

# Baron Growth Fund

## DEAR BARON GROWTH FUND SHAREHOLDER:

### PERFORMANCE

Baron Growth Fund performed well during the March 2013 quarter. The Fund gained 13.38%. U.S. stock markets also achieved strong performance during the period. The Russell 2000 Growth Index, the benchmark small company growth index against which we compare Baron Growth Fund's performance, gained 13.21% during the quarter. This is despite investor concerns that "sequestration" would slow U.S. economic growth and that tiny European nation Cyprus would default and exit the Euro. The market's strong performance in the face of such concerns demonstrates the futility, in our opinion, of attempting to "trade the news" rather than attempting to invest in businesses for the long term. Our outlook for stocks remains favorable. This is because stocks are valued below their median valuations for the past century; businesses are growing; and stocks historically have provided better returns and better protection against inflation than other asset classes.

U.S. markets also performed well during the first three months of 2013. Baron Growth Fund's performance approximated the performance of its benchmark during the period. This follows two years, 2011 and 2012, in which Baron Growth Fund outperformed its benchmark. Although Baron Growth Fund slightly trailed its benchmark's results in the four year period

**Table I.**  
**Performance (Retail Shares)**  
**Annualized for periods ended March 31, 2013**

	Baron Growth Fund <sup>1,2</sup>	Russell 2000 Growth Index <sup>1</sup>	S&P 500 Index <sup>1</sup>
Three Months <sup>3</sup>	13.38%	13.21%	10.61%
One Year	21.08%	14.52%	13.96%
Three Years	15.84%	14.75%	12.67%
Five Years	8.58%	9.04%	5.81%
Ten Years	11.66%	11.61%	8.53%
Fifteen Years	9.03%	4.12%	4.27%
December 31, 1999 – March 31, 2013			
"The Bad Times"	7.99%	2.66%	2.41%
December 31, 1994 - December 31, 1999			
"The Good Times."	29.90%	18.99%	28.56%
Since Inception (December 31, 1994)			
"All the Times."	13.60%	6.90%	8.99%

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares as of September 30, 2012 was 1.32%. *The performance data quoted represents past performance. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost. The Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit [www.BaronFunds.com](http://www.BaronFunds.com) or call 1-800-99BARON.*

<sup>1</sup> The indexes are unmanaged. The Russell 2000® Growth Index measures the performance of small-sized U.S. companies that are classified as growth and the S&P 500 Index of 500 widely held large-cap U.S. companies. The indexes and the Fund are with dividends, which positively impact the performance results.

<sup>2</sup> The performance data in the table does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.

<sup>3</sup> Not annualized.



**RONALD BARON**  
**CEO AND PORTFOLIO MANAGER**

**Retail Shares: BGRFX**  
**Institutional Shares: BGRIX**

from 2007 through 2010, the Fund outperformed its benchmark by 670 basis points per year on average since its inception on December 31, 1994. Of course, you cannot rely on past performance to project future results. You can be certain, however, that we have not changed our research intensive, investment process.

We are proud of Baron Growth Fund's performance from its inception on December 31, 1994 through December 31, 1999, in what we call the "Good Times." We are equally proud of Baron Growth Fund's performance record during the past 13 years, the most difficult period for financial markets in the history of America.

After the Internet bubble burst in early 2000, our benchmark index fell about 50% through 2002. This decline was so dramatic because stocks in 1999 had been accorded historically high valuations, i.e., over 30 times earnings per share, when the norm for more than a century was 10-20 times! Baron Growth Fund's net asset value per share was nearly unchanged during that three year period. This is because Baron Growth Fund had not invested in highly valued, not very profitable, Internet businesses. Following the gyrations of the past 13 years, the benchmark index has increased 2.66% per year, including dividends, from December 31, 1999 through present day. Baron Growth Fund has increased about 176.96%, 7.99% per year.

During the March 2013 quarter, Baron Growth Fund's outperformance was driven by stock selection. Although the Fund is underweight in the Information Technology sector relative to the benchmark, the Fund's Information Technology holdings had the greatest impact on the Fund's outperformance in the quarter. We think our Information Technology investments are competitively advantaged businesses with recurring revenue, high margins, large growth opportunities and strong management teams. On the negative side, the Fund was hurt by its significant underweight position in the Health Care sector. This was primarily due to our decision to avoid biotechnology stocks, which we believe are often driven by binary outcomes and lack the characteristics of businesses we favor. As highlighted below, however, one



of our Health Care holdings, rural hospital provider Community Health Systems, Inc. was the top contributor to performance for the quarter.

Overall, most of the stocks in the Fund performed well. 59.51% of our investments increased in value by double digit percentages; 29.52% of our investments increased in value by single digit percentages; and only 8.10% made a negative contribution to our results. We try to explain some stock price movements during the period in the sections "Top Contributors" and "Top Detractors." Regardless, in many instances, we regard gains and losses in the short term as "random." To give you a feeling of how random, several investments, like distributor United Natural Foods, Inc. and leading heart valve manufacturer Edwards Lifesciences Corp., that fell in value during the period, are among businesses with long-term prospects we continue to think are most favorable.

