

UK MARKET RIPE FOR STOCK PICKERS

Milena Mileva, Investment Manager. Third Quarter 2018



THIS PAPER IS INTENDED SOLELY FOR THE USE OF PROFESSIONAL INVESTORS AND UK INTERMEDIARIES AND SHOULD NOT BE RELIED UPON BY ANY OTHER PERSON. IT IS NOT INTENDED FOR USE BY RETAIL CLIENTS.

RISK FACTORS

The views expressed in this article are those of Milena Mileva and should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect personal opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

Potential for Profit and Loss

All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk. Past performance is not a guide to future returns.

Stock Examples

Any stock examples and images used in this article are not intended to represent recommendations to buy or sell, neither is it implied that they will prove profitable in the future. It is not known whether they will feature in any future portfolio produced by us. Any individual example will represent a small part of at least one of our UK Equity portfolios. Examples are inserted purely to help illustrate our investment style.

This article contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this article are for illustrative purposes only.

This communication was produced and approved on the stated date and has not been updated subsequently. It represents views held at the time of writing and may not reflect current thinking.

Annual Past Performance to 30 June Each Year

	2014	2015	2016	2017	2018
UK Equity Alpha Composite Net (%)	6.2	8.3	-2.5	23.3	24.9
UK Equity Core Composite Net (%)	12.8	5.8	-2.7	23.4	14.1
UK Equity Focus Composite Net (%)	8.3	6.2	-2.6	25.6	14.4

Source: Baillie Gifford & Co. Sterling.
Changes in the investment strategies, contributions or withdrawals may materially alter the performance and results of the portfolio.

MILENA MILEVA

Investment Manager

Milena completed her MPhil in Politics at Oxford University in 2009, having graduated with a BA in Social & Political Science from the University of Cambridge in 2007. She joined Baillie Gifford in 2009 and is an Investment Manager in the UK Equity team.



UK MARKET RIPE FOR STOCK PICKERS

Being a UK equity fund manager may seem a somewhat depressing occupation these days. As the spectre of the country's exit from the European Union looms large, there are plenty of doomsayers taking the view that investing money in UK stocks is a foolish thing to do. Why would anyone bother evaluating UK investment opportunities when you could invest in the innovative dynamism of certain parts of corporate America, or the allure of China's fascinating journey to global economic dominance? Against these competing attractions, the fate of the UK PLC seems a sorry one.

We, however, refuse to be disheartened. Rather than being dull and futile, investing in the UK market is for us a greatly rewarding exercise. This is simply because there are some tremendously exciting British businesses which we wish to help grow to become multiples of their current size in the years to come. Some of these companies might not be household names, but they are true world leaders in their fields. They have built enviable competitive positions that rivals find hard to match. They are run with ambition and a real sense of purpose, confidently unlocking large growth opportunities which often span the

globe. They feed on powerful, deeply entrenched social trends and, through innovation, aim to solve some of the most intractable challenges facing the industries they operate in. We believe that these companies' prosperity will not be easily derailed. Their strengths and adaptability should enable them to drive their vision, even amid evidently seismic political and economic events. And, by continuing to be sizeable, highly committed and patient shareholders of these businesses, while acting on our clients behalf, we have put ourselves in the privileged position of taking a disproportionate share of any future success.

TAKE YOUR (STOCK) PICK

We are unashamedly bottom-up investors. You will not hear us muse on, or attempt to predict, the daily twists and turns of economic data, stock market sentiment, or government policy. We do not think we can add much on those issues. What we do love to talk about, however, is the companies in our portfolios. As the following examples show, our enthusiasm for some of the exceptional UK growth businesses spans a wide variety of different industries.

We are particularly keen on **Renishaw**, a manufacturer of high precision measurement, position sensing and motion control equipment. The UK might no longer have the reputation for being an industrial and engineering powerhouse but, in Renishaw, we have a rare example of a truly world-leading UK engineering business. The company has more than 70 offices in 35 countries, although almost three-quarters of its 4,000 employees are based in the UK. Its products play a part in a broad range of industries from auto and aerospace manufacturing, to semiconductors and dentistry. We are impressed by the company's sustained commitment to high levels of research and development spending and its obsession with ultra efficient automated manufacturing. Renishaw has effectively become the gold standard in its industry and secured an unparalleled competitive position. And, looking ahead, we believe it is at the heart of long-term secular trends towards advanced manufacturing, helping customers in various industries across the globe to automate their processes to become more productive.

