Pan Europe Stewardship Report

As at 31 December 2022

Baillie Gifford™

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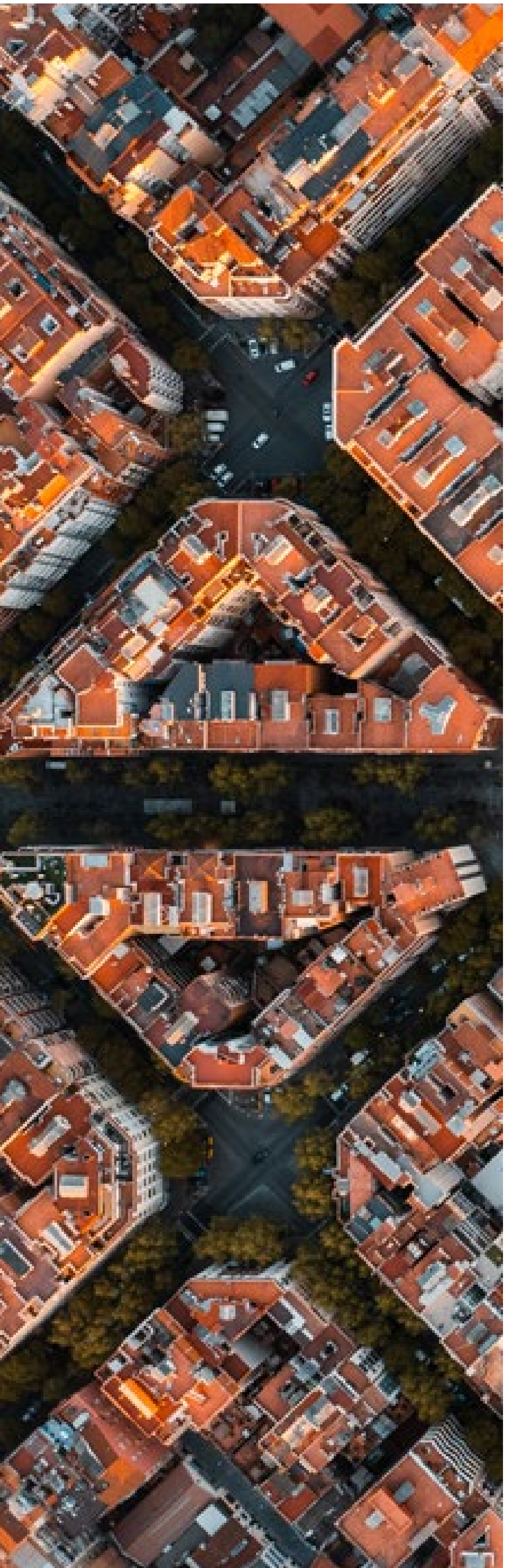


Introduction

The European Equities Team, responsible for the Pan Europe portfolio, incorporates environmental, social and governance (ESG) issues throughout the investment process. This is achieved through a combination of company specific and thematic ESG research, engagement on significant issues and proxy voting activity. This report provides an overview of our approach, including:

— How we integrate ESG into our research framework

— An example of thematic ESG research on Europe's energy transition

— Updates on our climate audit and commitment

— Baillie Gifford's Stewardship Principles

— Examples of our company engagements

— A record of our proxy voting activities.

We value transparency and dialogue, and we encourage you to challenge and engage with us on our views and approach as we strive to improve our practices.

How we think about ESG integration

Materiality matters when it comes to ESG. Our bottom-up analysis focuses on the most important issues according to a company's business model and context. In doing so, we refer to credible external standards and frameworks but come to our own conclusions.

Our dedicated research analyst provides challenge, coordination, and technical analysis to help support the integration process. The following three principles and questions guide our ESG research.

Principles

1. The integration of ESG into the investment process contributes to a better understanding of investee companies. Thoughtful consideration of ESG factors should improve investment decision-making and enhance long-term investment outcomes for the benefit of our clients.

2. We are not looking to invest in perfect companies. Instead, we aim to understand the material ESG risks and opportunities as they relate to the business and the portfolio, including whether they are improving or deteriorating over time.

3. We do not believe in a 'one-size-fits-all' approach. We adjust for the age, stage and operating environment of each business and record why our views on specific ESG topics differ from conventional thinking.

Questions

The above principles are actioned in three questions from our 10-Question research framework, which is used to access portfolio holdings. Questions 3, 6 and 7 of our research framework ask:

— "Does the company have a special culture?"

