Baillie Gifford UK Growth

Investment companies | Annual overview | 15 September 2022

Patience will be rewarded

Baillie Gifford UK Growth Trust (BGUK) has seen a marked fall in its NAV during the last 12 months as inflation expectations have risen, bringing with them interest rate rises and, in all likelihood, a recession. The derating of many growth stocks has been severe and BGUK's managers say that selling has been indiscriminate, with good companies being hit as well as the bad. However, this provides an opportunity for long-term investors. They have been reappraising their investment cases in light of the strongly changing market conditions and have been adding to holdings that they think are fundamentally attractive. The managers believe strongly that their patience will be rewarded over the longer term. An NAV recovery would also likely be accompanied by a narrowing of BGUK's discount, which is currently close to its five-year high.

Focused portfolio of UK growth equities

BGUK aims to achieve capital growth by investing in a concentrated portfolio (35–65 holdings) of UK equities, with the aim of providing a total return in excess of the FTSE All-Share Index. The portfolio will predominantly comprise constituents of the FTSE 350 Index, but where appropriate, it may also include convertible securities, and equity-related derivatives for efficient portfolio management purposes. BGUK may also invest up to 10% of its total assets in unlisted investment opportunities.

Year ended	Share price total return (%)	NAV total return (%)	MSCI UK total return (%)	MSCI UK Growth total return (%)	MSCI World total return (%)
31/08/18	17.0	8.2	3.6	3.6	12.7
31/08/19	(8.2)	(5.5)	1.3	12.5	7.6
31/08/20	6.0	3.6	(16.0)	(4.4)	6.8
31/08/21	40.1	32.3	23.8	19.7	26.8
31/08/22	(36.2)	(26.9)	9.2	(1.2)	0.9

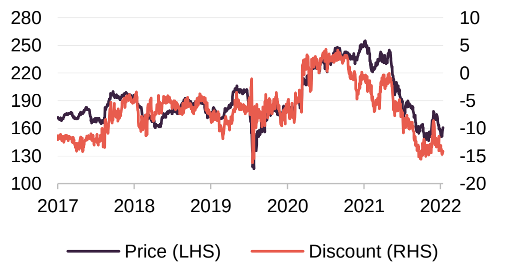
Source: Morningstar, Marten & Co

Sector	UK All Companies
Ticker	BGUK LN
Base currency	GBP
Price	160.80p
NAV	187.29p
Premium/(discount)	(14.1%)
Yield[1]	2.4%

Note: 1) Yield calculated using recommended final dividend of 3.91p per share for the year ended 30 April 2022, to be approved at the AGM on 9 September 2022.

Share price and discount

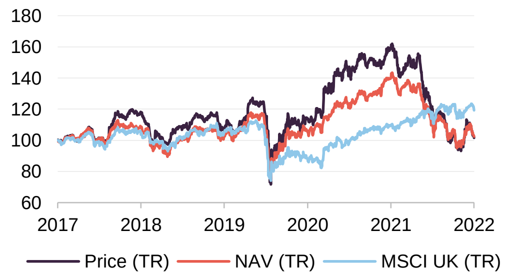
Time period 31/08/2017 to 12/09/2022



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/08/2017 to 31/08/2022



Source: Morningstar, Marten & Co

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Domicile	England & Wales
Inception date	8 July 2005
Manager	Iain McCombie and Milena Mileva
Market cap	242.8m
Shares outstanding (exc. treasury shares)	151.9m
Daily vol. (1-yr. avg.)	336.2k shares
Net gearing	3.1%

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Click for BGUK's peer group analysis

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Fund profile

Focused UK growth equities portfolio

Further information can be found at Baillie Gifford's website: www.bailliegifford.com

BGUK aims to achieve capital growth predominantly by investing in a portfolio of UK equities, with the aim of providing a total return in excess of the FTSE All-Share Index. The company invests in a relatively concentrated portfolio of between 35 and 65 stocks, the majority of which are constituents of the FTSE 350 Index.

The managers take a stock-picking approach, and the size of individual stock holdings depends on the managers' degree of conviction, not the stock's weight in any index. BGUK may, if appropriate, use convertible securities, and equity-related derivatives for efficient portfolio management purposes.

Baillie Gifford took over the management of BGUK's portfolio at the end of June 2018 and has been managing it for just over four years now. While BGUK has been an investment trust since its launch in 1994, its name was changed in May 2021 to explicitly include the word trust. This was done to clarify that BGUK is an investment trust and therefore has all the advantages of a closed-end structure over an open-ended fund.

About the managers

Well-resourced investment team.

Baillie Gifford has 135 investors/analysts, spread across 23 teams, most of whom are based in its Edinburgh office. It is structured as a partnership and encourages a collegiate approach to managing money, although it allows its portfolio managers the freedom to have the final say about their portfolios. It managed or advised on about £231bn at the end of June 2022, of which £14.1bn was invested in UK equities. BGUK is co-managed by Iain McCombie and Milena Mileva (see page 27 for brief biographies of the managers).

Constructed without reference to a benchmark

BGUK's benchmark is the FTSE All-Share Index, although the portfolio is not constructed with reference to this or any other benchmark index. We have substituted the MSCI UK Index for the All-Share in this report and have also included comparisons against the MSCI UK Growth Index and the MSCI World Index.

Managers' view

A perfect storm in the UK

BGUK's managers acknowledge that it has been a very disappointing period for growth stocks in the UK, which they remark has been subject to a perfect storm. The UK market is heavily weighted towards a small number of disproportionately large companies, particularly in the energy, banking and pharmaceuticals sectors, which have fared relatively well. A narrow group of these stocks has propelled UK indices higher. In the face of steeply rising inflation and similar interest rate hikes designed to bring inflation back under control, a recession now looks inevitable. Investors have been retreating into areas such as these, which tend to be perceived as safe, dumping growth stocks and favouring value in the process.

Some areas of BGUK's portfolios have benefitted from the current environment – for example, some of its financials holdings – but, broadly speaking, rising interest rates are negative for equities in general and particularly for growth equities where a larger proportion of their value is being more heavily discounted from the future.

In common with its peers, BGUK has had a difficult period but has found it particularly challenging as its portfolio is in aggregate focused on mid to smaller companies, which have been generally more affected, and its portfolio is also concentrated, with big index under weights, which has impacted its relative performance.

Nonetheless, the market dislocation has created some opportunities. The managers say that the sell-off has been indiscriminate, with both good and bad companies being heavily derated.

Sticking to their knitting – focusing on the long term

The managers say that the big question for them is: How to approach the current environment? They say that, in periods like this, the market gets tunnel vision and becomes very short term. Their approach is to take a step back and focus on the long-term opportunities.

Although the portfolio is managed with a strong bottom-up focus, the managers say that it is nonetheless rational to reappraise their investment cases in light of changed market conditions. The key question they ask of each investment is: Does the long-term hypothesis remain in place, or have fundamentals been weakened? Based on this analysis, the managers have been adding to a few holdings that they think are fundamentally attractive, for example Experian, Farfetch and Games Workshop, but have also been trimming and exiting positions.

The managers comment that trade and private equity buyers are taking advantage of attractive valuations. They cite the examples of Ultra Electronics, which has left the portfolio following its takeover by Cobham; HomeServe, whose bid from the Canadian private firm Brookfield Partners, for US$4.08bn, looks set to close in Q4 (the offer price of £12 per share was a 71% premium to the undisturbed closing price on the last day before the offer was announced); and Euromoney Institutional Investor, which has accepted a £1.7bn bid from private equity houses Astorg and Epiris. In the case of HomeServe, the managers note that its shares have been quite volatile, while the underlying business has not. They think that Brookfield saw a unique asset and took advantage of current pricing. However, they feel the bid price is reasonably fair, observing that the founder and largest shareholder recommended the offer.

Challenges in expanding gearing

The managers say that they have wanted to expand the trust's gearing to take advantage of low valuations, but from a practical perspective, this has been difficult.

BGUK has recently received cash from the Ultra Electronics sale and more is expected to come from the sales of HomeServe and Euromoney. This reduces its net gearing by default and, given the less liquid nature of some of its holdings, this can take time to redeploy. The trust has been reducing cash by undertaking repurchases of its shares and these are being financed through existing cash and borrowings where possible, rather than through selling down existing holdings.

Key portfolio themes remain unchanged

As we have discussed previously, BGUK managers are looking for companies that have a number of key attributes (see page 9) and so, whilst they are not thematic investors per se, there are a number of long-running themes that can be seen within the portfolio. Specifically, they like tech generators or tech enabled companies, as well as companies that are R&D driven, as they believe that significant value can be created with innovation. The managers say that, despite the near-term market noise, their key categories have not changed and the underlying trends remain the same. Growth financials continue to be a significant part of the portfolio, reflecting the strong secular growth opportunities available here (for example, with an ageing population, the move away from defined-benefit pensions schemes and the trend towards self-investment).

