Baillie Gifford™

Europe ex UK Quarterly Update

30 September 2024

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Potential for Profit and Loss

All investment strategies have the potential for profit and loss.

Stock Examples

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Product Overview

Europe ex UK is a regional equity strategy that aims to generate positive long-term total returns through investment in continental Europe and the Republic of Ireland. We believe the European equity markets offer active managers a broad selection of high-quality companies capable of delivering attractive and sustainable earnings growth for shareholders.

Risk Analysis

Key Statistics	
Number of Holdings	42
Typical Number of Holdings	30-50
Active Share	87%*
Annual Turnover	28%

*Relative to MSCI Europe ex UK Index. Source: Baillie Gifford & Co, MSCI.

The third quarter was not without incident with the market moving from despair to optimism

One of the contributors to performance was DSV, a freight forwarder, which announced an acquisition. We believe serial acquirers are an underrated class of growth company

With growth recovering, the portfolio looks well positioned

Key Facts

Assets under management and advice	US$293.0bn
Number of clients	633
Number of employees	1708
Number of investment professionals	376

Third Quarter Performance

The third quarter served to highlight the stock market's manic-depressive nature. We began with outright despair after a weak US jobs report, but ended with optimism after interest rate cuts from the Federal Reserve and European Central Bank, and the promise of stimulus in China.

The portfolio outperformed the index and there were a number of notable developments over the quarter. Adyen, the Dutch payments company, released results which showed accelerating growth while its competitors, including PayPal's Braintree, saw growth decelerate. Meanwhile, Nexans, the French high voltage cables manufacturer, performed well after an agreement was struck between the Cypriot and Greek energy ministries which increases the likelihood of the Great Sea Interconnector project going ahead. This project, which will connect the energy grids of Israel, Cyprus and Greece, will see Nexans supply a 900km subsea cable, the longest ever made. Maybe the biggest news, though, was the announcement that the freight forwarder DSV would be acquiring its peer, DB Schenker.

In contrast, performance was negatively impacted by a number of holdings. During the quarter Hungarian low-cost air carrier, Wizz Air, French-based semiconductor manufacturers, Soitec, and shopping e-commerce platform, Allegro.eu were all notable detractors.

Acquisition-led growth

Acquisitions get a bit of a bad rep. For some, growing by acquisitions makes a company an inferior investment prospect, while a big deal might be a sell signal. Investors, like all human beings, are prone to hyperbole. There are numerous studies which show that Merger & Acquisitions (M&A) activity is not inherently bad and not every deal ends up a horror show like Time Warner and AOL. For instance, a study of five thousand of the world's largest companies by McKinsey found that between 2009 and 2019, 23 per cent of companies whose growth was driven predominantly by inorganic activity grew revenues above 10 per cent[1]. This is a notably higher proportion than companies whose growth was primarily driven by organic sources at 13 per cent. As with many things, it's important to take things on a company-by-company basis.

In the case of DSV, acquisitions have been an important lever for growth throughout its history. You could say M&A is in its blood given that it was founded as a merger of nine Danish hauliers in 1976. Over the last two decades, DSV has followed a consistent playbook. Every few years it has done a big deal, acquiring a smaller, lower margin peer before extracting synergies with ruthless abandon. Big deals conjure up integration worries but DSV's approach and high-performance culture seem to have enabled it to succeed where many others fail. The result has been an impressive operating profit compound annual growth rate (CAGR) of 16 per cent over the past 20 years. The Schenker deal, should it go through, is an especially big deal at €14bn. This is a risky move, but it is a risk worth taking. It will likely take DSV from the number 3 player in air and sea logistics to the top position. With greater scale comes greater exposure to different routes and freight types, and importantly the ability to extract better terms from shippers and carriers alike.

The portfolio contains several companies which use acquisitions as an engine of growth. DSV is an outlier in that it does big deals. Most of the serial acquirers we have invested in follow a programmatic approach to M&A, doing several deals a year. This is a function of the fragmentation of their industry. The greater the fragmentation, the longer the consolidation runway and, therefore, the longer the duration of the growth opportunity.

