Baillie Gifford™

Positive Change Fund

October 2024

Investment specialist Rosie Rankin speaks with investment manager Thaiha Nguyen about her reflections on the year so far, including changes in the portfolio, current challenges and opportunities.

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Rosie Rankin (RR): Hello, welcome to the Positive Change Update. I'm Rosie Rankin, an investment specialist, and I'm delighted to be joined today by Thaiha Nguyen, an investment manager and decision maker for Positive Change. Welcome, Thaiha.

Thaiha Nguyen (TN): Thanks, Rosie. Hi, everyone.

RR: We have lots to discuss and explore today. Our three main areas of focus are going to be; firstly, performance; secondly, changes to the portfolio- and I know there are a number of new ideas to discuss; and thirdly, Outlook.

Now, Thaiha and I will talk for about 20 to 25 minutes, and then there will be plenty of time for Q&A. Now, you can submit your questions at any time using the question function at the bottom of your screen. A huge thank you to those of you on the call who have already submitted questions in advance. Lots to get through. So, let's get started. Thaiha, performance first of all.

Now, long-term performance for positive change has been very strong and well ahead of benchmark. But over more recent years, it's been weaker. And if we look at year to date performance, the fund has returned about two and a half percent, whilst the benchmark has returned just over 16. That's to the end of August. So, could you talk us through some of the reasons for this, please?

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TN: Yes, so the performance to date has been weak and we understand that it is disappointing for clients. Let me zoom out a bit to answer your questions. The past three years have been challenging for the fund due to three reasons. The first is the macro reason. We were hit by the unexpected and fast-rising interest rate, which makes growth stocks with long-duration cash flow less attractive, leading to a large shake up towards the end of 2021 and into 2022. Coming into 2023, We have seen an extreme concentration of returns among a few stocks, the Magnificent Seven. Because we don't have exposure to those names apart from Tesla, our relative performance was hurt, particularly not owning NVIDIA. The third reason is due to stock specific reasons. So although there are companies in the portfolio that have performed really well, like NuBank, MercadoLibre, Duolingo, Alnylam, to name a few.

Some of companies unfortunately had a very difficult period and faced significant challenges like Illumina, Umicore, and Orsted. And so, the team has reviewed those stocks and sold a few of them, which I'm happy to go through later if you're interested. But to summarize, it is due to macro reasons, there's companies that we don't own, and also a few companies that we own.

RR: Perhaps focusing a bit on the companies we don't own, and you particularly referenced NVIDIA, and I'm sure people may be curious as to why we don't own it within Positive Change. Could you elaborate on that a bit?

TN: Yeah, so we actually looked at NVIDIA a few times in the past. And it's worth reminding the audience here that Positive Change is a global impact strategy with two equally important objectives of attractive financial returns, but also positive impact on environment and society. Companies would need to meet both of our objectives to get into the fund. So, I remember the first time we looked at NVIDIA was back in 2018. And at that time, we were not convinced on the impact side because gaming was still a big part of NVIDIA's business. And then we looked at the company again in 2020, and this time there were emerging opportunities in AI, in data centers, in automotive and healthcare, et cetera, which are more impactful.

But then from the investment side, we were unsure of the company's competitive advantage, because some of their biggest customers were talking about developing their own custom chips. Fast forward to 2023, when NVIDIA became

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almost a household name, when Chat GPT-4 broke through. Admittedly, we were slow to appreciate the scale of the opportunity here. We recently had a more thorough look into the case again. And although we all agree that this is a phenomenal company, valuation has unfortunately run up to the point where we don't think that the valuation, that the upside from here is sufficiently attractive. But we're still monitoring the developments of the space and the development of the company. If valuation pulls back, then we would reconsider.

RR: That all sounds really clear, Thaiha, and a good reminder as well that the strategy does have two equally important objectives. Now, when we're thinking about NVIDIA, of course, a lot of the excitement stems from that opportunity that we're all seeing in artificial intelligence. I'm curious in terms of our portfolio exposure to AI, could you talk a bit about positive change and the opportunities we are seeing within AI?