Key portfolio areas are as follows (figures as at 30 April 2022):

- Growth financials (23.4%) – Hargreaves Lansdown, Legal & General, AJ Bell, Hiscox, St James's Place, Helical, Wise, Prudential, IG Group, Lancashire Holdings, Just Group and IntegraFin.
- Market share gainers (21.1%) – Ashtead, Bunzl, 4imprint, HomeServe, Inchcape, Volution Group and Howden Joinery.
- R&D innovators (10.6%) – Genus, Wayve, Abcam, Oxford Nanopore, Exscientia, Creo Medical and Renishaw.
- The digital consumer (10.8%) – Rightmove, Boohoo.com, Farfetch, Naked Wines, Games Workshop, Auto Trader, Diageo, Burberry Just Eat and takeaway.com.
- The digital enterprise (7.0%) – FDM, Molten Ventures and FD Technologies.
- Niche industrials (7.1%) – Victrex, Bodycote, Halma, and PageGroup.
- Powerful brands (9.4%) – Diageo, Burberry and Games Workshop.
- Data, data everywhere (7.4%) – RELX, Experian and Euromoney Institutional Investor.
- Commodities (2.8%) – Rio Tinto.

We have discussed previously the allocation to Rio Tinto as it might look a little out of place when set against the wider portfolio. The managers say that the company has a diversified portfolio of high-quality assets with key strengths in iron ore, copper and aluminium. They believe that the growing demand for these materials – both to build renewable infrastructure required for the transition into a low carbon economy and to invest in infrastructure – combined with constrained supply growth is expected to result in improved pricing, to which Rio Tinto is exposed.

Unlisted opportunities

At its AGM on 5 August 2021, shareholders approved proposals to allow the trust to invest up to 10% of BGUK's total assets (measured at the time of investment) in private companies. Any private investment needs to have a market valuation in the region of £500m or more, and, crucially, it must offer something that cannot be accessed in the listed space at the time of investment. BGUK's managers say that they are generally interesting opportunities in the late-stage private market and that the trust's closed-end structure is well suited to investing in these.

Since we last published, BGUK has made its first private investment, taking a position in Wayve, which is a company that is using AI technology to try and overcome the hurdles needed to allow vehicles to operate with fully autonomous driving (level 5). The managers say that it has a differentiated approach, which is more scalable and capital light. The position is discussed in further detail on pages 12 and 13.

Otherwise, the managers highlight that there has been a well-documented trend of companies staying private for longer and, in a more challenged macroeconomic environment where raising equity through listed markets becomes more expensive, this will likely be more prevalent. They say that, at present, with listed markets having fallen heavily, there are many opportunities to exploit in the public space and this is where they are focusing their efforts. However, the managers continue to believe that deploying capital selectively into private holdings will be value-accretive over time.

It should be noted that BGUK's private investments are subject to the same bottom-up analysis and debate that is applied to the trust's listed investments (see below). It is also noteworthy that BGUK's managers have an extensive pipeline of unlisted opportunities – over the past 18 months, Baillie Gifford has assessed 140 UK private companies.

Investment philosophy and process

The underlying approach

Baillie Gifford believes that markets are inefficient at pricing long-term growth, especially over a time horizon of at least three years, and that this creates an opportunity to generate alpha. For this reason, it aims to encourage a culture of long-term thinking within the firm. Baillie Gifford believes that there is persistence of good company management, business models and stock prices. This translates into a culture of 'sticking with the winners'.

Three-stage team-based approach

As an investment house, Baillie Gifford has a strong emphasis on using a team-based approach, as it believes that teams make better decisions than individuals. Integral to this is a culture of debate, with a challenge-driven mentality across the firm. Baillie Gifford could be considered as effectively being made up of a small number of investment teams with different strategies. The UK equities team uses a consistent three-stage approach that comprises:

- discovery;
- debate; and
- decision.

There are two lead portfolio managers on the team: Iain McCombie (the head of the team) and Milena Mileva (BGUK's co-managers – see page 27 for their biographies). The team also has a Head of Research, as well as a number of graduates from the company's graduate programme (these rotate every 12 months). In addition, the team has two dedicated ESG analysts who are embedded within the UK team's investment framework.

Stage 1 – Discovery

This is the idea-generation part of the process. Every six weeks the team has their prospects meeting, which sets the research agenda for the following six weeks (the UK stock universe is 500+ stocks and the team has a priority list of around 200 companies). Baillie Gifford holds the view that it is important for both portfolio managers and analysts to carve out time to do their own research. This is part of their objectives and helps to keep them accountable for their investment decisions (as discussed below, while there is considerable debate around stocks, the lead portfolio manager makes the final decision).

For the prospect meeting, team members bring along 'half-formed' ideas to discuss (an analyst or PM may have seen something that has caught their eye and open it up to the wider group). The discussion is open-minded and constructive. Baillie Gifford does not believe in coverage for the sake of having coverage. For example, even if a stock is large, the team will not cover it if there is no expectation of ever wanting to invest in it. That's not to say that the team does not keep an eye on the broader market; they will look at such stocks when looking at the competitive landscape, for example.

In the discovery stage, the team can draw on external research providers and other in-house teams, but Baillie Gifford tries to encourage analysts to hunt for new ideas. They are encouraged to follow their enthusiasms and look at things they are drawn to and are excited about. This frees the analysts, who are all generalists, allowing them to get a broader perspective. It is noteworthy that the analysts are not divided along sector lines and there is no concept of 'maintenance research' at Baillie Gifford. When the team is talking to companies, the conversations with their management teams focus on the long-term prospects of the business.

Iain and Milena are able to draw on the resources of the whole investment team when analysing companies, and can sit in on meetings with companies outside their geographic remit. This is especially beneficial when trying to identify how companies compare with competitors domiciled in other markets.

Stage 2 – Debate

The debate stage is the most important stage of the investment process. It is structured around a concise investment note which, for the UK equities team, is limited to a maximum of three pages, to keep the arguments focused with a clear recommendation at the end (there is, however, no limit on the number of supporting pages that can be attached to the back of the note). Notes are structured around Baillie Gifford's five-question framework:

- **Edge – why is a stock interesting?** This focuses on the industry background, company-specific factors, competitive position and key issues pertinent to the investment case.
- **Growth – what will it look like in five years?** This focuses on sales, profit margins and the capital allocation.
- **Sustainability – what are the governance and sustainability considerations not considered elsewhere in the report?** This focuses on management alignment, board structures and sustainable business practices.
- **Valuation – should we own it?** This focuses on the company's valuation, the reasons why a company should trade well, and the likely valuation in five years and beyond.
- **Discipline – What would make us sell?** This focuses on the key risks and any non-negotiables of the investment case.

In addition, another member of the team will be appointed to play the role of devil's advocate ahead of the discussion. The purpose of this is to uncover assumptions and challenge these so that ultimately a superior recommendation can be reached. The head of the UK equities team, Gerard Callahan, takes detailed minutes of these discussions, which provide an anchor for the team for future discussions. Specifically, Gerard's notes record the risks identified around a stock as well as the reasons for selling. This is important, as it acts as a barrier to analysts and portfolio managers from shifting the goal posts on stocks over time, forcing them to retain their objectivity.

Stage 3 – Decision

In terms of portfolio construction, while the team actively discusses all of the stocks, the final decision as to what enters the portfolio is down to the lead manager, or managers of the respective portfolios. This is designed to give individual accountability on top of the team discussion.

Sell discipline

In terms of sales, loss of faith in a company's management is an instant trigger for a sale. The managers also sell if they feel that a business model is not working, or if the market has caught up with their expectations for a company.

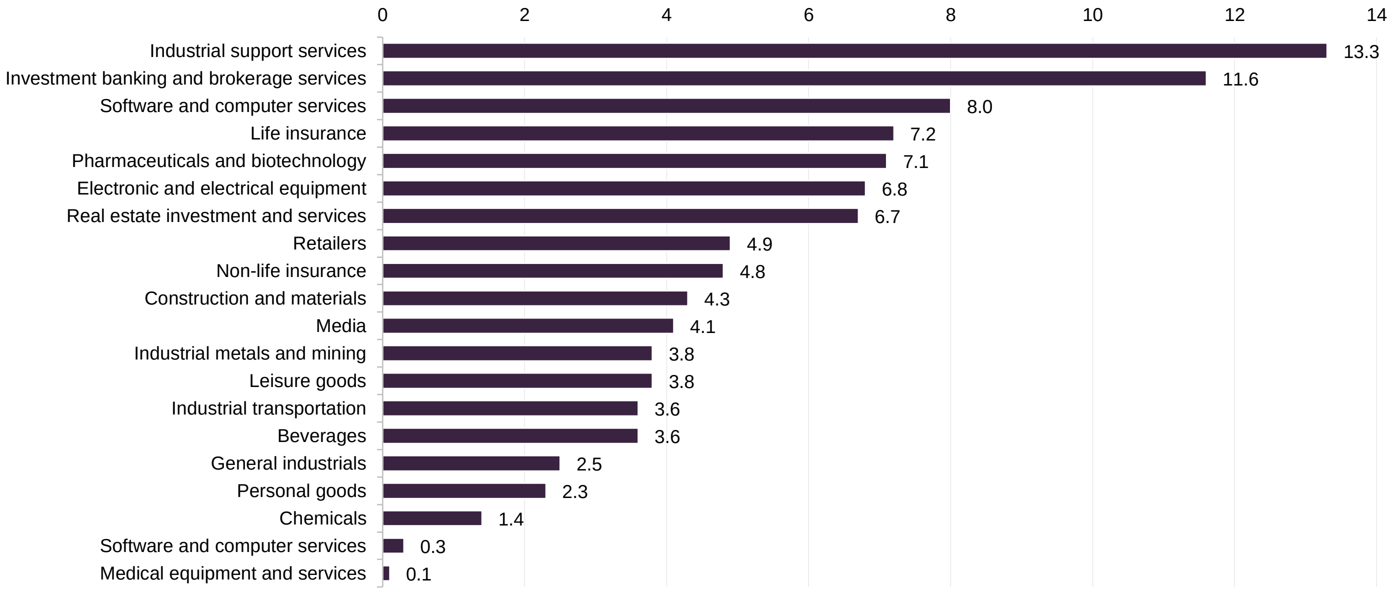
Asset allocation

As at 31 July 2022, BGUK's portfolio had 48 holdings, a decrease of four over the previous 12 months. As illustrated in Figure 7, the portfolio is reasonably concentrated with the top 10 issues accounting for 38.1% of BGUK's total assets as at 30 July 2022; an increase of 1.1 percentage points over the previous 12 months.

