U.S. Discovery

Philosophy and Process

Baillie Gifford™

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The U.S. Discovery Strategy aims to deliver excellent long-term investment returns by investing in a portfolio of high potential, immature smaller companies in the United States with a view to owning them over a 5–10 year investment time horizon as they grow.

Baillie Gifford

Since 1908, when Baillie Gifford was founded as an investment partnership, the firm has been wholly owned by the people who look after and invest for our clients.

Through each successive generation of partners our single focus on generating superior, long-term investment results for our clients has been the bedrock of our growth.

Partnership defines us

The absence of external shareholders allows us to put our clients' needs first. It brings stability and a long-term time frame to everything we do in our business, whether choosing the best investments for our clients' portfolios or continually investing in the firm and developing our people.

Our partnership structure brings freedom from short-term pressures, allowing us to be truly active investors. Portfolios are shaped by where the best investment opportunities lie, rather than where the index dictates. We encourage a strong culture of inquisitiveness, debate and respectful trust in which our investors are nurtured and thrive.

Our investment approach

Curious about the world

The best investment ideas spring from analysis of future possibilities, not short-term probabilities. Our research covers the globe. We set no barriers to the scope of our research, encouraging fresh perspectives and the use of diverse sources of information.

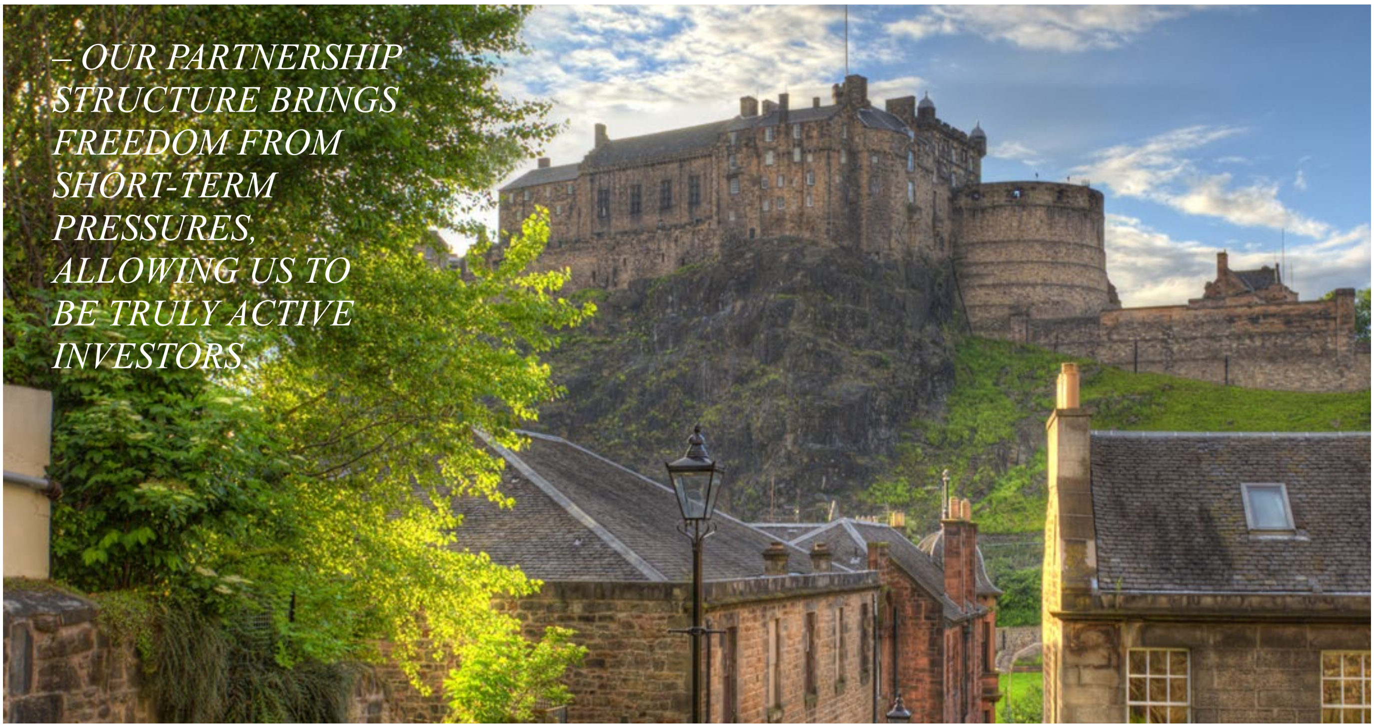
Fundamentally driven

The world is complex. We believe that the way to generate long-term returns for our clients is to focus on identifying and investing in those companies which have the potential to grow at a faster rate, on a more sustainable basis, than the market believes.

