# **Baron International Growth Fund**

### **DEAR BARON INTERNATIONAL GROWTH FUND SHAREHOLDER:**

#### **PERFORMANCE**

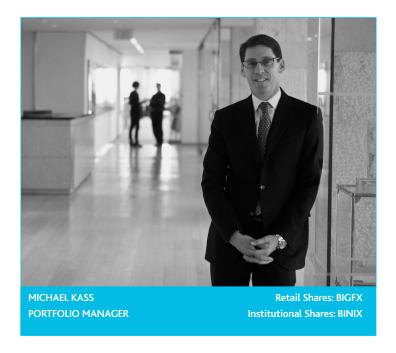
The Baron International Growth Fund (the "Fund") appreciated 0.91%, while our principal benchmark index, the MCSI ACWI ex USA IMI Growth Index, returned 5.00% for the fourth quarter of 2012. For the full year 2012, the Fund gained 17.80%, while the principal benchmark appreciated 16.69%. During the fourth quarter, the global equity markets remained firm, driven by further signs of financial stabilization in Europe, irrefutable evidence of an economic recovery in China, as we anticipated last quarter, and a sudden and dramatic political turn of events in Japan. In sum, we are quite encouraged by the strength of the global equity market in the midst of the U.S. fiscal cliff and debt ceiling negotiations. Looking forward, as the market receives clarity over this remaining issue, we are optimistic regarding international and, in particular, emerging market equities in the year ahead. Although somewhat out of favor in the most recent quarter, we remain confident with our disciplined approach and focus on high quality, capitalefficient growth companies driven by strong and entrepreneurial management teams.

Table I.
Performance (Retail Shares)†
Annualized for periods ended December 31, 2012

	Baron International Growth Fund <sup>1,2</sup>	MSCI ACWI ex USA IMI Growth Index <sup>1</sup>	MSCI ACWI ex USA Index <sup>1</sup>
Three Months <sup>3</sup>	0.91%	5.00%	5.85%
One Year	17.80%	16.69%	16.83%
Three Years	6.97%	4.90%	3.87%
Since Inception (December 31, 2008)	15.36%	12.93%	12.20%

Performance listed in the above table is net of annual operating expenses. As of the last fiscal year ended December 31, 2011, annual operating expense ratio for the Retail Shares was 1.73%, but the net annual expense ratio was 1.50% (net of the Adviser's fee waivers). 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 Adviser has reimbursed certain Fund expenses (by contract as long as BAMCO, Inc. is the adviser to the Fund) and 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 or call 1-800-99BARON.

- † If the Fund's historical performance was impacted by gains from IPOs and/or secondary offerings, there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs and secondary offerings will be the same in the future.
- The MSCI ACWI ex USA indexes cited are unmanaged, free float-adjusted market capitalization weighted indexes. The MSCI ACWI ex USA IMI Growth Index Net USD measures the equity market performance of large, mid and small cap growth securities across developed and emerging markets, excluding the United States. The MSCI ACWI ex USA Index Net USD measures the equity market performance of large and mid cap securities across developed and emerging markets, excluding the United States. The indexes and Baron International Growth Fund include reinvestment of dividends, net of foreign withholding taxes, which positively impact the performance results.
- The performance data does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.
- Not annualized.



While we were pleased overall with our performance for the year, which exceeded our benchmark, we were disappointed with our fourth quarter performance. The relatively weak fourth quarter was attributable to a number of unusual company-specific factors, as well as a general shift in investor sentiment towards more cyclical and financially leveraged stocks that had largely underperformed previously in the year. For the full year, strong stock selection in the Health Care and Consumer Discretionary sectors drove our outperformance. Notably strong contributors in these sectors were Eurofins Scientific SE and Grifols SA, both European health care related investments, as well as Hathway Cable & Datacom Ltd., DEN Networks Ltd. and Zee Entertainment Enterprises Ltd., representing our Indian digital media theme, and Anhanguera Educacional Participações SA and Kroton Educacional SA, our Brazilian post-secondary education investments. Our largest single contributor to performance for the year was Eurofins Scientific SE, a French food, pharmaceutical and environmental testing and certification provider that exceeded earnings expectations and successfully executed its organic and acquisition driven growth plan. Poor stock selection in the Information Technology, Financial and Energy sectors was a significant detractor from relative performance for the year. We believe our lack of exposure to beaten down, developed world bank stocks was a factor here, as improving sentiment in Europe sparked a significant rally in global banks in the second half of 2012. Within Information Technology and Energy, operating disappointments at companies such as Velti plc, Ubiquiti Networks, Inc., Net 1 UEPS Technologies, Inc., Daum Communications Corp. and Borders & Southern Petroleum plc dragged down performance. The largest individual detractor for the year was NII Holdings, Inc., a Latin American wireless communications provider, whose inability to launch its enhanced 3G network on time led to market share and ARPU declines.

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Table II.

