

Upfront: episode nine

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Financial journalist Cherry Reynard and investment manager Gary Robinson delve into the post-election rally in US markets, assess the continuing momentum of AI, and discuss the Baillie Gifford US Growth Trust's private holdings.

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Cherry Reynard (CR): Good morning, I'm Cherry Reynard, your host for Upfront, where we bring you the latest insights on Baillie Gifford's UK funds. Today, I'm speaking with Baillie Gifford partner Gary Robinson, who'll be answering your questions live, so do send them in by clicking on the drop-down menu on your screen. Before the audience questions, we have Impact Director Edward Whitten talking on Ecolab, a leader in hygiene and infection-prevention solutions. Welcome to Upfront.

So, welcome, Gary, it's good to have you back here. Now, just a reminder, Gary is a partner in the firm and an investment manager for the American Fund, as well as the US Growth Trust. Now, a lot has happened since we met about a year ago, American markets have continued their strong performance, and Trump's recent win in the US election seems to have been taken well by the market. Now, I know your time horizon is much longer than 12 months, but what stands out for you since the last time we spoke?

Gary Robinson (GR): It's nice to be back, Cherry, this time without the long hair and beard. If you don't recognise me, I have actually been on this before. It's been a much better year, couple of years, after a pretty rocky period following on from Covid, and actually I think there've been a couple of quite important developments in the last year that I'd point to that are quite encouraging from the perspective of our strategy.

The first is just that there are a number of companies in the portfolio which are starting to refocus on accelerating growth, having gone through this period of adjustment, where they were trying to drive up their operating margins and improve their efficiency. It's not that they're no longer focused on efficiency or showing discipline, it's just they've reached a level of profitability where they can now actually start to think about driving those growth initiatives forward again.

So, one example from the portfolio would be Shopify, which provides software for merchants to run their businesses online. Shopify was quite volatile around Covid, it's a company which serves online

businesses, primarily, so in the post-Covid period, when lockdowns ended and people started shopping offline again, Shopify's margins turned negative. And so over the last few years, what the management team have really been focused on is driving the business to a sufficient level of profitability, and actually we're now at a point with Shopify where it's free cash flow margins have reached 20%, which is a very healthy level.

And what the management team are saying is we're happy with this level of profitability, and any future scale benefits that we get are going to be reinvested back into accelerating the top line sales and marketing or R&D. So I think that's quite exciting from the perspective of a growth investor, and there are a number of companies in the portfolio that would fall into that sort of category across public and private holdings. On the private side, Stripe is in a similar boat. Faire is in a similar boat. So that's the first one.

The second one that I'd point to is at the beginning of the year I was getting a lot of questions on the Magnificent Seven, is there any point in thinking about anything outside the Magnificent Seven, given their weight and contribution to market returns? And I never really bought into that argument. The Magnificent Seven are a large part of the index because of how they've done historically, but it doesn't tell you anything about the future.

And I think the future will probably look quite similar to the past in the sense that we've always had huge turnover in the companies at the top end of the index from one decade to the next. And I think the next decade will be no different to the previous decade. You go back ten years, Tesla and Nvidia, those current Magnificent Seven companies, were mid-caps. And I think ten years from now, some of the companies that'll be the biggest companies in the world are small companies today, and those are the companies we're trying to find. And what's encouraging about the recent period is that we've started to see the performance broaden out beyond those Mag Seven companies into a broader range of mid and smaller companies.

CR: Okay, interesting. So we can look forward to a new acronym.

GR: The Terrific Ten I think, yes.

CR: Terrific Ten, oh, okay, right. Heard it here first. So looking at Trump, does he really matter for companies in the portfolio?

GR: People love talking about Trump, and it's obviously very topical right now, given that he just won the US election, but I don't think he matters that much for long-term investors. And what I'd point to as evidence for that is just you look at two of the biggest contributors to our historic performance, Amazon, Nvidia, those companies are up many-fold over the last ten years, and I think you could have literally reversed who was in the White House in each of those presidential cycles and those companies would still have done extremely well. Because it was really about the market opportunities that they were addressing, and their ability to execute into those market opportunities. It was the bottom-up stock-picking that mattered for those businesses, not what was going on with policy.

So by and large, I think for long-term growth investors, who's in the White House doesn't matter that much. It matters at the margin, but not that much. Even if you wanted to try and incorporate this into your investment thinking, one of the challenges is just working out what Trump actually wants to do and then what the balance of those factors will be. So, for example, will a Trump presidency be inflationary? Well, on the one hand, he's talking about tariffs, tariffs are inflationary. On the other hand, he's talking about the Department of Government Efficiency potentially taking \$2 trillion out of the Federal budget. That's highly deflationary. What is the balance of those two factors? Very, very difficult.