**Table II.**  
Top contributors to performance for the quarter ended March 31, 2013

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap (billions)	Total Return	Percent Impact
Community Health Systems, Inc.	2004	\$2.4	\$4.4	54.16%	1.14%
Genesee & Wyoming, Inc.	2004	0.5	4.4	22.38	0.60
Arch Capital Group Ltd.	2002	0.4	7.0	19.42	0.59
ANSYS, Inc.	2009	2.3	7.6	20.91	0.52
ITC Holdings Corp.	2005	0.8	4.7	16.59	0.48
Choice Hotels International, Inc.	1996	0.4	2.5	26.41	0.45
MAXIMUS, Inc.	2011	1.2	2.7	26.65	0.44
DeVry, Inc.	1995	0.4	2.0	33.80	0.44
Gartner, Inc.	2007	2.3	5.1	18.23	0.42
Core Laboratories N.V.	2006	1.2	6.4	26.48	0.38

Rural hospital provider **Community Health Systems, Inc.'s** shares rose 54.2% in the first quarter and increased over 114.9% in the last twelve months. The primary driver of performance has been the anticipation of health care reform. Improving admission trends are also contributing to Community Health's multiple expansion from historically depressed levels. (Susan Robbins)

Shares of **Genesee & Wyoming, Inc.**, a leading short line railroad, rose 22.4% during the first quarter after completing a transformational acquisition of its primary competitor for \$2 billion. The combined entity makes Genesee & Wyoming the dominant regional rail operator in the U.S., adding revenue diversity and cementing barriers to entry. In addition, private equity firm The Carlyle Group acted as a strategic equity partner in this transaction, making a \$350 million investment at \$65 per share and advising on future acquisitions. (Matt Weiss)

**Arch Capital Group Ltd.** is a specialty insurance and reinsurance company. The stock rose during the first quarter due to better than expected earnings results and an improving insurance market. Arch also announced an acquisition that would allow it to enter what we believe to be an attractive new business line, mortgage insurance. (Josh Saltman)

**Table III.**  
Top detractors from performance for the quarter ended March 31, 2013

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap (billions)	Total Return	Percent Impact
United Natural Foods, Inc.	2011	\$1.8	\$2.4	-8.19%	-0.15%
Agrinos AS	2011	0.3	0.2	-46.32	-0.08
Companhia Hering SA	2010	2.3	2.9	-12.89	-0.06
Edwards Lifesciences Corp.	2003	1.5	9.4	-8.88	-0.05
Booz Allen Hamilton Holding Corp.	2010	2.3	2.0	-2.80	-0.04

Shares of **United Natural Foods, Inc.**, the largest distributor of natural and organic products in North America, detracted from the first quarter's performance, despite continued strong fundamentals. The company's largest customer is Whole Foods, which is experiencing robust, though moderating, growth in the face of tough comparisons. We believe United Natural Foods will continue to benefit from a greater focus on health by consumers; growth of organics from less than 10% of grocery today; and conventional supermarkets devoting more space to the category. (Matt Weiss)

**Agrinos AS** declined 46.3% in the quarter. Agrinos is a green technology company with a unique, microbial product that enhances crop yields. The company's stock price performance in the quarter was weak because a delay in receivables collection led to a change in accounting policy, with no revenue booked for Mexico in the fourth quarter. We continue to believe Agrinos has disruptive technology and exciting long-term growth prospects. (Catherine Chen)

## RECENT PURCHASES

**Table IV.**  
Top net purchases for the quarter ended March 31, 2013

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap (billions)	Amount (millions)
Pinnacle Entertainment, Inc.	2013	\$0.9	\$0.9	\$21.0
Myriad Genetics, Inc.	2013	2.0	2.0	10.2
Interval Leisure Group, Inc.	2012	1.0	1.2	9.5

We initiated a position in **Pinnacle Entertainment, Inc.** during the quarter. Pinnacle is a regional gaming company with casinos in Louisiana, Missouri and Indiana. It is in the process of acquiring Ameristar Casinos, which should be highly accretive for the company and increase its diversity of assets and cash flow. Assuming the Ameristar acquisition closes this year and that the company completes its \$580 million Lake Charles casino and \$200 million Ohio racetrack with slot machines in 2014, the combined entity can almost triple its earnings. Management has indicated it will use its cash flow to repay debt. This would add significant value given the leverage post acquisition. (David Baron)

