Baillie Gifford™

European Growth Trust plc

Philosophy and Process

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Potential for profit and loss

All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk.

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Trust information

Baillie Gifford European Growth Trust plc is an investment trust listed on the London Stock Exchange and is not authorised or regulated by the Financial Conduct Authority. As with any investment, your clients' capital is at risk. A Key Information Document is available on request.

Trust aims

The trust aims to achieve capital growth over the long term from investment primarily in listed and private European equities which have the potential to deliver a return in excess of the FTSE Europe ex UK index.

Trust details

SEDOL	0329501
ISIN	GB0003295010
AIC sector	Europe
Launch date	28 June 1972
Year end	30 September
AGM	Typically January
Final results announced	Typically November
Dividends paid	Typically January/Feburary
Management details	Baillie Gifford & Co Limited are appointed as investment managers and secretaries to the company. The management contract can be terminated at 6 months' notice.
Annual management fee	0.55% on the lower of the Company's market capitalisation or net asset value up to £500m, reducing to 0.50% thereafter calculated and payable quarterly.

Philosophy

Investing in Europe's great growth companies

We aim to create value for our clients and society by finding and owning Europe's great growth companies. To generate remarkable returns over time we strongly believe that our investment philosophy and process needs to break from convention. Since the inception of our first European Equities Strategy in 1985 we have been working on this very task. There are three core beliefs which underpin our investment approach, outlined on the following pages.

Outliers

Experience tells us that most companies fail to add shareholder value. The majority of long-term stock market value creation is not generated by aggregating a large number of mediocre returns from average companies. In fact, long-term stock market value creation is dominated by a small number of special companies. We do not want to own a collection of average companies in the hope of achieving a good frequency of positive returns, we aspire to own these special 'outliers' which we believe can earn us a multiple of our initial investment. We have calculated that the probability of a European stock at least doubling over a five-year period is 30%. This means that when analysing a company, we are assessing whether the probability of that stock at least doubling is greater or less than that base rate of 30%.

Having a hurdle rate of at least two times return over five years is an ambitious target but it allows us to focus on that very small subset of companies capable of generating outstanding returns. These outliers typically have large, attractive market opportunities to pursue, have developed strong competitive advantages and are backed by founders and management teams who put the sustainability of their business ahead of short-term gain. In addition, by including the ability to invest in private companies with valuations of at least €500 million (capped at 20% of total assets at the time of investment); we believe we enhance our chances of finding these outliers.

Unconventional approach

To find these outliers, we must be prepared to be deliberately unconventional in our approach. We think that there are three aspects to this:

01

Optimism

We need to think about what can go right, rather than what can go wrong in an investment case. We need to be willing to embrace uncertainty and recognise that we will make mistakes. We need to recognise that returns in equity markets are asymmetric, with the maximum loss capped to the initial stake and the upside unbounded. For our portfolios, returns are determined less by the occasional, and inevitable mistakes, but by those very successful investments.

02

Dare to be different

We must be comfortable ignoring the benchmark and our competitors. Our portfolios will look different to the majority of our peers and the benchmark, reflecting the uniqueness of our approach and our ability to invest in innovative private companies.

03

Genuinely long term

Finally, we must be prepared to own businesses for the very long term. We believe great businesses can be structurally mispriced as the market often underestimates their durability and attractiveness. In aggregate our average holding period will typically be between five and ten years, implying a portfolio turnover of 10–20%. We are likely to hold individual companies for a much longer period.

Unique insights

Prioritising unique, alternative sources of information over traditional sources of investment information is essential if we are to generate exceptional returns. Academia, visionaries, futurists, and companies themselves can all provide us with insights which can lead to greater understanding of potential investments but also the practice of investment itself.

The investment philosophy has evolved over time, reflecting an increased understanding of investment returns thanks to Baillie Gifford's sponsorship of academic work in the field. This has allowed us to evolve our philosophy and process to focus on Europe's special growth companies and, we hope, Europe's big winners.

