Investor webinar - your questions answered

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Stewart Heggie (SH): Hello and thank you for dialling into this live webinar, your questions answered. I'm Stewart Heggie and today I'm joined by the managers, Tom Slater and Lawrence Burns.

Now we've been hosing these webinars on a six-monthly cycle and their purpose is for Tom and Lawrence to answer your questions and for them to be shared with a wider audience. Today I'm going to begin by asking some of the questions that you've sent in advance, and thank you to those of you that did. However, if you've not yet asked a question and you would like to do so, the Q&A function should be open at the bottom of your screen.

Finally, this webinar is scheduled to take around 45 minutes. If we do have lots of questions at that point, I think we'll go beyond that mark, but we'll give it a hard stop on the hour. Great, well, let's get to it.

Tom and Lawrence, I was reviewing some of the questions that we received and people seem to be curious to know how you allocate your time and to what extent it's been influenced by the recent fall in the share price. Since we last sat down six months ago, can you just tell us a little bit about how you've spent your time since then? Lawrence, would you like to go first?

Lawrence Burns (LB): I think the key role as an investors is really about learning. That doesn't change, irrespective of what market environment you happen to find yourself in. I think in some ways there's two buckets, if you talk about the day in the life of different types of learning.

The first one is perhaps a rather boring one. It's about sitting down, reading company reports, reading information, learning, reading books and just trying to understand what is going on in our companies and the world. At Baillie Gifford you'll see that our investment floor is often compared to a library.

The second slightly more interesting one, is really about learning from other people. Getting out in the world, meeting interesting people, having conversations and learning that way, so we're not just reliant on learning at the desk.

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You said the last six months, over that last six-month period there's been a lot of travelling for both of us, of going out and meeting company holdings and people we think can teach us more about what's going on in the world. Myself and Tom went to China for two weeks in May. A few months ago I was in Europe, visiting the founders of Spotify, Delivery Hero, Zalando, HelloFresh. I think it's the combination of those two forms of learnings that end up taking the majority of our time as investors.

SH: Tom, yourself?

Tom Slater (TS): I think Lawrence captured it pretty well. I think one of the most useful inputs is spending time with the people that run and founded the companies we own. Some of those individuals are geniuses and we're definitely not. Just picking up the insights that they have to share with us, translating that into what you do in the portfolio is really helpful.

LB: And we're in a really privileged position. As Tom rightly said, they're geniuses, so the insights that we get are really very valuable and I think it builds a lot of the time on Baillie Gifford's reputation that we have that access and it's really important input for the fund.

SH: On these investment trips, I'm not sure how much we've actually shared about those in the past, but who do you go on them with? How are they organised and how do they ultimately translate into investment decisions within the portfolio?

TS: I would say that what's really important is to have a clear, well-understood philosophy and framework for thinking about investments.

But then it's not really very valuable for Lawrence and I to sit together all the time and chat. What's valuable is for us to go off and do different things, meet different people, get different sources of information, and then come back together and try and generate insight from those different experiences.

Trips for me are mostly done on my own. It's just going from company to company, it's shoe leather, really. I just think you get a much more rich experience from actually visiting companies on their own territory. Actually seeing where it operates, seeing what makes those businesses tick.

You can go to conferences and see hundreds of businesses over the course of a week, but if there's thousands of other people doing that, then you're just swallowing the bullet points that those companies want to promote. Then the chances that you generate differentiated insight are close to zero.

SH: Moving on, we've had some questions from shareholders who invested when the share price was higher than it currently is right now. I'm just going to take one of those, as it was written.

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The share price has fallen and you remain invested in many of the same companies. Therefore, we need their share prices to recover or exceed previous highs. What gives you the confidence that they will do so? Maybe to you, Tom.

TS: The starting point of the question, that you're invested in most of the same companies that you were, will be true whether the stock price had gone up or the stock price has gone down. Because the essence of what we do is that we're very long term. That you shouldn't expect radical change in the lineup in the portfolio.

All the time we're evaluating new ideas, we're comparing them to what we own, but we change our minds only very slowly about where we think the best opportunities lie.