— "Are management and stakeholders well aligned?"

— "How does it contribute to society?"

If a company fails to answer them satisfactorily, our confidence in its ability to grow sustainably over time will be significantly reduced.

Full 10-Question research framework

Growth

Q1	What is the five-year growth potential?
Q2	What about the next ten years and beyond?

Edge

Q3	Does the company have a special culture?
Q4	How sustainable is the competitive position?
Q5	Are returns attractive and improving?

Alignment

Q6	Are management and stakeholders well aligned?
Q7	How does it contribute to society?

Return

Q8	How likely is a 2x return over 5 years?
Q9	How might we make more than this?
Q10	What doesn't the market appreciate this?

Bottom-up research and engagement

ESG factors present both risks and opportunities to our investee companies. We admire Avanza, the Swedish savings and investment platform, for its strong culture and stakeholder alignment. The company shows its dedication to passing on the cost savings it achieves to customers by consistently reinvesting them in reducing prices and enhancing services. This forms a key pillar of its competitive advantage and is something that we monitor as part of ongoing research and engagement.

On the other hand, the emergence of a toxic work culture at Ubisoft Entertainment was a material concern that formed the basis of focused research and engagement. In the highly competitive gaming industry, attracting and retaining talent is crucial. We believe that effective talent management is essential for cultivating successful gaming franchises. These franchises were key considerations behind our initial investment in Ubisoft. Despite extensive engagement, we were unable to gain sufficient conviction in management's ability to effectively address the ongoing cultural issues. Ultimately, this contributed to our decision to sell our holding.

Further engagement case studies can be found on page 12.

Thematic research

In addition to looking at ESG factors for each company, we conduct thematic ESG research. As well as adding insight into our research on existing holdings, this can be a fruitful avenue for idea generation and investment opportunities. One example of this is our overview on page 4 of Europe's energy transition, which we consider one of the decade's most significant growth opportunities.

Europe's energy transition

Tipping points and transformation stories

Climate change represents a risk to the entire market and an existential threat to humanity. Increased emissions linked to human activity are causing temperatures to rise, with Europe experiencing its hottest summer in 2022. Averting climate catastrophe calls for a profound change from fossil-fuel dependency towards an economy powered by clean technology ('cleantech'), eco-friendly and eco-efficient alternatives to existing technologies that limit their environmental effects. Evidence suggests an energy transition is already underway on the global stage. Low-emission sources of electricity will meet almost all new demand by 2025, cleantech has become central to industrial policy, and investment in clean energy passed a milestone of $1trn in 2022. The reorientation of supply and demand as part of the transition presents both risks and opportunities for investors – there will be winners and losers. Europe is at the epicentre of these developments, and we see the following advantages for long-term investors:

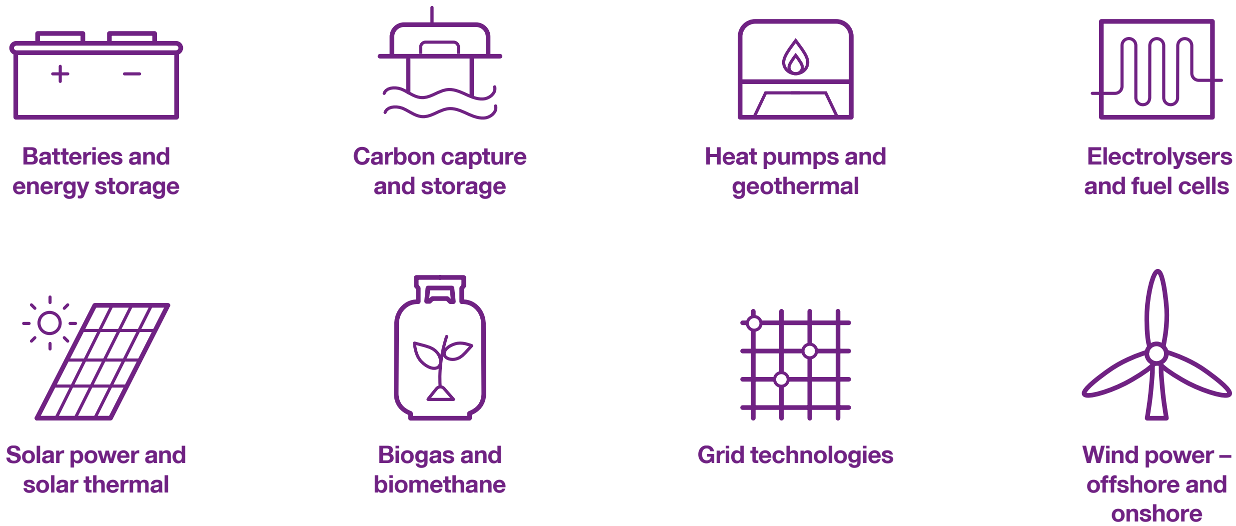
— Investing ahead of tipping points – exponential changes in policy narratives, technology cost curves and cleantech deployment rates represent an inflection point for the energy transition. Significant value-creation opportunities exist when investing ahead of the tipping points that precede the mass adoption of cleantech.

