PRIVATE COMPANIES INTRODUCTION

Private companies matter to long-term growth investors as never before. Tom Slater, investment manager and partner at Baillie Gifford, talks to his colleagues Peter Singlehurst, Chris Evdaimon and Robert Natzler about why this is and how it shapes Baillie Gifford's approach to investing in private companies.

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This film was produced and approved in December 2020 and has not been updated subsequently. It represents views held at the time of recording and may not reflect current thinking.

Tom Slater (TS): Hello and welcome to this discussion of Baillie Gifford's capabilities in investing in private companies. Today, with me you have Peter Singlehurst, Chris Evdaimon, and Robert Natzler. I'm Tom Slater, a partner at Baillie Gifford. Just to start us off, I would like to say a few words about how we got into investing in private companies in the first place. We'd noticed that some of the big public companies that we invest in were creating the tools that were allowing companies to grow rapidly, with very limited requirements for capital, which in turn was allowing them to stay private for longer, to control their own destiny.

And it was clear to us that if we were going to retain access to the most exciting growth opportunities in the world, then we had to do something to expand our access, which took us into the world, back in 2012, of investing in private companies. Today, we have about $5 billion of assets invested in private companies, and around $40 billion of assets invested in companies that we first invested in when they were private. I think that speaks to the breaking down of the barriers between private and public companies and the way that they finance themselves.

So maybe just to get us started, could you maybe, Peter, tell us a little bit about why we're investing in high-growth private companies. What is the opportunity there for us?

Peter Singlehurst (PS): I think Tom, as you mentioned, there has been real profound change in how and where companies capitalise themselves. Many of the businesses that we look at in the later stages of the private markets would have been public in any other period of history. But for a variety of reasons, those companies are staying private much much longer. And there are hard and soft factors behind this. Hard factors would include things like regulatory change, Sarbanes-Oxley, the JOBS Act, but I think what's often overlooked is some real soft cultural factors which are pushing companies to stay private longer.

There has been a real cultural shift amongst founders in the perceptions of staying private versus being public. Many companies actually want to stay private for much longer periods of time to avoid the short-term pressures of the public markets, but also become they derive competitive advantage from remaining private, by being able to focus on the core mission of their business.

Now, as these companies stay private longer, it means that there is a change in where value accrues. More value is accruing whilst companies are private, and less value is accruing whilst they're public. But we also believe that the traditional model of investing in private companies isn't equipped to deal with this change which is happening. 10-year limited life funds don't enable long-term hold periods, they don't enable investors to provide that continuity of capital and ownership and stewardship of businesses as they transition into the public markets.

TS: Great, thanks Peter. And Chris, if you could expand for us please a little bit on what you think are edges in getting access to some of these private opportunities?

Chris Evdaimon: In one word, I think it is our reputation. We really work hard, everyone in the team works hard to earn the trust and the respect of the entrepreneurs that we back. You can ask, how do we do that? We try in multiple ways, by demonstrating our understanding of their companies, by sharing our learnings from their sector, by helping them to transition to a public company for the right reasons and at the right time, where they know that Baillie Gifford is likely to be a buyer and then remain a patient shareholder for the long term.

This is why in the past couple of years alone, more than 70% of the investment rounds that we closed were directly solicited by the companies or vice versa, and very often through referrals from within the Baillie Gifford portfolio. And examples of such rounds include companies like Bytedance and TransferWise and our multiple investments in SpaceX. On average, we receive our required allocation in more than nine out of ten investment cases.

TS: Peter, you say that the sort of high-growth companies that we're looking for, maybe just going a bit deeper into that and explain what stage we're looking at investing in some of these companies.

PS: Yes, absolutely. We are trying to look at companies that can deliver transformational growth, and in doing that, we're asking a different set of questions. We're trying to have meaningful conversations around business models and competitive advantages, and the quality of management teams. The scale of upside, the ability to scale into that upside. These are the sort of questions that we've been asking for businesses whether privately or publicly for many years.

TS: And if we think about the stage of company that we're investing in from these areas, Rob, how can Baillie Gifford help those companies at that particular stage of investment?

Robert Natzler: I think it's always easier to start with how we don't try and help these companies. What we don't try and do is sit on their board and tell them how to run their businesses. As Peter alluded to earlier, these are companies that are often later and more developed. They don't need that from their investors. I think I see two areas though where they do quite like what we bring. The first is in the conversations that we have, not only with the management but with their board and the other people on their camp table.

Conversations reminding them that what's important is to go for the long-term strategic objectives that can make that business great and fortify it over the long term, rather than spending every single minute of every single day worrying about possible short-term tactical missteps, and so in communicating that ambition and that willingness to embrace uncertainty, I think we bring value to the table and I think a lot of founders think we do too.

The second place, which is much more of an emerging area, is when these companies decide to go to public markets. Now, we all know that for us, the IPO is just one more funding round, it's not a massive event. But the fact remains that for founders, IPOs are disruptive events in which they wave goodbye to a large number of people on their camp table, with whom they've built deep relationships in private markets, and they say hello to people who may well be much shorter term in their approach to the business than the founders would like them to be.

By being that investor, Baillie Gifford can reliably show that it is better aligned with the interests of the company than anyone being brought in to give short-term advice around the time of an IPO.

TS: That's really interesting. Peter, if I could get you to expand a bit on that last point from Rob around alignment and what role it plays in our approach to investing in private companies.

PS: I think when we first started learning about the private markets many years ago now, we were struck by the misalignment that we found within the traditional world of private company investing, and there were really two key areas I would highlight. The first is, as we've touched on, the prevalence of relatively short-term funds, capping investment time horizon, and the second was high costs.

So maybe it's looking at those each in detail. Many of the founders building these companies do so with a very long-term time horizon. They're not trying to create something over a period of a few years that they can exit. They're looking to build something that lasts and is sustainable. And if you look at where the capital comes from, many of our clients and their own beneficiaries have very long-term capital needs. Many have pension funds where they have very long-term liabilities.

One was charging much lower fees than is common within the industry, and the second was trying to use fund structures that were much longer term and would permit that longer-term hold period, and connect the long-term desires of the founders to build businesses of scale over many years, if not decades, with the long-term needs of our clients, and have structures in that chain, with our own long-term investment philosophy that facilitated the alignment throughout the value chain around long termism and around low cost.

We really strongly believe that by bringing that alignment, we can be part of an ecosystem which is mutually beneficial to all parties. And of course, it's nice knowing that having low fees means that more of the returns that we make for our clients with their capital is kept by our clients.

TS: I think that really strikes a chord that we are in private companies, investing in a way that is very similar to the way that we've invested in public companies for more than 100 years at Baillie Gifford, focusing on long-term winners, being loyal and supportive shareholders.

I think one of the things that's most exciting to me about it is the opportunity to invest in world-class companies that we think can really drive growth and returns over very long periods of time.

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