We conduct rigorous qualitative research to establish whether prospective investments have the competitive, financial, and strategic advantage to deliver on that potential.

Collaborative research

We like to share. Investment ideas are discussed and debated across our investment teams, from those of the most junior analysts to partners of the firm. We are always looking for that novel insight, offbeat observation or penetrating challenge to enhance our collective understanding. There are no enduring right answers in investment, so we never stop asking questions.



Global perspective matters

Companies increasingly operate in a global environment – it is not sufficient to consider investment opportunities in isolation. We also need to understand their competitive positions and underlying attractiveness against their international peers. The presence of the majority of Baillie Gifford's decision makers in one building enables us to easily share perspectives and debate issues – the constant flow of formal and informal investment discussions allowing us to draw together all the pockets of expertise that reside in our investment teams. We further ensure a global perspective by occasionally moving individuals between these teams: we value breadth of perspective and experience over narrow specialisation.

Clients come first

Baillie Gifford is solely an investment management company. We close our investment strategies to new clients before we gain too many assets to reasonably manage, and we keep our business simple so that we can focus on investment activities. Client relationships are handled by members of our highly experienced Clients Department, who oversee all aspects of delivering our services to clients, ensuring that investment managers are free to concentrate on investment issues.

Investment philosophy

The U.S. Discovery strategy aims to deliver superior investment performance for our clients by investing in the most innovative and entrepreneurial smaller companies in the United States which have the potential to be the big winners of the future. We aspire to identify these companies early on in their development and own them over the long term as they strengthen their competitive edge and grow. We believe that immaturity coupled with strong growth potential are more important attributes than simply a company's smallness.

Our philosophy is underpinned by the observation that it is often less mature, entrepreneurial companies which drive innovation and shape the evolution of their industries. Incumbents are typically too entrenched in their mind-set and fail to adapt quickly enough to changes in the environment or new competitive pressures. Without the bureaucracy and fixed mind-set prevalent in larger businesses, dynamic and innovative smaller companies are best placed to prosper in a rapidly evolving world. Moreover, the market backdrop is increasingly supportive for these businesses, with the technology toolkit expanding the frontiers of innovation and accelerating the rate at which businesses can scale. For those ambitious companies prepared to embrace change and innovate we believe the growth opportunity is as great as it has ever been.

The ‘how’ and ‘why’ of our investment philosophy are underpinned by three key tenets.

1. We invest for the long term

We seek to own companies which strive to disrupt established industries or build entirely new ones. Our experience in investing in these types of businesses has taught us that structural change often takes years to permeate an industry and therefore the true potential of innovative smaller companies may also take many years to become evident. There will be challenges along the way and inevitable periods of market doubt, testing the conviction of management and investors alike. The wide range of potential outcomes, the multi-year horizon until a potential pay-off, and the possibility that a business might fail are risks that few are willing or able to take. Most of the investment industry is reluctant or poorly equipped to handle these challenges, meaning that many can’t fully embrace the real opportunity which immature growth companies present.

Core to our investment philosophy is an aspiration to be long-term, supportive owners of the companies in which we invest. Our ability to take such an approach is underpinned by the stability of Baillie Gifford’s partnership structure and investment culture, and we believe this gives us an edge when investing in immature high potential companies. Patience, and our long-term investment time horizon, allows us to look through short-term share price volatility and harness the asymmetry which is inherent in equity markets to capture the disproportionate impact of successful investments. And through being patient and supportive, we aim to encourage company management to make thoughtful decisions with a multi-year time horizon in mind, rather than a quarterly one. We believe this creates long term value for the companies we invest in and in turn, for our clients.

2. We invest for growth

It is well understood that over the long-term company fundamentals drive share price performance. Superior equity wealth generation comes through above-average growth rates and long-term compounding of cash flows. A key feature of equity investing is the asymmetrical nature of possible returns, such that the downside of any investment is capped but the possible upside on the initial investment is unbounded. The appeal of investing in immature companies is that this asymmetry can be particularly pronounced. Consequently, we focus our thinking on the upside to the investment case and seek to identify those companies which have the greatest potential to grow their revenues, earnings and cash flows at an above average rate over the long term.

3. We invest actively

Our purpose as professional investors is to direct capital towards those ideas and opportunities which, after taking into account the probability of outcomes, can offer the highest return over the long term. Our fundamental job is to weigh up what is proven and tangible alongside what has promise and long-term potential. Integral to this is recognising the role of innovation and entrepreneurialism in business development; together they provide the fuel for experimentation, growth and competitive edge.