TN: Yes, so I would say that AI probably affects every company in our portfolio. I would categorize the exposure to AI into three groups. The first group are companies that are providing the infrastructure to enable the growth of AI, such as ASML and TSMC, as those companies are very critical to the production of AI chips. The second group are companies that are leveraging the power of AI to advance their products and services, as well as lower the cost of production. A few examples here would be Tesla using AI to develop autonomous driving, as well as its humanoid robots. In the education sector, we have Duolingo and Coursera using AI to develop content at lower costs. In healthcare, we have Moderna using AI to help with drug discovery and drug development. In agriculture, even the 200-year-old company John Deere is leveraging AI to develop computer vision for the precision agriculture segment, as well as autonomous tractors.

So you can see from those examples that AI really touches every corner of the economy. The third group are companies that are helping support the growth of AI in an environmentally responsible manner. I was surprised to learn that Ecolab's water management and hygiene solutions are in very strong demand as the growth of AI requires water intensive semiconductor manufacturing facilities. We also need a lot more water to cool down the data centers that power the AI products.

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RR: Great, so AI and the opportunities there are much more broadly spread than just seven stocks that are dominating the index just now.

Moving on from performance to talk about some of the new ideas in the portfolio. Now, we've had seven new ideas in the portfolio this year. It's really exciting to see this fresh crop of ideas. I wondered if you could share and discuss a few of those today.

TN: Yeah, so since the beginning of the year, like you say, we made seven new purchases and five complete sales. The new purchases are across different industries, impact themes, and also have very different growth profiles. I would highlight three names. The first one in the healthcare market is Insulet. which is a medical device company specializing in diabetes care. Insulet makes insulin pumps that deliver insulin automatically to patients rather than patients having to inject insulin manually multiple times a day. Insulet's pump called the Omnipod is a clear market leader here because it is the only tubeless pump. So it's very compact and it brings greater convenience to patients compared to other cumbersome tube pumps on the market. You combine that with a very smart and sophisticated algorithm, the result is that patients have more time in the optimal glucose range. Beyond that, Insulet also has a competitive advantage within distribution because it is the only disposable pump on the market. As a result it is allowed to be sold through retail pharmacies in the U.S. at a much lower upfront cost than competitors.

There are 11 million type 1 and insulin-intensive type 2 diabetes sufferers in the U.S. and in Europe. but the penetration is still very low, especially in type 2 diabetes, which is like low single digits at the moment. We are very attracted by that opportunity as well as the competitive advantage that Insulet enjoys. We have been following Insulet for a while and the sharp selloff of the stock in response to GLP-1's , we think gave us an opportunity to buy this stock at a more attractive price.

The second stock that I want to introduce is Schneider, which is in the environment and resource needs theme. Schneider manufactures and sells hardware and software for energy management and industrial automation. The company's products are very critical to upgrading and expanding energy infrastructure. As

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you know, electrification and the need to fight against climate change really support a structural growth opportunity that we think is going to last multiple decades. Schneider's has a broad range of products in its portfolio. It has an extensive distribution network, which we think makes it well-placed to benefit from the rising demand for electrification.

Besides that, there's also an exciting long-term opportunity from the building out of data centres to cater to AI demand, which we talked about earlier. We believe that the company is entering a period of higher structural growth than in the past and can compound earnings at an attractive pace for a long time.

The third company that I want to talk about is Grab in the social inclusion theme. Grab is often known as the Uber of Southeast Asia. It is the largest ride-hailing and food delivery platform in the region, offering economic opportunities for millions of drivers and MSMEs, micro, small, and medium-sized enterprises in the region. Before investing in Grab, we commissioned third-party research from an organisation called 60 Decibels. The research showed overwhelming benefits that MSMEs experienced from joining digital platforms such as Grab, including higher incomes, improved financial resilience, and greater digital literacy. The penetration of Grab's services is still low at the moment, but it should rise along with the economic growth of the regions. We think that Grab's competitive advantage is really strong. It has dominant market shares in all the markets that it operates in. And we also think that is defendable due to network effects and the company's heavy investment in technology. Interestingly, we think that the more capital-constrained environment due to higher interest rates will support more rational competitive behaviours, which eventually allow companies to achieve sustainable profits, like what Uber has been able to demonstrate recently.