If I was to put a positive spin on it, though, you'd say you'd look at the people around Trump going into this administration, you've got a lot of true business people, technologists, former venture capitalists, so the positive spin in that these people understand what America needs to do in order to succeed in the technology sector. And I think there's a reasonable chance that the Trump administration helps to get some of the unnecessary regulation out of the way that will enable America to excel in areas like cryptocurrency and AI.

CR: Okay. 2024 was another really AI-focused year. We talked about it last time, but I think it's built even more momentum since then. Has your view on it and its likely trajectory evolved at all?

GR: My overarching view hasn't really changed, and we spoke about this last time I was on, and that's that, and this isn't controversial but I think AI is incredibly important. It's probably the most important new innovation since the internet, maybe even more important than the internet. And I think it's going to have a profound impact on the economy and on businesses over the long term. So that's not changed. We have actually been reducing Nvidia over the last year. That's not to do with a changing view on AI, in fact we've probably become more positive, it's more the fact that Nvidia's just performed extremely well, they'd growth to be a large percentage of the portfolio, and we're just doing portfolio management and balancing risk-reward.

One area where my thinking has moved on a little bit though is in the application layer of AI, and how new companies, or even our existing companies, what do they need to do, or what do they need to have, in order to be successful in this new AI paradigm? And there are two critical ingredients that I've come to view as being important for navigating this new technology wave. The first is these AI tools, they're available off the shelf, they're commoditised, any company can gain access to them, so if you want to build the competitive advantage on the basis of AI, you need to bring something different to the table. And so I think for companies to really build an edge in AI, they'll need to have large-scale, centralised, proprietary data that they can draw upon in order to fine-tune these models and produce something genuinely different for the consumer. So that's number one. Or their customers.

Number two, just as important I think, is leadership. I think to drive forward with this new technology, it'd be really advantages for a company to have a CEO in place that is technical, product-orientated, who understands AI, that has the vision, and also the internal capital, internal gravitas to really drive forward and execute on that vision.

CR: Okay. Could you give examples of companies that you hold that fulfil that criteria?

GR: Yes. I think one of the most interesting examples in the portfolio is Duolingo, which is the language-learning app. I mentioned the two things, the data side, the leadership side. On the data side, Duolingo is a mobile, native, highly-scaled consumer application. The application's been downloaded over half a billion times. There are over 20 million users that log into Duolingo every day and complete the exercises. And there are literally billions and billions and billions of exercises. And that's creating a rich data set for Duolingo to draw upon and fine-tune it's AI models that it's using, that's number one.

Number two, leadership, Duolingo was founded by a gentleman called Luis von Ahn. Prior to founding Duolingo, he was a professor of computer science at Carnegie Mellon University. He's technical, product-orientated, he understands AI, he's a mission-driven individual and he knows where he needs to take the company with this. And I don't think it's actually that surprising that Duolingo has been one of the most active companies in our portfolio in terms of incorporating AI into its products. It's really been on the front foot. And a recent example of this is that they're now offering their top-tier subscribers the ability to have spontaneous conversations with chatbots on the platform in a foreign language. And that's one of the things that's really critical to unlocking proficiency.

CR: Okay, amazing. Any other direct plays on AI that you'd highlight?

GR: I mentioned the data piece and how important it is for companies to have their data in order, in order to make the most of AI. In most companies, particularly legacy companies, the data's a bit of a mess. Companies that have been built up via acquisition, they may have legacy IT, on-premise IT, and only recently moved to the cloud, or a hybrid on-premise, cloud environment. These companies have data scattered all over the place in silos, difficult to access and difficult to bring together. And we actually have a couple of companies in the portfolio, there's one on the public side and one on the private side in the US Growth Trust, that do what I call data wrangling. These are companies that help organisations get their data in order. And you need to get your data in order if you want to do stuff with AI.

The public one is Snowflake. That helps companies wrangle their structured data, so the data that's in tables and things. And then there's a private company called Databricks that we own in the US Growth Trust that helps companies wrangle their unstructured data. Another one that I'm particularly excited about right now as a play on AI is Cloudflare. I wouldn't have called this an AI play six, 12 months ago. Cloudflare, its core business, it's built this infrastructure in local cities, and this IT infrastructure in local cities, to help its customers run their websites in a faster, more efficient and more secure way. But it's now leveraging that local infrastructure, these local data centres, to build out GPU capacity, graphic processing units which AI runs on, to enable its customers to run AI workloads at the edge, close to the customer.

