Baillie Gifford™

Health Innovation
Q1 investment update

April 2024

Investment manager Rose Nguyen and investment specialist Richie Vernon give an update on the Health Innovation Strategy covering Q1 2024.

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

Richie Vernon (RV): Hello, and welcome to the Health Innovation Investment Update for the first quarter of 2024. As a reminder, health innovation is a concentrated thematic equity strategy, and it seeks to invest in the innovative high growth companies that we think are driving a revolution in human health.

My name is Richie Vernon. I'm one of the investment specialists in our team, and today I'm delighted to be joined by Rose Nguyen, investment manager, and one of three decision makers on the strategy.

Rose, welcome.

Shall we start with the environment?

We've talked in the past about how difficult it's been over the last couple of years for innovative healthcare companies. How's the environment today, and are there any signs that it's improving?

Rose Nguyen (RN): The environment has been very challenging for healthcare companies over the past three years because of high interest rates and declining COVID-related sales for many companies in the sector. However, we are seeing signs of that changing and improved funding conditions for many companies in the healthcare sector. In the last quarter of 2023, we saw a significant increase in the number of M&A deals and licensing deals in the drug industry, and increased capital velocity in the ecosystem. These are really good signs that the healthcare sector is returning to a more normalized environment. At the portfolio level, we have also seen a broad sense of optimism and positivity among our company holdings. Notably, several of our early-stage biotech holdings have been able to raise capital in recent months. An example is Denali, which is the U.S. biotech developing drugs for Alzheimer's disease. It has been able to raise $500 million in February this year in a follow-on offering. And this is just an example of many other companies in the portfolio. So broadly speaking, we think that the environment is really turning around, and the combination of accelerating innovation and low relative valuations compared to the broader market make healthcare a very exciting place for long-term investors.

RV: It certainly sounds like an attractive opportunity at the moment.

In terms of performance, over the quarter, we were up in absolute terms, but we did trail both the MSCI ACWI benchmark and the Healthcare index. Can you explain some of the reasons behind that?

RN: The relative underperformance of the strategy compared to the benchmarks was mainly due to a few idiosyncratic issues that we have with a few company holdings. So, nothing systematic, but more at the company-specific level. An example is WuXi Biologics, which is a Chinese contract manufacturer for biopharma companies. It has been caught in the crosshairs of geopolitical tension between U.S. and China. Several lawmakers in the U.S. are trying to advance a bill that will restrict activities of WuXi Biologics in the U.S. These concerns caused negative sentiment in the market and sent the share price down significantly. However, we think that these risks are perhaps overplayed. And despite all of these concerns, the company keeps executing and investing in its overseas facilities to diversify its footprint. We think that at the current valuation of WuXi Biologics, it [won't] take a lot for the company to go right from this level. Besides that, the portfolio remains in very good shape. Many of our top holdings keep executing well. An example is Shockwave Medical, which is a U.S. MedTech company. It was growing at above 40 per cent year-on-year in the last quarter of 2023. Overall, we remain very confident about the shape of the portfolio, and we remain excited about the number of investment opportunities that we are seeing today.

[Regarding the] shape of the portfolio, we did make a number of changes this quarter. Three complete sales: Masimo, Teladoc, and Novocure. Could explain why we decided to move on.

RV: Upon some risk assessment analysis of the portfolio, we decided to exit a few holdings where we think our investment thesis has been broken. An example is Masimo. It is a U.S. manufacturer of patient monitoring devices and sensors. Our case for Masimo was based on its entrenched footprint in healthcare systems and in the hospital systems. We believed that the company could expand further into other adjacent product markets. However, we were very concerned when Masimo decided to acquire South United, which is a manufacturer of audio systems for the consumer market, which is entirely different from Masimo's core business. The reason for that acquisition was so that Masimo could expand into the consumer healthcare market with things like wearable watches, baby monitors, and so on. We really questioned that capital allocation decision, and we think that was [value destructive to shareholders]. We gave management some time to prove that they could extract value from that deal. However, the results so far have been disappointing. That's why we decided to exit the holding for our clients. We moved on from companies like Masimo, where we lost our conviction. But we're also seeing on the other side of the coin, with lots of new ideas come into the portfolio, and we had four over the last quarter.

RV: I wondered if you could highlight maybe a couple of those names and why we're excited about them.

RN: Of course. Like I said, the combination of accelerating innovation in the healthcare sector and low relative valuations compared to the broader market make this an exciting time for long-term investors. Two of the new buys this quarter have both suffered from the broader environment in healthcare, which resulted in their undemanding valuation. Yet they remain very innovative businesses with massive market opportunities. One of them is Insulet. It is a U.S. manufacturer of insulin pumps for diabetic patients. We like Insulet for three main reasons. First, it is the only company on the market at the moment with a tubeless insulin pump that makes it very easy for diabetic patients to manage their disease. It has been gaining share from competitors and it has a very strong competitive edge due to its manufacturing capabilities as well. The second is the massive growth opportunities that we see for Insulet in the diabetic market. Penetration of insulin pumps is less than 50 per cent in the U.S. among type 1 diabetic patients and even less than that in other European and emerging markets. That is even before mentioning the type 2 diabetic market. And the third is that Insulet has suffered from a sell-off related to concerns about the rise of obesity weight loss drugs. So people are worried that these weight loss drugs would reduce the market opportunity for Insulet. However, we think that those concerns are overdone. Weight loss drugs do not have an impact on type 1 diabetic patients. The low adherence to these drugs mean that patients are unlikely to stay on the drugs for a long time and therefore the type 2 diabetic population may continue growing in the foreseeable future as well. This is the reason why we decided to take a new holding in Insulet for our clients.

Another new buy that we are also very excited about is BioNTech. It is known for its COVID-19 vaccine. However, many people do not know about the strong and rich cancer franchise that BioNTech has developed over the past years. Its share price is down 70 per cent from the peak in 2021 due to declining COVID vaccine sales. However, the company has a very strong balance sheet position and that allows it to invest in the cancer franchise and to grow that franchise. It's one of the most exciting biotechs currently, we believe, in the cancer area. So that's the reason why we decided to take a new holding in BioNTech.

RV: I think those two new ideas are probably a perfect place to end this. Thank you very much for your insights on the portfolio.

So there you have it. Hopefully lots of reasons for optimism and an improving investment environment, a portfolio with lots of resilient companies who continue to perform well, and lastly, lots of new ideas at attractive valuations. Thank you very much for watching and we hope you join us again next time. Goodbye.

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Health Innovation

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

	2020	2021	2022	2023	2024
Health Innovation Composite	4.0	82.3	-25.0	-14.0	-11.3
MSCI ACWI	-10.8	55.3	7.7	-7.0	23.8

Annualised returns to 31 March 2024 (net%)

	1 year	5 years	10 years	Since inception
Health Innovation Composite*	-11.3	1.6	N/A	4.0
MSCI ACWI	23.8	11.5	N/A	11.7

*Inception date: 31 October 2018.

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.

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