

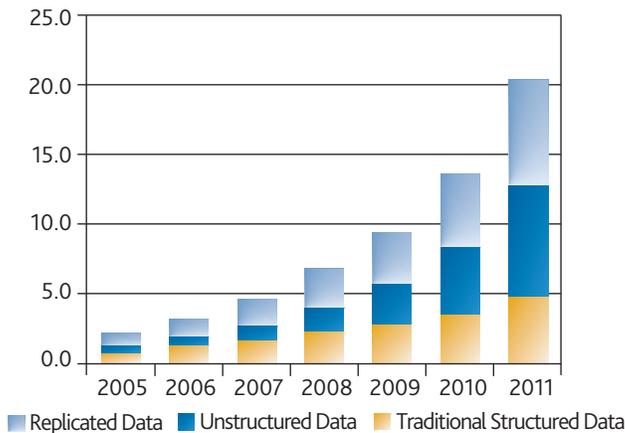
Information Services Drive Business Efficiencies

As investors, we search for market leaders across a range of industries, from industrials to energy, consumer to financials, and healthcare to hospitality. Despite the diversity of end markets, these companies all share the need to maximize revenue and improve their operating efficiency. Companies turn to business service providers in order to achieve these goals. Information, professional and business services vendors represent almost 17% of domestic GDP according to the Bureau of Economic Analysis. These businesses offer a wide range of services, from legal, accounting, and tax preparation to payroll processing, outsourcing services, a wide range of consulting services.

At Baron, we have found investment opportunities across many niches within business services. The most compelling investment opportunities are a subset of the market that we call information services.

Information services businesses are benefitting from secular global growth in data. According to IDC, data volumes will grow at a 45% CAGR through 2015 from 1.8 trillion gigabytes to 7.9 trillion gigabytes. This is happening due to the proliferation of network-enabled devices, advances in computing like SaaS (Software as a Service) and virtualization, and changes in the way consumers and businesses use technology. This is driving significant growth in structured data from traditional applications such as ERP and CRM systems, and even faster growth in unstructured data from almost an endless vari-

DATA VOLUME AND VARIETY ARE EXPANDING



Source: Engineering and Technology Magazine

ety of sources that include text, audio, video, email and web content.

Businesses are confronted by a deluge of data. They turn to information services vendors to help identify the “needles” of high quality data in this vast haystack, and to assist in extracting insightful information that will help them make better operational decisions.

Information services vendors all start with a highly valuable proprietary asset, such as a unique data set or an unparalleled team of analysts or PhDs. Much of the required investment is in collecting the underlying data and creating the tools, which gives information services businesses high operating leverage. Most products are delivered electronically, so while it is expensive to create the first product, it costs almost nothing to produce the second or third.

Many of the leading companies have invested decades of time and hundreds of millions of dollars to develop their core assets, giving them significant barriers to competition. These vendors then build robust analytical tools that allow end users to extract, manipulate, and apply the underlying data to everyday business problems.

The proprietary information and accompanying analytical tools eventually become a critical part of the end users’ day-to-day workflow in the same way that Microsoft Office has become the standard for every office worker. Old habits are hard to break, creating a sticky business model. Leading information services businesses generate retention rates that are above 90%.

Information services companies generate tremendous amounts of free cash flow. Many information services businesses are selling more and more high-margin subscriptions, enabling them to expand their margins on an annual basis and grow rapidly. Just like publishers who sell magazine subscriptions, information services companies generally get paid at the beginning of the year while they deliver their product over the following twelve months. Additionally, the capital expenditures required to run these businesses are low. Unlike building a car or a



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plane, which requires huge factories and heavy equipment, information services companies' tools are computers and telephones, which are cheap to purchase and maintain. The best companies use their cash to pay down debt, repurchase stock, pay a dividend, or invest in the future growth of the company.

Within the information services space, we have made selective investments in the vendors that have large and growing addressable markets and are benefitting from positive secular trends.