And there are going to be certain AI workloads which will really benefit from being run at the edge, because the latency is something which is very important for these applications running efficiently, like self-driving, for example, falls into that category. This is going to be an absolutely massive market, longer term, and Cloudflare looks really well-positioned to capitalise on that. It just announced that it signed a \$7 million one-year contract for an AI inferencing customer in the last quarter. It sounds very exciting.

CR: Okay. Now, I guess because it's interesting, the temptation is to focus on technology all the time, and obviously that's an important area of growth, but are there any non-technology companies that you hold that you would highlight?

GR: Yes, I think there's a perception that all we do is invest in hard tech companies, we've got SpaceX and Tesla, Amazon in the portfolio, and talking to you about these data wranglers and Cloudflare, but that's not all we do. Our aim is to find America's exceptional growth companies and own them for the long term. And what we're looking for are companies that have got the potential to deliver outsized returns over five, ten, 15, 20-year periods. And tech companies are a good place to hunt for those, but it's not the only place that you can find those kinds of outliers.

And so, two historic holdings I'd highlight in the portfolio that fall into the more compounder growth category, but with outstanding long-term track records, would be Watsco, which is a heating, ventilation and air-conditioning distributor that's been consolidating what is, fundamentally, a local market in the US. And yet another one, there's a company called CoStar, which is a real estate information services company that's been quite acquisitive, consolidating this industry, and runs a wonderful, efficient business and a great capital allocator.

So those are two historic examples, and we've actually added a couple of new examples to the portfolio over the last 12 months in that category. The first one is a company that we participated in the IPO of called Lineage Logistics, which is a large operator of cold chain warehouses in the US. This is a very fragmented industry that's been run, historically, by mom and pops with very little technology. What Lineage is doing, it's consolidating this fragmented industry and then using technology to improve the efficiency of the warehouses and the cold chain supply chain. So that's one example.

And then a second one, which we just bought very recently for the portfolio, is a company called SharkNinja, which you may be familiar with. It has two brands, the Shark brand and the Ninja brand. It makes consumer products. It's a fantastic company, very high levels of operational efficiency, fantastic pace of innovation. And it's just going in and really changing these markets by launching innovative products at reasonable price points and is building a very strong brand with the consumer.

CR: Yes, I'm sure Ninja air fryers are on lots of people's Christmas lists, actually. Now, private companies are an important area for the US Growth Trust, I wonder if you could talk a little bit about how those investments fit into the overall growth strategy?

GR: Yes. This is why we launched US Growth Trust back in 2018. We've been running the American Fund since 1997, but what we observed over time was that... Our aim with the American Fund is, again, to find the exceptional growth companies in America and hold on to them for the long term, and what we'd observed over time was that private companies were staying private for longer. So by the time they came to public markets, they already had very, very large market caps. Facebook is an example from way back, but if you look at the market caps of some of the late-stage private companies today, or the valuations of some of the late-stage private companies today, like SpaceX and Stripe, etc.

And so we felt that in order to really capture the upside from these exceptional growth companies, it would be beneficial to have a vehicle which could cast its net wider, across both public and private markets. So, the US Growth Trust has got scope to invest up to 50% of its assets into private companies, and today about a third of its assets are in private companies.

We're not looking to do anything radically different from the past with this, we're just looking for the same exceptional growth companies, they're a bit earlier stage but the same exceptional growth companies, that we've been looking for in public markets for decades now. And the names that we have in the private part of the US Growth Trust will be familiar to a lot of people. Our largest holding in the portfolio, not just our largest private holding but you're largest holding in the portfolio, is SpaceX. It's a very exciting company and very unique asset. And the second-largest company in there is a wonderful founder-run payments and FinTech company called Stripe.

CR: Okay. And just to wrap up before we turn to the Q&A, give me your outlook for the next five years. What's going to be important?

GR: I'm optimistic for the next five years. The last five years have been quite volatile. It was what I'd describe as being a once-in-a-generation event with Covid, and then there were some downstream impacts of that that really impacted on our portfolio. One was just the demand volatility post-Covid, which impacted on digital businesses, and the second piece was the inflation that came about on the back of government stimulus and supply chain disruptions that drove up real interest rates and compressed the valuations of high-growth companies.

