UK GROWTH TRUST MANAGER INSIGHTS

Investment manager Milena Mileva shares an annual update on the portfolio, reflecting on the market environment, performance and turnover, and opportunities for holdings.

As with any investment, capital is at risk. Past performance is not a guide to future returns.

This communication was produced and approved in August 2023 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

For a Key Information Document for the Baillie Gifford UK Growth Trust, please visit our website at www.bailliegifford.com

Milena Mileva: Hello and welcome to this annual update of the Baillie Gifford UK Growth Trust. My name is Milena Mileva, and I co-manage this investment trust alongside my colleague Iain McCombie.

BGUK is a concentrated, long-term, actively managed portfolio of what Iain and I consider to be some of the best British growth businesses.

What does that mean in practice? Well, we aim to identify high-quality companies that enjoy sustainable competitive and cultural advantages and, therefore, have the potential to deliver superior earnings growth over many years. We then hold onto them long enough for their unique strengths to emerge as the dominant influence on share prices.

However, when we reflect on the market environment over the past year, it has been top-down factors which have been critical in driving share prices: inflation, interest rates, and geopolitics have all come to the fore.

Performance

The higher interest rate environment has had a significant impact on the valuations of faster growing companies, where forecast profits and cashflows are far out into the future. We are, of course, biased to investing in such companies and performance of the portfolio has struggled as a result.

In addition, our UK index is dominated by a small number of large businesses – such as the oil majors, banks, and big pharma – which have outperformed strongly.

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We are still of the view that these shares do not constitute attractive long-term growth investments but their strength in the short-term has been a headwind.

To put it simply, this has not been a favourable backdrop for this differentiated, growth portfolio, and I am disappointed to have to report on a year of poor relative performance.

Portfolio update

So, what have we been doing? Our portfolio turnover remained very low at 5 per cent, which implies an average holding period of 20 years. Fellow shareholders should not mistake these low levels of activity for complacency.

The reasoning here is that despite the valuation re-set, we are confident that the business fundamentals and growth prospects of our holdings remain very strong, and the vast majority have continued to show pleasing operational and financial progress.

Indeed, amidst all the doom and gloom surrounding the UK and global economy, we are encouraged by what we are hearing from our management teams and by their ability to find new opportunities to grow their business.

For example, the plant hire business Ashtead, which is finding new areas to rent (very lucratively in the case of hiring out floor cleaning equipment); the platform business Autotrader offering an ever-expanding suite of products to automotive retailers; or hobbyist retailer Games Workshop making progress in monetising its deep pool of intellectual property across the broader media space.

These are just some examples of the opportunities arising from our holdings and the reasons why we remain deeply enthusiastic about the businesses we are invested in.

There is no denying, however, that the economic environment has become tougher and more uncertain, and it would be naïve to suggest that our holdings are somehow immune to this.

Outlook

As we aim to hold future winners through the cycle, we have been carefully monitoring the financial resilience of the companies we invest in and are satisfied that over 93 per cent of the portfolio is invested in businesses with positive earnings or free cashflow.

Furthermore, the Trust's holdings compare favourably to the benchmark in terms of quality and resilience. For example, over five years they have grown their revenues well in excess of the market, are generating higher profit margins and have a much lower net debt-to-equity ratio compared to the market.

For the small minority of unprofitable holdings, primarily early-stage businesses investing for growth, we are satisfied the balance sheet strength is sufficient to see them through a weaker macro-economic environment.

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We made only two new purchases in the year – IT value added reseller Softcat and Belfast-based software consulting and development firm Kainos. We think both companies enjoy very exciting long-term growth opportunities driven by the growing need for corporates to invest in their IT estates.

Importantly, both of them have established strong competitive positions enabling them to consistently outperform the underlying industry and gain market share.

For example, Softcat differentiates itself through the quality of service provided by its highly engaged employees, who share in the success of the business. We believe that its business model and culture set it apart from its peers, and its scale and investments in developing its capabilities add to a sustainable competitive advantage.

Iain and I have also been critically appraising the investment hypothesis for the handful of portfolio holdings, mostly online consumer-facing businesses where short-term operational performance has disappointed, to evaluate their long-term growth prospects as well as their resilience against the current economic backdrop.

This is what led us to selling our holding in Just Eat Takeaway as we had growing concerns over the industry dynamics and the company's potential to achieve profitable long-term growth.

Looking forward

Looking ahead, while share price performance has been challenging, there are some noteworthy indications of green shoots emerging.

Operational performance is now being rewarded and there is less correlation to what we saw in the earlier parts of last year when all growth stocks appeared to be hit indiscriminately. This is particularly important for UK Growth Trust, given our investment approach of selectively backing a range of individual businesses.

However, there is no doubt that we are living in uncertain times and there is a lot of pessimism out there. As active investors, we have the fantastic opportunity to form our own differentiated views by carefully assessing the unique characteristics of individual companies and weighing up their idiosyncratic risks and opportunities.

Doing this, whilst staying focused on the long term, enables us look to the future with optimism. We believe that the key to generating attractive long-term returns remains growth, quality, and resilience, and striking the right balance between that interplay.

Our approach remains one of patient investment in a portfolio of what we believe to be excellent businesses run by sensible management teams. We remain excited by what the coming years will bring.

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Annual Past Performance to 30 June Each Year (Net %)

	2019	2020	2021	2022	2023
Baillie Gifford UK Growth Trust PLC	-0.2	-2.5	31.7	-35.1	11.1
FTSE All-Share Index	0.6	-13.0	21.5	1.6	7.9

Source: Morningstar, FTSE. Share price, total return in sterling. Returns reflect the annual charges but exclude any initial charge paid.

Past performance is not a guide to future returns.

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- Market values for securities which have become difficult to trade may not be readily available and there can be no assurance that any value assigned to such securities will accurately reflect the price the Trust might receive upon their sale.
- The Trust's risk is increased as it holds fewer investments than a typical investment trust and the effect of this, together with its long-term approach to investment, could result in large movements in the share price.
- The Trust can make use of derivatives which may impact on its performance.

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- The Trust's exposure to a single market may increase risk.

- Share prices may either be below (at a discount) or above (at a premium) the net asset value (NAV). The Company may issue new shares when the price is at a premium which may reduce the share price. Shares bought at a premium may have a greater risk of loss than those bought at a discount.

- The Trust can buy back its own shares. The risks from borrowing, referred to above, are increased when a trust buys back its own shares.

- The aim of the Trust is to achieve capital growth. You should not expect a significant, or steady, annual income from the Trust.

Further details of the risks associated with investing in the Trust, including a Key Information Document and how charges are applied, can be found in the Trust specific pages at www.bailliegifford.com, or by calling Baillie Gifford on 0800 917 2112.

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