One company that we believe epitomizes what we look for in an information services investment is Gartner. Gartner is the leading independent provider of research and analysis on the information technology industry. IT is becoming increasingly strategic to businesses, as companies of all sizes look to deal with the challenges and opportunities presented by growth of social technology, mobile handsets, cloud computing, and a tidal wave of "big data".

Gartner's research business employs a team of 810 analysts who track, evaluate and quantify technological developments. Analysts come to Gartner after a minimum of 10 years of experience in their field, so they have deep industry expertise, real world experience, and a wide range of industry contacts.

We believe Gartner has a vast untapped market opportunity. With 2011 research revenue of \$1 billion, the company is serving just over 2% of its addressable market. The company has just 1,200 salespeople, and currently covers just 31% of the 108,000 companies that it will ultimately be able to target. Of the potential clients that Gartner's sales force actively covers, less than 25% are currently clients.

The Gartner brand is highly valued in the IT community, and quickly becomes a critical part of a user's daily workflow. Every year, Gartner's clients view 5.5 million research documents, conduct 290,000 calls or meetings with analysts, tap into a terabyte of continuously updated market data, and have 2,300 contracts reviewed. This leads to close to 100% of clients renewing their contracts with Gartner each and every year. Given its high value and low churn, Gartner is also able to raise prices, generally at a 3 to 6% annual rate.

Gartner also demonstrates the operating leverage inherent in information services models. Margins are currently running around 19%, up from 12% just 7 years ago, and we still see a long runway for expansion. Finally, Gartner has generated a tremendous amount of cash. In 2011 alone, the company generated over \$200 million of free cash flow, which it primarily uses to repurchase stock.

Another exciting information services investment is Nielsen Holdings. Nielsen is a global information and measurement company that provides clients with a comprehensive understanding of consumers and consumer behavior. The company is geared toward delivering critical media and marketing information and analytics about "what consumers watch" and "what consumers buy" on a global and local basis. The "Watch" business has become the de facto standard for measuring television audiences in the U.S. Nielsen uses a combination of technology and panel surveys to gather granular data about television viewership trends and demographics, which it then compiles into ratings using its proprietary methodology. Nielsen's ratings are so critical to selling TV advertising that they have effectively become

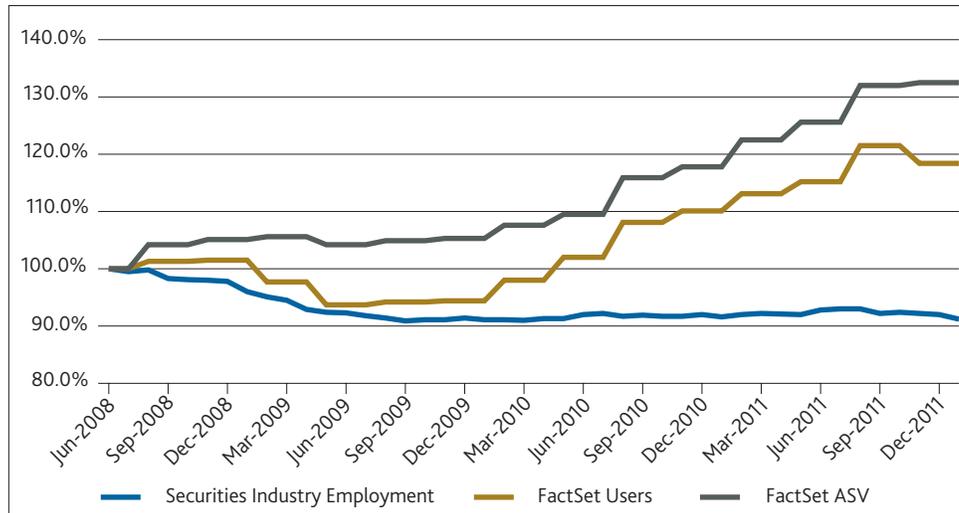
a currency to broadcasters and advertisers, with all TV ads bought, sold, and settled based on Nielsen data. The company is now leveraging its data collection expertise, infrastructure, and methodologies to generate ratings for online ads and for mobile campaigns.