Part of what makes these companies so interesting is just how unglamorous they are. Most operate in slow growing, Main Street-type industries where organic growth is unlikely to be much more than GDP growth. Without many attractive opportunities for internal reinvestment, these companies instead deploy their cash flow into dealmaking. This can take a business from being a GDP-like grower, to a double-digit earnings growth machine. For the full year of 2023, Beijer Ref, a heating, ventilation and air conditioning (HVAC) distributor, generated organic revenue growth of just one per cent, reflecting a weak economic backdrop, but it boosted this with acquired growth from the 15 acquisitions it did, with 42 per cent revenue growth the net result.

The deals they do are small, often acquiring family-owned, profitable private businesses which have sticky customer bases. The sole acquisition Beijer Ref has consolidated in its accounts so far this year, an Australian company called Quality Air Equipment, generates net revenue of less than $15m, for instance. The value of that acquisition is far greater than the revenue contribution, though. It adds a node to a growing network and buys local knowledge which could spawn further acquisitions, almost like a flywheel effect.

This practice of stacking growth upon growth according to McKinsey's study, can lead to outperformance. Companies which made more than two

[1] McKinsey & Company: "The Ten Rules of Growth" (2022)

acquisitions per year outperformed companies whose growth was solely from organic sources, delivering an excess total return over organic growers of 2.1 per cent per year[2]. So, beyond just fragmentation, what are the requirements to be a successful serial acquirer? A good description comes from the conclusion of the book, "Deals from Hell". In it, Robert Bruner writes, *"my advice to the business practitioner is to be coldly realistic about the benefits of acquisition. Structure your deals very carefully. Particularly avoid overpaying. Have the discipline to walk away from uneconomic deals. Work very hard to achieve the economic gains you hypothesised. Take nothing for granted."*

You can see these maxims being applied by Constellation Software (CSI), a Canadian vertical market software serial acquirer whose stock has risen a whopping 23,000 per cent since it listed in 2006. CSI, which is the parent company of one of the portfolio's largest holdings, Topicus, makes its acquisition criteria clear on its website. It seeks to acquire "good" vertical market software businesses, while sometimes being able to buy "exceptional" ones. A "good" acquisition target is defined as:

- Number 1 or Number 2 market-share holder in a niche vertical market
- Revenues of at least $5m
- Hundreds or thousands (not dozens) of customers
- Unimposing competitors
- An offering price that has been determined

CSI has a database of thousands of potential acquisition targets and takes a long-term approach to building relationships with them. It has maintained clear internal rate of return (IRR) hurdles and devolved much of the M&A process to its underlying business units, taking advantage of their entrepreneurialism and industry expertise. Not deviating from their discipline saw CSI grow its free cash flow at a 27 per cent CAGR between 2006 and 2023, now generating more than $1bn in free cash flow. As CSI grows, the greater the size of deals it has to pursue which has led to a lowering of the hurdle rates. Topicus, which was spun out of CSI in 2021, is applying their playbook in Europe, and is at a much earlier stage in its development. This, and Europe's highly fragmented nature, should enable it to gobble up its targets at high rates of return for many years to come. Indeed, its 2023 results saw revenues grow 23 per cent, of which 16 per cent came from acquisitions, at a return on invested capital of 38 per cent. This return profile is possible by focusing on a part of the market too small for most private equity firms, there is less competition to inflate the price and on top of that you can add real value by making operational improvements. By having established playbooks in place, CSI and Topicus can be decentralised and still make multiple acquisitions every year.

The latest new purchase for the portfolio is another serial acquirer. Instalco acquires installation businesses in the Nordics, providing heating, plumbing, electrical and ventilation services. The businesses it acquires typically take on projects worth between $100,000 and $7m. Like CSI, Instalco looks for owner-led and entrepreneur-driven companies which have demonstrated profitable growth and have high customer retention and satisfaction. The number of these businesses is enormous with Instalco claiming there are 25,000 of them in Sweden alone. Since listing in 2016, it has compounded its free cash flow at 33% as it adds more companies and more customers to its network. Recently the shares have been weak due to a Swedish construction slump. This has provided us with the opportunity to buy a company with a strong capital allocation track record and a long growth runway at a discounted valuation.