— Investing in transformation – beyond companies offering products and services that enable the energy transition (pure plays), some businesses are investing in their own transformation towards newer transition-aligned segments. Provided they can demonstrate improved economic characteristics in new segments, these companies can reward investors willing to wait for them to shine.

The European Union (EU) policy environment is dynamic and evolving fast. Climate has been a long-term strategic priority for EU policymakers, but competitive pressures from the US and China have prompted a rethink. To date, the EU has led the way regarding its ambitious emissions reduction commitments. The cornerstone policy is the Green Deal Industrial Plan (GDIP), representing the ambition to be the first continent to reach climate neutrality. Its underpinnings consist of sector-specific targets and carbon pricing via the emissions trading scheme. These areas were strengthened by the legal framework set out in the 'Fit for 55' implementation package – so-called due to the planned 55 per cent reduction in emissions by 2030. More recently, the REPowerEU initiative introduced an energy security lens. Energy efficiency and renewable generation commitments were ramped up to reduce the EU's reliance on Russian gas. Continued climate policy momentum has contributed to the EU's transition-enabling environment. Notably, the EU's carbon price recently passed the €100 mark. If sustained, this is enough to bring earlier-stage cleantech (eg green hydrogen and heat pumps) into cost-competitive territory with the incumbent fossil fuel-based industry.

The nature of the policy debate has shifted with the introduction of the US Inflation Reduction Act (IRA). The IRA provides sizeable, targeted tax incentives for corporates and consumers of specific clean technologies. The GDIP and the accompanying Net Zero Industry Act is Europe's response and represent a shift in emphasis from emissions rules and carbon pricing towards creating more precise cleantech demand signals. A new target has been proposed of at least 40 per cent of 'strategic net-zero technologies' (ie cleantech) to be manufactured in the EU by 2030 – see page 05 for the eight technologies identified. State aid rules have also been updated to enable greater flexibility for EU member states to provide cleantech subsidies. Substantial subsidy support already exists in the EU, provided by the REPowerEU and InvestEU programmes. Still, we have heard first-hand from some of our holdings how difficult they can be to access. An explicit aim of the GDIP is to speed up investment and facilitate access to financing specifically for European cleantech manufacturing. Additional areas of focus include simplifying regulation and enhancing skills. The EU has adopted an ambitious approach to permitting cleantech manufacturing sites but faces criticism about the continued lack of clarity around funding mechanisms available to specific cleantech.

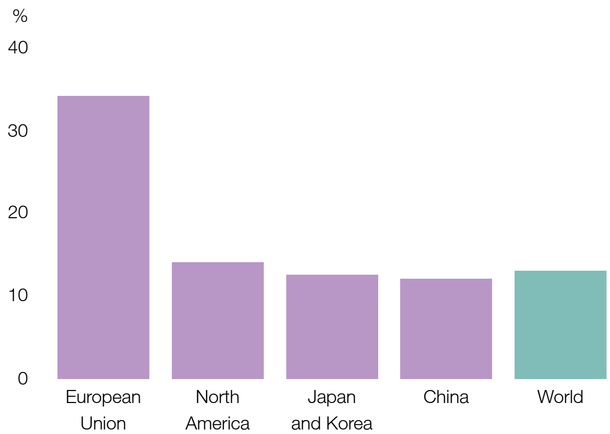
Strategic net zero technology



These policy developments show that states are increasingly willing to intervene in the market to accelerate the energy transition. To use the framing of economist Carlota Perez, this supportive and mission-oriented policymaking "tilts the playing field" to create the ideal preconditions for a "turning point." Perez's historical perspective on previous technological revolutions suggests that the interplay between government and the market has been a pivotal catalyst to more widespread change.