Top contributors to performance for the quarter ended December 31, 2012

	Percent Impact
Compagnie Financière Richemont SA	0.51%
Tower Bersama Infrastructure Tbk PT	0.49
Eurofins Scientific SE	0.47
PATRIZIA Immobilien AG	0.40
Kroton Educacional SA	0.38

Earlier in the year, poor sentiment weighed on the luxury space due to fears of a consumer slowdown, especially in China and Hong Kong. With signs of an upturn in China, **Compagnie Financière Richemont SA**, a Swiss luxury powerhouse with brands in watches and jewelry like Cartier and Van Cleef & Arpels, has performed strongly, its shares rising 30.9% in the fourth quarter. During the quarter, it reported positive fiscal first half earnings with 21% revenue growth and 152 basis point margin expansion.

Tower Bersama Infrastructure Tbk PT is the second largest independent owner of wireless towers in Indonesia. Tower Bersama's share price rose during the fourth quarter after announcing impressive quarterly results. Data traffic is growing at high rates in Indonesia, and operators are investing in network assets to accommodate it. As a result, Tower Bersama is generating increased leasing revenue and cash flow from colocation activity. Tower Bersama's Indosat tower acquisition closed during the quarter.

Shares of **Eurofins Scientific SE** outperformed. Eurofins provides analytical testing services to clients in the food, pharmaceutical, and environmental industries. Organic revenue growth exceeded management's mid-term objective. We believe the company's growth prospects remain strong, driven by increased regulation related to food safety and the environment, as well as the outsourcing of non-core activities by pharmaceutical companies.

**Kroton Educacional SA** is one of the largest for-profit, post-secondary education providers in Brazil. Its shares have returned 32.0% in the fourth quarter as it posted phenomenal results on the back of the Financiamento Estudantil (FIES), a revamped student loan program provided by the Brazilian government. While the FIES should benefit the industry as a whole, we think it should benefit Kroton even more given Kroton's substantial exposure to students with this loan.

Table III.

Top detractors from performance for the quarter ended December 31, 2012

	Percent Impact
Velti plc	-0.98%
Kirkland Lake Gold, Inc.	-0.83
Mellanox Technologies Ltd.	-0.71
Net 1 UEPS. Technologies, Inc.	-0.67
Better Place, Inc.	-0.53

**Velti plc** is a leading global mobile marketing company. Shares of Velti declined significantly in the fourth quarter as a result of the company missing in the third quarter expectations and announcing a divestiture of certain European assets at relatively low prices. Since the third quarter report, the company has brought on a new CFO, and the company is focused on improving free cash flow generation in 2013.

**Kirkland Lake Gold, Inc.** operates a gold mine in Ontario, Canada. The stock price declined sharply in the fourth quarter due to operational delays in its expansion project. This postponed the expected production growth and reduced liquidity, creating the need to raise additional capital. We believe the company is making progress on its expansion project and will eventually increase annual gold production from 100,000 ounces to over 250,000 ounces. We expect that the reserve base will grow as the company continues to discover high-grade deposits.

Mellanox Technologies Ltd. supplies semiconductor-based systems for computing, storage, and communications applications connecting servers to servers and servers to storage, providing high bandwidth and low latency. After nearly quadrupling during the year, Mellanox's shares declined sharply in the fourth quarter, as valuation ran ahead of fundamentals and investors realized that triple-digit growth is unsustainable.

**Net 1 UEPS Technologies, Inc.** (UEPS) offers a smart card-based system, which facilitates electronic payments and transactions for underserved emerging market populations. UEPS was recently awarded a long-term contract to administer benefits for the South African Social Security Administration (SASSA). In early December, UEPS disclosed an SEC investigation into possible improper payments made to secure the SASSA contract. Given this development, we sold our position.

Better Place, Inc. is the first private global end-to-end electric vehicle (EV) infrastructure provider with operating networks in Israel and Denmark. We invested in Better Place in December 2011, ahead of its commercial launch, with the view that its innovative approach to EVs would enable it to jump start EV adoption in Denmark and Israel. Our expectations were not met; execution was above budget and behind schedule. This, plus a recent management change, caused us to mark down our investment significantly.

### **PORTFOLIO STRUCTURE**

Table IV.
Top 10 holdings as of December 31, 2012 - Developed Countries

	Percent of Net Assets
Eurofins Scientific SE	3.5%
Ryanair Holdings plc	2.4
Fanuc Corp.	2.1
SodaStream International Ltd.	2.1
Compagnie Financière Richemont SA	2.0
Ingenico SA	2.0
Intertek Group plc	2.0
SoftBank Corp.	1.8
Grifols SA	1.8
The Japan Steel Works Ltd.	1.8

Table V.

Top five holdings as of December 31, 2012 - Developing Countries

	Percent of Net Assets
Tower Bersama Infrastructure Tbk PT	2.2%
Financial Technologies Ltd.	2.1
TOTVS SA	1.8
Kroton Educacional SA	1.7
Anhanguera Educacional Participações SA	1.6

# **Baron International Growth Fund**

Exposure by Country: At the end of the fourth quarter of 2012, the Fund was invested 67.2% in developed countries and 28.8% in developing countries, with the remaining 4.0% in cash. The Fund seeks to maintain broad diversification by country at all times. A detailed review of the Fund's holdings by country is available at the back of this Baron Funds Quarterly Report.