Serial acquirers don't get much attention because they don't feature at the top end of the index and at face value, they don't do anything innovative or special. However, their ability to self-fund high growth rates at impressive returns on capital, makes them very attractive investment candidates. In periods of weakness, they look even more attractive. As CSI President Mark Leonard wrote, *"If I have the access to capital and there is a downturn, we will buy as much as we can."* Perhaps this is sage advice for all investors in a time of uncertainty like this.

2 McKinsey & Company: "The Ten Rules of Growth" (2022)

Performance Objective

+2 to 3% p.a. gross of fees over rolling 5 year periods vs index.
The performance objective is aspirational and is not guaranteed. We don't use it to compile the portfolio and returns will vary. A single performance objective may not be appropriate across all vehicles and jurisdictions. We may not meet our investment objectives if, for example, our growth investment style is out of favour, or we misjudge the long-term earnings growth of our holdings.

Periodic Performance

GBP	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	0.2	0.1	0.1
1 Year	18.3	15.4	2.9
3 Years	-9.6	6.8	-16.4
5 Years	5.1	8.2	-3.1
10 Years	8.8	9.0	-0.2
Since Inception	8.8	8.4	0.3

USD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	6.4	6.2	0.1
1 Year	30.1	26.8	3.2
3 Years	-9.8	6.6	-16.3
5 Years	6.9	10.1	-3.2
10 Years	6.7	7.0	-0.2
Since Inception	8.2	7.8	0.3

EUR	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	2.2	2.0	0.1
1 Year	23.4	20.3	3.1
3 Years	-8.6	7.9	-16.5
5 Years	6.4	9.6	-3.2
10 Years	8.1	8.3	-0.2
Since Inception	8.3	8.0	0.3

CAD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	5.0	4.9	0.1
1 Year	29.9	26.7	3.2
3 Years	-7.8	8.9	-16.7
5 Years	7.3	10.5	-3.2
10 Years	8.8	9.0	-0.2
Since Inception	8.7	8.3	0.4

AUD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	2.4	2.3	0.1
1 Year	21.0	18.0	3.0
3 Years	-8.5	8.0	-16.6
5 Years	6.3	9.5	-3.2
10 Years	9.3	9.5	-0.2
Since Inception	8.6	8.2	0.3

Annualised periods ended 30 September 2024. 3 Month & 1 Year figures are not annualised.
Inception date: 31 December 1989
Figures may not sum due to rounding.
Benchmark is MSCI Europe ex UK Index (FTSE World Europe ex UK Index prior to 31 December 2016).
Source: FE, Revolution, MSCI, FTSE.
The Europe ex UK composite is more concentrated than the MSCI Europe ex UK Index.

Discrete Performance

GBP	30/09/19-30/09/20	30/09/20-30/09/21	30/09/21-30/09/22	30/09/22-30/09/23	30/09/23-30/09/24
Composite Net (%)	45.5	19.4	-41.7	7.0	18.3
Benchmark (%)	0.2	21.8	-12.1	20.0	15.4

USD	30/09/19-30/09/20	30/09/20-30/09/21	30/09/21-30/09/22	30/09/22-30/09/23	30/09/23-30/09/24
Composite Net (%)	52.6	24.5	-51.7	17.0	30.1
Benchmark (%)	5.1	27.0	-27.2	31.2	26.8

EUR	30/09/19-30/09/20	30/09/20-30/09/21	30/09/21-30/09/22	30/09/22-30/09/23	30/09/23-30/09/24
Composite Net (%)	41.9	26.0	-42.9	8.3	23.4
Benchmark (%)	-2.3	28.6	-13.9	21.4	20.3