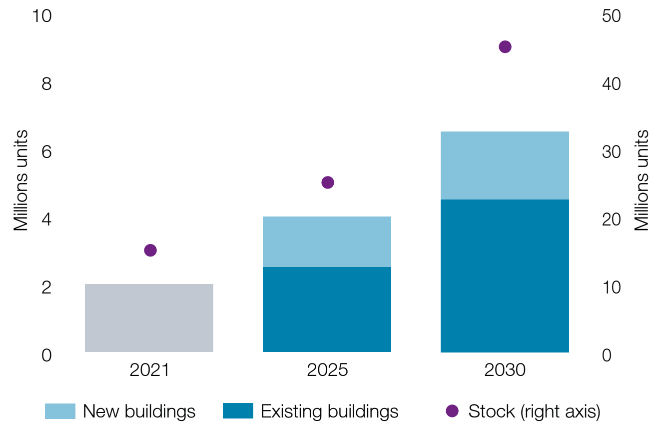
There are parallels between this 'surge cycle' at the societal level and the economic principle of S-curves at the individual technology level. S-curves chart the growth trajectory of innovative manufactured technology where adoption begins slowly, progresses rapidly, and eventually levels off. They help us understand the tipping points as cleantech adoption gains momentum and becomes mainstream through market-share gains. S-curves represent a feedback loop between the economies of scale realised by manufacturers, resulting in continued cleantech cost reductions, which incentivise their adoption and deployment.

Annual growth in sales of heat pumps in buildings in selected regions, 2021



Source: The Future of Heat Pumps (2022), International Energy Agency (p25, 34).

EU heat pump installations and stock in the Announced Pledges Scenario*, 2021–2030



*assumes that governments around the world meet all announced energy- and climate-related commitments in full and on time.

Europe's shift to energy-efficient and electrified heat pumps, helped by European subsidy incentive schemes, illustrates the S-curve dynamic. The EU is the fastest-growing market for heat pumps globally, and this rapid growth is expected to continue and displace the incumbent gas-fuelled boiler technology. Our holding in NIBE, the heat pump and climate solutions manufacturer, demonstrates the value creation opportunity by investing ahead of tipping points before rapid adoption. Over the past decade, NIBE has been one of the best performing companies in the portfolio. Alignment to a growth theme, however, is not sufficient. Important aspects of the investment case are NIBE's decentralised and lean culture, which underpins a successful acquisition strategy and sustained commitment to product quality. The quality of management is also a critical component of the investment case, and we back executive teams that we trust to pursue a capital allocation strategy that enables investment ahead of future trends.

Beyond the pure plays, we see businesses that are transition stories in themselves to be exciting investment prospects. Companies in the transformation process towards transition alignment can offer more significant opportunities for insight and mispricing than the premium valuations often attached to pure plays. We are looking for evidence that their underappreciated cleantech segments have superior economic characteristics and will be able to shine – as the example of Nexans illustrates.

Nexans is a cable manufacturer for a variety of industries managing its transition into becoming an 'electrification pure play.' The deployment of renewables and electrification of sectors requires significant grid capacity upgrades in the interests of meeting new energy demand and increasing the efficiency of transmission. Nexans is divesting its commoditised businesses to focus purely on high voltage (HV) cabling, where it has already developed deep expertise and a leading position. The more technical nature of the innovation, assembly and installation of HV makes it a cabling market with comparatively high barriers to entry and an improved returns profile. This strategic transformation presents an opportunity for long-term shareholders willing to wait for it to come to fruition, which led us to invest in the business.

In conclusion, mission-focused EU policymaking and the interaction with cleantech innovation create a step-change in the opportunity set available to us as investors. However, alignment to this growth theme can only form part of a broader investment thesis. We are looking for companies demonstrating a more comprehensive set of characteristics indicative of outlier returns. Our ability to take a longer-term view enables us to invest ahead of tipping points in innovative cleantech and act as supportive shareholders to transformation stories that are reorienting towards the transition.

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Climate audit

Climate change and the energy transition pose risks and opportunities that are material to competitive edge and investment returns. Our stewardship actively considers the systems change that is unfolding and how it affects our portfolio holdings. The climate audit records our assessment of company alignment with the global goal to limit warming to net +1.5C this century; also known as the achievement of net zero emissions by 2050. We also have our own net zero portfolio commitment to guide our actions. By 2030, we commit that 90 per cent of portfolio companies by number will demonstrate robust alignment with appropriate net zero pathways. By 2040, the whole portfolio will be aligned. New buys will have an extra two years to comply with this target.