# Baron Growth Fund

**Myriad Genetics, Inc.** develops, markets and performs novel genetic tests in its own proprietary labs. It has a lab in Utah and recently opened a second facility in Munich, Germany to process international tests (a big opportunity as nearly all of current revenues are from U.S. customers). MYGN performed about 150,000 tests in 2012 for breast, colon and skin cancers. The company has 193 issued patents, as well as numerous patent applications in the U.S. and foreign countries. It also has numerous trade secrets (including a one-of-a-kind breast cancer genetic mutation database), which are likely even more important than the patents. We believe that MYGN has the ability to grow revenues by expanding its current test menu as well as growing its European operations and introducing new tests (prostate cancer and companion diagnostics for pharmaceutical usage). (Randy Gwartzman)

We increased our position in **Interval Leisure Group, Inc.** in the quarter as the timeshare industry continues to grow and the company continues to expand its resort affiliations. We continue to believe the company remains attractive especially as timeshare resort development expands given strong developer returns and easier financing. Consumers continue to find value in timeshares especially as hotel rates continue to rise and consumers continue to take yearly vacations. Interval continues to generate strong and consistent cash flow, which they continue to return to shareholders through dividends and debt reduction. We still find value in the stock at current levels and believe as timeshare development increases, the company should increase its members as well as revenue per transaction as people transact more given the multitude of properties. (David Baron)

## PORTFOLIO STRUCTURE AND STRATEGY

Baron Growth Fund owns about one hundred stocks. Its top ten holdings comprise 27% of the Fund. We believe this diversified Fund offers investors potentially better than market returns with less than market volatility. Our strategy to accomplish this is to invest for the long term in a diversified portfolio of appropriately capitalized, well-managed, growing, small-cap businesses at attractive prices. We think these businesses have the potential to double in size within five years. We believe that a portfolio of investments diversified among several industries all of which are dependent upon different, non-correlated fundamentals will likely reduce portfolio volatility. In addition, many of the companies in which the Fund invests have significant recurring revenue, which makes our portfolio less volatile than the Russell 2000 Growth Index. We find these businesses through our dedicated research effort.

These well-managed businesses have significant barriers to competitive threats. These barriers tend to give our companies pricing power. Most of our companies produce significant cash flows which are often reinvested in their businesses to increase their revenues and margins over the long term. We believe the Fund has an opportunity to meet its objectives, although there is no guarantee that it will do so.

We think the financial characteristics of the businesses in which the Fund has invested for the long term, on average seven years, are demonstrably superior to its benchmark. Our businesses have faster historical growth rates, higher profit margins, and higher returns on capital than the composite of companies in the benchmark index. We believe these

characteristics should offer investors significant excess returns over time, although we obviously cannot guarantee it.

**Table V.**  
**Top 10 holdings as of March 31, 2013**

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap (billions)	Amount (millions)	Percent of Net Assets
Arch Capital Group Ltd.	2002	\$0.4	\$7.0	\$216.8	3.3%
ITC Holdings Corp.	2005	0.8	4.7	200.4	3.0
Dick's Sporting Goods, Inc.	2004	1.4	5.8	193.9	2.9
Community Health Systems, Inc.	2004	2.4	4.4	189.6	2.9
Genesee & Wyoming, Inc.	2004	0.5	4.4	186.2	2.8
LKQ Corp.	2007	1.2	6.5	182.2	2.8
ANSYS, Inc.	2009	2.3	7.6	173.0	2.6
Gartner, Inc.	2007	2.3	5.1	155.1	2.3
FactSet Research Systems, Inc.	2006	2.5	4.1	148.2	2.2
Penn National Gaming, Inc.	2008	2.5	4.2	145.3	2.2

## Thank you for investing in Baron Growth Fund.

Thank you for joining us as fellow shareholders in Baron Growth Fund. We believe the growth prospects for the businesses in which Baron Growth Fund has invested continue to be favorable. Of course, there is no guarantee this will be the case.

We are continuing to work hard to justify your confidence and trust in our stewardship of your family's hard-earned savings. We are also continuing to provide you with information that I would like to have if our roles were reversed. This is so you will be able to make an informed judgment about whether Baron Growth Fund remains an appropriate and attractive investment for your family.

Respectfully,



Ronald Baron  
CEO and Portfolio Manager  
April 9, 2013

For more information about this Fund please scan this QR code with any bar code reader on your mobile device.



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*Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The Baron Family of Funds is described in prospectuses which contain this and other information about the Funds. You should carefully read the prospectus before investing. You can obtain a copy of the prospectus by contacting the Funds' distributor, Baron Capital, Inc., at 767 Fifth Avenue, New York, New York, 10153, or by calling 1-800-99BARON, or by going to our website at [www.BaronFunds.com](http://www.BaronFunds.com).*

The Adviser believes that there is more potential for capital appreciation in smaller companies, but there also may be more risk. Specific risks associated with investing in smaller companies include that the securities may be thinly traded and they may be more difficult to sell during market downturns. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

The discussions of the companies herein are not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this report reflect those of the respective portfolio managers only through the end of the period stated in this report. The portfolio manager's views are not intended as recommendations or investment advice to any person reading this report and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

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