CAD	30/09/19-30/09/20	30/09/20-30/09/21	30/09/21-30/09/22	30/09/22-30/09/23	30/09/23-30/09/24
Composite Net (%)	54.0	18.1	-47.6	15.2	29.9
Benchmark (%)	6.0	20.5	-21.1	29.1	26.7

AUD	30/09/19-30/09/20	30/09/20-30/09/21	30/09/21-30/09/22	30/09/22-30/09/23	30/09/23-30/09/24
Composite Net (%)	43.6	23.5	-45.8	16.6	21.0
Benchmark (%)	-1.1	26.1	-18.2	30.7	18.0

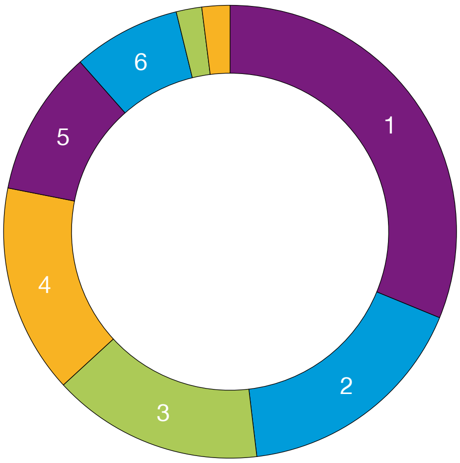
Benchmark is MSCI Europe ex UK Index (FTSE World Europe ex UK Index prior to 31 December 2016).
Source: FE, Revolution, MSCI, FTSE.
The Europe ex UK composite is more concentrated than the MSCI Europe ex UK Index

Top Ten Largest Holdings

Stock Name	Description of Business	% of Portfolio
Prosus	Portfolio of online consumer companies including Tencent	5.6
Topicus.com	Acquirer of vertical market software companies	5.2
DSV	Freight forwarder	4.8
Schibsted	Media and classifieds advertising platforms	4.7
Nexans	Cable manufacturing company	4.2
Hypoport	Technology-based financial products and services	4.2
Ryanair	European low-cost airline	4.1
ASML	Semiconductor equipment manufacturer	4.1
Atlas Copco	Manufacturer of industrial compressors	3.6
Kingspan Group	Building materials provider	3.5
Total		43.9

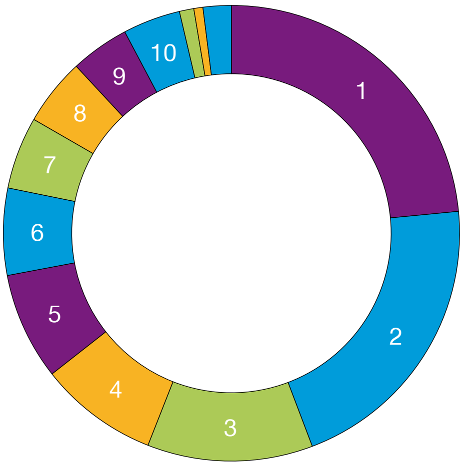
Totals may not sum due to rounding.

Sector Weights



		%
1	Industrials	31.2
2	Information Technology	16.9
3	Financials	15.1
4	Consumer Discretionary	14.9
5	Health Care	10.4
6	Communication Services	7.7
7	Consumer Staples	1.8
8	Cash	2.0

Geographical Location Weights



		%
1	Netherlands	23.5
2	Sweden	20.8
3	France	11.7
4	Denmark	8.4
5	Ireland	7.6
6	Switzerland	6.2
7	Norway	5.1
8	Italy	4.8
9	Germany	4.2
10	Poland	4.1
11	Hungary	1.0
12	Luxembourg	0.6
13	Cash	2.0

Totals may not sum due to rounding

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	5	Companies	4	Companies	None
Resolutions	100	Resolutions	9	Resolutions	None