Figure 1 provides a breakdown of the portfolio by sector as at the end of July 2022 and illustrates the diverse nature of the investment ideas within the portfolio. It should be remembered that whilst this provides a useful illustration, the allocations are a result of the managers' stock selection decisions and will change based on these, rather than big macro views. As should be expected of a concentrated growth portfolio such as this, which is not managed with respect to a benchmark, there are large chunks of the market to which BGUK offers no exposure.

Reflecting the long-term approach that the managers follow, portfolio turnover tends to be very low (5.3% for the last financial year) and so the evolution of the portfolio's sector allocation will also likely be slow-paced. Unsurprisingly, given the managers' focus on maintaining a focused portfolio of individual growth ideas, the active share will tend to be high (currently around 85%).

Figure 1: Sectoral allocation as at 31 July 2022

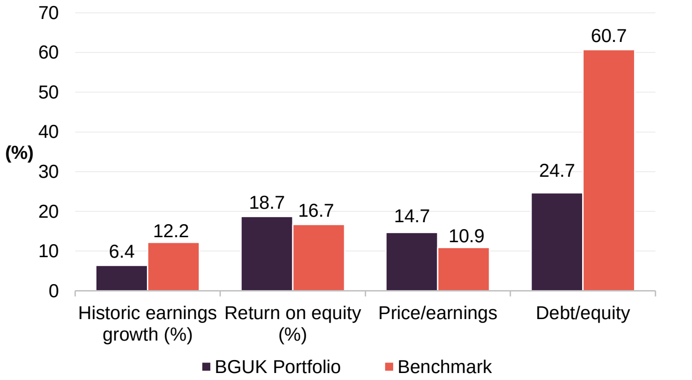


Source: Baillie Gifford UK Growth

Portfolio characteristics

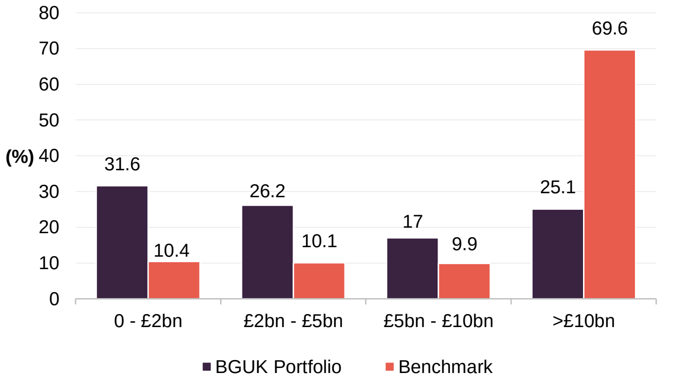
As illustrated in Figure 2, BGUK has a markedly different portfolio to the benchmark. Specifically, while BGUK's portfolio clearly trades at a significant premium to the benchmark, it has a superior return on equity and has much lower debt levels. As illustrated in Figure 3, BGUK's portfolio has a strong bias to mid-cap and small-cap stocks when compared to the benchmark. Once again, this is not something that the managers set out to achieve, but is a result of their stock selections and, specifically, reflects where they are able to find the best opportunities.

Figure 2: BGUK portfolio valuations versus benchmark as at 30 April 2022



Source: Baillie Gifford, Marten & Co. Note Historic earnings growth is trailing five years. Return on equity is 12-month forward estimates. Debt/equity excludes financials.

Figure 3: BGUK portfolio market cap split versus benchmark as at 30 April 2022



Source: Baillie Gifford, Marten & Co

New additions and exits

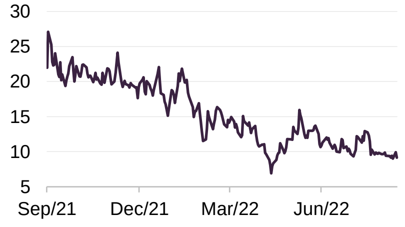
Reflecting the managers' low-turnover approach, the number of stocks entering and exiting the portfolio in a given year is likely to be limited. For example, during the year ended 30 April 2022, five new positions were added: Exscientia, Oxford Nanopore Technologies, Naked Wines, Wayve (this is a new private holding), and Wise, while three positions were exited in their entirety: Ultra Electronics, James Fisher & Sons and Jackson Financial.

Naked Wines was discussed in detail on page 10 of our August 2021 initiation note and we recommend readers see this for more details.

As noted on page 5, Ultra Electronics has left the portfolio as it was subject to a takeover by Cobham (while Home Serve and Euromoney Institutional Investor, which are also subject to recommended bids, are expected to leave the portfolio later this year, assuming that these transactions complete as expected). James Fisher & Sons is a marine engineering services company, which BGUK's managers say has interesting IP. It is exposed to the oil & gas sector and has faced headwinds in the form of low energy prices for a number of years that, when coupled with poor execution, has meant that growth has not come through as anticipated. Jackson Financial was demerged from Prudential in September 2021, resulting in two separate listings. BGUK continues to hold Prudential, but Jackson – which is focused on the US – was not relevant to BGUK's mandate and so the position was sold.

Exscientia – leveraging AI in drug discovery

Figure 4: Exscientia share price (US$)



Source: Bloomberg

Founded in 2012, Exscientia (www.exscientia.ai) is a pharmaceutical technology business based in Oxford that is using Artificial Intelligence (AI) to precision-engineer drug discovery more rapidly. The company's ambition is to address the major inefficiencies associated with the drug discovery process within the small molecules drugs area, which is currently very costly, time consuming and has a high failure rate. Exscientia's technology is trying to address these limitations by applying AI to help navigate big data to derive new insights. By focusing on both design and experiment, Exscientia is able to significantly accelerate the pre-clinical drug discovery stage to enable the delivery of new treatments to patients worldwide. The managers say that there has been a lot of hype around the potential for AI, but it is very interesting to use it in areas that humans are traditionally not so good at.

Exscientia established a collaboration with Sanofi in January 2022 that is focused on development of up to 15 novel small molecule candidates across oncology and immunology. The company received an upfront cash payment of US$100m and has the potential to earn US$5.2bn in total milestones plus tiered royalties. It says that several targets have been identified since the agreement was signed. It also has an agreement with Bristol Myers Squibb and commenced its eighth discovery project with BMS in early 2022 for a yet-to-be-disclosed oncology target.

Oxford Nanopore Technologies – technology and heavy derating make this an attractive proposition

Figure 5: Oxford Nanopore share price

Source: Bloomberg

Oxford Nanopore Technologies (nanoporetech.com) has developed a new generation of sensing technology that uses nanopores (nano-scale holes) that are embedded in high-tech electronics. These can perform direct comprehensive analysis of single molecules. Having successfully developed a novel system for DNA sequencing, the managers are very excited about the broader applications of its technology platform within areas such as scientific research and personalised medicine. The technology's unique combination of accuracy, portability, low cost and real time detection distinguishes it from other analytical tools that are available. The companies' first products sequence DNA and RNA but it says that its sensing platform has the potential to be adapted for the analysis of other types of molecules; for example, proteins. BGUK's managers say that the company is pushing innovation in healthcare and is highly differentiated.

Wayve – BGUK's first private investment

Wayve (www.wayve.ai) is developing software for self-driving cars in London using end-to-end deep learning. Where others have mixed machine learning with rules-based engineering and have divided their systems and organisations into the 'sense, plan, act' paradigm of traditional robotics, Wayve is training a single neural net on the whole problem, without human-coded rules. It uses only cameras, with no LIDAR or HD maps.

Transportation is an enormous market that is cost sensitive and has a constrained supply of drivers. Self-driving vehicles should be much cheaper, more reliable and safer than human drivers, and so should experience a huge amount of demand and, as software products, be very profitable. This is a very difficult problem, but the pay-offs to making a system work and getting regulatory approval are extremely large.

