

A long term commitment to growth investing

October 2023

Join portfolio manager Joe Faraday, investment specialist Katie Muir and host Matt Coyle as they provide an update on performance, recent portfolio activity and why we have confidence in our approach.

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

Matthew Coyle (CO): Well, thanks, everyone. I can see numbers are ticking up nicely, so good morning, and welcome to the Q3 International All Cap webinar. I hope everyone is well today, and thank you for taking the time to join us. For those on video, please use the Q&A function to ask any questions. And if you're dialling in, then please feel free to email any questions to events@bailliegifford.com, that's events@bailliegifford.com.

So, the macro environment continues to be very challenging, particularly for growth investors. And we've seen a sharp divergence between growth and value during the quarter. And September, in particular, showed just how significant the acute change can be, and we've certainly seen that come through in performance. For those of you who know us well, you will know that focusing on a very short period of time is not common. But I think it is important just to highlight how quickly things have moved.

You will know that our focus remains on delivering long-term attractive returns, and very much thinking about stocks that can provide those for us. To discuss the portfolio in more detail, I'm delighted to be joined by portfolio construction group member Joe Faraday, and Katie Muir, one of our investment specialists. Good morning, guys. Joe, would you like to start us off?

Joe Faraday (JF): Okay, super. Well, morning, everybody. And to kick off with, I want to share some broader reflections on what's on our minds, as a portfolio construction group. But I think, first up, before I do that, to be very clear, as Matt alluded to, it's continued to be a challenging period of performance, and we take full responsibility for that. Our aim is very much to turn that around and to ensure that we deliver long-term returns for you, as our clients, over the long term. Our interests are aligned with you, as our clients, and that's whether I'm talking as an individual, each of the individuals across the portfolio construction group, us as a team, or here, as a collective at Baillie Gifford.

We are staying true to our investment philosophy. For us, it's about being growth investors, taking a long-term view. Sure, there are some lessons and reflections from the recent period of performance in the last two or three years. We will always constantly look to enhance our process and our approach, and in recent times, that's been working closely more with our risk colleagues, broadening out the growth types, or the resolve that's been needed to navigate through

tougher periods. And I think it's really worth emphasising that we've had this strategy, or this approach, for well over 30 years now. The strategy itself has endured five drawdowns or tougher periods, and both Iain and myself have been here, at Baillie Gifford, for actually four of those.

So, I'll come back to performance in a moment and expand on what has been going on, but if I turn to the first point I'd really like us to cover, it's what's on our minds more broadly from a process angle, and what we're seeing across the portfolio. There are three key points I want to strike home here. So, the first of those is around our confidence and our message of what we're seeing, in terms of growth, quality, and resilience. We remain very upbeat, in terms of the long-term prospects for the holdings, as we think out over the next five [to] ten years. Where will earnings growth and free cash flow per share be for all of the holdings across the portfolio. In terms of business quality and profitability potential of businesses, again, we remain upbeat on returns on capital and so on and so forth. And then resilience, which is something that's always there in our portfolio, a rock-solid balance sheet, strong interest cover, the ability to fund at these times is absolutely paramount. So, it's a blend of those three qualities that we think we are very confident about what we see across the holdings in the portfolio as a whole.

The second main point in what's on our minds is idea generation. It is a great time to be finding new ideas. There's strong competition for space in the portfolio. And Katie will come on in a little bit and talk about some of what we've been up to. But the investors have been really active in idea generation. There was just under 1,000 company meetings last quarter alone [at Baillie Gifford], and we're making a big, concerted effort to make sure we're broadening out the growth types that there are across the portfolio.

And then my third point is around the portfolio itself. These are world-class companies that just happen to be international. We're pleased with the holdings, how they're doing, where their long-term potential lies. And we can walk through [the] four big growth drivers that we often refer to, but in healthcare, [the portfolio holds] Olympus in endoscopy, [and] Cochlear in hearing implants, as world leaders. In the online disruption space, [there is] Auto Trader in car classifieds in the UK, or what's now called LY, LINE Yahoo Holdings in Japan, with its PayPay business being a dominant leader there, and growing quickly.