Company Engagement

Engagement Type	Company
Environmental	ASML Holding N.V., Kingspan Group plc, Moncler S.p.A., Ryanair Holdings plc, Wizz Air Holdings Plc
Governance	ASML Holding N.V., ASSA ABLOY AB (publ), CRISPR Therapeutics AG, Compagnie Financière Richemont SA, LVMH Moët Hennessy - Louis Vuitton, Societe Europeenne, Mettler-Toledo International Inc., Moncler S.p.A., Prosus N.V., Reply S.p.A., Ryanair Holdings plc, Soitec SA, Wizz Air Holdings Plc
Strategy	ASML Holding N.V., Epiroc AB (publ), Kingspan Group plc, Ryanair Holdings plc

Company	Engagement Report
ASML	Objective: To gain insights into ASML's strategic direction under the new chief executive officer (CEO) Christophe Fouquet. Discussion: Our visit to ASML's Eindhoven facility provided a valuable opportunity to engage with the new CEO and other key executives. Christophe Fouquet was appointed CEO in April 2024 joining ASML in 2008. Our impression is that succession planning was well thought through, with Fouquet largely taking full control a year before the official handover date. As seamless as this transition has been, we do not underestimate the changes that Fouquet's appointment will bring. While the previous decade was characterised by the strong leadership of the former CEO and chief technology officer, Fouquet appears to be fostering a more distributed leadership approach across the company's 40,000+ employees. Given ASML's success over the past decade, we were intrigued to hear Fouquet openly discuss areas he aims to improve to ensure continued success. His humility was striking, exemplified by an anecdote where he requested a demotion upon joining ASML to first learn the ropes of lithography. Fouquet's strategic focus now is on adapting to individual customer requirements, acknowledging the diverse needs of major clients such as TSMC and Intel. The introduction of dedicated customer teams, led by the new Chief Customer Officer, Jim Koonmen, further demonstrates ASML's commitment to becoming even closer to its customers. Fouquet also emphasized the importance of ongoing cost reduction for clients, aiming to reduce the cost per exposure by 30% by the end of this decade. Outcome: The meeting reinforced our confidence in ASML's culture of long-termism, strategic direction and technological leadership. Though the company remains confident in long-term demand, the roadmap is more complex than in the past. Fouquet has a clear vision for what the company needs at this stage in its evolution. His ability to reduce costs for clients while at the same time boosting ASML's margins will likely define the success of Fouquet's era. We will continue to monitor.
Ryanair	Objective: This post-AGM visit to the company HQ included meetings with departments across the business. For board engagement, our aim was to better understand the skills of the new board appointees; for the sustainability team we were seeking clarity on decarbonisation planning especially with regards to sustainable aviation fuel (SAF); and for our meeting with the chief operating officer (COO), we wanted to explore supply chain disruption. Discussion: The Chair justified recent board nominees in the context of operational execution. The sustainability team clarified SAF contracts and other measures targeting emissions reductions are embedded in their 2050 NZ plan. The COO introduced Ryanair LABS and discussed some of the supply chain bottlenecks currently facing the company. Outcome: A thorough update on the business across operational, sustainability and supply chain matters. These meetings should help us better calibrate the opportunity in the next few years and boost our confidence that Ryanair has a tangible edge in sustainability versus its LCC peers and long-haul carriers.
Soitec	Objective: To encourage simplification of executive pay plans and the strengthening of minimum ownership requirements for executives. Discussion: We spoke to the chair of the remuneration committee, Delphine Segura Vaylet, following this year's AGM. On the call, we outlined reservations over the complexity of executive pay plans. We also queried the suitability of some non-financial performance metrics included in the latest policy. Delphine explained that the committee adopts a benchmarking approach each year, but acknowledged our concerns. She added that the non-financial metrics discussed would be reviewed by the committee. Finally, we sought to understand the board's thinking on building executive ownership. We noted levels of executive ownership and corresponding requirements are both relatively low. Delphine agreed that this was a topic the board could pay more attention to going forward. Outcome: Delphine appeared open to the feedback provided, intimating that action would be considered by the remuneration committee. She also asked if we could share our updated remuneration principles, which we have committed to doing. We look forward to being consulted on executive pay going forward and will monitor related developments.