Both of those things are in the rear-view mirror now, and we're finally starting to see the fundamental growth of the businesses that we own be reflected in share prices. So that's pretty encouraging. And then, from the perspective of just a growth investor, we're going through another one of these periods of change right now, with the emergence of AI, and there are going to be a lot of exciting growth companies, winners, created on the back of this change. And I think it will be a very fertile hunting ground for high-conviction growth investors like us.

CR: Okay, great. Now, stick with us for the Q&A. For those of you watching live, we'll be back with Gary to answer your submitted questions right after we hear from Edward Whitten, so you still have time to get your questions in. As part of each programme, we feature an in-depth look at some of the transformational companies Baillie Gifford invests in. Today, we're exploring Ecolab, the company ensuring your food sources remain clean and safe.

Edward Whitten (EW): There is nothing more precious to human life than water, but how businesses extract and create value from water is increasingly in competition with the needs of households to access safe and sufficient amounts of it. The North American company Ecolab has spent over 100 years developing products and services that benefit both sides. Its primary mission is to help companies all around the world be better stewards of water, at the same time saving them resources and money.

Ecolab is perhaps best known for its hygiene and food safety services, but it's much more than a chemicals business. It works at over 3 million customer locations around the world, for companies big and small and industries ranging from food and leveraging to mining, and from hospitality to manufacturing. For Ecolab, it is by design not chance that the value it creates for customers also helps them reduce their environmental impact. Often behind the scenes, Ecolab and its subsidiary Nalco provide solutions grounded in chemistry which, on average, help customers reduce water use by over 30%. Water use is typically related to energy use, and so Ecolab also helps customers reduce greenhouse gas emissions.

But most importantly, these solutions help its customers reduce costs and achieve their financial objectives. This alignment between value and purpose is why Ecolab has been so successful for so many years, and we think it will continue to unlock growth opportunities among the company's existing client base, but also in new growth areas like data centres and microelectronics. For us, the key to any company's long-term success is in how it approaches its customer relationships. It's how a company proves its worth not just at the point of sale but also how it adds value over time and achieves pricing power.

In isolation, interventions are important but make a small dent in the global challenge of managing fresh water use and climate change. But incremental changes delivered at the scale Ecolab has achieved, mean big numbers and bold targets. By 2030, the company plans to help customers save over 300 billion gallons of water annually, or enough to meet the annual drinking water needs of 1 billion people. Growing expectations that businesses must reduce their environmental impact, as well as the age-old need for businesses to improve their bottom lines, means that as it enters its second century, there's never been a more exciting time to be invested in Ecolab.

CR: So that was Impact Director Edward Whitten introducing Ecolab. You can learn more about Baillie Gifford's other holdings by visiting the website. Right, Gary, we have questions for you. I think inevitably there are a few on valuations, which I'm going to bring together. One was Anthony Bolton, Fidelity veteran, quoted this week as saying all the red lights are flashing around concentration risk in the UK market. And then I'm going to put that together with the recent run on Tesla's share price. So how worried are you about those, concentration risk and valuation risk?

GR: The market's concentrated right now to a degree that it hasn't been for a very, very long time, so the S&P 500 is pretty concentrated, but some of our clients measure us against an index called the Russell 3000 Growth, and the top five companies in the Russell 3000 Growth are almost 50% of the index. So really quite remarkable.

CR: Yes.

GR: And that's why you have to be selective, right? We're not blindly buying the Magnificent Seven, we're looking at these companies on a case-by-case basis, and we're buying the ones for the portfolio that we think are attractive at this juncture. And we own four of them, and we don't own three of them. We don't own Alphabet, we don't own Microsoft, and we don't own Apple. And we've actually been reducing Nvidia. So I think you have to be selective, but taking a step back, I think the high-growth companies in the market, the valuations are a far cry from where they were during the peak Covid years, the high-quality SaaS companies are trading on price-to-sales multiples which are a third to a quarter of the level that they were at the peak of Covid.

And so I think, for the high-growth companies in the market, particularly in the mid and small end of the market cap spectrum, the valuations have actually come in quite a long way from where they were at peak. We're still finding very attractive opportunities in this market. Tesla did have a big jump-up in share price quite recently, and we've taken some money off the table, but there, I think people still misunderstand what Tesla fundamentally is as a business. There are a lot of auto analysts that cover the company, and they treat it like an auto company, and I'm not sure that's quite right. This is more of a software company than an auto company.