Nielsen's "Buy" business combines the use of technology and panels to build a global database of retail transactional measurement data. The data is then used by consumer packaged goods (CPG) companies and retailers to measure sales and market share, improve brand management, uncover new sources of demand, launch and grow new products, analyze sales, improve marketing mix, and establish more effective consumer relationships. We are excited about Nielsen's ability to expand its global coverage into developing markets, thereby providing its clients with enhanced insight into a vast and growing population of emerging middle class consumers. We believe Nielsen is uniquely positioned to provide measurements in developing markets given its scale, brand, and unique ability to provide global clients with a standard measurement methodology around the world.

We think Nielsen's proprietary data, unique analytical capabilities, and pristine brand serve as extremely high barriers to entry. Nielsen data is deeply integrated into the business processes of its clients, making its data and services extremely sticky, and providing the company with high retention rates and pricing power. The company has benefited from strong operating leverage given the high fixed costs involved in collecting and processing billions of transactions monthly. The company has generated robust free cash flow given the modest capital investments required to run its business.

“We invest in people, not just buildings.”

FACTSET IS TAKING MARKET SHARE



Source: Bureau of Labor Statistics, FactSet

Finally, we want to highlight our investment in FactSet as a unique example of our information services investment strategy. FactSet is a rapidly growing supplier of financial intelligence to the global investment community. FactSet's core applications include tools that help investors perform detailed, data driven analysis on individual companies and industries, screen for new investment ideas, monitor markets via real-time news and quotations, and better understand the components of portfolio performance. FactSet's core assets include its proprietary databases and unique and flexible analytical capabilities.

We estimate that the company's product line address an \$11-\$16 billion subset of the financial intelligence market, implying an opportunity 15 to 22 times larger than the \$725 million in revenues earned in 2011. On a user basis, FactSet currently has just 47,300 subscribers out of a market that currently includes over 600,000 potential users.

Like most information services companies, FactSet has generated high incremental margins. However, instead of reporting margin expansion like many of its peers, the company has aggressively reinvested its profits back into its business to improve its R&D, sales, and support functions. We believe this has been a key driver of the company's ongoing market share gains, allowing FactSet to prosper despite end markets that are less than robust. Over the last 12 months, FactSet has added \$80 million of new annual subscription volume (representing more than 11.1% year over year organic growth), while global market data spending has only grown around 3%. The most telling statistic, as shown in the chart above, overall domestic industry headcount is currently down 8.8% off its peak in June 2008, while FactSet's user count and annual subscription volumes have grown 18% and 31%, respectively, over the same period.

Like most information services companies, FactSet generates outstanding cash flow. The company is not particularly acquisitive, preferring to rely on organic product development to improve its product portfolio. Therefore, the company has been able to return its excess cash above its reinvestment to shareholders. Over the last 12 months, the company returned almost \$250 million of cash to shareholders, including \$202 million of share repurchases and \$47 million of dividend payments.

We expect data growth to continue unabated. Companies of all types will need to identify high quality information and turn it into insights that can be impactful on their businesses. We think leading information services vendors will continue to benefit from this trend, and are uniquely able to convert sustained demand for their products into growing levels of cash generation. Overall, we are extremely excited about the opportunity to invest in best-in-class information services companies.

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The discussion of market trends and companies throughout this report are not intended as advice to any person regarding the advisability of investing in any particular security. Some of our comments are based on current management expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time of the publication of this report and are subject to change any time based on market and other conditions, and we have no obligation to update them. Investing in the stock market is always risky.