RR: Three completely different companies across three very different impact themes, obviously Insulet, US medical device manufacturer, Schneider, European company, Grab, Southeast Asian platform business. I know for us, the quality of management teams and their ambition and intent is really important. Have we met the management teams? Any plans to?

TN: So yeah, Li Qian has been meeting with Grab's management team on multiple occasions over the years. One of our impact analysts is now in Singapore and will

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have the chance to visit the company's headquarters there. For Schneider, positive change has not had the opportunity to meet the management yet, but many colleagues from other strategies within Baillie Gifford have met them. We leverage a lot of their knowledge and assessment of the management team from them. I think it's worth reminding everyone that although Positive Change is a team of 10, we can tap into a much broader resource of over 100 investors across the investment floor in terms of idea generation, company engagement, et cetera. For Insulet, actually, Apricot, our senior impact analyst and I are going to Boston next week for a bioprocessing conference and we will meet Insulet there as well as another new holding, Vertex Pharmaceuticals. So very much looking forward to the trip.

RR: Thaiha, we've talked a bit about performance and new buys. Looking ahead and in terms of outlook, what's on your mind? Are you feeling optimistic?

TN: Yeah, so as mentioned earlier, one of the reasons for our underperformance was macro reasons. With the macro environment, particularly inflation and interest rates are stabilizing. There are suggestions from various central banks around the world to cut interest rates. We think that the biggest headwind to performance is now behind us.

Secondly, we absolutely believe that over the long term, share prices will follow fundamentals. On a forward-looking basis, both revenues and earnings growth of our portfolio companies are much higher than the index. So the three-year forward sales growth for the fund is close to 12 per cent versus 4 per cent for the index. The three-year forward earnings growth is 18 per cent versus 9 per cent for the index. So yeah, our fund is always trading at the premium versus the index, but that is justified given the higher growth potential and higher quality earnings. Importantly, the valuation gap versus the index has been closing over time, where the revenues and earnings growth gap is widened. We think that that will support share price returns in the future.

Thirdly, The world around us is becoming a lot more uncertain from both environmental and social stances, as can be seen from the very recent catastrophic Yagi Typhoon in Asia to the ongoing conflicts in the Middle East. We believe that we would need a lot more innovative solutions to fight climate change,

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to raise living standards, to cure diseases. We need companies like those in the positive change portfolio to help with theis. So yes, short-term performance has been disappointing. There's no denying that, but we're very excited and confident about the outlook for our fund.

RR: Really pleased to hear. There's lots to be optimistic about. Now, before I move on to questions, just to summarize what you've said, Short-term performance has been weak, but we're on a firm footing for the future. There's a wide range of new ideas across the portfolio, and the portfolio characteristics are really giving us confidence as well. And of course, investment returns are just one of our objectives. Our impact objective is equally important. And we have recently published our 2023 impact report a couple of months ago. Now you can find our impact report on our website, and we've shared a QR code. I'll leave it up there for a few seconds. If you want to scan that, that should take you directly to the impact report that shares the impact of every single company in the portfolio along with some aggregate portfolio metrics. And we're always delighted to hear any feedback on the report as well. So please do feel free to contact us with any thoughts there.

Great, well, let's move on to questions. Thank you very much to everybody who's been sending in. We've got quite a few to get through, which is great.

The first question that was sent in was about our process. Does our process limit our potential opportunity set? Is there a veto that means that it's really sort of shrinking our universe?