Process

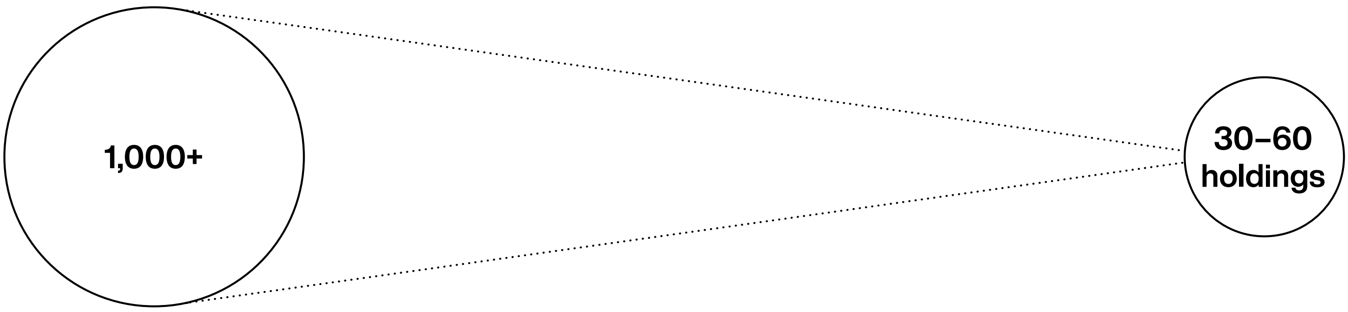
What are we looking for?
Europe's outliers

Idea generation
Academia
Private Companies
Journalists
Visionaries

Research
10Q framework
Minimum 2x return hurdle

Discussion
Weekly stock discussion
Input from other BG investment teams

Decision
Monthly portfolio construction meeting



Our process

We think it is neither productive nor lucrative for us to cover the whole universe of companies we could theoretically invest in. Instead, we have a clear idea of what we are looking for and aim to be disciplined in our pursuit of identifying Europe's great growth companies. Rather than conducting superficial research on a large number of investment opportunities, we perform in-depth analysis on a small number of companies. We are wary of replacing or diluting our existing holdings simply in the name of doing something new.

Our 10-question research framework sits at the heart of our investment process and helps focus our attention on those factors which we believe are most associated with potential outliers.

Growth

1. What is the five-year growth potential?
2. What about the next ten years and beyond?

We prefer companies that are ambitious in what they want to achieve. We seek to own companies which reinvest their capital aggressively to pursue large, structural growth opportunities. This may take the form of investing in organic or acquisitive growth.

Edge

3. Does the company have a special culture?
4. How sustainable is its competitive position?
5. Are returns attractive and improving?

Growth is meaningless if the business does not possess a durable competitive advantage. It is in the search for enduring corporate excellence that we spend most of our time, analysing companies to learn more about their culture and to deepen our understanding of the elusive elements that combine to make up a company's competitive edge. There is no magic recipe, but we believe that by diligently practicing the art of business analysis we can dramatically improve our odds of success.

Alignment

6. Are management and stakeholders well-aligned?
7. How does it contribute to society?

Great businesses achieve the rare feat of aligning the interests of its most important stakeholders: its customers, its employees, its executives, its owners and, ultimately, society at large. Alignment creates the ability for a business to endure. We believe that a long-term mindset is a crucial prerequisite for aligning interests. Adopting a long-term view entails resisting the temptation to maximise short-term profits at the expense of one or more groups of stakeholders. More specifically, it also means that the people running the company behave like owners. It should thus come as little surprise that we expect the majority of our portfolio to consist of companies with a long-term inside owner.

Return

8. How likely is a two times return over five years?
9. How might we make more than this?
10. Why doesn't the market appreciate this?