The managers believe that Wayve looks well placed. In theory, its approach is much cheaper and better able to adapt to edge cases and new environments than more traditional approaches, which are yet to be deployed beyond limited pilots, despite the many billions invested. Experts are increasingly speaking of Wayve's approach as the way forward for autonomy, and, despite limited investment and data so far, the company has achieved impressive performance in difficult cities, including ones where it hadn't trained the AI. Now armed with data from its delivery fleet partners, Wayve looks to have the ingredients needed to build the system, prove the safety case and integrate into delivery networks.

Wayve has an extremely high-quality team. The founders' academic records initially attracted some of the best machine learning experts as investors, advisors and employees. Now, some prominent autonomous vehicle veterans are also moving over to Wayve, further validating its approach and readying it for its next set of tasks.

Baillie Gifford gained its exposure through Wayve's US$200m series B fundraising round that completed in January 2022. This round, which brought the total equity raised to over US$258m since inception, was backed by a prominent group of global financial and strategic investors. Eclipse Ventures, a long-time supporter of Wayve, led the round. Along with Baillie Gifford, there was new participation from D1 Capital Partners, Moore Strategic Ventures and Linse Capital, as well as additional support from Microsoft and Virgin. Ocado Group is a strategic investor in the company. The new investment is expected to enhance Wayve's ability to scale and deploy next-generation autonomous technology globally.

Reflecting the risks and early-stage, this is a small (40bp) position, but the managers see strong potential, with a number of potential valuation inflexion points. For example, the company will be starting pilots with Ocado and DPD vans later this year, which will provide the system with an incredible amount of data and Microsoft is building a vision-based supercomputer for them to perform simulations on. The managers say that, hopefully, we will see Wayve deploy its technology in six to seven years' time, but they note that there are still regulatory hurdles to overcome. The UK Regulator is using a statistical approach and developers of autonomous driving systems will need to prove that their systems work and are better than a human driver. One unknown is how much better autonomous systems will need to be.

Figure 6: Wise share price

Source: Bloomberg

Wise – savage derating has created an opportunity

Wise (wise.com), formerly TransferWise, is a London-based fintech company that provides an online platform to send and receive money internationally at low-cost, thereby disintermediating the international money-transfer services of the traditional banks that have charged a premium for this relatively simple service. Having recognised that the process of transferring money abroad is expensive, slow, opaque and inconvenient, Wise is on a mission to improve the process for both individual consumers and businesses. The managers think Wise's strong customer proposition provides a long runway for continued market share gains in what is a large, global, cross-border market. Baillie Gifford owned Wise in its private company portfolios prior to it coming to market, which gave the BGUK's managers a good opportunity to get to know management and the business. The company has continued to develop well in their view but has been subject to a savage derating since October last year as rising inflation has raised concerns about the outlook for the global economy and, for Wise, what this would do to the level of transfers. The managers think that the market doesn't understand Wise's business model properly and that the share price fall has been hugely overdone. Reflecting this, they've been adding to the position and expect they will continue to do so, opportunistically.

Top 10 holdings

Experian, Diageo and Rightmove have moved up into the top 10.

Figure 7 shows BGUK's top 10 holdings as at 31 July 2022 and how these have changed over the 12 months. Reflecting the managers' long-term, low-turnover approach, most of the top 10 portfolio holdings will be familiar to regular followers of BGUK's portfolio announcements.

New entrants to the top 10 are Experian, Diageo and Rightmove. Names that have slipped out of the top 10 are Genus, Howden Joinery and Ultra Electronics.

We discuss some of the more interesting developments in the next few pages.

Figure 7: Top 10 holdings as at 31 July 2022

Holding	Sector	Business	Portfolio weight 31 July 2022 (%)	Portfolio weight 31 July 2021 (%)	Percentage point change
Auto Trader	Technology	UK second had car advertising portal	4.4	3.7	0.7
Volution Group	Industrials	Ventilation equipment supplier	4.4	4.0	0.4
St. James's Place	Financials	UK Wealth management	4.3	4.5	0.2
Experian	Technology	Financial information services	3.8	1.7	2.1
Games Workshop	Consumer discretionary	Toy manufacturer	3.8	3.2	0.6
Ashtead	Industrials	Construction equipment rental	3.6	3.8	(0.2)
Diageo	Consumer staples	Alcoholic beverages	3.6	2.7	0.9
Abcam	Health Care	Online antibody supplies	3.4	3.1	0.3
Rightmove	Real estate	Online property portal	3.4	3.0	0.4
Renishaw	Industrials	Metrology products	3.4	3.4	-
Total of top five			20.7	20.7	-
Total of top 10			38.1	37.0	1.1

Source: Baillie Gifford UK Growth, Marten & Co

Experian (3.8%) – opportunity following sharp derating

Experian (www.experian.co.uk) is an American-Irish multinational consumer credit reporting company with operations in 17 countries globally. Its biggest market is the US, which accounted for 65% of its US$5.4bn of revenues in 2021, followed by the UK and Ireland (14%), Latin America (12%), and EMEA/Asia Pacific (9%). Experian says that it holds and manages the credit history and repayment data of 1.3bn people and 166m businesses worldwide. For consumers, it provides credit scores and credit reports and, for businesses, it provides both marketing and credit services and fraud and ID services.

BGUK's managers consider that Experian benefits from a number of positive growth trends (Experian itself has predicted revenue growth of 7–9% for the current financial year, despite the global economic squeeze) that will see it grow both its consumer services business as well as its business-to-business offering. They comment that its recent operational performance has been better than expected and that it has strengthened its competitive position (there has been considerable investment in the business, and it is now reaping the benefits). Despite this, the company has derated heavily on concerns of rising inflation will restrict its growth (Experian believes that its products can help consumers better manage with higher inflation) and BGUK's managers saw this as an opportunity.

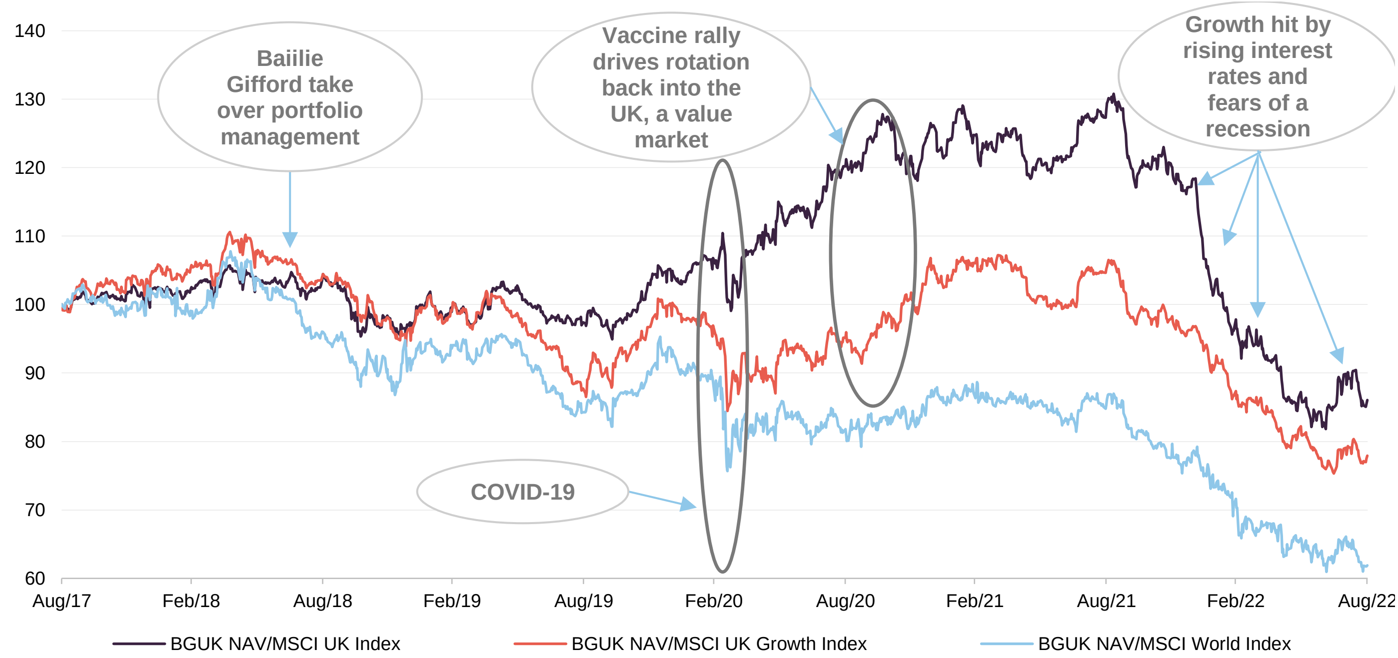
Performance

Up-to-date information on BGUK and its peers is available on the QuotedData website.

Just over four years have passed since the team at Baillie Gifford assumed responsibility for the management of BGUK's portfolio. As is illustrated in Figure 8, BGUK had been markedly outperforming the MSCI UK, MSCI UK Growth and MSCI World, until rising inflation sparked fears of rising interest rates which, when coupled with rising energy prices, particularly in the aftermath of the invasion of Ukraine, led to major fears of a recession. This has driven a significant rotation away from growth, which has had a substantial impact on BGUK, with its strong growth focus, as well as its peers (see pages 18 to 22).