TN: A very good question. So we don't approach our universe with an exclusionary mindset. We don't have a list of stocks that we veto. Our process really seeks to be inclusive of companies that meet our dual objectives, which I mentioned earlier. So yes, the dual objectives do reduce the investment universe, but we don't think that it affects the performance. Quite the contrary, we believe that companies which are solving a large environmental and societal problems will have a huge growth runway, their products and services will be in high demand, and that is a critical condition for outsized investment returns. So there's a book that the team used to discuss called For Profit, a history of corporations by William Magnusson. And in the book, he presented eight case studies of great enterprises from the Roman

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Empire to today. And he found that all of those companies can attribute their success to addressing a particular societal need of time. When they lost purpose and were managed to enrich the vested interests at the expense of the wider society, they declined or demise followed. So again, we do really believe that impact and investment go hand in hand, and there's no need choose between the two.

RR: Thank you, Taiha. A couple of people have been asking about SDR. I'll maybe pick up that question because actually, I've been working a lot on that just in terms of will positive change have an SDR label and what work's going into that. So, at the moment we have applied to the FCA for a sustainable impact label.

A question has come in, would this change the way that the fund is managed? It would not change the way that the fund is managed at all. It will change the disclosures that we're required to make, and we're working through that, but that is where we are. So we're currently in the midst of the application process for that.

RR: Moving back to the investment side, Thaiha, someone has asked about the sales. Now you referenced there's been a number of sales this year. Could you talk a bit more about some of those names that have left the portfolio and the rationale, please?

TN: Yes, so we made five complete sales to date. They are Umicore, the Belgian manufacturer of cathode materials for batteries. 10X Genomics, which is a single cell sequencing company. Wuxi Biologics, which is the Chinese CDMO, contract manufacturing business for biologics drugs. Orsted, the offshore wind company, and Discovery, which is a South African-based health insurance company. So all of them have performed worse than we expected when we made the investment. In most cases, it is the combination of the external challenges, the macro environment, industry challenges, and also internal execution missteps that they made. To give you an example, in the case of Orsted, which is the Danish offshore wind company, the offshore wind industry has faced lots of challenges, including inflation, interest rates and supply shortages, changes in tax credits in the US, which made Orsted wind projects, especially in the US, less attractive

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economically. The company had seen financials being hit very hard because they had to write off a lot of those projects.

There are also internal challenges with some of the decisions that they made with their suppliers. For example, they made a forward commitment with their suppliers, which made us question the management's ability to deal with shocks and also undermined our trust in the management team in terms of capital allocation. So, taking those combinations of the challenging environment and also the lack of trust in the management team going forward, we decided to sell the holding. There are similar stories across other names that we mentioned.

RR: Thank you, Thaiha. Sticking with companies in the portfolio and perhaps ones that have had a more difficult few years, I have a question here just about Moderna. And what are we thinking currently about the prospects for Moderna? They're obviously burning through a lot of cash just now in terms of their research and development spending. So can they make a breakthrough in the next three years?

TN: Yeah, so just to remind everyone that we made an investment in Moderna at the IPO back in 2018. At that time, we didn't know what COVID was going to be. So we didn't invest in Moderna because of the COVID vaccines. I think what we are really attracted to with Moderna is the mRNA platform, its scalability and the ability of the company to conduct very productive research and transform healthcare by having a completely new modality of treatment. So the company had a very difficult period after the COVID period, but we think that the pipeline is still very, very exciting. So the company now had its second vaccine, which is going to be commercialized very soon, the RSV vaccine. The company also made a lot of progress with its vaccine franchise, but also its personalized cancer vaccine. I mean, they made a lot of progress with the respiratory vaccine franchise, but also with the personalized cancer vaccine. So they had very positive, for example, phase two data in some of the cancer vaccines. So yes, the company is burning through a lot of money at the moment, mainly for R&D, but we think that it is going to be recouped once the vaccines are on the market. We still believe in the platform potential of mRNA.

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RR: Great. You mentioned in terms of one of the sales that we made, Wuxi Biologics, which is a Chinese company. Questioning about China and how we're thinking about Chinese companies. We don't currently have any in the portfolio now. So share your thoughts.