I think the fundamental point is that over the very long run stock prices follow earnings of business. What we have had over the past two or three years, and we say this with the benefit of hindsight, is that those stock prices run ahead of the fundamentals because of what was happening to interest rates.

But, actually, in terms of the operational performances of those business, by and large they've been really pretty robust, pretty impressive. And so, you've had some of the valuation premium come out of those stocks, but actually, there's nothing that's really changed in the majority of those investment cases. We don't like inflicting this type of volatility on our shareholders, but we see very little to change our minds on the longer competitive advantages and opportunities that those businesses are going after.

SH: We should perhaps talk about some of your higher conviction holdings, the larger holdings. Lawrence, perhaps one for you. Moderna is a large and high-conviction holding. In light of recent share price performance, why so?

LB: It's been an interesting time with Moderna. But I think it's also offering us still the opportunity to own a once in a generation healthcare platform. We've talked about this a lot in terms of what is mRNA? It's a code that allows your body to design various different proteins. The opportunity there, given so much is made of proteins, is very, very wide.

Then when you look at Moderna's pipeline, you can see some of that breadth. Yes, it's been very successful in Covid, but you also have its flu vaccine, which has got good results for RSV, another respiratory disease for which there hasn't previously been a commercially available vaccine. And also some of the success that they've had within the personalised cancer vaccine cutting death rates by nearly half.

It's that broader platform that really interests us, rather than what is an endemic steady-state market for Covid. The value of that I think is something that is really being ignored at this point by the market. You're looking at Moderna being a $25

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billion company. It’s got about $15 billion of cash, which it's continuing to use to invest in that broad platform. That allows it multiple shots on goal, in a way that even within the healthcare space I think is unusual.

That’s why our underlying excitement has really been there. And actually, the share price has been bumpy, but if you look at that platform validation, that has actually continued to come through quite nicely. As I said, with flu, RSV and personalised cancer vaccine. Covid revenues have been obviously a very different sort of stake, but actually, that broader platform is largely showing the signs that we’d hope it would.

SH: Just staying on some of the larger holdings, and in this case NVIDIA, which has appreciated in value recently. How do you think about valuations and the future upside that can be generated from stocks such as NVIDIA, who have seen such huge share price gains this year?

TS: NVIDIA makes the chips that are used in artificial intelligence systems. We've seen the capabilities of those systems expand meaningfully and that’s driven a huge wave of demand for NVIDIA’s hardware.

To give you some sense of the scale of that, so the third quarter of 2022, they did about 6 billion of revenue. In the thrid quarter of 2023 they’re talking about doing 16 billion. So, you've had this huge acceleration in what is already a very big business. This isn't hype about AI, this is real orders, real dollars flowing through into the business.

The way that I conceptualise this from a valuation standpoint is we’re looking for companies that have a massive opportunity and then we’re thinking about their ability to capitalise on that opportunity. And so, if a stock price goes up, the questions you need to ask are has the opportunity got bigger? Has the likelihood of capitalising on that opportunity increased?

Now if you can respond positively to both of those questions, then it may very well be that despite the increase in the price of the shares, the valuation hasn’t increased.

If you look at NVIDIA, we've seen very clear evidence that that opportunity has got larger. We've seen evidence that they’re able to capitalise on that opportunity. The question that's top of my mind is how are they going to fair against new entrants into this market. It is clear that there's huge demand. I can make a convincing case that that demand picture will look robust for the next decade, but are customers going to buy all that technology from NVIDIA?

For us, we’re able to answer that question with a fairly confident yes at this point, that’s why we’re happy to allow this to run to a large position in the portfolio.

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Linking us back to the earlier question about what we've been doing with our time, Lawrence was actually in New York three or four weeks ago, seeing Jensen while he was there, the founder of NVIDIA. I don't know if you would add anything to that, Lawrence.

LB: Yes, I think there'd be two points. One is that the opportunity for AI is broad and large, but it's quite difficult to know what the right applications for it will be and what will be the most successful. But I think the advantage of owning NVIDIA is that you can be somewhat agnostic about the different use cases for AI. But, I think, as Tom was saying with the competitive position, quite confident that whatever the use case of AI, it's highly likely to need to be trained on an NVIDIA chip. They have about a 90 per cent of generative AI is trained today using NVIDIA chips.