The luxury goods companies, discount food retailers, factory automation, this is a portfolio that contains exceptionally good, world-class businesses that we're very excited about for the next five to ten years. So, that's what's on our mind. It's blending with what's been going on, in terms of performance, which I'll come on to now, just in a second, and walk through, along with the confidence around growth, quality, resilience, really robust, strong idea generation and competition for space in the portfolio, and then confidence in backing these businesses, and what we expect them to deliver for long timeframes.

So, if we now turn on to performance, investment performance, and walk through what we've been seeing in the portfolio in more recent times. And I'm going to frame this around the past quarter, or almost a year-to-date timeframe, as well. So, clearly, there have been headwinds that have continued for growth. We don't need to walk through all of that familiar rhetoric from the last two or three years now, but higher interest rates, higher inflation, higher oil, commodity complex, etc. But what I want to call out in more recent times is three quite specific factors.

The first of those is Japan. And Japan, I would account for it being about half of the degree of underperformance we've seen. The second is China, and that's direct and indirect exposure. I think that's been about a quarter of the underperformance. And then the last component is some European stock specifics. So, to expand on each of those. So, Japan. There is a lot going on in Japan. As Matt mentioned, a lot seemed to happen in Japan in September, or from the

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middle of the summer months. So, there are three drivers happening in Japan at the moment, in terms of leading to the degree of underperformance that we've seen there.

Signs of higher interest rates, 0.7 per cent instead of 0 per cent. Inflation, 2 per cent instead of 0 per cent for the first time in almost 30 years, and even some components, or underlying product types, we've seen double digit inflation. This is Japan. Wow. And then the last one is the Tokyo Stock Exchange, the TSX, having a big push around shape up or ship out, and trying to force companies that are trading on lower than book value to really sort themselves out, get rid of cross holdings, really address the sizable discounts, or the lower than book value multiples these are trading on, or they'll be forced to delist or not be part of the main index constructs, which would have broader ramifications.

But it's a confluence of those factors that's led to a very sharp value rally in the Japanese market over the last two or three months. And that poses a really big headwind, because the primary exposure we have through Japanese businesses, extremely high quality growth businesses, they're almost nothing to do with any of those areas. We don't own the financials. We don't own the trading houses. We own high quality domestic focused or export orientated businesses that have kind of being left behind in that.

And we can expand on that in the Q&A, if it's an area of interest, or follow up on that, but our general view is that you see these periods happen in Japan, but also, there's a big question, does that become more pervasive? And ultimately, as we always expect, fundamentals will get rewarded. The companies we have in Japan are strong businesses. They're world leaders. They will perform operationally well over time, and that will be rewarded in the long run.

The second factor behind underperformance is China. So, direct and indirect exposure there. So, there are actually quite a few of the Japanese holdings in the consumer discretionary orientated spaces or industrials. Out of Europe, some of the luxury names, or again, industrials. So, [the] lack of a real strong recovery post-COVID in China has posed a big headwind. And that's in the forms of top line growth recovery, in terms of margin potential of businesses, as well. And there's also some of the domestic Chinese holdings, where those are held, where we have emerging markets holdings, that posed headwinds on that count as well.

The third component of underperformance is Europe, and I'm going to call out two specifics here. One is simply not owning Novo Nordisk. We've owned that in the past. We sold that a good number of years ago now. And the other is Adyen, the rapidly growing disruptor business, that reported earnings growth, or bottom line growth, of basically 20 per cent to 25 per cent. The expectations were mid to high 30s, so that was a disappointment. And there are concerns around the extent of competition that business is seeing. And again, I'm happy to expand on that, or if that's a topic of interest, please do just reach out and ask us.

So, those are the main components of the degree of underperformance that we've seen, homing in on the various attribution reports and drills we do. If I turn to actually some of the positives, there are some of these, some of the rapid growers. So, MercadoLibre [held in portfolios with emerging market stocks] is a good standout, as it has been for a good period now. Also, I mentioned earlier Z, or the now LY Holdings, that grew top line 10 per cent, profits 20 per cent, PayPay, its payments business, [grew] 40 per cent. So, great strong growth coming through from that company.