We assess alignment on a company-by-company basis, considering the specific industries and regions they operate in. We regularly update our climate audit exercise, at least annually, to inform research and engagement efforts. It is important to note that the pace of company alignment depends on global progress and effective policy support.

While we have flexible portfolio guidelines and make subjective investment decisions, we cannot guarantee that this process will result in superior investment returns or guarantee a positive outcome for the environment or society.

The climate audit captures alignment in two dimensions.

Assessment of net zero targets

Firstly, to assess the extent to which targets, strategy (and increasingly actual emissions performance) are set to deliver falling emission volumes (or, for some, intensity) over time.

To mark a company as showing leadership in 1.5C alignment, the starting point is demonstrating that target disclosures and pathways match (or are consistent with) the thresholds and methodologies of the Science Based Target initiative and the Transition Pathway Initiative.

For a representative portfolio, roughly 59 per cent of holdings by market value have targets to reduce direct and value chain emissions in line with the Paris Agreement, based on a representative portfolio. Around 95 per cent of holdings by market value report on their scope 1 and 2 emissions. This equips us with a more accurate reflection of where emissions are concentrated than if we had to rely on estimated data.

Assessment of transition role

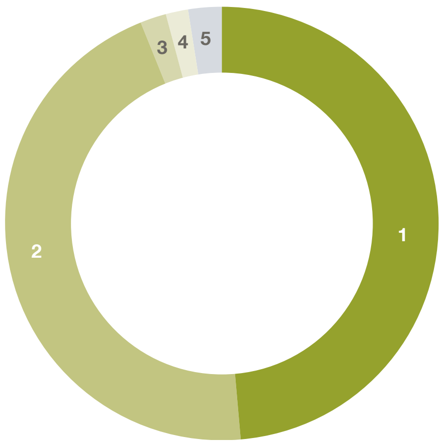
Secondly, each company is allocated to one of four transition role categories that provide a broad assessment of the underlying business and strategic positioning, from ‘materially challenged’ to ‘solutions innovator’.

We assess where each company sits relative to a successful transition towards net zero emissions globally. The judgements are company-specific not sector-based assumptions and are predominantly qualitative in nature. This allows us to classify companies in the same sector in different categories depending on their overall potential to transition. Our assessment currently has four categories:

1. Solution innovator: companies whose primary purpose is the innovation and commercialisation of products and services that will drive a successful transition.
2. Potential influencer: companies who are carbon-light by direct emissions but could accelerate the transition through their choices and influence.
3. Potential evolver: companies that tend to be carbon-heavy or firmly embedded in the higher carbon economy but are beginning to develop viable pathways to transition.
4. Materially challenged: companies whose core business is likely to decline through the transition, with their pathway to strategic adaptation to a low-carbon world unclear.

Opportunity

The strategic business positioning of companies in the portfolio relative to the transition (their transition role).



		% market value USD
1	Potential influencer	48.7
2	Potential evolver	45.3
3	Solutions innovator	2.1
4	Materially challenged	1.4
5	*Not assessed	2.5

Source: Baillie Gifford & Co. Based on a representative portfolio.
Valuation date – 30/12/2022. Figures may not sum due to rounding.
*This portion represented our holding in Just Eat Takeaway, which we have since sold.

As the above visual demonstrates, in regard to the climate transition, a significant proportion of the portfolio is classified as either a potential influencer or evolver. The only portion that we would classify as materially challenged is due to our holdings in the airlines Ryanair and Wizz Air. As part of attempts by regulators to internalise the environmental costs of air travel, these companies risk facing higher operating costs through more ambitious emissions taxation measures. Both companies are leaders in efficiency, with the lowest emissions per passenger kilometre in the sector. However, reducing absolute emissions as they grow will depend on technological solutions that are not yet proven at scale. We are monitoring developments in this area, particularly sustainable aviation fuels (SAF) and are actively engaging with both companies on their decarbonisation pathways. We attended Ryanair's sustainability event at Trinity College Dublin, where we heard from senior management and business partners. We were encouraged by the level of ambition in relation to its SAF target and by the long-term contracts the company has in place to secure supply.

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Baillie Gifford's stewardship principles

Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries, leading to sustainable benefits for the economy, the environment and society. All the European Equities Team are involved in stewardship work. As long-term investors, we believe our approach to monitoring holdings, engaging with management and voting thoughtfully supports investment performance. Over the following pages, we explore how we consider and integrate ESG matters into our investment process through engagement, proxy voting and research framework. Our approach is framed around Baillie Gifford's five core stewardship principles.