The second one would be, and this is what we got from meeting Jensen, even as you move away from all the wonderful possibilities of AI, his case would still be there's an ability to disrupt the traditional computing within data centres. And to move to what they call accelerated computing, which is really adding in their GPUs to work alongside CPUs.

When pushing him on that, his view was that that opportunity is a trillion dollars in data centres today and an awful lot of that would be much better if it's shifted to accelerated compute using NVIDIA. And that's the case, even if some of the things that we're hoping about AI don't come to fruition for other, general tasks. It would still be useful to make that shift and I think that starts to get you into the scale of the opportunity, that you've got that rearchitecting of data centres plus all the additional AI opportunities which often get more of the attention.

SH: AI was a popular topic in the questions, but how are you as fund managers factoring AI into your thinking and how that might translate into returns for the trust? Is there a value chain of companies that you're thinking about investing in?

TS: We're pretty early in this, so I think we've got to be cautious about jumping to conclusions, we've just got to keep learning. Now there are some things that we know already. We talked about NVIDIA and we can see the strong position that they have in the silicon in this area.

You then get into they're training these foundational models. And what we know about that is that it's really expensive, and so there's not many companies that can play in that market. Either because they don't have the financial wherewithal or the technology background to do it.

The early beneficiaries look to be the large platform technology companies. We do know that this technology is most likely deployed in the cloud, not in a

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distributed fashion. So, the big cloud players, the Amazons, the Microsofts of this world look well positioned.

So, we think about those companies, but also open-minded to the fact that actually, when you've seen these technology transitions, you've seen agile new entrants come into those markets and be able to create long-term, big-growth franchises. We saw that in mobile, we saw that in the transition from desktop to cloud, we saw that from the growth of internet.

The incumbents will benefit from this, those with deep pockets, but being open-minded to the new entrants, as well.

SH: You mentioned new entrants. We just actually had a question through there on portfolio construction, which is in three parts.

What has been the biggest addition, the biggest disposal and the biggest surprise of the year so far? That's to either of you.

LB: Maybe I'll start with disposal and you can do the more interesting addition. We've talked about this a bit before, but we have had a reduction in our allocation towards China. A lot of that’s been about raising the bar and that’s meant that we've sold out of a couple of Chinese holdings. One of the largest there and more long-standing was Alibaba, which was actually our first private investment.

That’s really recognising a couple of things. The first is that as you try and put those geopolitical risks and domestic regulatory risks into your scenario analysis, you require a corresponding amount of upside to make it worth taking those risks. That means that you're raising the bar, and we've done that across the portfolio in relation to our Chinese holdings.

Then I think secondly, with Alibaba, that there were a number of competitive battles that they looked less well placed than they have been in the past. I think when you go through those regulatory periods, the culture changes, it becomes one that's more trying to preserve what you have, rather than to ambitiously and radically grow and disrupt what you don't have. I think that changes the nature of companies at times.

At the same time, we've continued to find companies within China, such as Pinduoduo, where we have added. That we think actually are facing a disruptive opportunity, explosive growth. They’re growing 60 per cent top line revenue, very profitable as well, growing bottom line about 45 per cent year-on-year. And their valuation is a fraction in terms of P/E multiples, what you’d expect for that kind of growth rate.

Hopefully that gives some of the nuances of some of the different trading we've been doing. But you might want to come with some other examples.

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TS: I think we should mentioned the disposal of Illumina, which is a very long-standing holding. I think we bought it in May 2015. I think maybe earlier than that, 2011.

Gene sequencing and genome sequencing I think remains an absolutely critical technology in healthcare, and one that we remain absolutely excited about the opportunity for. But the execution at Illumina in recent years has been disappointing. You've seen management change there, but we don't think there are any quick fixes.

At a time where you're thinking about edge, you think about competition in those markets and where there are real challenges, I think it's important to accept where this one just hasn't turned out how you hoped. So, move on.

LB: Perhaps just adding one more on the additional side, if that's okay. I think the other side, going back to your earlier question, that holding the same portfolio. We have also made additions and we found things that we're able to buy at valuations that we haven't been able to access in previous years.