We believe that to outperform over long periods of time, it is necessary to build a portfolio that has the potential to produce asymmetric returns. Not only do we look at the probability of an investment to at least double over five years but also consider what might happen if the investment thesis really works out.

Alternative sources of insight

We also seek outside opinions. Because great minds think unalike.

In the European Equities Team we are dubious about the value of conventional perspectives. We actively avoid market noise, sell-side research, and business school orthodoxy. If we are to conduct high-quality research and generate exceptional returns, we must consider unique, alternative sources of insight. We utilise a wide range of resources to secure alternative sources of information: from hosting industry experts in our offices, to the firm's sponsorship of the Edinburgh International Book Festival to tasking freelance journalists with researching particular topics.

Our relationships with both public and private companies, founders and visionaries is of particular importance to us. These relationships regularly provide us with opportunities to learn and gain insight into culture, the business models of the future, and competitive advantages. The benefits from considering these alternative sources has a flywheel effect, improving not only individual pieces of research but also the investment process more broadly.

In addition, an area of growing importance to us is academic sponsorship. The firm now spends a significant amount of money supporting programmes at UK universities, including a Genomics studentship, a dementia research fund, and a PhD for 3D printing.

We have established partnerships with Delft University in the Netherlands, where they assist our thinking in innovative areas like robotics and drones. We have also been enjoying an expanding relationship with the Santa Fe Institute, the world's leading research centre for complex systems science, as well as with Arizona State University, where the work of Hendrik Bessembinder has been of particular interest to us. This work has been useful in driving forward our own thinking on the asymmetry of long-term stock returns and our ambition to access the outlier stocks on behalf of our clients.

How we integrate ESG

We believe strongly that companies should be able to meet the needs of the present without compromising the ability of future generations to meet their own.

By considering each company's environmental and social impact, and their governance practices, we will not only mitigate any financial risk from their activities but also help companies become more robust and contribute to long-term returns. Each member of the team integrates ESG into their analysis via the 10-question framework. This in turn is boosted by the specialist input of the team's dedicated ESG analyst. This analysis on its own will not be responsible for generating returns; we see it as an essential part of our toolkit which will help us identify those special companies that have outlier potential.

There are two aspects to our integration of ESG:

01

Fundamental research

Questions 3, 6 and 7 of our research framework are explicitly focused on uncovering ESG risks and opportunities.

02

Stewardship

Baillie Gifford's over-arching ethos is that we are 'actual' investors. We seek to deliver long-term returns for our clients and to benefit society. Therefore, we have a responsibility to behave as supportive and constructively engaged long-term investors. Our approach favours a small number of simple principles which help shape our interactions with companies. These stewardship principles are as follows:

- Long-term value creation
- Governance fit for purpose
- Alignment in vision and practice
- Sustainable business practices

Portfolio construction

So, what does the future of Europe look like? Here are the ins and outs.

We aim to construct high conviction portfolios of between 30 and 60 of Europe's great sustainable growth businesses which can at least double in value over a five-year period. Our investment universe is defined as those companies with a market cap greater than €500 million. This provides an opportunity set of over 1,000 companies. However, we don't attempt to cover the entire ground – our performance will be driven by what we do own rather than what we do not.

We employ a team-based decision-making approach. All team members undertake fundamental company research and submit ideas for discussion after having completed our 10-question research framework. After the team discusses an investment case, a company may be brought forward for consideration at a separate portfolio construction group meeting.

Operating as a team does not mean that we require consensus for a new holding to be bought. Instead we believe it is crucial for us to back individual enthusiasm. This allows controversial ideas to get into the portfolio. In our experience, it is often these types of investments that end up providing asymmetric returns. At the same time, it is our overall conviction and enthusiasm which determine holding sizes; this ensures we are investing in the most attractive investment opportunities.

The result of our construction process is a concentrated portfolio of companies, with exceptional growth characteristics and differentiated corporate cultures that will enable them to execute on their opportunity over the very long term.