Votes Cast in Favour

Companies	Voting Rationale
Prosus N.V., Richemont, Schibsted B, Soitec, Wizz Air Holdings Plc	We voted in favour of routine proposals at the aforementioned meeting(s).

Votes Cast Against

Company	Meeting Details	Resolution(s)	Voting Rationale
Prosus N.V.	AGM 21/08/24	3	We opposed the resolution to approve the remuneration report because of concerns with quantum and misalignment between pay and performance. Our concern also relates to the stretch of targets under the long-term incentive plan, all of which we do not deem to be in the best interest of long-term shareholders.
Prosus N.V.	AGM 21/08/24	8	We opposed the resolution to approve the remuneration policy because of concerns with a special 'moonshot' award for the CEO, in addition to the regular long-term incentive plan. We do not believe that the conditions attached to the award promotes appropriate pay for performance.
Reply Spa	EGM 17/09/24	10	We voted against the amendment to the articles as it will allow the company to continue to hold shareholder meetings exclusively through a proxyholder, which will limit shareholder participation. We believe shareholder participation in shareholder meetings is a fundamental and important shareholder right and without reassurances that this provision will only be used in exceptional circumstances we do not think it is in shareholders' best interests to support this amendment.
Reply Spa	EGM 17/09/24	20	We opposed the amendments to the articles of association which would enhance the increased voting rights mechanism at the company. The resolution would allow shareholders who have shares carrying double voting rights to gain a supplementary voting right for every twelve additional months of possession, up to a maximum of ten votes per share. While we support the principle of rewarding long-term shareholders, given the company is controlled already, we believe this could further entrench management.
Reply Spa	EGM 17/09/24	30	We opposed the resolution which sought authority to issue equity without pre-emptive rights because the potential dilution levels are not in the interests of shareholders.
Richemont	AGM 11/09/24	10	We opposed the request to authorise other business. We do not believe this is in the best interests of clients who vote by proxy.
Richemont	AGM 11/09/24	5.17	We opposed the election of a non-executive director because of concerns relating to their suitability to chair the audit committee having previously been an employee of the company.

Company	Meeting Details	Resolution(s)	Voting Rationale
Richemont	AGM 11/09/24	9.3	We opposed the approval of executive variable remuneration due to ongoing concerns with remuneration practices which we do not believe are in the best long-term financial interests of shareholders. Concerns include poor disclosure and a lack of responsiveness to previous shareholder dissent.

Companies	Voting Rationale
Wizz Air Holdings Plc	We opposed the resolution which sought authority to issue equity because the potential dilution levels are not in the interests of shareholders.

Votes Abstained

We did not abstain on any resolutions during the period.

Votes Withheld

We did not withhold on any resolutions during the period.

Votes Not Cast

Companies	Voting Rationale
Ryanair	We no voted this meeting as the company has restricted the voting rights of non-EU holders of Ordinary shares and ADRs post-Brexit.

New Purchases

Stock Name	Transaction Rationale
Instalco	In its ten-year lifespan, Instalco has become a key player in consolidating the Nordic technical installation industry. Its shares have seen a spectacular run since listing in 2017 but have experienced recent weakness due to a challenging construction and M&A backdrop. There is still a long runway for further consolidation and we think that the M&A environment will improve in time. The valuation is appealing for a company capable of generating attractive organic growth which it can supplement with the growth it acquires through its consolidation efforts. Based on these attractions, we took a new holding for the portfolio.

Complete Sales

Stock Name	Transaction Rationale
Kering	We have struggled to gain faith in growth at Kering rebounding. The appointment of fresh management to stabilise Gucci feels sensible but unlikely to be revolutionary. The brand faces an unenviable balance between retaining high net-worth clients, who were alienated by its previous creative director, while also speaking to a new generation of younger luxury consumers whose spend is rising fastest. Other brands in the portfolio remain sub-scale and capital allocation has atrophied in recent years. The impending retirement of Chairman and CEO François-Henri Pinault heightens our concern around the group's future direction. We have therefore sold the shares and redeployed the capital into higher-conviction names.

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