While inflation may continue to move up, there are signs that it is starting to moderate and that the global financial authorities may have done enough to start to get it under control. Current valuations would appear to suggest that the market is pricing in particularly negative outcomes for growth stocks. If the interest rate and growth outlook turn out to be better than the market is currently expecting, this could trigger a rotation back into growth, which could be sharp.

Figure 8: BGUK's NAV total return relative to various indices, over five years to 31 August 2022



Source: Morningstar, Marten & Co

As we have discussed previously, BGUK was able to differentiate itself when COVID-19 was impacting financial markets. At present, many of the factors that were previously tailwinds for the strategy have turned around and become headwinds. However, BGUK's managers follow a deep fundamental investment process and remain convinced of the merits of the trust's portfolio. If these recover as the economy stabilises, now may prove to be a very attractive entry point.

Figure 9: Cumulative total return performance over periods ending 31 August 2022

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	10 years (%)	YTD (%)	BG tenure* (%)
BGUK NAV	(5.5)	(3.5)	(11.1)	(26.9)	0.3	2.5	69.5	(24.5)	(5.7)
BGUK share price	(10.3)	(1.8)	(16.4)	(36.2)	(5.3)	1.7	63.0	(33.9)	(11.7)
MSCI UK	(1.3)	(3.1)	1.2	9.2	13.6	19.3	85.5	3.9	13.0
MSCI UK Growth	(4.2)	0.4	(0.2)	(1.2)	13.0	31.7	117.8	(6.2)	29.0
MSCI World	0.2	2.4	3.0	0.9	36.7	65.8	255.8	(4.0)	56.1
Peer group average NAV	(5.6)	(6.9)	(11.4)	(22.3)	8.3	7.9	118.3	(21.0)	(2.1)
Peer group average share price	(4.5)	(5.2)	(13.0)	(26.3)	8.8	7.9	137.5	(22.9)	(6.8)

Source: Morningstar, Marten & Co

Results for the year ended 30 April 2022

For the year ended 30 April 2022, BGUK provided NAV and share price total returns of -16.0% and -27.9% respectively, both significantly behind the returns on the broader MSCI UK index (15.6%) and the MSCI UK Growth Index (8.4%). It was also markedly behind of its All-Share benchmark, which BGUK's annual report says returned 8.7%. This is a marked turnaround versus the prior year where BGUK provided NAV and share price total returns of 37.7% and 53.7% respectively, both significantly ahead of the returns on the broader MSCI UK index (20.8%) and the MSCI UK Growth Index (18.6%). It was also markedly ahead of its All-Share benchmark, which BGUK's annual report says returned 25.9% for the year ended 30 April 2021.

For the 2021 year, the outperformance for the year came solely in the first half, when investors favoured the trust's growth focus. While BGUK's portfolio rose markedly in absolute terms in the second half of that year, as the market surged in the second half on the back of positive news on vaccines, a rotation into value meant that it lagged the market. Moving into the 2022 financial year, these trends accelerated. More defensive stocks in the oil & gas, banking and pharmaceutical sectors have been in favour (the main indices in the UK are quite heavily skewed towards these sectors, which BGUK tends not to own). Rising interest rates and energy prices, along with rapidly increasing fears of a recession have accelerated the rotation away from growth. BGUK's absolute performance and its performance relative to the broader market indices have suffered, particularly during the second half of the financial year. On the back of this performance, BGUK's managers say that they have spent a lot of time re-examining the fundamentals of the companies in the portfolio and they believe these remain strong.

Low volatility strategy

Figure 10 illustrates that there has been a noticeable increase in volatility YTD, which is evident in the shorter time frames. However, over the course of Baillie Gifford's tenure, BGUK's NAV volatility and share price volatilities have been lower than those of the average of the peer group and have been broadly in line with the peer group over the last 12 months, despite its stronger growth bias. It seems reasonable that, as markets settle, BGUK's NAV and share price volatilities should reduce and could reasonably be expected to trend back to being lower than the peer group average.

Figure 10: Annualised standard deviation of NAV and share price returns to 31 August 2022

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	10 years (%)	YTD (%)	BG tenure* (%)
BGUK NAV	21.28	26.32	29.13	25.45	25.79	22.30	20.16	28.83	23.53
BGUK share price	22.54	31.87	33.23	31.25	35.03	29.12	24.29	34.31	31.12
MSCI UK	8.30	18.82	19.98	18.67	24.23	20.70	18.61	20.52	21.92
MSCI World	18.89	22.85	23.36	20.04	23.33	20.53	17.59	22.66	21.56
Peer group average NAV	18.13	24.85	27.38	24.89	28.08	23.78	21.41	27.51	25.35
Peer group average share price	30.56	35.35	35.49	31.54	39.22	32.94	26.87	34.80	35.20
BGUK NAV volatility ranking in peer group	5/9	4/9	6/9	4/9	2/9	2/9	5/9	6/9	2/9
BGUK share price volatility ranking in peer group	2/9	3/9	3/9	4/9	2/9	1/9	2/9	5/9	1/9

Source: Morningstar, Marten & Co

Peer group

Please click here to visit QuotedData.com for a live comparison of the UK All Companies peer group.

BGUK is a member of the UK All Companies sector, which comprises nine members. All of these are illustrated in Figures 11 through 13 and there has been no change in the composition of this peer group since we last published, although Independent will leave the peer group later this year if its proposed merger with Monks proceeds. Members of UK All Companies will typically have:

- over 80% invested in in quoted UK shares;
- an investment objective/policy to generate majority of returns from capital growth.
- a majority of investments in medium- to giant-cap companies;
- a majority of expenses allocated to capital; and
- a UK benchmark.

It is worth noting that, while the peer group is fundamentally capital-growth-focused, the Baillie Gifford approach is characterised by a particularly strong emphasis on growth, which is a differentiating factor when comparing BGUK to its peers.

As highlighted in the performance section above, Baillie Gifford took over the management for BGUK at the end of June 2018 following a period of poor relative performance under the previous manager, and so has managed the portfolio for a little over four years now.

Figure 11: Peer group cumulative NAV total return performance to 31 August 2022

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	YTD (%)	BG tenure* (%)
BGUK	(5.5)	(3.5)	(11.1)	(26.9)	0.3	2.5	(24.5)	(5.7)
Artemis Alpha	(3.8)	(4.2)	(11.5)	(27.3)	4.3	1.0	(21.3)	(14.1)
Aurora	(6.7)	(6.6)	(14.8)	(7.0)	23.7	14.6	(14.8)	6.3
Fidelity Special Values	(2.3)	(4.7)	0.2	(4.4)	21.8	26.0	(4.2)	16.8
Henderson Opportunities	(4.3)	(9.4)	(12.6)	(20.6)	23.3	19.9	(19.3)	6.4
Independent	(4.3)	(8.9)	(13.1)	(27.5)	(4.1)	(11.1)	(25.1)	(22.0)
JPMorgan Mid Cap	(7.8)	(10.4)	(18.7)	(35.3)	(8.6)	(6.7)	(32.6)	(14.2)
Mercantile	(7.6)	(7.7)	(13.0)	(28.9)	5.0	11.4	(26.2)	1.5
Schroder UK Mid Cap	(8.4)	(6.7)	(7.6)	(22.8)	9.1	13.8	(21.1)	6.5
BGUK rank	5/9	1/9	3/9	5/9	7/9	6/9	6/9	6/9
Sector arithmetic avg.	(5.6)	(6.9)	(11.4)	(22.3)	8.3	7.9	(21.0)	(2.1)

Source: Morningstar, Marten & Co

As illustrated in Figure 11, the sharp rotation away from growth stocks has seen all of the peer group post negative NAV returns during the last 12 months (ranging from -4.4% to -35.3%) with BGUK's fall of 26.9% ranking middle of the pack, despite its markedly stronger growth bias versus its peers. These marked falls have inevitably eaten into the longer-term performance records of all of the funds, but there is the potential for marked recoveries if it turns out that the market is pricing in a steeper slowdown/higher interest rate rises than come to pass. It is also possible that quality growth stocks could navigate an inflationary environment better than some value positions, particularly those in commoditised industries that are unable to pass on cost increases.

Looking at Figure 12, it can be seen that the significant falls in NAV have been reflected in even larger share price falls (an average fall of 22.3% for NAV total return over 12 months versus 26.3% for share price total return), reflecting a marked widening of discounts across the sector. BGUK's managers have a long-term investment style and so we consider that long-term horizons will be superior for assessing the strategy.