One example would be we've taken a new holding in the Korean ecommerce company, Coupang. That's a company where its share price since its IPO will have fallen something like 60 or 70 per cent. But actually, if you look at what they've achieved underlying, they've been growing their top line 20 pe cent year-on-year. They've moved from unprofitable to a run rate delivering $2 billion of free cash flow a year. And yet, the market isn't really giving much time for that.

I think that's indicative of some of the opportunities, as well, that we're seeing in this environment. Where you're having companies, both that we own and some that we don't own, that are executing fundamentally very well, but are not being rewarded in any way by the market. And as much as we can, we're looking to be opportunistic around that.

SH: You've mentioned edge and you've mentioned China. We've received a question in response to China. In your recent notes, now presumably this is in *Trust* Magazine, on your China trip, you reported that CATL appears to be outspending competitors in EV battery R&D. Does this challenge your confidence in Northvolt?

LB: I think what is special about Northvolt, and I think the point is absolutely right, that your competition is formidable on the Chinese side. But what's special is one, as geopolitical tensions increase, it only creates more need for Northvolt, not less. The need for Europe to have its own battery supply chain. Batteries are vital for the economy, for societies in the 21st century. Not just for electric vehicles, but also for the grid. Dealing with the intermittency of wind and solar energy, to store that energy when the wind isn't blowing and the sun isn't shining.

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I think for the West and for Europe to have a supply that is localised, is going to be hugely valuable. That would be point one.

I think point two would be Northvolt are looking at making the battery that is most carbon neutral. In terms of how it's produced, using hydro-electric power sources in northern Sweden. That's also going to give it a battery that isn't just local and home grown and secures supply, but also one that has a much lower carbon footprint. I think those are two structural advantages that Northvolt has as we look out there.

I think in many ways that speaks to the demand that they're seeing. When they've got an order book of $55 billion worth of orders, of companies that are wanting them to continue to make their batteries for them. From Volkswagen, from Volvo, from a range of customers.

SH: Sticking on stocks for a while. Why do the managers persist to believe that Ocado will actually perform? Is that one for you, as well, Lawrence?

LB: What you see around the world is still relatively low penetration of groceries sold online globally, but increasing. The difficulty is for various supermarkets around the world, is 'how do I deliver those groceries profitably?'. That is a difficult challenge and more so than other areas of commerce.

Because when you're ordering groceries, you can be ordering 45 items at a time out of a possible 45,000 SKUs. You're wanting them within a few days. You're dealing with items that are heterogenous, that have to be controlled in different temperature zones and need to arrive unspilled, unbruised, and all of those factors that make it a very difficult logistical challenge.

For Ocado, they've developed over the last 20 years a technology that can do that profitably. When we speak to the customers that have signed up Ocado around the world, what we get back is this was basically the only system out there that actually was working live and could show us datapoints that would work. And so, you've seen many, many supermarkets partner with them.

Now it is an investment case that requires patience because there's a lot of upfront costs. As you build each of the facilities and build out your robotics, that requires capital. But once these facilities mature overseas, the margin profile becomes very attractive and you should see them being very profitable.

I think the other element here is that what we're looking for in Scottish Mortgage is companies that have a chance of potentially delivering a very large multiple of return. Groceries is multi-trillion-dollar market. If Ocado execute this and get this right, they can be a much, much more valuable company, and so it really has that right tail that often attracts us.

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SH: The mention of Northvolt has prompted some questions on privates and, Tom, particularly on when we might expect to see some activity come back to the IPO market. There was an article in the Financial Times, I think it was last week, regarding a potential IPO for Northvolt. Do you have a reasonable idea of when a Northvolt, a SpaceX or some of the other component parts might IPO?

TS: No, is the short answer. You had that period through the first half of 2022 when the market was in freefall. I think everybody froze at that point, maybe people are waiting to see what's going to happen. Then you've had a period through the second half of 22 and into 23, where you've had relative calm. It's not been a strong market, but you haven't seen that type of disconcerting, rapid decline.