As of 3/31/2012, certain Baron Funds held positions in the companies mentioned in this newsletter. Their percentage of assets for each of these companies and their top holdings were as follows: **Baron Asset Fund** are: Gartner, Inc. 4.2%, IDEXX Laboratories, Inc. 3.8%, Equinix, Inc. 3.7%, Fastenal Co. 3.6%, Ralph Lauren Corp. 3.1%, Verisk Analytics, Inc., 3.1%, SBA Communications Corp., 3.0%, priceline.com, Inc. 2.8%, Mettler-Toledo International, Inc. 2.7%, Arch Capital Group Ltd. 2.7%, FactSet Research Systems, Inc. 2.5%, Nielsen Holdings N.V. 2.0%. **Baron Focused Growth Fund** are: Hyatt Hotels Corp. 6.9%, Verisk Analytics, Inc. 6.1%, Fastenal Co. 5.5%, Genesee & Wyoming, Inc. 5.0%, Airgas, Inc. 5.0%, AMERIGROUP Corp. 4.9%, Dick's Sporting Goods, Inc. 4.9%, American Campus Communities, Inc. 4.5%, MSCI, Inc. 4.5%, Booz Allen Hamilton Holding Corp. 4.3%, FactSet Research Systems, Inc. 3.5%. **Baron Growth Fund** are: Dick's Sporting Goods, Inc. 3.7%, Core Laboratories N.V. 2.8%, ITC Holdings Corp. 2.8%, FactSet Research Systems, Inc. 2.6%, AMERIGROUP Corp. 2.6%, Arch Capital Group Ltd. 2.5%, Mettler-Toledo International, Inc. 2.4%, MSCI, Inc. 2.4%, ANSYS, Inc. 2.3%, Equinix, Inc. 2.2%, Gartner, Inc. 1.9%. **Baron Opportunity Fund** are: Equinix, Inc. 4.1%, Gartner, Inc. 3.4%, SBA Communications Corp. 3.0%, RealPage, Inc. 3.0%, CARBO Ceramics, Inc. 2.8%, CoStar Group, Inc. 2.8%, priceline.com, Inc. 2.7%, Polypore International, Inc. 2.6%, Velti plc 2.4%, ANSYS, Inc. 2.3%, FactSet Research Systems, Inc. 1.1%. **Baron Partners Fund** are: Fastenal Co. 10.5%, ITC Holdings Corp. 9.9%, Hyatt Hotels Corp. 9.2%, Arch Capital Group Ltd. 9.0%, Dick's Sporting Goods, Inc. 9.0%, FactSet Research Systems, Inc. 8.5%, Verisk Analytics, Inc. 6.7%, The Charles Schwab Corp. 5.6%, MSCI, Inc. 4.7%, C.H. Robinson Worldwide, Inc. 4.5%. **Baron Small Cap Fund** are: SBA Communications Corp. 3.4%, TransDigm Group, Inc. 3.4%, Equinix, Inc. 3.3%, Penn National Gaming, Inc. 3.2%, Liberty Media Corp. 2.7%, Fossil, Inc. 2.4%, Gartner, Inc. 2.3%, Clean Harbors, Inc. 2.1%, Waste Connections, Inc. 2.0%, Intuitive Surgical, Inc. 2.0%.

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We offer twelve mutual funds* in Retail as well as Institutional Share Classes, Separately Managed Accounts, Sub-Advisory Services* and an Offshore Fund.

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BARON SMALL CAP GROWTH

BARON SMID CAP GROWTH

MUTUAL FUNDS

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BARON EMERGING MARKETS FUND (BEXFX, BEXIX)

BARON ENERGY AND RESOURCES FUND (BENFX, BENIX)

BARON FIFTH AVENUE GROWTH FUND (BFTHX, BFTIX)

BARON FOCUSED GROWTH FUND (BFGFX, BFGIX)

BARON GLOBAL ADVANTAGE FUND (BGAFX, BGAIX)

BARON GROWTH FUND (BGRFX, BGRIX)

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