

International Smaller Companies Q1 investment update

April 2024

Investment manager Remya Nair and investment specialist Eoin Anderson give an update on the International Smaller Companies Strategy covering Q1 2024.

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Eoin Anderson (EA): Hello, and welcome to this investment update for Quarter 1, 2024 for International Smaller Companies. My name is Eoin Anderson, I'm an investment specialist on the strategy, and I'm joined today by Remya Nair, one of the portfolio managers. As a reminder, International Smaller Companies is a small cap portfolio of small, exciting and most importantly growing businesses from within the international equity universe.

So Remya, the end of 2023 saw something of a cooling in industry expectations and this provided quite a supportive environment for our holdings. Has that continued into 2024?

Remya Nair (RN): Yeah, Eoin, we're a few months into 2024 now, I suppose. And what we have been observing is that international small caps still sit rather behind their larger cap peers. As you will have seen, the large cap space has enjoyed some recent excitement around new drugs, the medical industry, AI developments, etc. And some of that hasn't really passed through to their smaller counterparts. And what we believe is that in this particular rally and market recovery, given interest rates remained quite high, we think that these longer duration assets, these capital-hungry businesses, which often tend to be smaller companies, have not been as much in favour as their larger, more predictable peers.

However, that being said, as we always say, a quarter is a short period of time. That's how we view it, though it has been obviously embedded in a longer period of tough performance for us and a tough time for small companies. We really do believe that we have some exceptional businesses here in our portfolio that ultimately will reap the rewards of their fundamental operational excellence and their performance in the future. So we remain very optimistic.

EA: Okay. So a short time period, as you say, but year to date, the portfolio has underperformed. Are there any company specifics or themes that you would draw on to explain that?

RN: Yeah, a few specifics probably worth mentioning. The first probably being the share price effects of Global Unichip. It's a Taiwanese semiconductor company. Bear in mind, it's actually one of our top performers last year. The share price there doubled and it had done exceedingly well. And we accept that in the semi space, there is some embedded cyclicality, there's volatility. We've seen this with our other semi names as well, for instance, Megachips, which is a Japanese custom chip designer, much like Global Unichip. And we still remain actually very excited about Global Unichip's long-term potential. We think that they stand to really benefit from an increasing market and demand for specialism in the semi space, for custom chip design that have come out of emergent AI technologies and new developments in that space. So we remain, yeah, quite excited by it and we're actually speaking to management in Taiwan a few weeks from now to hear a little bit more about their developments there.

The other area probably worth mentioning as well is some continued underperformance we've seen in our Japanese names. As you know, the depreciation of the yen against the US dollar these last two years now has had a big impact on domestic Japanese businesses, especially perhaps also particularly the high growth businesses. For instance, we have Raksul, which is a cloud-based logistics platform. Bengo4, which is an online legal platform. These have recently suffered some share price weakness. What I would say though, is on the flip side, other businesses in our Japanese space that have a more international opportunity set, for instance, DMG Mori, which is a machine tool manufacturer which derives revenues from outside of Japan, has actually been one of the top contributors this quarter. So we're really seeing a balance there in our Japanese names. And it remains a very exciting opportunity set for us. We think there are some incredible Japanese businesses and we continue to see it as a good space for us for investment.

EA: Okay, maybe continuing on that more positive theme, what has been performing well in the portfolio over the past few months?

RN: Yeah, a few things come to mind. The first being Nanoform. It's our Finnish drug development technology company. They're really, really exciting, really unique business. What they're essentially doing is working quite closely with pharma companies to use its nanocrystalline technology to try and improve the solubility of drugs, both existing drugs and new drugs, into the human body. Nanoform has actually really led the performance in terms of share price performance this quarter, and that's been mostly due to a quite encouraging, exciting announcement they've made around a blockbuster drug. I believe it's currently being used to treat prostate cancer. And they've had some strong results in some ongoing studies in trying to increase solubility there. So that's been fairly exciting.

Another one worth mentioning probably is our South Korean names. There are some really unique companies in the South Korean space. And as you know, we've recently taken some more investments there, bought some shares in some new companies, one being Hanator, which has also been a strong performer. It's a package holiday business, and it's really seeing some growth, both coming from travel normalizing after the Covid period, but also a real trend amongst consumers in Korea to spend higher levels of their disposable income on travel-related expenses, which has been quite exciting.

The other thing worth mentioning that we've seen recently with South Korea is the country has taken a real effort and has announced a concentrated plan for what they call capital markets revitalization. What they seem to be doing is to try and attract more investment into their domestic capital market. And the way in which they're doing this is to try and really improve their standards of transparency, of corporate governance, of profitability amongst many businesses. And some of the recent performance among South Korean names has been related to that news and related to the positive, I suppose, reception around that.

EA: So there's an awful lot going on at company level, at market level, macroeconomic level. How are management teams feeling generally? And are there any themes in terms of company activity?

RN: Yeah, it's a good question. I'd start by saying that interacting with management teams and keeping up with them is a really important part of our process. We find that it really helps us understand the unique opportunities and challenges they're facing. And in each of these, management teams are dealing with them in a variety of ways that we're learning about. There have been maybe some broad themes around the types of company activities that we're seeing, one in particular being companies or management teams trying to make their businesses more nimble, more lean.

We've seen that through some cost-cutting measures, for example. Some of our European names, such as Storytel, which is a Swedish e-book platform and also New Work, which is a German recruitment business. They've announced, alongside some recent results, also some plans to reduce their workforce and really prioritize their efforts and their capital onto their core platforms and their core markets. What we're also seeing is some continued M&A activity, not just in terms of our holdings being acquired, as we'd seen in the last quarter, but also management teams making a real effort to invest counter-cyclically and harness the potential of their horizontal integration or their vertical integration, acquiring peers or complementary products and platforms. One example here this quarter is Jade, which is our really interesting Japanese online apparel retailer. They were previously known as Locondo. Jade has announced an acquisition of one of their rival platforms, so that's actually quite exciting and we believe it really stands to improve their competitive advantage.

EA: So again, we're a few months into the new year. What's the team been working on and what are you looking at doing and what are you excited about moving into the rest of the year?

RN: We're working on lots, as always. We've got lots of new ideas coming in. We've obviously dealt with a tough environment for the last few years and that's accompanied a widening opportunity set in some ways. We see that as opportunistically as possible. We've really been able in the last year or so to reintroduce travel and interacting with companies face-to-face, going to visit them at their headquarters as an actual tool in our toolkit as part of our research process. As you know, we really value those opportunities. We think that they can help add a lot of insight, a lot of perspective as inputs into our research process. So we've been doing much of that. I've just gotten back from the Netherlands and Belgium another colleague has just gotten back from Southeast Asia. So I'm sure we'll have lots of new ideas inspired from that and we hope to explore them together and see where the year takes us.

EA: Great. Thanks very much, Remya. And thank you very much for joining us. If you do have any comments or questions, please don't hesitate to get in touch with your representative here at Baillie Gifford. Thank you.

International Smaller Companies

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

	2020	2021	2022	2023	2024
International Smaller Companies Composite*	-13.3	86.3	-13.7	-12.3	0.6
MSCI ACWI ex US Small Cap Index	-20.8	70.4	0.4	-9.9	13.4

Annualised returns to 31 March 2024 (net%)

	1 year	5 years	10 years	Since inception
International Smaller Companies Composite*	0.6	4.2	N/A	4.2
MSCI ACWI ex US Small Cap Index	13.4	6.7	N/A	6.6

*Inception date: 28 February 2019.

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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