We build our portfolio without reference to benchmark indices. Instead, we choose to follow our curiosity in the pursuit of identifying interesting innovative businesses with the potential to grow to many multiples of their current size. Our resultant portfolio is the output of the individual ideas that we identify. Holdings are sized according to investor enthusiasm and potential for outsized returns rather than under/overweight limits relative to an index.

Investment process

Coverage

We invest in companies with a market capitalisation of $10 billion or below at the time of initial purchase, of which we estimate there are approximately 9,500 in the United States. As bottom-up stock pickers, maintaining broad coverage across this investment universe is impractical and, more importantly, of little value to our clients. Most smaller companies have little scope to innovate or meaningfully differentiate themselves from peers and are therefore of no interest to us. Instead, we focus our efforts on identifying businesses which we believe will benefit from a combination of:

- A structural change in the company's market backdrop, be it due to societal change, technological change, demographics or environmental issues.
- The company's response to such change, through innovation, the use of technology, or a new business model.

We don't systematically screen the investable universe in search of new ideas. Traditional quantitative screening tools are backward looking and of little help in identifying future winners. Instead, our approach is purely qualitative. Every member of the team is first and foremost an analyst and spends the majority of their time writing stock research. They are all generalists and are encouraged to pursue their own enthusiasms, regardless of industry or sector classification.

Idea generation

The large scale of our investment universe means that many companies don't always receive coverage from sell-side analysts, and even when they do, it is typically of little interest to us since what is produced is focussed on a shorter timeframe than our own investment time horizon and readily accessible to other investors. We don't believe that it's possible to achieve superior results by utilising the same information as everyone else. Identifying stocks for inclusion in the portfolio therefore requires us to actively seek out and engage with alternative informational sources. These inputs include attending industry conferences and trade shows, visiting technology hubs, speaking to academic thought leaders to discuss innovative technologies and societal changes, sponsoring academic research projects and receiving input from inquisitive researchers who work independently from us on a commissioned basis providing additional in-depth analysis on a wide range of topics. Twice a year, the Discovery investment team holds reading days, the purpose of which is to share knowledge, exchange ideas and encourage discussion on broader topics of interest.

We benefit from a broader research effort in the US investment universe across the various Baillie Gifford investment teams which we can draw on to source new ideas. We welcome the input from our investment colleagues and invite them to share their enthusiasm and insight with us.

Identifying potential

Within the Strategy we seek to hold immature, disruptive businesses. We focus on understanding where innovation is happening and the necessary conditions and factors which need to come together for it to succeed. We look for inefficiencies which are ripe for disruption, we seek parallels across different industries that have been impacted by technological change and explore the commercial implications which may follow. The companies which we have found to be most attractive exhibit common characteristics and these are the key attributes we look for in potential new ideas:

— **Opportunity:** problem solvers often looking to drive change by disrupting existing markets or creating entirely new ones, producing large growth opportunities which can be exploited over the long term.

