# *US EQUITY GROWTH Q2 INVESTMENT UPDATE*

Investment specialist Patrick Stapleton and investment manager Kirsty Gibson give an update on the US Equity Growth strategy covering Q2 2023.

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**Patrick Stapleton (PS)**: Hello. My name is Patrick Stapleton. I'm a US equity investment specialist here at Baillie Gifford, and I'm joined here today by one of the US Equity strategy team's four named decision makers, Kirsty Gibson. So Kirsty, it's been another busy several quarters for us in equities and performance have seen some positive tentative steps. What have been some of the most interesting developments that we've seen in the past quarter?

**Kirsty Gibson (KG)**: I think it's fair to say that the focus on growth and profitability has continued. You know, this is not an easy environment for the companies within which we invest our clients' capital, but that focus on growth and profitability in tandem is really beginning to come through in the numbers in the financials that we see. And that has definitely driven some of the performance that we've seen.

I think that we don't need every company in the portfolio to be profitable in the next quarter, and I think it's worth emphasizing that. But we do need to be able to see a path for them achieving their long-run opportunity set. So, after we've considered the competitive positioning of a business, its opportunity, its financial position, its capital requirements and the adaptability of the management team, if we're still comfortable with all of those things, then we can continue and will continue to hold those businesses.

Now to pull out some specific examples of interesting developments, I think the first one I would touch on would be Roblox. So Roblox is an online gaming platform that's particularly popular with the 9- to 12-year-old demographic worldwide, and Roblox has seen some strong and solid user engagement and growth over time. And this has led to strong bookings growth.

And what's really interesting for Roblox at the moment is they believe that bookings growth this year is going to be larger. It's going to cover its infrastructure costs, and next year bookings growth is going to exceed their compensation costs. And this is particularly interesting because it's been driven by innovation. It's not been driven by an increase in sales and marketing spend.

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The company spends around 4 per cent of its revenue on sales and marketing. So, this means that Roblox is emerging as a self-sustaining business whilst at the same time they are just getting started in that opportunity of aging up their cohorts and moving from that 9- to 12-year-old demographic up to that kind of 17- to 24-year-old demographic, which is much more lucrative from a revenue perspective. So that's very exciting.

Another company would be Pinterest. So, Pinterest is the online visual discovery platform. It's basically an online pin board, and under the leadership of their new CEO, Bill Ready, the company is focusing on making its pins much more shoppable. And the reason for doing this is that there is no Western location in which brands can go to to get that full funnel advertising experience.

And by full funnel, I mean from discovery all the way through to purchase. And Pinterest has seen some good progress in click-through rates and also in saves of shoppable pins. And they've been opening up to third-party advertising platforms in order to continue to bring in that inventory, that advertising content. So, I think Pinterest is really well described as a sort of online shop window, and I think with the advent and the changes that the CEO has brought in, I think you could say that that shop window is very much open for business.

I think we couldn't talk about interesting developments, however, without touching on the topic of AI. So, on the last one of these quarterly updates, my colleague Gary spoke about this idea that if a computer is a bicycle for the mind, then AI is a rocket ship. And I think that's a really good analogy, so I'm just going to plagiarize it. I think that it really does feel like a paradigm shift that we're experiencing. You know, companies are racing to integrate generative AI into their products into their services and even their business processes. It's hard to find a company at the moment that's not talking about AI, and that's true of the companies that we own in the strategy as well.

I think Gary, on the last update, talked about a couple of companies that were integrating generative AI to Duolingo, which is the gamified language platform. They're using generative AI for spontaneous conversations. And he also spoke about Shopify, which is using them for AI chatbots.

Now, Roblox, that I mentioned earlier, they've actually just released two new features, the first of which is about enabling people to create materials on their platform using natural language. So, if I was wanting to wear a new skin, as they would call it on their platform, I could say, 'I'd like it to be blue', 'I'd like it to be shiny', and I could describe it in those terms and it would be created for me.

The second new feature is about code generation, and this is particularly interesting because it opens up the platform for more people to create on it. Someone like me who doesn't have a coding background can create code again using natural language. So you can start to see how generative AI could be an accelerant to the Roblox platform because of the fact that you've now got more content being created, which potentially makes the platform itself much more valuable.

Now, I also couldn't touch on the topic of AI without talking about one of our long-term holdings and actually one of the largest holdings in our portfolio, and that's NVIDIA. Now the companies

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and the industry surrounding AI is moving very quickly and evolving very fast. And I think it's honestly fair to say that nobody knows precisely how it's going to play out. But NVIDIA looks to be an early beneficiary, at least.

So, NVIDIA makes chips called GPUs and these are the infrastructure for the development of large language models. Now NVIDIA had what can only be described as a monstrous quarter and that looks set to continue given the fact that they were supply-constrained for the first half of this year and the demand for their products is growing over time. But NVIDIA 's opportunity is more than just a couple of quarters, we believe it's more than just a flash in the pan and there is over one trillion dollars of data infrastructure globally, which is almost entirely run on what's known as CPUs.

Now, the rise of accelerated computing and generative AI is potentially driving a value shift towards GPU use. And so they have the opportunity to capture some of that trillion dollars of infrastructure. And given that NVIDIA is very much focused on GPUs, and they have a software offering which is very sticky in order to program those GPUs, it looks very well positioned to benefit.

