a number of additions over the quarter.

DF: Yes, a number of additions, two I'd probably highlight because they were both companies that I met on a recent trip to Japan. Bridgestone, a tyre maker. What I like is it's quite a simple business, selling cars and referencing the earlier comments about not owning any of the Japanese automakers. Tires are a simpler business. Bridgestone is one of the two leading companies in this area. They've been making some operational improvements. They've been moving the brand into a more premium area, which has been helpful to margins. They've been improving downstream distribution. And most significantly in the recent quarter, they announced a very large share buyback, an 11 per cent share buyback. So I think they're doing all of the right things.

And in the case of Unicharm, which is in the personal care area, and 80 per cent of its sales are within Asia. What impresses me and what came out of the company meeting was not just how well they're doing within the home market, how well positioned they are for the changing demographics of Japan, but the success that they're having in very large consumer markets, prospective markets, such as India, where three years ago they were the number three and today they're the number one brand.

AH: Super. Last question from me, how are you feeling about the portfolio in aggregate?

DF: It goes back to my earlier comments around unpredictability and really what one wants at this time is a portfolio that can continue to grow, that is resilient to some of the unpredictable shocks and where you're not having to pay too much for all of that. And in terms of growth, the overall portfolio characteristics are sales and profits growth about 1.6 times that of the market. So, a lot of companies that impress us in this area, but to pick out one, an IT service company like Shift, which is growing its top line at about 30 per cent, but profits at an even faster pace because it's improving its margins.

In terms of resilience, we're looking at companies which have on average gross margins 1.5 times that of the index and free cash flow yields of 1.6, 1.7 times. So, reference back to Bridgestone that I mentioned earlier, where it's able to use some of that free cash flow to buy back its shares.

And finally, on valuation, we talk about a price earnings premium that we're having to pay for growth. That's now come down to about 30 per cent. But on an enterprise value, to EBIT, earnings before interest and tax basis, we're only paying a very small premium for that sort of growth. And a company like Hamamatsu Photonics, which is in that area of semiconductors, which I mentioned before makes opto-semiconductors quite a specialist area, they're very much now in that, well, they're actually at quite a big discount to the market.

AH: Thank you, Donald. That's a very positive note to end on. To recap the main points today, the macro environment should be much more supportive for our domestically-orientated portfolio versus owning the large-cap cyclical and export-led companies, which we don't have in the portfolio. We think that the Japan growth portfolio is exposed to structural growth, which puts us in an exciting position, as Donald has demonstrated by the portfolio characteristics. Thank you for listening today and we hope this has been a helpful update.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

Japanese Equities Growth

Annual past performance to 31 March each year (net%)

	2021	2022	2023	2024	2025
Japanese Equities Growth Composite	55.8	-17.5	-12.7	11.6	-5.6
TOPIX Index	38.9	-7.2	-3.5	24.3	-0.4

Annualised returns to 31 March 2025 (net%)

	1 year	5 years	10 years
Japanese Equities Growth Composite	-5.6	3.4	3.4
TOPIX Index	-0.4	9.0	5.7

Source: Revolution, Japan Exchange Group. US dollars. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

Past performance is not a guide to future returns.

Legal notice: The TOPIX Index Value and the TOPIX Marks are subject to the proprietary rights owned by Tokyo Stock Exchange, Inc. and Tokyo Stock Exchange, Inc. owns all rights and know-how relating to the TOPIX such as calculation, publication and use of the TOPIX Index Value and relating to the TOPIX Marks. No Product is in any way sponsored, endorsed or promoted by Tokyo Stock Exchange, Inc.

Risk factors

This communication was produced and approved in April 2025 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this communication are for illustrative purposes only.

Important information

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Financial intermediaries

This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe

Baillie Gifford Investment Management (Europe) Ltd (BGE) is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. BGE also has regulatory permissions to perform Individual Portfolio Management activities. BGE provides investment management and advisory services to European (excluding UK) segregated clients. BGE has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. BGE is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

Hong Kong

Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 is wholly owned by Baillie Gifford Overseas Limited and holds a Type 1 license from the Securities & Futures Commission of Hong Kong to market and distribute Baillie Gifford's range of collective investment schemes to professional investors in Hong Kong. Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 can be contacted at Suites 2713-2715, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. Telephone +852 3756 5700.

South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Australia

Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a “wholesale client” within the meaning of section 761G of the Corporations Act 2001 (Cth) (“Corporations Act”). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a “retail client” within the meaning of section 761G of the Corporations Act.

This material contains general information only. It does not take into account any person’s objectives, financial situation or needs.

South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

North America

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited (‘BGE’) relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

Israel

Baillie Gifford Overseas Limited is not licensed under Israel’s Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755-1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

Singapore

Baillie Gifford Asia (Singapore) Private Limited is wholly owned by Baillie Gifford Overseas Limited and is regulated by the Monetary Authority of Singapore as a holder of a capital markets services licence to conduct fund management activities for institutional investors and accredited investors in Singapore. Baillie Gifford Overseas Limited, as a foreign related corporation of Baillie Gifford Asia (Singapore) Private Limited, has entered into a cross-border business arrangement with Baillie Gifford Asia (Singapore) Private Limited, and shall be relying upon the exemption under regulation 4 of the Securities and Futures (Exemption for Cross-Border Arrangements) (Foreign Related Corporations) Regulations 2021 which enables both Baillie Gifford Overseas Limited and Baillie Gifford Asia (Singapore) Private Limited to market the full range of segregated mandate services to institutional investors and accredited investors in Singapore.

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com