How we come together to discuss ideas

Weekly stock discussions

Every week, the investment team, as well as guests from other investment teams, meets to discuss company research. These meetings are not in place to make final decisions on companies, instead they help to shape pieces of research and determine whether to keep progressing with an idea.

Monthly portfolio construction group

The decision makers on the team meet on a monthly basis, giving their thoughts on the current portfolio and potential new purchases. This meeting is deliberately separated from our stock discussions to provide time for reflection before making a decision.

Bi-annual reading days

Every six months, the team steps away from day-to-day research to consider interesting topics and consider how we might evolve our investment approach.

Holding is often harder than selling

The ownership of potential outliers is a challenging enterprise. It requires a lot of mental fortitude. Conventional investment wisdom often suggests selling stocks in drawdowns and taking profits on winners. However, by applying this orthodox approach we would risk foregoing significant future returns. In our experience, it is inevitable that outliers will face periods of drawdown; the path to exceptional returns is not linear. It is imperative that we remain focused on fundamentals and the long term in the face of such noise. Likewise, after a strong run of performance, we must be conscious of further upside in the context of a business' long-term opportunity set.

Foregoing future returns is a significant opportunity cost for our clients, and it's one we would rather avoid. We continually monitor the companies we own, testing the validity of an investment case and assessing the probabilities of achieving at least double from its current valuation over a five-year period. Our unconventional approach and belief in seeking unique insights enables us to do this. By thinking more about what can go right, rather than wrong in a business, we put ourselves in a better position to exploit the asymmetric nature of equity returns. Seeking out unique insights allows us to gain deeper and more useful understanding of businesses, industries and markets and enables us to abstract ourselves from the noise of the average market participant opinion. Ultimately, we believe valuation is a much shorter-term consideration than the quality of a business and that our willingness to own successful businesses has underpinned the performance we have generated for our clients over the long-term.

Of course, we must also be prepared to sell a stock. When we do so, it is likely because of the fundamental impairment of the investment case, or if we feel that the probability of earning a two times return over five years is below our base rate of 30%. We will also reduce a holding if we think that the probability of achieving that return has reduced. Causes of the impairment of an investment case include:

- A loss of trust with the management team
- A severe deterioration in business or industry economics
- A deterioration in innovation or ambition

Risk

To outperform a benchmark an investor has to differ from it, so we set out to be different and at times unconventional. Benchmarks are not risk free and we therefore do not believe that tracking error captures meaningful investment risks. We simply invest and diversify sensibly and pragmatically in the knowledge that we will be wrong some of the time. Baillie Gifford's independent Investment Risk, Analytics and Research Department oversees all portfolios and provides a useful independent assessment of portfolio risks, but we have a healthy scepticism of quantitative benchmark-relative measures and never make investment decisions based solely upon them.

Managing risk

We believe risk is not about short-term under performance against an index or the control of tracking error, but is fundamentally about avoiding investing in companies that materially disappoint on operational delivery. The main element of risk control is therefore investing only in opportunities that we have fully researched, and for which we understand the key issues.

However, we acknowledge that regardless of our high levels of fundamental due diligence, sometimes the outcome will differ from our original investment thesis.

The company is invested in a diversified portfolio of between 30 to 60 European securities. The company may not invest more than 10% of total assets in any one individual stock at the time of investment.

The board recognises that investment in some European countries can be riskier than in others. Investment risks are diversified through holding a wide range of securities in different countries and industrial sectors. The company has the ability to invest in securities that are listed in countries which are not included in the FTSE Europe ex UK index, where these securities have a meaningful connection with continental Europe. The board has the authority to hedge the company's exposure to movements in the rate of exchange of currencies, principally the euro, in which the company's investments are denominated, against sterling, its reporting currency. Up to 20% of total assets, as measured at the time of initial investment, can be invested in private investments. The level of gearing within the portfolio is agreed by the board and the absolute amount of any gearing should not exceed 20% of net assets at time of drawdown, excluding any private investments in the calculation of net assets. No more than 10% of the total assets of the company may be invested in other listed investment companies (including investment trusts) except in those that have stated that they will invest no more than 15% of their total assets in other listed investment companies. In this case, the limit is 15%.