Prioritisation of long-term value creation

We encourage company management and their boards to be ambitious and focus their investments on long-term value creation. We understand that it is easy for businesses to be influenced by short-sighted demands for profit maximisation but believe these often lead to sub-optimal long-term outcomes. We regard it as our responsibility to steer businesses away from destructive financial engineering towards activities that create genuine economic value over the long run. We are happy that our value will often be in supporting management when others don't.

A constructive and purposeful board

We believe that boards play a key role in supporting corporate success and representing the interests of minority shareholders. There is no fixed formula, but it is our expectation that boards have the resources, cognitive diversity and information they need to fulfil these responsibilities. We believe that a board works best when there is strong independent representation able to assist, advise and constructively test the thinking of management.

Long-term focused remuneration with stretching targets

We look for remuneration policies that are simple, transparent and reward superior strategic and operational endeavour. We believe incentive schemes can be important in driving behaviour, and we encourage policies which create alignment with genuine long-term shareholders. We are accepting of significant pay-outs to executives if these are commensurate with outstanding long-run value creation, but plans should not reward mediocre outcomes. We think that performance hurdles should be skewed towards long-term results and that remuneration plans should be subject to shareholder approval.

Fair treatment of stakeholders

We believe it is in the long-term interests of companies to maintain strong relationships with all stakeholders, treating employees, customers, suppliers, governments and regulators in a fair and transparent manner. We do not believe in one-size-fits-all governance and we recognise that different shareholder structures are appropriate for different businesses. However, regardless of structure, companies must always respect the rights of all equity owners.

Sustainable business practices

We look for companies to act as responsible corporate citizens, working within the spirit and not just the letter of the laws and regulations that govern them. We believe that corporate success will only be sustained if a business's long-run impact on society and the environment is taken into account. Management and boards should therefore understand and regularly review this aspect of their activities, disclosing such information publicly alongside plans for ongoing improvement.

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Engagements

We engage with the companies that we invest in on behalf of our clients, encouraging a long-term focus and meaningful change when needed. The following are some examples of engagements linked to the five stewardship principles.

- Prioritisation of long-term value creation
- A constructive and purposeful board
- Long-term focused remuneration with stretching targets
- Fair treatment of stakeholders
- Sustainable business practices

Richemont

Objective: We had multiple engagements with the Swiss luxury holding group, Richemont's board to discuss contentious proposals on the 2022 AGM ballot.

Discussion: An activist shareholder had put forward three proposals to improve board representation for minority shareholders. These included electing a new director to the board. We spoke to the chair of Richemont, Johann Rupert, to discuss these proposals. While we support initiatives aimed at minority representation, on balance, we agreed with the chair and felt these proposals would be disruptive and not in shareholders' best interests. We also engaged with the proposals' proponents ahead of reaching a voting decision and had a separate engagement with the Senior Independent Director, Clay Brendish, due to our concerns regarding the poor structure and disclosure of executive remuneration.

Outcome: We publicly communicated our support for management in opposing the shareholder proposals. We also provided a constructive challenge on how the company can improve executive remuneration.

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Nexans


© REUTERS/Lefteris Karagiannopoulos

Objective: We met with the head of sustainability, and investor relations at Nexans, the cabling manufacturer, to better understand the broad coverage of emissions captured in reporting. Its comprehensive approach results in a considerable scope 3 emissions figure for a company of its size. In turn, this has implications for the carbon intensity of portfolios with holdings in Nexans.

Discussion: Nexans includes the energy lost due to resistance across all its cabling for their whole usable lifetime. We learnt that Nexans' rationale for measuring energy loss enables it to focus on improving the transmission efficiency of its high-voltage cabling products – thereby improving the environmental profile versus that of competitors.