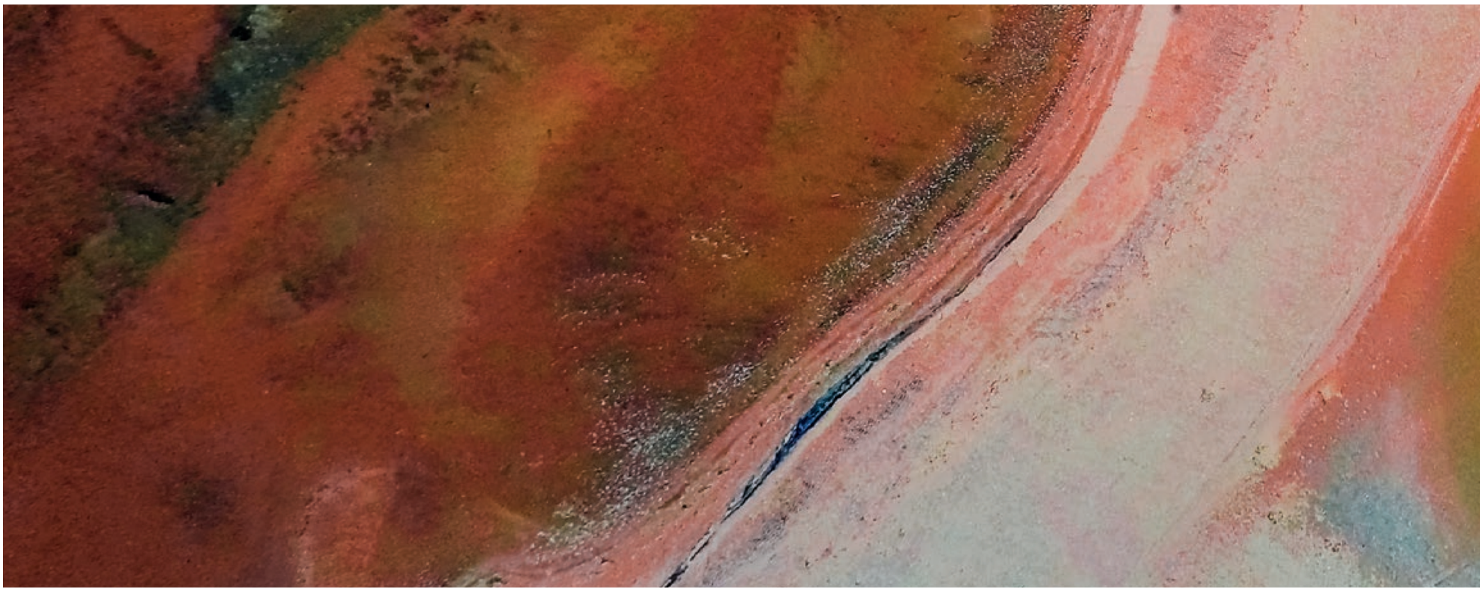
— **Competitive edge:** exhibiting a strengthening competitive position. A company's ability to innovate and meaningfully differentiate itself from peers is fundamental to our ability to earn superior investment returns.

— **Corporate culture:** the corporate culture is aligned with the strengths of the company, where incentives are structured to encourage innovation and adaptability to changing conditions. We recognise management as being key in shaping the vision, ambition and culture of companies early in their life cycle. We seek to identify and support management who have a clear sense of purpose, the skill and vision to identify and execute against an opportunity, and whose timelines align with our own.

— **Scalability:** typically have business models which are inherently scalable, where growth becomes easier with scale and returns increase over time. These could be asset-light digital businesses which benefit from strong self-reinforcing network effects or businesses underpinned by platform technologies which can be applied in many directions to solve different problems.

Innovation is not predictable or linear, it happens in fits and starts with inevitable hurdles along the way. Early iterations are frequently dismissed as unworkable but evolution of an initially raw concept can, in time, yield huge commercial revenue. We believe that focusing on identifying the key attributes and approaching investment with a genuine long-term perspective, accepting a degree of uncertainty and backing robust innovation and entrepreneurial management gives us the best chance of achieving our goal of identifying the companies that have the potential to really matter and to capture long term capital appreciation.

Portfolio construction



Decision making

The U.S. Discovery Strategy is managed from within the Discovery investment team. All of the team members contribute to the generation of new ideas, the ongoing monitoring of existing holdings and stock discussions. While regular ad hoc discussions take place, the investment team meets on a formal basis every week to consider investment ideas and every six weeks to discuss the portfolio and individual stock enthusiasm. In addition, portfolio managers Svetlana Viteva and Douglas Brodie meet each quarter to review the portfolio's positioning.

We encourage a team-based approach to portfolio management and each team member inputs into the portfolio construction process during these regular meetings. While the portfolio managers are ultimately responsible for all portfolio decision making, we seek to give analysts a high degree of influence and to accommodate individual enthusiasm. Once purchased, each holding's operational progress and valuation are continually monitored.

Portfolio structure

We aim to own 40–75 stocks at any time. Individual holding sizes reflect liquidity considerations, conviction and idiosyncratic company risks known in advance. New positions will typically be initiated at 1–1.5% of the strategy and will be subject to an upper limit of 5% at the time of initial purchase. Less proven companies with more binary outcomes will go in at a smaller-than-average holding size, thus limiting a potential negative impact on the portfolio. Because the Strategy aims to provide exposure to the most exciting smaller companies in the U.S., the market capitalisation of new holdings is limited to $10 billion or lower at the time of initial purchase. At an overall portfolio level, under normal circumstances, at least 80 per cent of assets will be invested in securities of small-and mid-capitalisation companies, which are defined as companies with market capitalisations of $30 billion or less. This allows us to retain exposure to a small number of truly exceptional companies whose market capitalisations grow to exceed $30 billion. Furthermore, under normal circumstances, at least 80 per cent of assets will be invested in securities of issuers located in the U.S.