Figure 12: Peer group cumulative share price total return performance to 31 August 2022

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	YTD (%)	BG tenure* (%)
BGUK	(10.3)	(1.8)	(16.4)	(36.2)	(5.3)	1.7	(33.9)	(11.7)
Artemis Alpha	(4.8)	(6.3)	(17.3)	(30.5)	16.3	11.2	(24.1)	(7.7)
Aurora	(6.9)	(4.8)	(15.9)	(8.8)	15.2	7.5	(12.7)	(1.6)
Fidelity Special Values	(5.6)	(8.3)	(9.2)	(13.5)	12.1	19.1	(12.8)	7.1
Henderson Opportunities	(0.8)	(7.6)	(11.4)	(19.8)	34.2	29.4	(20.1)	11.2
Independent	15.5	6.8	(0.3)	(18.7)	0.9	(15.6)	(14.3)	(36.8)
JPMorgan Mid Cap	(9.5)	(10.0)	(21.4)	(43.6)	(9.8)	(7.8)	(35.0)	(24.2)
Mercantile	(10.3)	(9.6)	(17.0)	(34.7)	0.2	6.5	(30.1)	(3.8)
Schroder UK Mid Cap	(7.6)	(4.7)	(7.9)	(31.3)	15.3	19.0	(22.9)	6.5
BGUK rank	8/9	2/9	6/9	8/9	8/9	7/9	8/9	7/9
Sector arithmetic avg.	(4.5)	(5.2)	(13.0)	(26.3)	8.8	7.9	(22.9)	(6.8)

Source: Morningstar, Marten & Co

As is illustrated in Figure 13, BGUK is now the third largest fund in the peer group, having edged slightly ahead of Independent, which it is proposed will roll into Monks by way of a Section 110 scheme of reconstruction. All of the peer group have experienced market falls in their market capitalisations since we last published (the sector average has fallen from £550.0m to £403.7m) – a combination both of falling NAVs as investors have rotated away from growth to value and a widening of discounts that has accompanied this. BGUK's market capitalisation still falls below the sector average as the peer group is distorted by the colossus that is Mercantile. Nonetheless, BGUK's market cap remains well above the peer group median of £201.2m (not shown).

When we last published BGUK was the third most expensive (third only to Aurora and Fidelity Special Values), which we felt was in part a reflection of the strength of the Baillie Gifford growth offering in the prevailing climate. The situation has since reversed, with the type of growth strategies offered by Baillie Gifford being markedly out of favour. Reflecting this, BGUK is now much better value.

BGUK's ongoing charges are below the sector average for the peer group, despite the peer group average of 0.69% being pulled down by both Aurora and Independent for reasons explained below. BGUK's ongoing charges ratio is also below the sector median (0.63% versus 0.76%).

Aurora (one of the smaller funds in the sector with a market cap less than half the size of BGUK's) has a particularly low ongoing charges ratio because it does not charge a base management fee. Instead, it charges a performance fee (unlike the overwhelming majority of its peers) to compensate. However, Aurora's is not the lowest, as this spot is occupied by Independent, a self-managed trust (although soon to be absorbed by Monks Investment Trust if the proposed merger proceeds) that does not pay an investment management fee to external fund managers. Instead, it pays a salary to its manager, who is also a shareholder in the trust.

Gearing is another consideration, and this can be more of a concern for investors when markets are at more elevated levels. BGUK's gearing levels (data as at the end of July 2022) are minimal and well below the sector averages. Aurora and Independent continue to have net cash balances (Independent's is significant but could end up being used to fund a cash exit for those shareholders who are not keen on the Monks transaction). These trusts will, therefore, be less exposed in the event that markets continue to fall back, but will suffer more heavily from cash drag if markets rebound.

Figure 13: Peer group comparison – size, fees, discount, yield and gearing as at 12 September 2022

	Market cap (£m)	St. dev. of NAV returns over 5 years	Ongoing charges (%)	Perf. fee	Premium/ (discount) (%)	Dividend yield (%)	Gross gearing (%)[4]	Net gearing (%)[4]
BGUK	**242.8**	**22.3**	**0.63**	**No**	**(14.1)**	**2.4**	**3.1**	**3.1**
Artemis Alpha	**102.2**	**22.5**	**1.05**	**No**	**(11.4)**	**1.8**	**Nil**	**16.5**
Aurora	**155.5**	**24.7**	**0.49**	**Yes[1]**	**(8.1)**	**0.9**	**Nil**	**(4.0)**
Fidelity Special Values	**878.3**	**22.9**	**0.76**	**No**	**(8.0)**	**2.5**	**20.4**	**10.0**
Henderson Opportunities	**86.7**	**22.9**	**0.87**	**Yes**	**(15.9)**	**2.6**	**16.0**	**13.6**
Independent	**240.9**	**19.6**	**0.24**	**No[2]**	**(3.8)**	**1.9**	**Nil**	**(19.0)**
JPMorgan Mid Cap	**201.2**	**27.3**	**0.83**	**No**	**(13.0)**	**3.3**	**10.5**	**9.8**
Mercantile	**1,533.1**	**26.6**	**0.47**	**No**	**(14.0)**	**3.6**	**19.1**	**8.6**
Schroder UK Mid Cap	**193.0**	**25.2**	**0.90**	**No**	**(12.1)**	**2.9**	**11.6**	**11.9**
BGUK rank[3]	**3/9**	**2/9**	**4/9**		**2/9**	**6/9**	**4/9**	**3/9**
Sector arithmetic avg.	**403.7**	**23.8**	**0.69**		**(11.2)**	**2.4**	**9.0**	**5.6**

Source: The AIC, Morningstar, Company factsheets, Marten & Co Notes: 1) Aurora does not charge a base management fee and, consequently, has a particularly low ongoing charges ratio. It charges a performance fee instead, based on the outperformance of its benchmark. 2) Independent is self-managed and does not pay an investment management fee to an external fund manager, which also gives it a very low ongoing charges ratio. 3) Market cap and dividend yield are ranked in increasing size order (the larger the market cap or dividend yield, the higher the ranking). All other rankings are in decreasing size order (the lower the standard deviation of returns, the lower the ongoing charges ratio, the lower the value of the premium/(discount), the lower the gross and net gearing, all correspond to a higher ranking).4) Gross and net gearing are as at 31 August 2022.

When we last published on BGUK, the trust was trading at a small discount (although, when its premium was in excess of 3–4%, it was tending to issue stock), but this has widened significantly so that BGUK is trading at a low double-digit discount. This marked discount widening is a trend that it shares in common with its peers (the peer group average discount has increased from 5.9% to 11.2% in the intervening period) and every peer has seen its discount widen with the exception of Independent, which narrowed following the announcement of the proposed merger with Monks.

As noted above, BGUK, like most of the funds in this peer group, does not pay a performance fee. In common with its peers, within what is a capital-growth-focused sector, BGUK's yield is low and remains fractionally below the sector average. It is noteworthy that, universally, the yields across the sector have increased – a reflection both of a recovery in dividends following the pandemic and a reduction in asset values, as investors have rotated away from growth in the face of rising interest rates. Despite its particularly strong growth focus, BGUK has not been more affected than its peers.

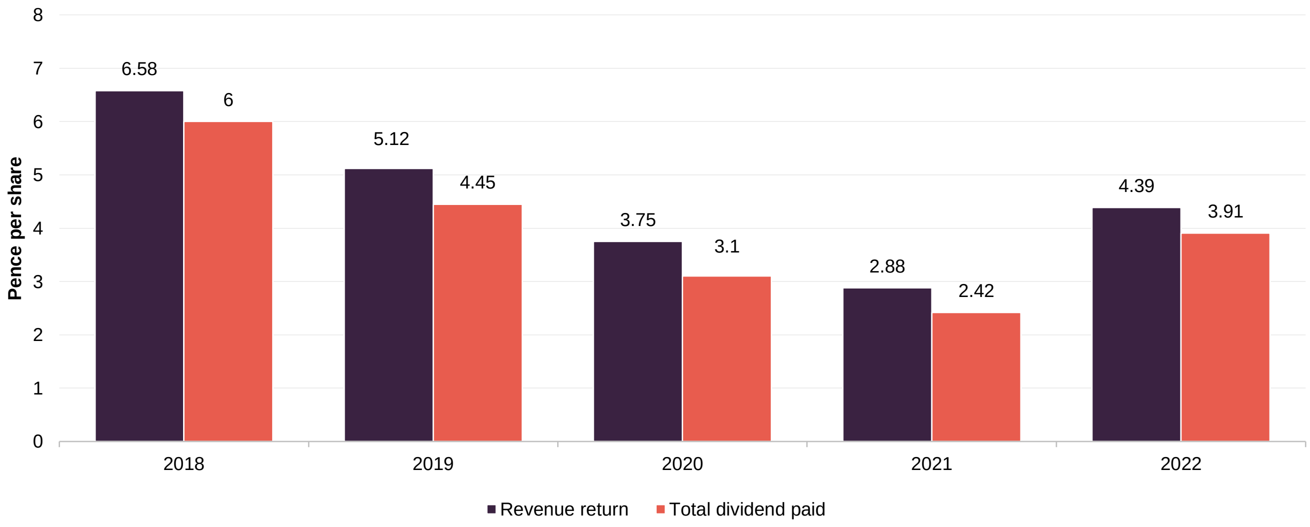
As discussed in the performance section above, the volatility of BGUK's NAV has tended to be one of the lowest in its peer group over the longer term, a feature that has been retained since the management contract moved to Baillie Gifford.

Dividend

BGUK's investment strategy focuses on generating capital growth for shareholders and dividends are paid to the extent that they are required to maintain BGUK's investment trust status. As such, while the UK has traditionally been one of the higher yielding markets, dividends are likely to form a small component of shareholders overall returns and BGUK pays one dividend in post the AGM each year. This is paid as a final dividend, following shareholders' approval at the AGM (now usually in September). For example, for the year ended 30 April 2022, BGUK's board is proposing the payment of a final dividend of 3.91p per share. This is equivalent to a yield of 2.4% on the trust's share price of 160.80p per share as at 12 September 2022.