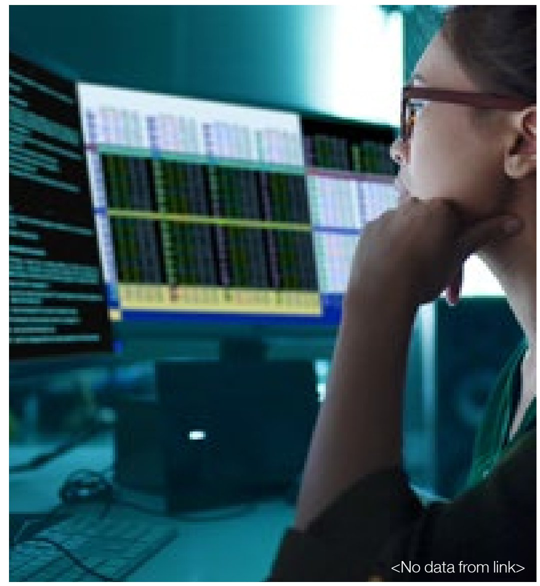
Outcome: Overall, we view the wide scope of the company's emissions reporting as a positive indicator of Nexans' climate ambition. We will monitor and continue to engage with Nexans on its emissions reporting methodology.

Avanza

Objective: Avanza, the Swedish savings and investment platform, contacted us for an ESG perspective on its early investigations into enabling customers to invest in cryptocurrency.

Discussion: We shared our analysis and findings on the most material ESG issues associated with Avanza's proposed partnership with a cryptocurrency exchange. We identified social considerations to be the most material area. The key social impact question is cryptocurrency's suitability as an alternative asset class for long-term saving. How Avanza intends to educate customers and frame the risk profile of this asset class relative to others is of central importance. We believe that many of the environmental objections surrounding cryptocurrency are misplaced when taking a long-term view.

Outcome: Avanza sought our input on this strategic issue, demonstrating the value we can add through the strength of our relationships with companies, enabled by our long-term holding period. On 16 June 2022, Avanza released a statement cancelling the examination of the potential partnership with Safello on crypto assets pending clearer regulation for the cryptocurrency market. We have noted that the European Markets in Crypto-Assets Regulation is progressing through the EU legislature, representing the first attempt at regulating the digital asset market. We will continue to monitor Avanza's involvement with cryptocurrency.



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Kering

Objective: One of Kering's fashion houses, Balenciaga, was heavily criticised after an advertising campaign which sexualised children. The incident was a source of profound disappointment for us as shareholders. We initially raised concerns about the Balenciaga controversy during the company's ESG roadshow. Kering's investor relations subsequently offered a call with the group managing director to continue this conversation.

Discussion: The group managing director started the call with an apology on behalf of Kering. After this, our conversation focused on how management thinks about creative oversight and reputational risk management as both a top-down process issue and a broader cultural and diversity issue across the group. On oversight, a new marketing and communication framework is being devised to reinforce the group's stance on sensitive issues and enable the individual houses to make better judgement calls. Additionally, there will be an explicit discussion of the balance between creative direction and the consideration of dissenting views at the twice-yearly meetings between the group management and the management of brands. Diversity among creative teams is essential, but Kering also recognises that nurturing a culture that embraces challenge is equally so.

© Shutterstock/Casimiro PT

Outcome: Kering has not issued a public statement in response to the controversy, but our engagements have reassured us regarding the considerable group-level work behind the scenes. It is clear with Kering that there is a delicate balance to be struck between group oversight with the ability to foster challenge and creativity at individual houses. Kering appears to be taking a thoughtful approach by updating internal processes. We will continue to follow up on the lessons learned from this incident during our regular engagements with the company.

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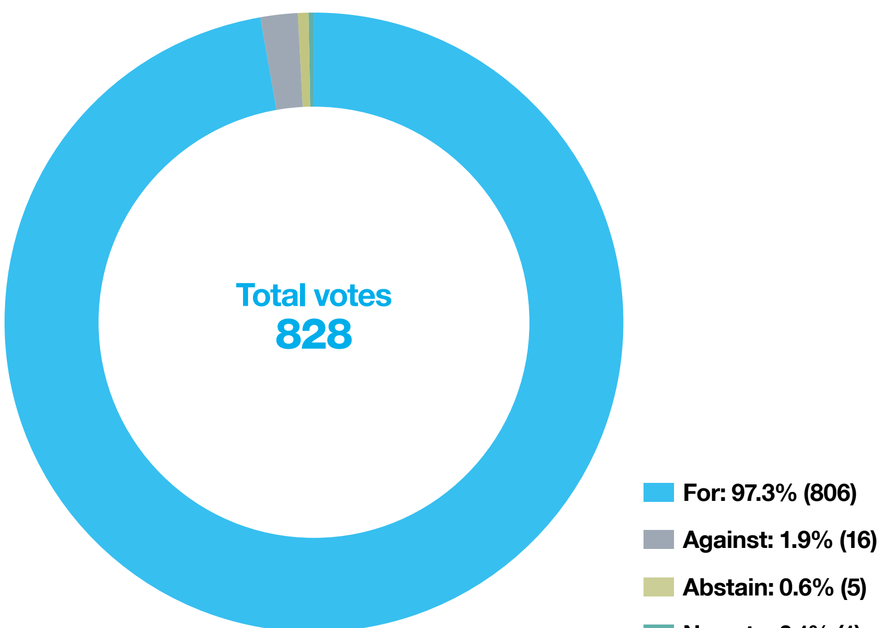
Proxy voting report