Animal genetics company **Genus** also plays a crucial role in enabling its customers to become much better at what they do. Through its focus on developing cutting-edge genomic and breeding techniques, Genus enables farmers around the world to improve the efficiency and sustainability of meat and milk production. For instance, the company is currently focusing on creating PRRSv resistant pigs. The porcine reproductive and respiratory syndrome virus is a major disease costing the global swine industry billions annually.

Healthcare systems everywhere are under severe strain. We believe that one way to tackle the problem of ballooning costs is by shortening drug development timelines and increasing R&D productivity. **Abcam**, one of our long-standing holdings, is well placed to address this challenge. The company is one of the world's leading suppliers of high quality antibodies and other reagents to the research and academic communities. Through its powerful e-commerce platform, its comprehensive data and proprietary intellectual property, Abcam aims



to help life scientists achieve their mission of understanding human biology and the underlying causes of illnesses faster.

We recently took a holding in **FDM** which enables global corporations to address a chronic and worsening shortage of IT skills. Its workforce is drawn mainly from recent science graduates, people returning to work and former military personnel. They are trained in FDM academies before working as consultants for FDM clients. This enables clients to increase

operations rapidly and flexibly without having to cede control of this vital area to offshore firms, or resort to the use of expensive contractors.

Renishaw, Genus, Abcam and FDM are great examples of dynamic and entrepreneurial UK business-to-business champions which aim to dominate their global markets. However, we have also been fortunate in identifying a handful of very exciting consumer-facing businesses. Some of them have leveraged the power of digital technology to create

innovative business models that make life much easier for customers.

Rightmove has brought house hunting to the modern age and transformed the slow-moving real estate industry.

Hargreaves Lansdown has used technology to empower UK consumers to save and invest with confidence.

Just Eat is changing how takeaway ordering works by seamlessly connecting time-poor, digitally-savvy modern consumers with a huge range of restaurants. These digital pioneers might lack the ubiquity of Amazon, Facebook, or Alibaba, but have carved themselves valuable and defensible niches. We say 'niches', but it is worth remembering that all of these companies operate in industries where total profits are measured in billions of pounds. By being first to market, they have also established competitive advantages which are difficult for rivals to overcome: one in five UK adults orders takeaway through Just Eat; Hargreaves dominates the DIY investment market with over one million consumers managing their savings on its platform; Rightmove's online portal registered 1.5 billion visits in 2017.

In the retail sector, there can sometimes be a perception that UK companies struggle to replicate the success they have achieved at home when they enter markets elsewhere in the world. However, in **Ted Baker** we have identified a UK retailer which defies this rule. This quirky brand is full of character but seems able to travel abroad exceptionally well, as shown by its continued strong growth in the US and Asia.



Renishaw, Genus, Abcam and FDM are great examples of dynamic and entrepreneurial UK business-to-business champions which aim to dominate their global markets.



LONG-TERM WINNERS AND THE NEED FOR A STRONG CORPORATE CULTURE

We have learnt a lot by owning these great businesses and hope we can use some of those lessons to spot other big winners in the future. One of the key things we have observed is just how crucial their unusual corporate cultures have been to their excellence. This manifests itself in a number of ways.

First, they are all united by an unwavering focus on the long term. Whilst most companies tend to pay lip service to long-termism, it seems to us that precious few have the courage to consistently follow this belief. For most, a quarter or two of weak demand or missed earnings expectations is sufficient to result in ad hoc cost cutting and various forms of financial engineering to shore up the numbers. In our experience, Renishaw's lumpy short-term profit progression and its volatile share price have never had any bearing on its commitment to invest in the long-term development of its business and its people. It is an attitude which has been fostered by its founders, who still own over 50% of the shares.