In the staples area, some of the more durable businesses. So, Cosmos, which we bought not that long back, or where we have Indian local holdings for certain clients, the likes of United Spirits, the Diageo or Johnnie Walker of India, we're seeing very strong growth there. And the last standout positive will be actually some of the UK names. So, Weir, Auto Trader, Trainline, a large number of those businesses are actually performing really well operationally, despite quite a

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tough backdrop, and that being rewarded, actually, in share price terms, as well.

So, those are the main points I want to make when we do our drill on investment performance. I now want to turn and just spend a minute or two just homing in on operational performance, and emphasise what we're seeing and hearing from individual companies, when we're drilling their news flow, when we're out there, meeting them on the ground, and when they're coming through Edinburgh, as well. So, if we turn on to operational performance, our ultimate aim is about backing the best businesses. So, Matt, I'll get you to toggle on to the next slide.

If we look through the lens of growth, quality, resilience, and look through what we have seen, and this is based on our weekly news flow monitoring, company meetings, etc., I would frame it as a quarter of the companies, we're very pleased with the progress that we're seeing. We're delighted. They're exceeding our forward-looking hypothesis. Around a half are tracking in line, and then a quarter, we're scrutinising and checking in on are they going to deliver? What's the resolve needed? How are they navigating through this period?

Now, there are lots of examples of this, and I'll just cherry pick a few, but if I think about top line growth, Ashtead, the industrial equipment business, is seeing a really strong demand, the Inflation Reduction Act being a big driver there. Wise, the foreign exchange payments business out of the UK, yet another UK business doing well, growing over 30 per cent, so strong top line growth from a good number of businesses. Pricing power, I think is a fascinating one, and we're seeing this is quite pervasive. So, you've got anything from Games Workshop's Warhammer figurines, discount food retailers managing pricing very, very well. And there are even interesting examples, like Atlas Copco, where if you see an order slowdown, its service revenues kick in, and that's higher margin, much stronger pricing power from that, and that's a really good counter cyclical for that type of business.

So, if we think about operating margins, we're seeing Spotify push margins. Great to see coming through from them, as well as growth. Trainline is seeing strong demand. That's all dropping straight through to the bottom line. And then a new purchase, which Katie will come onto, Hong Kong Exchange, formidable high margins from that business. It's really impressive.

And then a last area would be companies investing. We want to see companies deploying capital, and growing for the long term, So, Air Liquide is a new purchase, a good example of that. Sysmex, the testing and diagnostics business, adding ancillaries. Lonza in pharma outsourcing. You've got CPKC [and] Reliance. It's really good seeing companies committed to deploying capital, investing in headcount, SG&A, and trying to grow for the long term is what we really think is important to see.

So, if I pull that all the way back, it's continued to be a tough period, in terms of investment performance. We can walk through some of the big headline drivers for that. There's been some big macro headwinds. But when we think through the individual businesses, we think these are very special, strong, world class companies, and we're actually pleased and encouraged by what we're seeing from them on an operational count. So, with that, I will now pass over to Katie, who will walk through what we've been up to in more recent months.

Katie Muir (KM): Great. Thanks, Joe, and good morning, all. As Joe highlighted at the start, idea generation for the portfolio remains really strong. So, competition for space in the portfolio is very high. And I think one of the key benefits of the portfolio managers sitting day-to-day within their regional equity research teams, is that we can tap into all the research being done in those teams, and their specialist knowledge of stocks within the region, and then they bring all those insights and the best ideas to this international portfolio.

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So, over the past few months, we've taken a number of new holdings, which are shown on the slide. Two are European listed companies, and two are based in the developed Asia region. These new holdings also come from three different sectors, materials, financials, and IT. And importantly, they're even more diverse, when you consider the underlying growth drivers of the individual businesses, as well as the economies they are exposed to around the world.

So, the first of our new editions is a business called Air Liquide, which is a French industrial gases company. It is a company with a very strong market position, which its built up over the years, through both organic growth and through acquisitions. It now has a 30 per cent global market share in what is a very concentrated market of industrial gases. And the excitement here is really around the potential for growth for this business to accelerate, as a result of more demand for industrial gases related to efforts to both decarbonise the economy, and also, from the offshoring of industry to the US and to Europe. And incentivisation schemes, like the Inflation Reduction Act, which Joe mentioned relating to Ashtead earlier, in the US, which are also supportive for both construction and industrial investment.