These limits exist to protect against unforeseen outcomes, not to limit our ability to add value by investing meaningfully in our best ideas. We do not own stocks simply because they are large components of an index and have no stock underweight limits, reflecting this mindset.

Complementing the focus on fundamentals, Baillie Gifford has an independent Investment Risk, Analytics and Research Department which has overall responsibility for reviewing all portfolios using a variety of tools, and reporting their findings to the investment teams as a catalyst for discussions on portfolio risk.

Team

Management of the portfolio is by joint managers Stephen Paice and Chris Davies supported by the European Equities Team.

Stephen Paice
Head of
European Equities

Stephen is head of the European Equity Team. He joined Baillie Gifford in 2005, and became a partner of the firm in 2024. Stephen has been involved in running the European portion of the Global Core Strategy and Managed Strategy since 2019, as well as a member of the International All Cap Portfolio Construction Group. Prior to joining the team he spent time in the US, UK Smaller Companies and Japanese equities teams. Stephen graduated with a BSc (Hons) in Financial Mathematics in 2005.

Chris Davies
Investment Manager

Chris is an investment manager in the European Equity Team and has been a member of the International Alpha Portfolio Construction Group since 2021. He joined Baillie Gifford in 2012. He graduated BA (Hons) in Music from the University of Oxford in 2009 and gained a MMus in Music Performance from the Royal Welsh School of Music and Drama in 2010 and an MSc in Music, Mind and Brain from Goldsmiths College in 2011.

Alex Blake
Head of Investment
Trust Operations

Alex joined Baillie Gifford in 2014 and is head of Investment Trust Operations. Previously, he qualified as a lawyer before joining the corporate finance department of an Investment Trust broker. Alex graduated LLB from the University of Edinburgh in 2005.

Tom Hodges
Investment
Specialist Manager

Tom is an investment specialist in our Clients Department with responsibility for European Equities and International All Cap clients. He joined Baillie Gifford in 2021 having previously worked as a product specialist at Janus Henderson Investors. He graduated with a BA in Politics from the University of Nottingham in 2014.

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Board

The board has overall responsibility for the company's affairs. A number of matters are reserved for its approval including strategy, investment policy, gearing, treasury matters, dividend and corporate governance policy.

Michael MacPhee
Chair

Michael MacPhee was called to the English Bar in 1987, and joined Baillie Gifford & Co in 1989 and became a partner in 1998. He headed the firm's European department from 2003 to 2008 and thereafter co-managed a global investment strategy. From 1998 until his retirement from the firm in 2014 he was the manager of Mid Wynd International Investment Trust PLC. He is a director of Carbon Recycled Energy Limited. He was appointed a director of the company in 2016 and chair in 2017.

Andrew Watkins
Chair of the Audit Committee

Andrew Watkins (Audit Committee chair) was head of client relations, sales and marketing for Invesco Perpetual's listed investment funds business until his retirement in June 2017. He is currently chairman of Ashoka India Equity Investment Trust plc and CT UK High Income Trust plc, a director of Chelverton UK Dividend Trust plc and Consistent Unit Trust Management Company Limited. He was appointed a director of the company in 2019 and chair of the Audit Committee in 2024..

Emma Davies
Director

Emma Davies (senior independent director) is an experienced investment professional who has spent her career investing across global equity markets, as well as in the property and private equity markets in the UK. She has a sophisticated understanding of ESG considerations, particularly with regard to social and governance concerns. She is currently the chief investment officer at Guy's & St Thomas' Foundation and is also a non-executive director and chair of the audit committee of Riverstone Credit Opportunities Income Plc and a non-executive director of Octopus Future Generations VCT. She was appointed a director of the company in 2021.

