BAILLIE GIFFORD | *Long Term Global Growth*

Reflections

February 2023

Rising from the ashes

For growth companies, the last year or so has been a forest fire. While the blazing spectacle of share price drawdowns looks utterly destructive, it is ultimately nourishing. Deadwood is burned, making space for the green shoots of more capital efficient growth. The strong are separated from the weak and those which survive are left more robust.

This differentiation between the healthy and the brittle is the overlooked positive consequence of a higher cost of capital. When money is cheap, companies can – and therefore often do – spend first and ask questions later. When rates were near zero, any project returning more than nothing could be justified. In such environments, companies find it hard to maintain high capital allocation hurdles and a sense of direction about what not to invest in. When markets don't force this discipline, it requires exceptional independence of mind and strategic clarity to exercise restraint.

Now, as capital costs have increased, unruly companies have been required to pull back, while the disciplined outliers have been able to forge ahead and win share from those in retreat. This has been the clear theme emerging from our interactions with several LTGG holdings and we have been excited to see the strength of the green shoots across the portfolio.

The Trade Desk, held in LTGG since 2021, has long believed that growing companies – like children – are spoiled by abundance. CEO Jeff Green therefore insisted on reaching profitability off just $7m in outside capital, an exceptional achievement. This crucial milestone of self-sustenance allowed the company to reinvest its earnings and deepen its technological advantage. While remaining consistently profitable for eight years, The Trade Desk has grown revenue >35x and gained market share.

The competitive advantage from longstanding strategic clarity and financial discipline has enabled The Trade Desk to continue growing more than 3x faster than the rest of the advertising market in 2022. The company now sits on over $1bn in cash with no debt, while structural tailwinds in streaming TV advertising can support continued growth. This, coupled with financial discipline, will allow the company to put clear water between itself and competitors for many years to come.

Roblox is also benefiting from enduring capital-efficiency. This user-generated gaming platform, a holding since 2022, was already generating cash and self-financing at $100m in revenue, thanks to network effects powering organic customer acquisition. With operations remaining highly cash-generative, and with over $2bn in net cash on its balance sheet, Roblox has had the confidence to ramp its investments in infrastructure and R&D to continue deepening its ecosystem of users and game developers over the past year. The near-term benefit has been healthy growth in bookings, but the larger long-run payoff stands to be formidable competitive advantage in a gaming market which remains early in its evolution.

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Examples like these remind us of Google rushing out to hire engineers in the carnage of the dotcom bust – a countercyclical planting of green shoots which we consider pivotal to that company establishing what was one of the most enviable competitive positions in corporate history. We see uncanny echoes of this in the payment industry today, with Adyen continuing to hoover up discounted engineers to ramp innovation while its most serious competitor, Stripe, had to lay off 14 per cent of staff and dial back growth.

Adyen has long eschewed external capital, with a stubborn preference for self-sustaining growth. This was not rewarded when capital was cheap but is plainly beneficial now, as Adyen's expansion can continue regardless of the cost of capital going up. Adyen's processed payment volumes grew more than twice as fast as Stripe's in 2022 and Adyen continues to book 52 per cent EBITDA margins even after its opportunistic countercyclical investments. And so, as Stripe must divert energy to walking back its mistakes – burning the deadwood it has amassed through ruinous abundance – Adyen continues to get stronger.

Although these companies are exceptional when compared to the rest of the market, they are not the exception in the LTGG portfolio. This is no accident. The 10-question stock research framework, the longstanding bedrock of our investment process, places emphasis on differentiated management (Question 4: 'Is the business culture differentiated?') and prudent resource allocation (Question 8: 'How do they allocate capital?').

Our long-term investment horizon demands that we prioritise these factors. The payoff is a portfolio which a typical growth manager would envy in the current environment: with more than two thirds on net cash, compared to one quarter for the index, and more than 80 per cent of our holdings generating positive earnings or cash flow, even as the most recent weighted average revenue growth remains 21 per cent year on year in a difficult operating environment.

The LTGG portfolio therefore skews heavily toward companies which are masters of their own fate, like those described above. When we emerge from the ashes, with the deadwood cleared, they will be stronger than ever.

Important information and risk factors

Annual Past Performance to 31 December Each Year (Net %)

	2018	2019	2020	2021	2022
LTGG Composite	-1.6	34.1	102.0	2.4	-46.4
MSCI ACWI	-8.9	27.3	16.8	19.0	-18.0

Annualised returns to 31 December 2022 (Net %)

	1 Year	5 Years	10 Years	Since Inception*
LTGG Composite	-46.4	7.9	13.2	10.5
MSCI ACWI	-18.0	5.8	8.5	7.2

*Inception date 29 February 2004.

Source: Baillie Gifford & Co and MSCI. US Dollars.

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