Another new purchase to highlight is Hong Kong Exchange. So, as Joe said, we think this is a really special business, as it is a virtual monopoly, being the only stock exchange in Hong Kong. This dominant position results in very attractive financial characteristics, with the exchange enjoying high margins and very strong cash flows and returns. So, why did we decide to add this stock now? There is clearly a lot of concern about the health of the Chinese economy at the moment, and this has had a knock on impact on the valuation of Hong Kong Exchange. We think we're being offered an opportunity to buy what is a very high quality business, that we've admired for some time, at an attractive price.

We also added a couple of new names in the semiconductor space. Tokyo Electron, so we're still finding good ideas in Japan, despite the environment, and Soitec, which is a French listed business. In both cases, these are companies that we think have strong positions in the global semiconductor supply chain, in an industry with very strong growth tailwinds.

So, as well as searching for new ideas, we're always monitoring our existing portfolio holdings, testing if our conviction remains strong in the growth potential and in their competitive edge, and whether management is executing well, and if there remains upside in the valuation.

So, we are considering the same questions and holding them [the existing companies in the portfolio] to the same high bar that we're using for new ideas with our five question research framework. As a result of some of the recent reviews we've done on existing holdings, we've sold a couple of businesses which included Zalando and NIBE. For Zalando, which we'd held since 2017, this is a European online, multi-brand apparel retailer. And we think that growing competition in the online apparel market is going to make it much more difficult for this company to get the sort of market shares and margin levels that we originally thought it could, so we decided to sell that position and reinvest the capital elsewhere.

In the case of NIBE, which is a European heat pump maker, that's a holding we've been reducing for a while now. And the concern there is more around the valuation. The business has been executing well, but it's simply much more highly valued relative to its growth opportunity than it was when we originally invested. So, overall, there's a healthy pace of turnover in the portfolio. We're probably around mid-teens in percentage terms. And that's ticked up over the past year or so, but remains well within historical averages. And indeed, when you look at the entire portfolio, more than half of the holdings have been held for more than five years. So, it is still very much a long term, buy and hold portfolio, but great to see some new ideas coming in.

So, turning to some of the deeper dive discussions we've been having on the portfolio more recently. And from a risk

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perspective, this quarter, our focus was on the industrial sector. These quarterly sector reviews are part of our commitment, as a team, to review the largest portfolio exposures, as well as areas where there is low, or indeed, no, exposure, over a 12 month period. And the portfolio construction group does this, in conjunction with our risk analyst. So, earlier in the year, we examined financials, and in previous quarters, we've looked at the energy and material sectors, both examining existing holdings, where we have exposure to themes, but also, areas where we have limited exposure. And we've also looked at our consumer holdings in the past, and we'll examine them again before the year-end.

"So, in terms of industrials, the portfolio has just under 20 per cent invested in industrial sector holdings currently. And when we look at the opportunity set, and the top industrial companies, and those that have tended to generate the best returns over the long term, these often share some very common characteristics. And we've tried to summarise what we look for in industrial companies, or their key attractions, on the left side of the slide.

So, for high-quality industrials with attractive growth prospects, these very much tend to be global businesses that just happen to be listed in international markets. And these are businesses that tend to be dominant in a very niche field, which allows them to generate high margins and high returns on capital. They tend to be biased towards organic growth but are typically growing faster than the industry they serve. And another important feature of some of the best performing industrials, and indeed, some of our holdings, has been their ability to boost growth through bolt-on acquisitions. Serial acquirers are able to take out costs and have a good conversion rate of turning profit to net cash flow. Portfolio examples I call out here include Atlas Copco, Ashtead, IMCD, and DSV have all been very good at this.

Another attractive feature of our industrial holdings is that they often have a large aftermarket service revenue component to their business, as Joe mentioned before, which are higher margin, and offer recurring cash flows, important, particularly in more difficult macroenvironments. This, in turn, allows them to self-fund their growth, and they continue to invest heavily, even through cycles, as well as having the financial flexibility, given their strong balance sheets to make smaller acquisitions without having to rely on additional debt.