We went through a period where there was no IPO activity, there was just no capital markets activity at all. Then through into the autumn of 23, you started to see some activity return. These were companies that have been talking about going public for a while, they've just been waiting for an opportunity. Actually, you've seen some of those transactions happen.

I would classify that as green shoots. But for a more wholesale move to a more regular IPO market, it's dependent on so many variables and so dependent on confidence that you can't say. I think that for Scottish Mortgage and for all holdings, what's most important, though, is are these companies executing and delivering on that opportunity? Because for companies that are performing well, they will at some point be able to access capital markets and list.

We have a pool of permanent capital, it doesn't really matter to us when that happens. The constraint comes if they're close to or over the limit, then we can't deploy new capital into privates if there is a big stream of new opportunities.

SH: Just on that point, if memory serves, when we sat down six months ago the idea of asking shareholders to raise the 30% limit was discussed. I think we'd said that we might come back to shareholders about raising that limit. Does the continued low level of activity in the IPO market make it more likely that we will come back to shareholders?

TS: No, there's no change in that. If we felt that shareholders were missing out because of this limit, then we'd go and talk to shareholders about it. But we don't feel like there's many transactions that we're missing out on. We've been continuing to deploy some capital into our existing holdings through the first half of the company's year.

It is a constraint that bites at times, but it's not something that is causing us headaches. If it is, then we would start that conversation.

SH: The mention of SpaceX has attracted a couple of questions. I think it can be most easily summed up, could one of you share the investment case for SpaceX?

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TS: As it stands today, I think the first part is around the launch market. What you've seen is that this is a very big market, very big potential market, with rapidly growing demand. At the same time, most of SpaceX's competition has been struggling. Geopolitics makes Russian launches unattractive to Western companies. Other programmes are coming to a natural end, their replacements aren't being launched.

We've seen SpaceX move from being one of the options to being almost the only option of any scale in the commercial launch market. When you have a massive market share of a market with growing demand, that's often a very attractive position.

The next piece is around Starlink, which is the satellite internet service. There, a huge market, trillion-dollar-plus market. They have the ability to serve customers who are very poorly served by existing technology, so that allows them to gain real scale where there is no competition. But also, the nature of their technology allows them to compete very effectively with people who are providing internet access with other approaches. And so, that whole trillion-dollar market is accessible to them.

And again, nobody else can really do this. SpaceX is the only real, viable, at scale launch provider. And they're using that capacity, and certainly any excess capacity in that service, to launch Starlink satellites. Again, huge market share in low-earth orbit internet provision.

Those are the first two opportunities, but there are lots of other opportunities that flow from that, so it's really a company we're very excited about.

SH: Moving on from companies, we're getting a few questions around interest rates and inflation. Lawrence, perhaps one for you. If interest rates stay higher for longer, this is typically a headwind for growth companies. What are you doing to prepare for this? Will you tilt your style at all?

LB: I think it's really important to be clear about where your edge is, and to stay within your philosophical bucket and where your edge is. We're not adapting our philosophy around that. At the same time, you need to be aware about the broader shifts and what's going on.

What I think we've really seen is that you've seen quite a lot of adaptation at the company level to some of those changes, particularly in the availability of capital. If you look through the portfolio, we've had a number of companies swing from making losses because capital was cheap and they could continue to reinvest in the business, to saying we've recognised the financial conditions have changed. And they've moved very quickly to those and they've quite pleasingly been able to swing to profitability quite strongly. I think it's those adaptations that we've

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been focusing on monitoring, that are really driving some of the underlying change.

To give you one example around that, we invest in a Latin American ecommerce and finance company called MercadoLibre. Again, it's a company that's actually executed really well over the last few years. They're growing revenues in US dollars 30 to 50 per cent year-on-year. They've gone from breakeven to a 16 per cent operating margin last quarter, in the last couple of years.

And that's what you're starting to see as companies are reacting to the changes in the financial conditions, and it's been pleasing to see.

TS: I think Lawrence is absolutely right. If you look at only the listed portion of the portfolio, we've seen the free cash flow generation double with largely the same portfolio. From the first half for the year to the end of June 23 it doubled versus the year to the end of June 22.