And the self-driving capability that they're building internally at Tesla, I feel like this is partly because there've been a number of people who've cried wolf on this over the years, I think people are, pardon the pun, asleep at the wheel with regard to self-driving. I was over in San Francisco recently and took rides in Waymo, which is now generally available, and one of my colleagues who's based out there took me around in his Tesla and showed me the Tesla self-driving. We literally went from one meeting in Silicon Valley, the car park of that company, to the car park of another company that we were meeting, 20, 25 minutes away, without any interventions. It drove us from one point to the next. And so I think it's actually nearly there. And that is a massive opportunity for Tesla in the longer term that would more than justify its current valuation.

CR: Yes. Actually, that leads to another question, which is whether Elon Musk can run SpaceX and Tesla and do this new role that's been handed to him in the US government.

GR: The DOGE. I don't know. We've been asking ourselves this question for a long time. When he first started taking on responsibilities outside of Tesla and SpaceX, with the likes of the Boring Company and Neuralink, and then there was Twitter/X, and then there was xAI, and now there's DOGE. He's a unique individual, and he just seems to have a unique ability to juggle multiple tasks. And there hasn't been any, in our eyes, issue with execution at SpaceX or Tesla as he's taken on more responsibilities. I think he's just a remarkable individual. The DOGE one, this is a temporary thing he said, I think a 12 to 18-month project where he's hoping to go in as an advisor, along with Vivek Ramaswamy, and advise the government on where to find cost savings, but then get out and shut down the agency, so it's not a longer-term project like Twitter or some of the others.

CR: Okay, great. Then, a question specific to the US Growth Trust. How have you and the board managed the discount over the past 18 months or so?

GR: Yes, the board have been doing buybacks over the last 12 months, so we've bought a significant percentage of the company over that period, because the board took the view that the discount was at an attractive level. What they're trying to balance with this, it's a capital allocation decision, and it's not the only way that we can deploy capital. We can deploy capital into buybacks, which, at a certain level of discount, are quite attractive, but we can also deploy that capital into private companies. But one of the things that the board's thinking about is is it more attractive to do buybacks or is it more attractive to save that capacity for private companies?

One of the things to understand about the buybacks is that because the private company piece of the Growth Trust is illiquid, then to fund the buybacks we sell down the public companies, which drives up the private percentage, and we're limited on the percentage we can have in private. So when we do buybacks, we are actually using up unlisted capacity. So that's the equation that they're thinking about.

CR: Okay, great. And then I think we've got time for one more, which is on Moderna. It's had a tough time recently, what's going on there?

GR: Gosh, yes, a couple of things with Moderna. One was just that the Covid endemic market turned out to be smaller than the management team expected. Post-pandemic, there was this question of what would be the steady-state size of the Covid vaccine opportunity, and actually, I think partly because of politics, the scale of the Covid vaccine market in the US has been smaller even than the flu market in volume terms. Which doesn't make sense because Covid is still a lot more deadly than flu. So that's one piece of it.

The second piece was that the launch of their second drug, which is another vaccine for another respiratory illness, but this time RSV, hasn't gone as well as expected. This is really Moderna's first commercial launch, first traditional commercial launch, because the Covid vaccine launch was a big unusual in the sense that it was very much demand-pull into the market to fulfil a very, very high unmet societal need, whereas this time around they're having to build a sales force for the first time. And so they're taking a step back from all of that, though.

The hypothesis with Moderna is that the foundational technology of mRNA is going to have very broad applicability, and over the long term it's going to lead to Moderna having lots and lots of shots ongoing, ultimately lots of drugs on the market. And I think the evidence, from the pipeline at least anyway, is still supportive of that case, and we've seen very good results from their clinical trials in the personalised cancer vaccine space, for example, and that could be a very big market for the long term.

CR: Brilliant. Okay, thank you so much, Gary. Thank you for joining us today.

GR: Thank you.

CR: And thank you, all, for joining us as well. You can watch this, along with the previous episodes from this year, on the Baillie Gifford website, bailliegifford.com, where you can also find out more about the topics we've discussed on the programme. The UK Intermediaries team are here to help, so do get in touch if you have any questions. That's all from us until next year, when Upfront returns with an all-new line-up. So goodbye for now, and we'll see you in the New Year.

Annual discrete performance

Baillie Gifford US Growth Trust plc	30/09/19-30/09/20	30/09/20-30/09/21	30/09/21-30/09/22	30/09/22-30/09/23	30/09/23-30/09/24
Share Price (%)	101.5	20.9	-44.7	-15.5	35.4
Net Asset Value (%)	91.9	33.4	-39.0	-5.3	18.7
Index* (%)	9.8	24.7	2.1	11.2	24.1

Source: Morningstar, S&P. Total return in sterling.

*S&P500 Index (in sterling).

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