Table VI.

Percentage of securities in developed markets as of December 31, 2012

	Percent of Net Assets
Japan	13.6%
United Kingdom	8.9
Germany	8.1
France	5.5
Israel	5.3
Switzerland	5.2
Ireland	3.6
United States	3.2
Canada	2.6
Australia	2.2
Norway	2.1
Spain	1.8
Austria	1.5
Hong Kong	1.4
Italy	1.1
Sweden	1.1

Table VII.

Percentage of securities in developing markets as of December 31, 2012

	Percent of Net Assets
Brazil	7.6%
China	6.8
India	6.2
Indonesia	3.3
Korea	2.0
Russia	1.5
Mexico	1.4

The Fund may invest in companies of any market capitalization, though we generally focus on mid and smaller cap companies, as we believe such companies often have more attractive growth potential. At year-end 2012, the Fund's median market cap was \$2.8 billion, and, excluding cash, we were invested approximately 23.6% in large cap companies, 34.5% in mid cap companies and 37.9% in small cap companies, as defined by MSCI.

#### RECENT ACTIVITY

Given our outlook, during the fourth quarter we focused our idea generation on companies we see as beneficiaries of the changing environment in Europe, Japan and China, consistent with our investment discipline. Notable examples include **PATRIZIA Immobilien AG**, our third holding in the German residential real estate business. While we believe the fundamental outlook for residential rents and asset values appears quite favorable, particularly due to the extraordinary measures being taken to stabilize the Eurozone, we believe PATRIZIA is uniquely well positioned given its asset light business model and ability to source capital from German institutional partners on what we believe are very favorable terms. We took advantage of poor short-term investor sentiment towards advertising driven businesses in China by initiating a position in Sina Corporation (SINA). SINA is one of China's leading online platforms best identified as operating the highly popular Sina Weibo, a "Twitter-like" microblogging service with an estimated 400 million users. We believe Sina Weibo represents significant strategic value, far undervalued at the current stock price, and we believe recent rumors, if accurate, of a potential investment by Baidu, Inc. or Alibaba Group, if true, would serve to highlight such value. Additional new positions include Sanrio Co. Ltd. of Japan, which owns the Hello Kitty and other characters and operates an attractive global licensing business, and Kakaku.com, Inc., a Japanese diversified Internet operator with the leading price comparison and restaurant reservation sites, as well as popular e-commerce, real estate and travel related Internet businesses. During the quarter, we also exited positions where events caused us to lose investment conviction, including LG Household & Health Care Ltd., Itaú Unibanco Holding SA, Net 1 UEPS Technologies Inc., and Restoque Comércio e Confecções de Roupas SA.

#### **OUTLOOK**

Last quarter, we outlined how the elimination of near-term concerns over a European sovereign default helped drive an impressive third quarter rally in equities, and suggested accelerating signs of an economic recovery in China would likely benefit international markets, particularly emerging markets. During the fourth quarter, we witnessed additional signs of European financial stabilization, with sovereign bond spreads, in particular, narrowing to recent lows, and further, the irrefutable evidence of a recovery in China. While we have lingering concerns over long-term political compromise on European fiscal union, as well as the longer-term growth outlook for China, we remain confident and enthusiastic regarding the prospects for international and emerging market equities as we enter 2013.

Another reason global economic prospects are brightening in the new year is the impact of a new round of aggressive monetary support from central bankers. While many investors are familiar with Ben Bernanke's move to open-ended quantitative easing and unemployment rate targeting, a more significant recent catalyst is Japan, where a sudden and resounding change in political leadership in favor of Shinzo Abe and the LDP party was based on a pro-growth platform targeting higher inflation and aggressive monetary easing. We believe the recent rejuvenation of monetary easing campaigns, juxtaposed with negligible yields on higher quality government bonds, is finally driving capital into higher yielding, riskier assets, including equities and emerging market bonds. In our view, this trend is likely to become increasingly evident during the coming year.

Shifting to our investments, we remain steadfast in our commitment to leading entrepreneurial companies with what we believe are visible, long-term

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growth prospects and sustainable competitive advantages that generate more attractive returns on capital. During the past year, we had considerable success with our principal investment themes, which we believe continue to offer great promise over a long-term horizon. To review, we favor high quality companies positioned to serve the expanding middle class consumer in the developing world; to broaden credit availability and/or increase the sophistication of capital markets activities in such countries; to drive manufacturing and/or business process productivity to offset rising wage pressures; or to enable agricultural yield or energy efficiency on a capital efficient basis. We are enthusiastic over the potential of the investments we hold in the Fund.

Thank you for investing in the Baron International Growth Fund.

Sincerely,

Michael Kass Portfolio Manager January 8, 2013

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



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.

Non-U.S. investments may involve additional risks to those inherent in U.S. investments, including exchange-rate fluctuations, political or economic instability, the imposition of exchange controls, expropriation, limited disclosure and illiquid markets. This may result in greater share price volatility. Specific risks associated with investing in small and medium-sized 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.

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