I think founder involvement is another key trait that we've seen in successful industrials, which is particularly true in Europe, but also in Japan. And culture is another important factor we've identified, with Swedish engineering business Atlas Copco, a prime example of a company, which operates a decentralised business model, which allows them to drive product innovation, and each business maximising its own returns, which has resulted in much better overall business performance.

As you can see from the middle column, the portfolio has exposure across a broad range of industries and sub-industry groups within the industrial sector. Bigger exposures are to machinery companies, which range from Atlas, which I've talked about already, to Techtronic Industries, which manufactures lithium-ion battery-powered drills and tools, or is better known for its Milwaukee and RYOBI brands. But we also invest in the portfolio in mining equipment and service companies, such as Weir and Epiroc.

Other holdings include professional service companies. Examples here are Experian, which is a credit data and analytics company, and also, Recruit, which is a leader in online human resourcing. So, a broad variety of holdings, even within this sector. And newer ideas over the past few years have included special chemicals distributor, IMCD, rental equipment distributor, Ashtead, and freight forwarder, DSV, with the latter two of those newer holdings coming out of the work we did on industrials 12 months or so ago.

So, looking forward, energy efficiency, decarbonisation, and grid infrastructure, we believe are all big themes to which

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

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we are keen the portfolio has enough exposure to, as well as the reshoring trend. We'll continue to look for new ideas, as well as monitor the progress of existing holdings. And really, the result of this work was really to cement our conviction in existing industrial holdings and their longer-term growth prospects, and the quality and resilience that they have, which we believe remains high. We also drew up a shortlist of additional industrial companies from around the regions that we would like to put through our five-question framework, and debate at one of our upcoming stock discussion meetings.

So, just to finish off, turning to the outlook and what gives us grounds for optimism from here. Well, [while] we don't know when market sentiment will improve. We remain really encouraged by the operational progress being made by the vast bulk of holdings in the portfolio. A lot of companies, as Joe highlighted, are continuing to execute very well indeed. And while there are near term challenges for some, the longer term opportunity remains intact. And we also remain very confident in the structural tailwinds, which underpin the growth for many of the portfolio's holdings.

We tend to think about these in four groups. First, the rise in the number of middle class consumers, particularly in Asia. Second, the opportunity to apply innovation and technology to industry and manufacturing, areas such as semiconductors, software, factory automation, and electric vehicles. Thirdly is the continued digitisation of retail, media, and financial services. And the fourth tailwind is demographics, and how that is driving some of our healthcare-related holdings. So, while the macro environment remains uncertain, these structural trends are what gives us confidence in the longer-term growth outlook for the businesses held in the portfolio.

And just a final point. In the current environment, the quality and resilience of the portfolio are very important, as Joe highlighted earlier. We believe this portfolio is skewed towards businesses with durable competitive positions, and those with strong balance sheets that can continue to self-fund investment in their growth from their cash flow generated. And if you put these qualities together, it makes them very resilient to the tougher macro and economic environment. And we think that ultimately, they will emerge stronger. So, I'll now hand back over to Matt, and we can take any questions.

MC: Thanks, Katie and Joe, thanks very much for your thoughts there. So, in terms of questions, please do continue to send in any that you'd like to the group to answer. Maybe starting with one. Joe, you touched on operational performance. What is it that gives us confidence in the companies in the portfolio that there will be long-term winners? What are we seeing at the moment that gives us that confidence?

JF: I think this is something we challenge and test ourselves on all the time, and I can talk through loads of examples, and we've done so on this webinar, as we normally do. I think I'm just going to take that a little bit more from a process lens, though, if I may, because I think that's particularly important. So, I touched on there were about 1,000 company meetings last quarter [at Baillie Gifford], this year, we're probably going to do 4,000 company meetings, [by] 150 or so investors. So, we meet a huge number of companies. It's roughly 50/50, home, here in Edinburgh, versus on the road.

So, there is a huge amount of testing, meeting companies, and that's new [companies], existing, and that's embedded in our DNA, and the 150 or so investors, everyone's an analyst, so let's get the fundamental research right is a solid foundation or basis on which to work from. And then I think overlaid on top of that is the way in which we look at companies. So, both Katie and I have talked about the growth tailwinds. We see the growth, but on top of that, it's about the competitive edge [or] moat. And just as importantly, aligned management teams. We want to back these companies for five, ten years, so is it a visionary management team? Is it a family? Is it a founder? Is it professional? So, it's a blend of those combinations.