Sell discipline

We aspire to be long term and patient shareholders. We aim to retain ownership as long as a company continues to exhibit the key attributes outlined above – a large growth opportunity, a strengthening competitive advantage, a corporate culture which supports that and a business model which is inherently scalable. Our belief is that size is a poor proxy for maturity and we expect that our most exceptional holdings will grow to multiples of their starting size and beyond $10 billion. Subject to adhering to the Strategy's investment restrictions we do not look to sell our holdings based on a market capitalisation alone. We consider selling stocks when our fundamental outlook has changed or when we can no longer articulate how our views differ from that implied by the market price.

Managing risk

Ensuring the rigour of the research process is the most effective risk mitigation in the portfolio. Thorough fundamental company analysis underpins all investment decisions. Robust investment research and rigorous discussions prior to stock purchase aim to

challenge the investment hypothesis and draw out the potential downside risk of each investment. Ongoing research of existing holdings, sustained interaction with management and continuous re-assessment of the investment hypothesis are critical to managing risk.

Strategy performance will ultimately be defined by our ability to unearth and invest in businesses which have the potential to become many times their starting size. Implicit in owning a portfolio of unproven immature companies is that while some of them will succeed, others will fail. The greatest risk to performance is therefore not the loss of capital from those holdings which don't succeed, but the potential failure to find enough interesting ideas in which to invest.

If successful, our investment approach is bound to result in a degree of concentration at the stock level. Portfolio skewness is the inevitable consequence of allowing our winners to run. In order to ensure that there is no excessive concentration defining the top of the portfolio, whilst still allowing for exploitation of asymmetry of returns, the five largest holdings will not represent more than 40% of portfolio assets.

The following guidelines are therefore felt to best reflect the underlying risk philosophy:

Style	Growth
Benchmark	For performance purposes only and over rolling five-year periods, the portfolio will be measured against the Russell 2500 Growth Index
Number of holdings	40–75
Max market cap at time of initial purchase	$10bn
Max individual holding size at time of initial purchase	5%
Portfolio concentration	Top 5 holdings <40% of strategy
Overall portfolio market cap restriction	At least 80% of net assets invested in securities of small and mid-capitalisation U.S. companies with a market capitalisation of $30bn or less
Overall location of issuer restriction	At least 80% of net assets invested in securities of issuers located in the U.S.

In addition, Baillie Gifford's dedicated Investment Risk, Analytics and Research team produces a semi-annual risk monitoring report for the U.S. Discovery portfolio. Beyond compliance with the investment guidelines, this report includes strategy-specific topics, such as thematic correlations between individual stocks and capital raise risk among others.

Investment team

The U.S. Discovery Strategy is being managed from within the Discovery Investment Team.

Douglas Brodie

Douglas joined Baillie Gifford in 2001 and became a partner in 2015. He is head of the Discovery Team and has led the strategy since its inception. He is also manager of the Edinburgh Worldwide Investment Trust. He graduated BSc in Molecular Biology and Biochemistry from the University of Durham in 1997 and attained a DPhil in Molecular Immunology from the University of Oxford in 2001.

Svetlana Viteva

Svetlana joined Baillie Gifford in 2012. She is an investment manager in the Discovery Team. She is the lead manager for US Discovery Strategy and a deputy manager for the Edinburgh Worldwide Investment Trust. She graduated BA in Economics and BA in Business Administration from the American University in Bulgaria in 2008, MSc in Investment Analysis in 2009 and PhD in Accounting and Finance in 2012, both from the University of Stirling. She is a CFA Charterholder.

Luke Ward

Luke joined Baillie Gifford in 2012. He is an investment manager in the Discovery Team and a deputy manager for the Edinburgh Worldwide Investment Trust. Luke is also an investment analyst for the Private Companies Team. He graduated MEng (Hons) in Mechanical Engineering from the University of Edinburgh in 2012.

Zaki Sabir

Zaki joined Baillie Gifford in 2007. He is a senior analyst in the Discovery Team. He is also an investment scout for the Sustainable Growth Team. Zaki graduated BA in Business Accounting and Finance from the University of Newcastle in 2006.

Calum Holt

Calum joined Baillie Gifford as an investment analyst in 2019, working on the US Equities, Multi Asset and International Alpha strategies before joining Global Discovery. He graduated from Oxford University in 2018 with BA(Hons) in History.

Tia Chen

Tia is an Investment Analyst on the Global Discovery team. She joined Baillie Gifford in 2022. Tia graduated BA (Hons) in Land Economy from the University of Cambridge in 2021 and completed an MPhil in Real Estate Finance at the University of Cambridge in 2022.