Davina Curling
Director

Davina Curling has over 30 years of fund management experience. She was managing director and head of Pan European equities at Russell Investments. Prior to that she was head of European equities at F&C, ISIS and Royal & SunAlliance. Davina has also held positions at Nikko Capital Management (UK) and Kleinwort Benson and was previously senior independent director of BlackRock Greater Europe Investment Trust plc, retiring at the end of her tenure in 2023. She is currently the senior independent director of abrdn Asia Focus plc. She is a non-executive director of Henderson Opportunities Trust plc and an independent member of the Investment Committee of St. James's Place. She was appointed a director of the company on 1 November 2024.

David Barron
Director

David Barron has spent 25 years working in the investment management sector and until November 2019 was chief executive officer of Miton Group PLC following six years with the firm. Prior to this, he was head of investment trusts at JP Morgan Asset Management for more than ten years having joined Robert Fleming in 1995. He is currently chairman of Dunedin Income Growth Investment Trust PLC, chairman of the audit committee of Fidelity Japan Trust PLC and of BlackRock Sustainable American Income Trust plc. He was also a non-executive director of Premier Miton Group PLC until 7 July 2023. He was appointed a director of the company on 1 October 2023.

About Baillie Gifford

Baillie Gifford & Co is one of the leading privately owned investment management firms in the UK. Structured as a partnership, investment management is our sole business.

Baillie Gifford & Co is wholly owned by partners, all of whom work within the firm. We believe that the personal involvement in the business by the owners is crucial to maintaining the motivation and high standards essential to a modern investment house and maintaining a firm client focus.

A hallmark of the firm is the stability of our organisation and our commitment to continuing as an independent, private business based in Edinburgh. We are particularly proud of our low turnover of staff, both investment and administrative.

Baillie Gifford has a strong service culture. We make every effort to ensure that the service to investment trust boards and shareholders is of the highest possible standard.

Accounting and company secretarial services are provided by our in-house Investment Trust Department. This team currently provides these services to the other investment trusts managed by Baillie Gifford.

Investment Trusts managed by Baillie Gifford

Scottish Mortgage Investment Trust PLC	Global
The Monks Investment Trust PLC	Global
The Scottish American Investment Company plc	Global Equity Income
Edinburgh Worldwide Investment Trust plc	Global Smaller Companies
The Baillie Gifford Japan Trust PLC	Japan
The Baillie Gifford Shin Nippon Trust PLC	Japan
Pacific Horizon Investment Trust PLC	Asia Pacific
Baillie Gifford US Growth Trust plc	North America
Baillie Gifford UK Growth Trust PLC	UK All Companies
Baillie Gifford European Growth Trust plc	Europe
Baillie Gifford China Growth Trust plc	China
Keystone Positive Change Investment Trust plc	Global

Differentiation

We believe a number of features differentiate Baillie Gifford's investment philosophy and process:

Fundamental style

We are fundamental investors.
We undertake our own research with considerable emphasis on analysing companies' financial statements and assessing management.

Long-term investment horizon

Our aim is to select good quality stocks which will outperform over the long term. When assessing a stock, we look at a company's prospects over the next five years as opposed to the next five months.

Active portfolios

Having identified good quality stocks, we look to hold them in sufficient size to have a meaningful, positive impact on performance. We back our judgement.

Team-based decision making

We operate a genuine team approach.
Portfolios reflect the views and contributions of each investment team.

Stability of investment staff

Our partnership structure encourages a high degree of stability within the investment teams. All staff have the opportunity to become a Partner and this provides a major incentive.
We believe this ability to own part of a successful, growing business is significantly more than just a financial incentive. In addition, even at non-partner level, profits are shared across a wide base of the employees.

Continuity and repeatability

Our approach to investment has been established over many years. The consistent application of this successful philosophy and process explains our historic performance record and underpins our confidence that performance can be maintained into the future.

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