And then we can segue way and talk about lots of different company types, but map that back onto the portfolio, and I

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Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
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think we need to cut to the chase, it's about operational performance and what you're paying for that, as well, it's valuation. In today's common money, not making any adjustments, the portfolio is on 18 or 19 times earnings versus 13. So, a 50 per cent premium. We are typically always at a premium to the standard benchmark. We can also talk about the growth index, if that's of interest.

But the earnings growth potential we see from these businesses is vastly superior. So, on adjusted numbers, you're talking high single digit against low single digit. So, it's the longevity, the duration, and the level of that growth that's very important. So, that's the underpinnings that give us the confidence. And then it's the individual businesses themselves, and the traits and characteristics, and there being a diverse nature of companies, as well. So, I think that's what really matters for us.

MC: Thanks, Joe, I suppose you've both touched on a little bit, but one thing that we've highlighted there is China. And so, we've had a question in, which I think really cuts to this. How are we thinking about the risk of the indirect China exposure in the [Developed] EAFE [All Cap] portfolio? So, if we think of luxury names, some of the Japanese staples, etc., they seem to need to grow in China to make the multiples work. Any thoughts on that observation?

JF: Yes, well, I think there are key points there, and this applies to every holding. So, from an EAFE perspective, let's be careful, because China's 7.5 per cent, 8 per cent of the standard EAFE index [on a look through revenue basis], and India's 2 per cent. So, EM is important to EAFE, it's important to every company, China is important to every company, international EAFE, wherever it is in the world. So, we are being vigilant at that. That's something in our standard risk quarterly monitoring pack. We explore and scrutinise, with James Taylor, the dedicated risk analyst. So, we're thinking about that.

It's not also the level, it's the exposure that gives into China, and perhaps the hint to the question is, is that needed, is that the big catalyst for all of the growth, or how much of the growth? And luxury is really interesting at these times. Now, you've got Richemont, Burberry, Kering, I don't want to go into too many specifics, but they're on 15 times earnings. LVMH is in the low 20s. These look incredibly attractive. They could have a tough one, two, three years, but it's about the long term potential, and where these luxury franchises will be in five, ten, 20 years' time we find particularly appealing.

And I think the other facet I just want to add, and this is for wherever we are, there's lots of growth to go after in China, but it's about competition and treatment of minorities [shareholders]. So, there's plenty of growth, and LONGi is a good example of us selling and moving on from that in the ACWI ex US [All Cap strategy] variant, but what about levels of profitability? What about stewardship of the business and management alignment, treatment of minorities? And I think that actually, with these [developed markets] businesses, you get it enshrined, those traits, as well.

So, I think we've got to consider a combination of those factors. So, yes, there's exposure, our headline exposure [on a revenue basis] is roughly in line with the EAFE Index, and we're trying to weigh up the opportunities versus the risks there. And then in thinking about the luxuries, they look really compelling. And if you think, three, five, ten years out, just how strong these companies or these brands are, and will continue to be.

MC: And I suppose that's an interesting point, in terms of these global brands versus that other topic that we've talked about, reshoring, and almost domestically focused. But we still think there's enough in there for the luxury goods companies, in terms of ongoing demand there.

JF: Absolutely, yes.

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MC: Katie, you touched on a couple of the new purchases, two of them in the semiconductor space. We obviously have existing exposure in that part of the market. Can you give us a little bit of an idea of how those holdings complement what we have, and just the broader outlook for the semiconductor space?

KM: Yes, sure, Matt. I think the semiconductor industry is a very good example of an industry with strong growth tailwinds. I think the industry is currently about \$600 billion in size, and is expected to grow high single digits to exceed a trillion-dollar industry by 2030. So, the industry is really enabling digitisation all around us. So, these companies in this industry are very much the picks and shovels of our digital age. And while short term, there can be volatility, due to supply and demand mismatches, and the global macro outlook. Our base case is that the next few decades will see increasing demand for semiconductors, as they become central to global growth, and are also applied to a broader range of industries.