You've seen that growth in free cash flow, that is just adaptation. I think that what you also see, and it's around the companies, is think about making sure they have access to capital. That it's not a given, you need to be executing. And actually, that ability to access capital is really important.

Take an example like Aurora Innovation, which are building a driver for trucks, a self-driving mechanism for trucks. That business is pre-revenue, but in the summer they were able to go out and raise a large amount of capital despite the environment, which I think speaks to what they've been able to achieve from a technology standpoint. That makes them robust at these changing financial circumstances, even when they aren't generating profits.

With that one, just to flag that Aurora and the CEO, the founder of Aurora, Chris Urmson, is the first speaker on our new season of our podcast.

SH: Tom, you get a gold star for that. I was going to mention that at the end. Season two of the podcast, Invest in Progress, launched yesterday and it is indeed the first episode.

TS: We should be really clear about this, though. We don't think you can make successful predictions about what's going to happen in a complex system like the global economy. We don't know what's going to happen to interest rates, but we aren't changing what we do because of what's happening in interest rates.

Yes, a higher cost of capital is challenging for companies everywhere. I think Warren Buffet said that interest rates are like gravity for stock markets. We wouldn't deny any of those challenges, but we believe that the value created by a small number of exceptional companies over the long run is the way to make

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money. That's irrespective of the economic conditions, irrespective of interest rates.

SH: For underlying shareholders, one way to potentially make money would be to buy the trust on a discount. We've been asked a question about that. If the discount is near 20 per cent, I'm paying 80 pence for a pound's worth of assets. What's the catch?

TS: There is no catch. I think we own some of the most attractive growth companies in the world. We're at a period in markets where there's a lot of fear, there aren't a lot of new buyers for our shares, and that drives a discount.

It is both that you trade at a discount to the net asset value, that the investment trust structure also gives you gearing into markets, so that when you start to see markets rising or the companies that we own rising, that you get that geared benefit, as well as the opportunity and the discount.

We're recognising that by buying back shares, buying back our own shares, which we think we can do at an attractive price. I've been buying the shares as well. There isn't a catch.

SH: Good. I'm glad on that. Going back to private companies. The question's been asked about how private companies are adapting to the new funding environment.

TS: I think that the absolutely critical piece for a private company, if they want to access funding, is accepting the new reality. Private companies don't have to do that, of course. Their shares don't trade every day. You can structure the way that you access finance. But if you want to do a price round, find a price for your business, then you just have to be realistic about the environment in which you're operating. It's not 2021 anymore. And where companies have done that, they've been able to access very significant amounts of capital.

Stripe was an example of that earlier in the year, where they did a transaction running into billions of dollars, and it was at a significantly lower valuation than they'd had in 2021. But the stock market is significantly lower. If your listed peers are trading at a big discount to previous prices, why should you expect to have previous prices?

It is a more difficult environment, but for the companies that are executing, and that's not all of them across the market in our portfolio, but for the ones that are, the capital is there, as long as you're realistic about price.

SH: We've had a question about valuations, just going back to one of the earlier questions. It says you don't care about valuations. How do you respond to that? Lawrence.

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LB: I don't think you can be an investor and not care about valuations. I think it's about how you think about them that's different. What we're thinking about is not a spot multiple of earnings. A spot multiple doesn't tell you if a company is expensive or cheap on its own. The way we go about it is we think firstly over our time horizon, so thinking what happens to these companies over five and ten years, and that's the way we think about value. Your starting point today is a certain valuation, what do we think the revenues, the profits and the market will pay for that in five or ten years' time? That's what guides us.

The other point, along with time horizon, becomes that there isn't, the way we see it, one possible scenario. There are multiple scenarios. And so, we'll build out what would be called a base case, which we think might be the most likely. A bull case, which would be optimistic, a blue sky, which would be very optimistic but unlikely, and also the negative scenarios. And consider the entire spectrum of those possibilities on a five-to-ten-year time horizon.

That's really what ends up informing if this stock is attractive at these valuation levels or not. Sometimes you do that and you go, actually, on a probability weighted basis this looks attractive and I can see scenarios where you could make potentially five times your money.