As BGUK's dividend policy is to pay at least the minimum permissible to maintain its investment trust status after taking account of any variables, and the portfolio is not focused on generating income, it follows that the dividend level may vary from year to year. As is illustrated in Figure 14, which shows BGUK's revenue income and total dividend for the last five financial years (ending 30 April), the dividend was on a declining trend between 2018 and 2021, with a marked uplift in 2022 (an increase in dividends received of 61.6% year-on-year, which in part reflects a recovery following the pandemic when some dividends were cut aggressively).

Figure 14: BGUK revenue income and dividend by financial year (ended 30 April)



Source: Baillie Gifford UK Growth Trust

However, even during the down years, the trend has overwhelmingly been one of paying a covered dividend.

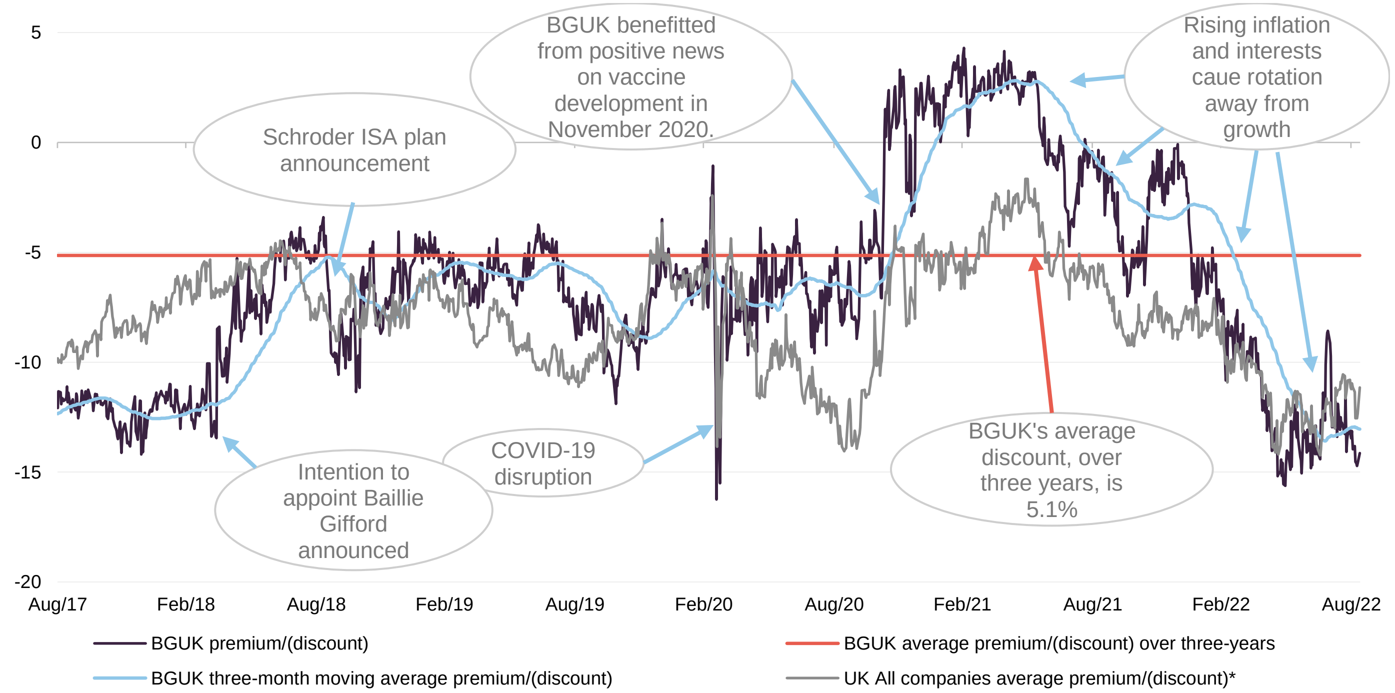
As Figure 14 shows, BGUKs revenue income has exceeded its dividend in recent years allowing the trust to build on its revenue reserve. As at 30 April 2022, BGUK had a revenue reserve of £14.9m or 9.73p per share (30 April 2021: £11.9m or 7.99p per share). BGUK is also permitted to pay dividends out of its capital profits.

Premium/(discount)

Growth rout has pushed discount out towards five-year high

When we last published in August 2021, concerns about the emergence of new COVID variants had triggered a switch back into growth-focused strategies and BGUK had seen its discount narrow so that it was trading around par. Today, there has been a sharp reversal of fortunes so that BGUK is currently trading at discounts that are approaching its five-year high.

Figure 15: BGUK premium/(discount) over five years



Source: Morningstar, Marten & Co

In recent years, markets have been very macro-driven and BGUK, with its strong growth-focused strategy, has benefitted during periods where growth stocks have rallied. At times, this has in part been counter-balanced by the fact that the UK has been treated as a value market by investors (a function of both an overhang from Brexit and the UK's handling of the pandemic, particularly during the early stages), and, consequently, BGUK's discount narrowed in November 2020 when good news on vaccines came through. However, growth is now strongly out of favour as investors fret about rising inflation, rising interest rates, a looming recession and how growth companies might fair in this environment.

As at 12 September 2022, BGUK was trading at a discount of 14.1%, which is approaching a level that is three-times its three-year average discount of 5.1% (one-year range: a discount of 0.08% to a discount of 15.6%). In fact, the current discount is only a few percentage points away from its five-year high of 16.2%, which was seen at the height of the COVID-related panic of March 2020.

As we discussed in our last note, BGUK performed very strongly during the pandemic and so the initial widening was very short-lived, but the current discount level suggests that markets are pricing in particularly negative outcome for BGUK and the growth stocks that it holds.

Clearly, there are good reasons to be concerned but we think that the current discount is overdone, particularly given the strength of the managers' investment process. The managers are looking for growth stocks with an edge – these will tend to have a competitive advantage versus peers, and so should be better placed to weather the effects of a recession, on average. The managers have explicitly established reasons why a company should trade well, have analysed the key risks around the investment and have established what situations would trigger a sell. This should ensure that the portfolio is resilient in more challenging times.

We also think that if the downturn is not as severe as expected, there could be a sharp reversion of BGUK's discount, as has been seen previously. As is illustrated in Figure 15, BGUK has overwhelmingly traded at a marked premium to the peer group since Baillie Gifford's appointment. Baillie Gifford's growth style has been particularly in demand during the last couple of years, but the tendency to trade at a premium to the sector predates this convincingly. We think that, should the outlook improve, BGUK could experience strong means reversion so that it once again trades at a premium to its peers.

Further discussion of BGUK's discount and the key developments highlighted in Figure 15 can be found on pages 20 to 22 of our August 2021 initiation note.

Share issuance and repurchases

BGUK has the authority to issue up to 10% of its issued share capital and repurchase up to 14.99% of its issued share capital, which gives it mechanisms through which it can moderate its premium or discount. The board says that it monitors the level of the company's discount or premium to NAV and will authorise share buy backs when it considers it to be in shareholders' best interests. Whilst there is no formal discount target, the board takes into consideration the trust's discount relative to its peers, the absolute level of discount, discount volatility and the long-term impact on liquidity from share repurchases. Recent experience suggests that it is happy to undertake repurchases in the 10–14% discount range. On the flip side, when BGUK is at a premium, the BGUK's board appears to be happy to see the trust grow in a measured way, and it also appears to be prepared to provide liquidity at premiums of around 4–5%.

Fees and costs

Low base management fee of 0.5% per annum; no performance fee

BGUK's management contract can be terminated at six months' notice.

Under the terms of the investment management agreement, Baillie Gifford is entitled to receive a basic management fee of 0.5% per annum of the trust's net total assets. The management fee is calculated and paid quarterly in arrears and there is no performance fee element. The management agreement can be terminated on six months' notice by either side.

Secretarial and administrative services

In addition to being BGUK's AIFM and investment manager, Baillie Gifford & Co also provides company secretarial and administrative services to the trust. The fees for all of these services are covered by the investment management fee discussed above.

The Bank of New York Mellon (International) Limited acts as both the depositary and custodian to the company. The fee arrangements for these are not disclosed, but are included within the trust's other administrative expenses.

Allocation of fees and costs

In BGUK's accounts, the investment management fees are allocated 30% to revenue and 70% to capital, reflecting the board's expectation of the long-term split of revenue and capital returns. The ongoing charges ratio for the year ended 30 April 2022 was 0.63% (2021: 0.65%). The trend during the last couple of years has been one of a falling ongoing charges ratio as BGUK's asset base has grown (both through share issuance when BGUK has been trading at a premium and through capital growth). With BGUK currently trading at a discount and capital values having fallen recently, it may be that we see a rise in the ongoing charges ratio. However, if either its discount narrows and it is once again able to issue shares, or there is a rebound in asset values, this may reverse.

Capital structure and life

Simple capital structure

BGUK has one class of ordinary share in issue. It can gear up to 20% of net assets.