And just to highlight a few. So, obviously, the automotive sector is probably one of the biggest opportunities. Electric vehicles, autonomous driving, cars increasingly becoming computers on wheels. So, the automotive chip market is expected to grow considerably from where it is today. And then there's computing and data storage, fuelled by the demands for servers, and to support applications, such as AI and Cloud. And then wireless communication, mobile infrastructure, the expansion of 5G. And then the industrial sector, Internet of Things, demand for computing and control chips, plus sensors and power and analogue semis, as well.

So, you're right, our main exposure to this whole industry to date has been through ASML, the Dutch-listed business, which has been held in the portfolio since 2017, and it has a monopoly in the most advanced lithography machines, used to make ever smaller, more powerful, and energy-efficient chips. For portfolios with emerging market exposure, we also hold TSMC, which is the leading foundry, or manufacturer, of the most cutting edge chips. So, they have been our two big semiconductor holdings, and they're really quite demand or technology-agnostic, in terms of the industry that is driving demand for semiconductors, because they operate across them.

And then through some of our industrial holdings, we also have exposure to the semiconductor industry. For example, Atlas Copco, they supply vacuum pumps that are used in the manufacturing process, SMC supplies pneumatic equipment, and new holding, Air Liquide, in fact, provides the constant supply of a pure form of industrial gases that are needed for the manufacturing process, as well. So, given our enthusiasm for the growth on offer from this industry, we've been spending a bit of time looking for other companies that occupy a point in the supply chain where we think the market is quite consolidated, which we think means they'll be able to increasingly attract more of the value, as the industry grows.

So, there's been quite extensive research done across the regional teams and Baillie Gifford, more broadly, and we've used this work to narrow it down to a shortlist, before deciding to buy two new names to add to our exposure. So, Tokyo Electronics equipment is really used in the etch, deposition, and silicon wafer cleaning stages of semiconductor production. So, this equipment is used to create the complex patterns and structures that are etched onto silicon wafers. And its equipment is really used in conjunction with ASML's by manufacturers, like TSMC, Intel, Samsung, and others.

And then if you turn to Soitec, they focus on making engineered substrates, which is, essentially, a special type of wafer that improves the performance of the semiconductor chip. It has better thermal or conducting properties, and that really outperforms traditional bulk silicon, and that means they can charge a premium price for that. And there's no real direct competitor for Soitec, given what they can do at scale, which means they have about 70 per cent market share in 200

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mm wafers, and 100 per cent share in 300 mm wafers. And that's backed by 20, 30 years of R&D experience, and more than 4,000 patents, which means they can make very high returns on capital and their scope for further margin expansion.

Soitec is at a different stage than Tokyo Electron, it's only a billion-dollar revenue business today, but we think there's scope for this business to be significantly larger, driven by increasing complexity of the chips required for smartphones, and also, as it expands into newer and faster-growing areas, such as the Internet of Things and electric vehicles.

MC: Thanks. It's definitely a more diverse way of playing that same theme that we've still got a lot of conviction in. Maybe two others to touch on. I think it would be fair to say that short-term performance has definitely been a mixture of macro and micro factors. And if we think a little bit about the macro, and I know it's not something that we generally spend too much time on, but just thinking about how the portfolio is likely to fare in an environment, where interest rates remain higher for longer. So, I'm just interested in some thoughts there.

JF: Matt, there's a lot in that. I think it's fair to say that the last two or three years, macro has been key. And I also think, intertwined with that, I'd throw in geopolitics as well. And something I spend quite a bit of time thinking about is just the way different stocks are behaving around the world, and it's just striking, the huge differences, not all things are moving in sync. And I think idiosyncratic or stock-specific risk or reward is firmly off the agenda. If you put a gun to my head and said, what's the split? I think almost 80 per cent is macro, 20 stock specific at the moment. Let's hope that gets to 50/50, or whatever the proportion should be.