TN: Yes, so we believe that there could be lots of exciting growth opportunities in China, given the size of the country and many critical problems needing innovative solutions. But so far, we have not found many companies that can satisfy both of our investment and impact objectives. For example, we've looked at a range of companies in the energy transition space from the producers of solar panels to solar inverters to batteries to EVs. But we generally struggle to identify durable competitive advantages for those businesses. And more recently, we cautious about the geopolitical tension between China and the West, lessons from our investment in Wuxi Biologics, which was completely hammered by changes in geopolitical tension. That said, we remain open minded about the opportunities and we are discussing if we could find companies that are leaning more towards the domestic market or companies that are exposed to less geopolitically sensitive regions like Southeast Asia or Latin America rather than to the West.

RR: That's really clear. I have a few questions in just on some company-specific questions. Firstly, moving to base of the pyramid and one of our companies there, Remitly, which does remittance services, predominantly for immigrants. The question is actually, given that Remitly operates in the same space as established players like Western Union and MoneyGram, what proposition and advantages does Remitly offer that differentiates it from these traditional money transfer services? And you know, why have we chosen Remitly for the portfolio?

TN: Yeah, a very good question. I think what separates Remitly from those traditional remittance companies like MoneyGram and Western Union is that Remitly is a 100 per cent digital mobile-based remittance company. So it is very convenient and very quick for immigrants to send money home. So instead of having to go into the physical branch of Western Union and MoneyGram and handing the cash, immigrants can do it within a few minutes by touching a few buttons on their mobile phones. So the time and the convenience, I think, is the big factor of why it has been growing so much faster than Western Union and MoneyGram. Also, we think that the investment in technology in some of the data

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and also fraud detection is bearing fruits for the company. So over the last few quarters, the company has been talking about operating leverage being realised by those technology investments, which we think is quite difficult for companies, like bigger companies doing things in a more traditional way to get right, so really offering that convenience and cheapness and that ease of service that makes it attractive.

RR: Yeah. The next company that's come up is one that I know is very close to your heart, Duolingo, and it's performed extremely well over recent years and is a positive contributor to performance. But what are your thoughts on whether it can sustain its relatively high valuation? What do we see in the future for Duolingo?

TN: Yes, so with Duolingo, I'm very excited about the opportunities here. There are 2 billion language learners in the world. Duolingo at the moment has over 100 million monthly active users. So the runway from that pure number is massive. And then the next layer that you can think of is their monetization capability. So right now, about 7 per cent to 8 per cent of their monthly active users are actually paid subscribers. So there's still a lot of runway for them to convert those free users into paid users. A third layer of growth I would say, which is over the longer term, is their ability to expand beyond languages. So they have launched new learning apps like maths and literacy, and very recently, music. They haven't monetized those opportunities yet, but in the future, those could add further to the revenue runway. So yeah, those are the three layers of growth that I see for Duolingo.

RR: And in terms of any threat that Duolingo is seeing from AI, am I right in thinking it's actually using AI?

TN: Yeah, it's really interesting because people have been thinking if AI gets to the point where it's so good that we can have real-time translation, then do people still need to learn languages? I think I definitely don't want to underestimate the future of AI, and I think at some point may be capable of doing so. But let's think about the reason why people learn languages. People learn languages not because they just want to make some conversations, asking for directions or ordering food at the restaurants, but they do learn languages because they want to have a deeper connection to a culture, or they want to connect to their families and friends. And so I think there's still a role for like the reasons why people still want to learn

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languages. And then to your point, Duolingo is a heavy user of AI. The founder, he's actually a computer science professor at Carnegie Mellon, and they have been using AI to improve their products from the beginning. working with OpenAI to launch a new product that incorporates a lot of AI features into the lesson. So yeah, I think they're a beneficiary of AI rather than being disrupted by it.

RR: Thank you for your enthusiasm shining through there, Thaiha. I've got a couple more questions to ask, but just if anybody has any final questions they would like to send through, you've got a few minutes to do so, but let's keep the conversation going and I've got a couple more questions to get through. One thing that you mentioned when we were talking earlier, Thaiha, particularly when you were talking about the new companies, was that sort of range of growth styles within the portfolio. Could you expand a bit more on that in terms of, whether we have shifted our growth style? Is there anything to think about there?