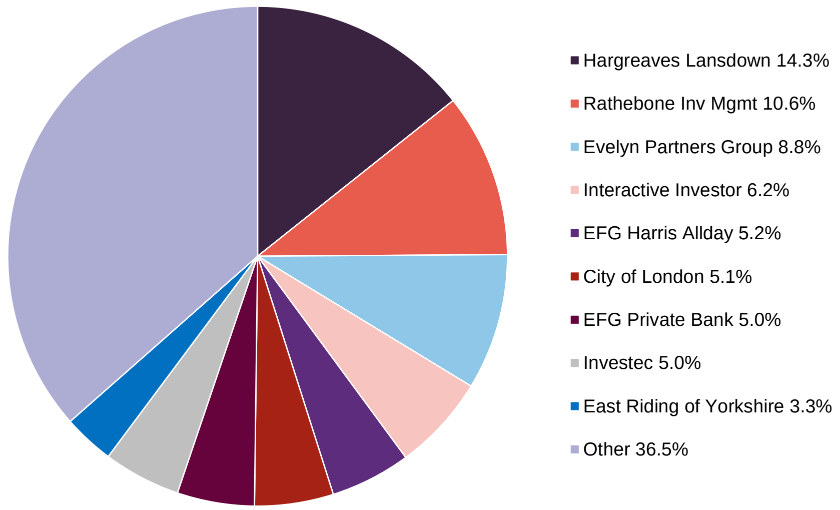
BGUK has a simple capital structure with one class of ordinary share in issue. Its ordinary shares have a premium main market listing on the London Stock Exchange and, as at 12 September 2022, there were 160,917,814 in issue with 8,971,700 of these held in treasury and 151,945,484 otherwise in general circulation.

BGUK is permitted to borrow, although net gearing is not permitted to exceed 20% of total net assets. Within this, the board sets borrowing limits, which it reviews from time to time, to ensure gearing levels are appropriate to market conditions. BGUK has a £30m one-year revolving credit facility with The Royal Bank of Scotland International that expires on 5 July 2023. As at 31 August 2022, BGUK had gross gearing of 3.1% and net gearing of 3.1%.

Major shareholders

BGUK's share register has a strong retail element and, reflecting this, there are a significant number of trading platforms and private client wealth managers that are prominently visible within BGUK's share register.

Figure 16: Major shareholders as at 12 September 2022



Source: Bloomberg, Marten & Co

Unlimited life with a five-yearly continuation vote

BGUK does not have a fixed winding-up date, but every five years, shareholders are given the opportunity to vote on the continuation of the company as an investment company at the annual general meeting (AGM). This is a special resolution. If this resolution were not passed, the board would put forward proposals to liquidate or otherwise reconstruct or reorganise the company. BGUK shareholders approved the last continuation vote at the August 2019 AGM. The next continuation vote is scheduled for the company's AGM in 2024.

Financial calendar

The trust's year-end is 30 April. The annual results are usually released in June or July (interims in November or December) and its AGMs are usually held in September of each year. As discussed on pages 22 and 23, BGUK pays one final dividend a year post the AGM if one is required to be paid.

Corporate history

Baillie Gifford has been managing BGUK for just over three years.

BGUK is a UK investment trust that was originally incorporated on 28 January 1994 as the Schroder UK Growth Fund Plc. The trust, which listed on the London Stock Exchange following its IPO on 10 March 1994, has a premium main market listing. On 13 April 2018, the trust's board announced that it had decided to terminate the management arrangements with Schroder Unit Trusts Limited and appoint Baillie Gifford & Co Limited in their stead. Baillie Gifford was appointed with effect from 30 June 2018, with the trust changing its name to Baillie Gifford UK Growth Fund Plc at the same time. On 25 May 2021, the trust changed its name to Baillie Gifford UK Growth Trust Plc. Baillie Gifford has now been managing BGUK for just over four years.

Management team

Iain McCombie

Iain joined Baillie Gifford in 1994 and has spent the majority of his career as an investment manager in the UK equity team. He became a partner in 2005. Iain graduated MA in Accountancy from the University of Aberdeen and qualified as a Chartered Accountant.

Milena Mileva

Milena joined Baillie Gifford in 2009 and is an investment manager in the UK equity team. She became a partner in 2022. Milena graduated BA in Social & Political Science from the University of Cambridge in 2007 and MPhil in Politics from the University of Oxford in 2009.

Board

BGUK's board comprises four directors, all of whom are non-executive and considered to be independent of the investment manager. Cathy Pitt is the most recent addition, having been appointed with effect from 5 August 2021, following the retirement of Scott Cochrane. Her appointment was not sufficiently progressed to allow it to be ratified at last year's AGM, so this took place at this year's AGM instead.

All directors stand for retire and stand for re-election annually.

BGUK's articles of association require that newly-appointed directors offer themselves for re-election at the next AGM. It is board policy that all directors retire and offer themselves for re-election at each AGM. The average length of service is 4.7 years, with Carolan Dobson, the chairman, being the longest-serving director, with 8.5 years of service.

Other than BGUK's board, its directors do not have any other shared directorships. The company's articles of association limit the aggregate fees payable to the directors to a total of £200,000 per annum, with any increase requiring shareholder approval.

Figure 17: Board member – length of service and shareholdings

Director	Position	Date of appointment	Length of service (years)	Annual fee (GBP)[1]	Shareholding[2]	Years of fee invested[3]
Carolan Dobson	Chairman	13 March 2014	8.5	40,600	26,949	1.1
Andrew Westenberger	Chair of the audit committee	15 November 2018	3.8	33,100	20,000	1.0
Cathy Pitt	Director	5 August 2021	1.1	29,100	5,362	0.3
Ruary Neill	Senior independent director	5 May 2017	5.4	30,600	20,000	1.1
Average (service length, annual fee, shareholding, years of fee invested)			4.7	33,350	18,078	0.8

Source: Baillie Gifford UK Growth Trust, Marten & Co Notes: 1) Director's fees are those expected for the year ended 30 April 2023. The chairman, audit committee chair and senior independent director positions have earned higher fees historically than other directors reflecting the additional responsibilities of these positions. 2) Shareholdings as per most recent company announcements as at 12 September 2022. Years of fee invested based on BGUK's ordinary share price of 160.80p as at 12 September 2022.

Recent share purchase and disposal activity by directors

Since we last published, Cathy Pitt has made her first purchase of BGUK shares since her appointment, with the purchase of 5,362 shares on 7 April 2022 at 185.42p per share. Following this transaction, all of BGUK's directors have personal investments in the fund, which we consider to be favourable as it helps align directors' interests with those of shareholders.

The levels of shareholdings of the remaining three directors' shareholdings were unchanged over the year ended 30 April 2022 and all directors' shareholdings have remained at the same levels so far for the current financial year.

The average interest is equivalent to 0.8 years or more of their fees, down from 1.7 years when we last published. While there has been a modest increase in directors' fees during the intervening period (we estimate an average increase of 5.3%), the main reason for the reduction has been the fall in BGUK's share price, which has impacted all of the directors. The fact that the board continue to have skin in the game may provide some additional comfort for shareholders.

Carolan Dobson (chairman)

Carolan has had a long career in fund management. She was previously head of UK equities at Abbey Asset Managers, and held a number of positions at Murray Johnstone, rising to be head of investment trusts, where she managed Murray Income Trust Plc.

Carolan was appointed to BGUK's board in March 2014 and subsequently became Chairman at the conclusion of the company's AGM on 4 August 2016. She is also chairman of the nomination committee and of the management engagement committee. Carolan is also the chairman of Brunner Investment Trust Plc and Blackrock Latin American Investment Trust Plc. She was previously a director of Woodford Patient Capital Trust Plc (now Schroder UK Public Private Trust Plc), Aberdeen Smaller Companies Income Trust Plc and JPMorgan European Discovery Trust Plc.

Andrew Westenberger (chairman of the audit committee)

Andrew is a Chartered Accountant and is currently chief financial officer of Integro Insurance Brokers and Tysers, an independent specialist broker and risk management firm. He is also a non-executive director and trustee of the Chartered Institute of Securities and Investments. Previously, he was group finance director of Brewin Dolphin Holdings Plc and Evolution Group Plc. He has also held senior finance roles at Barclays Capital and Deutsche Bank.

Cathy Pitt (director)

Cathy is a consultant partner at CMS specialising in investment funds, with particular responsibility for investment companies. She has over 20 years' experience as a senior corporate legal adviser in the investment management and investment trust sectors, with expertise in investment management regulation, investment company corporate affairs, capital markets and corporate governance. Cathy is also a non-executive director of Gresham House Energy Storage Fund Plc.

Ruary Neill (senior independent director)

Ruary has had a career in investment banking. He has worked for UBS Investment Bank in the UK, prior to which he spent several years in the financial sector working in Asian Equity Markets for UBS Investment Bank and Schroder Securities. Ruary is currently a director of JP Morgan Emerging Markets Investment Trust Plc and is a member of the Advisory Board, SOAS China Institute, London University.

Previous publications

Readers interested in further information about BGUK may wish to read our initiation note, ***"Looking way beyond the now"***, published on 18 August 2021. You can read the note by clicking on the link or by visiting our website.

IMPORTANT INFORMATION

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