And just to stereotype, if you're thinking about the world, if you weren't in the big seven in the US, you weren't in the quality growth in Europe, the Nestle's, Novo Nordisks, you weren't in value in Japan, and then cyclicals, commodities, and financials in EM, and trying to position for all of that is a completely different backdrop. And we stick to one primary investment style, and that's growth, long-term, structural growth, our style and approach, clearly, has been massively at odds with that. So, that's been a very big headwind.

I don't know what the batting average is of that, but perhaps every five or ten years, there will be these market backdrops that we need to navigate through, and this pulls us back to the growth, quality, and resilience. And then just on your other facet, higher for longer rate environment, we're at early innings with the rate cycle. We had rates go up, shock horror, we're back to where we were in the early, mid 2000s. Maybe this is the new norm. The big test, this is a shock for every business type, this is a real test of resilience, and we've got an amazing portfolio, in terms of balance sheet strength.

They're rock solid, they can fund this phenomenal free cash flow generation, and that bodes really well for how companies will, or the portfolio companies will get through that in the long term. So, I think the debate is only just starting on what the higher rate backdrop really, really means. And it's something blended with the right levels of growth and business quality that gives us a lot of confidence. And we're thinking through that, carefully exploring what some of these macro factors or impacts are, and we've spent time today about Japanese exposure means. Ultimately, we believe strong, underlying stock fundamentals will get rewarded. And that's what we major on, and that's what we focus on.

MC: Thanks. And I think maybe, and I'm conscious of time, but maybe just one more to finish on is, Katie, you talked a lot about new idea generation, which has been great. Can either of you maybe just give us an idea about some of the recent trips and ideas that have been coming out of the PCG, and what the Group's been up to recently, in terms of activity?

JF: Sure. I might shoot first, and I Katie's probably got an example, too. I might do what's coming up. Actually, it's

Baillie Gifford™

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

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interesting, because Stephen, along with Iain, is off to Switzerland, and they're getting out to see Lonza. Lonza has got a management change. The Chair really calls the shots, and the CEO has been ousted, so they're spending some concerted time with that company, and thinking about the breadth and the broader culture. And there's also a long list of other new ideas in the industrial arena that they're thinking about in that market.

And then actually, I'm off with one of our emerging market investors, Alex Summers, and Michelle, the ESG analyst from that team, back to India, to kick the tyres. And that's something I like to do every four or five years. I haven't been since pre-COVID. So, again, we've got some names there, in direct exposure. That's an area I find fascinating. So, there are two examples, and I think what's key is companies are coming through, and we're doing loads of calls, clearly, but it's getting out there and kicking the tyres that really does matter.

KM: I think Joe has covered it.

MC: Okay, thank you. Well, in that case, no more questions have come through. So, Joe, Katie, thank you for your thoughts and comments today. And the audience, thank you all for your time, and more importantly, for your ongoing support. We know that short-term performance has been disappointing, and we remain committed to the same growth, active and long-term philosophy that has been in place for the 30-year history of the International All Cap Strategy. We've endured difficult periods in the past, and we're confident that we can weather the current storm, and produce strong returns in the future.

In the words of Charlie Munger, "Growth investing is not about chasing short term gains or trying to time the market. It's about identifying companies with strong competitive advantages, scalable business models, and the potential for long term value creation."

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

	2019	2020	2021	2022	2023
ACWI ex US All Cap Composite	0.2	28.4	19.4	-39.6	12.6
MSCI ACWI ex US	-0.7	3.5	24.5	-24.8	21.0
EAFE Plus All Cap Composite	-1.5	24.7	17.1	-38.5	12.5
Developed EAFE All Cap Composite	-1.5	24.3	20.5	-39.6	12.8
MSCI EAFE Index	-0.8	0.9	26.3	-24.8	26.3

Annualised returns to 30 September 2023 (net%)

	1 year	5 years	10 years
ACWI ex US All Cap Composite	12.6	0.9	3.4
MSCI ACWI ex US	21.0	3.1	3.8
EAFE Plus All Cap Composite	12.5	-0.1	2.9
Developed EAFE All Cap Composite	12.8	0.1	2.9
MSCI EAFE Index	26.3	3.7	4.3

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.

Past performance is not a guide to future returns.

The International All Cap strategy comprises three distinct variants. Overall, the variants are broadly similar, with the key difference being the degree of exposure to emerging markets listed holdings.

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