**PS**: Right. So new capabilities being opened up by AI, but early exciting opportunity as well. That leads us to thinking about the future. And so how are you thinking about portfolio positioning for the coming five years?

**KG**: So, we're really excited. And I don't think we want to claim that it's going to be smooth sailing for the next five plus years. But I think there are three broad topics as to why we're particularly excited. The first is, capital is a scarce resource right now and those businesses which are self-sustaining or have a large enough war chest of cash to reach the point at which they're self-sustaining, have a significant opportunity in this environment to not just survive but also thrive.

Examples would be DoorDash, the restaurant and delivery platform in the US, or Tesla the EV manufacturer. Most people know that one quite well. And they are capital-intensive, yes, but they're also generating free cash flow, and that provides them with an opportunity and that is the opportunity to shore up their competitive position right now, but also then go on to emerge from this environment stronger than when they went in.

The second reason why we are excited for the long term is that the structural changes that we invested in prior to the pandemic that were accelerated by the pandemic, you know, they still continue after the pandemic. We believe that more people will be driving electric vehicles in five plus years. The shift will continue from cleaner to greener types of energy generation. We will see more shifting from on-premise to the cloud. AI will continue to grow. And we expect to see more and more personalized health care.

And then I think the final reason is we’re seeing the emergence of a new type of business model. So, I think the last 100 years for businesses, competitive positions were based upon atomic strength. So how many physical assets did you have and how good was your access to capital? The proliferation of the internet changed that. You saw the rise of a sort of byte-based model where being nimble, having a great idea, being very creative and having the ability to attract great



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talent enabled businesses like Alphabet and META, to be able to build strong competitive positions.

We're now seeing the combination of those two models coming together. So, we'll call it the atom and the byte-based model. And what's really exciting about this is that I think you could argue that byte-based models have actually disrupted a fairly narrow sector of the economy, mainly advertising, analytics, media, and to some extent commerce, whereas bytes and atoms combined is bringing disruption to a whole new swathe of the economy. Restaurants, logistics and healthcare, automotive.

And Moderna, the mRNA vaccine company; that's a really good example of this, because Moderna has the knowledge and the skillset to create the software to program, shall we say, those vaccines. But they also have the hardware knowledge or the understanding of how to manufacture them.

**PS**: And engaging with companies is such an important part of understanding that. We continue to engage with companies as we have done, leading to new insights in some cases. So, I'd love to hear from you about some of the highlights that we've seen from those conversations with companies in recent times.

**KG**: Yeah, absolutely. It's quite difficult to choose a few, so I'll try and narrow it down.

So I think the first one I'd mention would be a call we had with the CEO of Pinterest. So I mentioned Pinterest earlier. We were very keen to have a call with the relatively new CEO. He's been CEO for just about a year now, and we'd seen him present a variety of conferences and we'd been in group meetings with him, but we've never had much of that one-on-one time, and we were particularly keen to explore the sort of cultural changes, or not, that happened within the company since he took over.

And I think what was really reassuring to us was that Bill Ready, the new CEO, recognises that he needs to embrace what makes Pinterest special. He doesn't want to change the culture and evolve the company away from that. Being an environment where people feel safe to really express who they are as individuals, but also as brands, feeling that they can put their content on Pinterest knowing that it's in an environment which is safe.

But what he does bring is he brings a focus on performance and execution that the company maybe up to now has struggled a little bit more with. So, he's combining what makes Pinterest special with a skill set that potentially allows them to go on to be much larger in the future and much more successful.

I think the other meeting that I would highlight would be that when I was out in the US recently, I got the opportunity to spend some time with the CEO and founder of DoorDash, Tony Xu. I mentioned DoorDash briefly earlier, but it's an online restaurant delivery platform which does food delivery for restaurants, but also convenience and grocery. And we were really keen to spend some time with Tony to talk about his long-run ambitions for the business, beyond the sort of shorter term, you know, how did he see the business in the next ten plus years?

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And I think this was really refreshing because many of the conversations that we have been having with management recently have been more focused on shorter- and medium-term challenges. So, to be able to talk about his vision for the business was really interesting. And ultimately DoorDash wants to evolve beyond the industries within which it currently operates, and they want to reinvent the logistics for a city. They want to become the platform that everybody goes to to connect merchants and their consumers. Now, this is a grand ambition and it's not a sort of one- or two-year idea. This is going to take the next decade or so to play out. But what gives us some confidence and some comfort in their approach to this is DoorDash has a culture of breaking problems down to their lowest level of detail and really focusing on the nub of the issue and then building up from there.

And that technique has proven very effective in some very challenging industries that we've gone into initially. But also it's a way in which you start with small problems. But over time those small problems become a very, very large opportunity because there are lots of them to address.

**KG**: Fantastic. Well, thank you very much for that, Kirsty. We hope you found this insightful. Thank you very much.

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**Annual past performance to 30 June each year (net %)**

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| American Equities Composite | 8.3 | 49.9 | 79.8 | -61.7 | 31.2 |
| S&P 500 | 10.4 | 7.5 | 40.8 | -10.6 | 19.6 |

**Annualised returns to 30 June 2023 (net %)**

| | 1 year | 5 years | 10 years |
|---|---|---|---|
| American Equities Composite | 31.2 | 7.9 | 13.7 |
| S&P 500 | 19.6 | 12.3 | 12.9 |

Source: Baillie Gifford & Co and S&P 500. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.
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