And other times we get a bit disappointed that we get excited about a company and we go through that process, and it turns out that even though we think it's a great company, it's a little bit hard to see how you make that pathway to earnings multiples of upside.

Valuation is the starting point which you're investing in. It really doesn't matter, but it has to be seen through a time horizon and through a probabilistic nature.

TS: Maybe to pick up on that valuations don't matter. The bit of valuations that we don't think about, that we don't think add value is that so many people focus on what is the ratio between the price of this company and its earning? And they look at earnings for this year.

If this company is valued at 20 times this year's earnings, another one is valued at 30 times this year's earnings and the other one is valued at 40 times this year's earnings. We don't think you can look at those numbers and say anything useful about what the share price is going to do in the next five years. If one stock starts on 20 times earnings and another stock's on 40 times earnings, there's no evidence that the one that's on 20 times earnings is going to do better than the one that's on 40 times earnings. It just depends what happens to the earnings over the next five years. And that's where we focus our efforts, not on whether it's on 20 times or 40 times to start.

LB: And that says that actually, if you go back over the things that have driven Scottish Mortgage's performance over the long term, you'll find that when we

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first bought them, they will all have been at a high multiple and have actually added the most value over time. Because in some ways, what you are looking for is a company that has a very large growth opportunity and has that potential to grow earnings. And so, that large multiple, if you can get it for less, it's great, but often it comes with that. But if you're looking for a company that can grow exponentially, you can quite quickly wear down that multiple, as you rightly say, with the earnings.

SH: If we think about the valuations or the future valuations that you're interpreting to some of the private names, given how some of the tech companies, like an Arm or Instacart have performed following the recent IPOs, have you made any changes to the way that you're valuing private companies?

TS: You've had, for example Instacart, list on the stock market and then how they've performed subsequently in a weak market. I just don't think there's a lot of information in that. Stock prices will do what stock prices will do over short periods of time. Recently IPOd companies tend to be more volatile than the broader market.

But in terms of what it means for valuations in our portfolio, the first thing to say is Lawrence and I have nothing to do with those valuations. They're done independently by a third party, it's a separate group within Baillie Gifford. They're overseen by the board, they're audited externally. The inputs those groups look at are what are the listed peers doing? What have their stock prices done? What are their valuations? And that process feeds how we value the privates.

That of course takes into account market data, market trading, but I don't think there's much that can be inferred from the performance of a small handful of recent IPOs.

LB: And with the team that does it, Tom, it's also worth remembering that in the year to the end of the financial year, March 2023, they did about 530 revaluations of the private companies. I think in the last six months they've done closer to 800. But that gives you an idea of the responsiveness of adapting it to some of the listed peers over time that they're doing.

SH: It's fair to say that many of the private names have been written down in the portfolio, and materially so.

TS: If I may on this. I think people have and shareholders rightly have wanted to scrutinise the way that we value these private assets. If the market wants to apply a discount to our shares in its assessment of those assets, then that's for the market to decide.

What I believe is that we own some fantastic businesses in private markets and they're going to be a big source of value creation for our shareholders over the coming years. We see these businesses executing against big opportunities. You

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just need to get away slightly from this focusing on worrying about valuations or thinking things that are illiquid are automatically bad. These are some phenomenal businesses and getting access to them at a low cost for our shareholders, is I think one of the distinctive and important attributes of Scottish Mortgage.

SH: Private companies is perhaps one of the reasons that the rating of the company, of Scottish Mortgage, the discount has remained. Why do you think it's remained so wide for so long?

TS: I think that you've got a market-wide issue with the investment trust sector at the moment. Just about every investment trust is on a discount. I think there's a lot of nervousness out there about the economy. You're seeing a response to what's happening to interest rates. All of these things are variables that each on their own are very hard to predict, so thinking that you can predict in the aggregate is, in my mind, wishful thinking.

Yes, I think there has been a concern about private company valuations and it was really important that we get out there and demonstrate to people that this process is robust. Show people the results of that process, show that we factored market valuations into the way we value our private companies.

But I think that ultimately, you need confidence more broadly to return, to address some of those discount issues.

SH: We're coming on to the last few questions. There's a good one here and it's for both of you. What holding are each of you most excited about on a five-to-ten-year time horizon?