Second, these great UK growth businesses all have strong identities and a vision which extends far beyond the imperative to generate profit for shareholders. This in turn tends to result in them having a strong alignment with their customers and employees. Take Ted Baker's relentless obsession with the uniqueness of its product and the experience of its customers. Everything the company does is in service of this goal. We think this makes it very different to other listed retailers which can often focus

unduly on store targets and building up large estates. In the words of its own eccentric founder, Ray Kelvin:

“Dominant is an aggressive word, it is just about letting it grow naturally. I don't have a preconception of ‘in five years we will be there’ and ‘in 10 years we will be at this level’ because if you push it too hard, then the customer realises it is a forced brand. You have to nurture it and feel for it. Taking care of our customers and getting repeat business is the only thing we aim for.”

We believe this means that, unlike many of its peers, Ted Baker is not going to be disrupted by the accelerating shift to online shopping. On the contrary, we see the company fully embracing and capitalising on these changes in consumer behaviour.

Finally, all of these businesses realise that the only way they can achieve their long-term ambitions is by nurturing their own employees. Renishaw, for instance, faces a great challenge of recruiting enough skilled engineers in the UK. It is, therefore, well-known for taking care of its existing employees. And, through its long-standing apprenticeship programme, education outreach efforts, and comprehensive network of contacts with UK universities, it works hard to find new talent. We are equally encouraged by the great work and commitment of the FDM management team to increase the representation of women in IT, an industry where females are grossly underrepresented. Its ex-armed forces and other social inclusion and mobility recruitment initiatives are examples of the company's efforts to ensure the sustainability of its own business, but also to contribute to positive social change.

THE POWER AND IMPORTANCE OF LONG-TERM INVESTING

We are passionate advocates of the merits of long-term investment horizons. Whilst some of the companies we have shared with you are relatively recent discoveries, most have been sizeable holdings in our portfolios for a long time – for example, Ted Baker and Renishaw were first bought by Baillie Gifford in 1996. Our patience and commitment as shareholders have been handsomely rewarded. The temptation in such circumstances can often be to ‘take profits’. We think this would be a disservice to our clients because, no matter how successful they have already been, we are convinced that the best is yet to come for each of those businesses. With its expanding product capabilities, Hargreaves is going after a £1 trillion savings and investment market in the UK. Renishaw is applying its core skills in accurate measurement and its engineering excellence to entirely new (and large) markets such as metal 3D printing and neurosurgical robotics. Abcam is increasingly venturing outside research and academia in order to help customers in the diagnostics and therapeutics areas. Just Eat, FDM and Ted Baker are all looking to build successful international operations.



CONCLUSION

We are not arguing that conquering these new horizons will be an easy task for our companies. Setbacks along the way are inevitable, just as they have been in the past. However, the scale of the opportunity truly excites us. It is only through our continued patience and commitment as shareholders that we and our clients will be able to fully benefit from this great potential.



IMPORTANT INFORMATION

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is a unit trust management company and the OEICs' Authorised Corporate Director.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outwith the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Important Information Hong Kong

Baillie Gifford Asia (Hong Kong) Limited 百利亞洲(香港)有限公司 is wholly owned by Baillie Gifford Overseas Limited and holds a Type 1 licence from the Securities & Futures Commission of Hong Kong to market and distribute Baillie Gifford's range of UCITS funds to professional investors in Hong Kong. Baillie Gifford Asia (Hong Kong) Limited 百利亞洲(香港)有限公司 can be contacted at 30/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong. Telephone +852 3756 5700.

Important Information South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Important Information Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Important Information Australia

This material is provided on the basis that you are a wholesale client as defined within s761G of the Corporations Act 2001 (Cth). Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth). It is exempt from the requirement to hold an Australian Financial Services License under the Corporations Act 2001 (Cth) in respect of these financial services provided to Australian wholesale clients. Baillie Gifford Overseas Limited is authorised and regulated by the Financial Conduct Authority under UK laws which differ from those applicable in Australia.

Important Information South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

Important Information Canada

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005. It is the legal entity through which Baillie Gifford Overseas Limited provides some marketing functions in Canada.

CURIOUS ABOUT THE WORLD

bailliegifford.com/thinking

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