TN: Yeah, good question. So for Positive Change, we've always had a balanced approach to different types of growth. Since the inception of the strategy, we have held companies, you know, ranging from being a very early stage of development, with very high growth potential like Tesla, like Moderna. We also invested in companies where growth is slower, but we value the duration and the quality of that growth. So, for example, companies like Xylem, Ecolab, Novonesis, and John Deere have been held for a long time in the portfolio. So I don't think that we are having a style shift or anything like that. We've always had that balanced approach because we think that they're bringing different characteristics, and different resilience over the cycles for the portfolio. So range of impact themes and, a range of growth styles.

RR: Yep. Just final question to finish on, Thaiha, and it I guess ties in with your upcoming research trip to Boston as well. Some of the healthcare names have been really strong performers and have contributed very well to performance. Others have been strong detractors. What are your thoughts on healthcare? Any lessons learned to share?

TN: Yes, over the recent years, healthcare has been an area of quite poor performance for us. And again, it's a combination of both external and internal factors. So externally, the healthcare sector has been through a very unusual

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period with COVID-19. That makes it super challenging for companies to forecast and prepare for their demand, both on the way up and down. The sector then went through a period of biotech funding weakness, driven by rising interest rates and academic budget constraints. So our companies are not immune to such an environment. There's no doubt that these factors affect fundamental progress, but at the same time, some companies also face internal challenges, such as commercialisation like 10X, Berkeley Lights, and Discovery. Capital allocation missteps like Teladoc and Illumina. This period is unfortunate, but it provides us with some very useful reflections.

The first one is commercialisation. We think that the commercialisation of any new shiny technology will be challenging and unlikely to follow a linear progress. Just because the technology is very cool and transformative doesn't mean that it will be adopted very widely and quickly. So Berkeley Lights and 10X Genomics are examples of that.

The second lesson is that we have been attracted to disruptors, you know, the innovative and change-driven companies and that's very much aligned with our philosophy. But at the same time, we may have overlooked the incumbents, those companies with unchanged distributions and R&D and M&A advantages. The healthcare sector, especially in the US is quite messy and complicated involving multiple stakeholders and incumbents can have an unfair advantage over the early-stage startup companies. This is something that we may have underappreciated. So, in the future, we would like to incorporate those lessons. We want to think more holistically about our overall healthcare exposures. We want to pay more attention to the financial characteristics of those companies, their resiliencies over the cycles, and also, yeah, their different exposure to different segments within healthcare.

RR: Thank you.

I think really interesting reflections there, Thaiha. We've actually managed to get through all the questions that have come in. Thank you so much to everybody for your engagement in this webinar. It's very much appreciated. Apologies to those of you who had sound issues, the transcript will be published within the next few days. Please do feel very free to go to the positive change section on our website

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and look at the recently published impact report and indeed any of the intellectual capital that we share there. But Thaiha, thank you for your time as well. Thank you to everybody for joining us.

TN: Thank you.

Annual past performance to 30 June each year (Net%)

	2020	2021	2022	2023	2024
Positive Change Fund B Acc	51.0	49.4	-30.1	18.7	3.1
Index*	5.7	25.1	-3.7	11.9	20.6
Target**	7.9	27.6	-1.8	14.2	23.1

Source: FE, Revolution, MSCI. Total return net of charges, in sterling.
* MSCI ACWI
** MSCI ACWI Index (in sterling) plus at least 2% per annum over rolling five-year periods. It also aims to contribute to a more sustainable and inclusive world through investing in companies whose products and/or services contribute to impact themes addressing critical social and/or environmental challenges, measured over at least a five-year period.
The manager believes this is an appropriate target given the investment policy of the Fund and the approach taken by the manager when investing. In addition, the manager believes an appropriate performance comparison for this Fund is the Investment Association Global Sector.
There is no guarantee that this objective will be achieved over any time period and actual investment returns may differ from this objective, particularly over shorter time periods.

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— The Fund's concentrated portfolio relative to similar funds may result in large movements in the share price in the short term.
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