LB: Gives me more time to think. There's too many to choose from.

TS: I think that's right. I think the first point to make is that our largest holdings reflect our biggest enthusiasms. We've touched on some of them, on Moderna, on NVIDIA, Amazon, Tesla. These are businesses which we think are phenomenal opportunities that are enhanced by what's happening in AI, etc.

I think just more for shining a spotlight on some of the other areas of the portfolio or some of the newer areas of the portfolio. We took holding in a company called ODDITY in the last six months. This is a direct-to-consumer makeup and skincare business. Beauty and skincare is a massive category. There's been no real online players. You've seen some of the existing players move to some online sales, but actually, doing this with an online-only model is a completely different business.

Their lead brand is IL MAKIAGE, grown to be a pretty large brand in a very short space of time. They have a second brand, SpoiledChild, which has grown even more rapidly. This is a technology-first business that understands the internet, that understands the different model of sales that you need, and is going after a

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huge market place. Maybe just one that shareholders haven't really heard about, that's new to the portfolio that's really exciting.

LB: To answer it straight in many ways, it would actually be the private holdings that we've been touching on. It would be SpaceX and Northvolt. And the reason for that is, one, they both face tremendously large opportunities and have unusually strong competitive advantages.

But secondly, from my own personal investments, there's no other way to access those companies as an individual, for me at least, other than to do it through Scottish Mortgage. I think to be able to access those, to me is phenomenal. We've spent a lot of the last six or 12 months almost on the defensive about the private companies in terms of is the valuation done appropriately, do they have access to capital?

But actually, it's the private holdings that are showing some of the best operational data by far that we have, and do have access to capital. SpaceX's opportunity is huge as they take the cost down from accessing space by 90 per cent. I think some of those larger private holdings, where you're seeing that incredible operational performance, is really, really attractive and fascinating to continue to learn about.

SH: There's a question that continues to be asked quite a few times. Have either of you increased your personal holding in Scottish Mortgage recently?

LB: Yes.

TS: Yes.

SH: It was being asked lots of times. I think we should move to a final question and it is what is the question you hope is not asked of you today? That will relate to the Scottish Mortgage portfolio. You're not getting out of that.

TS: We were talking about this session earlier, you said to me somebody suggested asking how we were feeling. I've been very glad that you haven't asked that question. Just because I don't think feelings come into it very much. We have a clear philosophy around how we select our investments, how we hold our investments. We have a clear process, which we execute in a fairly clinical and dispassionate way around thinking about opportunity and likelihood of capitalising. It's not a very emotional process, so how I feel about it really doesn't come into it. I'm pretty glad you didn't ask me how I was feeling.

SH: You've kind of answered that question, well done.

TS: I assumed I had to answer them.

SH: Now, Lawrence, you've had a bit of time to think.

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LB: I think we're trying to be open. I think it can sometimes, if you go back to the private companies valuations ones, those ones are interesting because it's not us doing them. And so, you can get quite a lot of detailed questions on them, where it's a separate team that are doing those valuations and you don't interfere. But at the same time, you have to be able to talk about them in some detail, even though it's not your day-to-day job.

SH: Fair enough. Tom, Lawrence, thank you very much for your time today. And thank you for everybody at home. I can say that this session has been recorded and will be available on the website with a transcript soon.

Now before we go, one thing that I should mention again, Tom, is that the second season of the Scottish Mortgage podcast, Invest in Progress, launched yesterday. A QR code should be showing on your screen now, if you'd like to have a listen. If you're signed up to our emails, you probably already got the news about the podcast. And if you're not signed up on our emails, you can do so on the home page of the website.

Thank you very much for joining us and your ongoing support. Goodbye.

Scottish Mortgage Annual Past Performance To 30 September each year (net %)

2019	2020	2021	2022	2023
-6.4	97.8	44.5	-45.0	-13.9

Source: Morningstar, share price, total return, sterling.
Past performance is not a guide to future returns.

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Unlisted investments such as private companies, in which the Trust has a significant investment, can increase risk. These assets may be more difficult to sell, so changes in their prices may be greater.

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