Exercising the voting rights attached to our clients' holdings is an integral part of our stewardship responsibilities. Co-ordinated internally by our dedicated ESG Services Team, our investment-led voting decisions focus on what we believe are our clients' best interests. The investment managers are actively involved in this process. We do not outsource any stewardship activities and communicate to company management if we vote against them to maintain an ongoing dialogue. Voting supports our ability to build long-term relationships with investee companies and strengthens our position when engaging with them. For this reason, we prefer that our clients delegate voting authority to us.

We invest in high-quality management teams where we believe the governance structure supports the long-term investment opportunity. We seek to avoid investments where corrective action is required to generate value. Accordingly, we support most resolutions put forward by investee companies, voting against proposals on the few occasions where we disagree with decisions taken by management or where we have not been able to engage or successfully influence change. We understand the nuances of responsible stewardship and therefore use abstentions when we think voting decisions are not black or white. We review the merits of each proposal on a case-by-case basis, considering the broader context in which companies operate. This approach enables us to maintain constructive relationships with management and the board as part of a gradual, long-term engagement process.

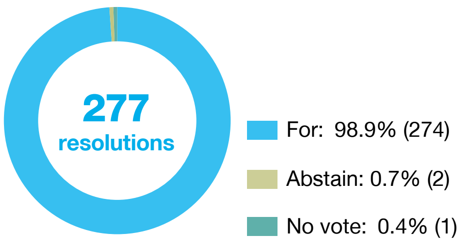
Pan Europe voting record



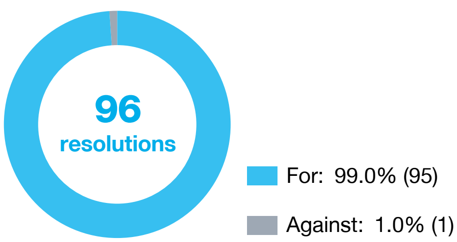
Source: Baillie Gifford & Co. Based on a representative portfolio.
Data from 1 January 2022 to 31 December 2022.
Figures may not sum due to rounding.

Notable examples of voting action

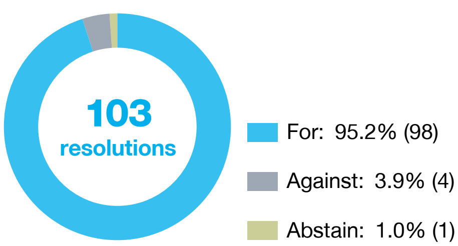
Director elections



Remuneration



Share capital



Source: Baillie Gifford & Co. Based on a representative portfolio.
Figures may not sum due to rounding.
Data from 1 January 2022 to 31 December 2022.

AddLife: Director election

We opposed the election of two nominees, Eva Elmstedt and Eva Nilsagård, due to overboarding concerns. We engaged with the company on this issue before the AGM, seeking clarity on the number of mandates, but did not gain the necessary reassurance. Attendance for both individuals is good, but the number of external board positions held by the audit committee chair, Eva Nilsagård, remained a cause for concern – particularly at an acquisitive company. We have since sold our holding in AddLife, due to a combination of factors that we thought undermined the original investment thesis.

Beijer Ref: Director election

We abstained on the election of a director who is also a member of the nomination committee due to concerns with overall board independence. We subsequently engaged on this matter with the chair, Kate Swann. This was a helpful discussion with a chair who is both a veteran of the industry and corporate governance expert. We shared perspectives on the importance of board independence in the interests of protecting minority shareholder rights and were reassured by the appointment of an independent audit committee chair.

Cellectis: Share capital and remuneration

Ahead of voting at the 2022 AGM, we contacted the company for additional information regarding some items relating to equity issuance. After considering the company's response, we continued to oppose the authority to issue warrants to directors as remuneration. This was due to the inclusion of non-executive directors as potential beneficiaries. We believe issuing independent directors with warrants could compromise their independent judgement. Following the submission of our votes, we wrote to the company to explain our concerns.

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