

A different approach to small cap investing Baron Growth Fund



Ron Baron,
CEO & Portfolio Manager

Baron Growth Fund is a different kind of small cap fund. We believe that what makes it different – our approach to investing – is better than following what everyone else does. We don’t strive to be like everyone else; we strive to be exceptional. Of course we do not always achieve our objectives.

Before describing how we are different, we point out the one thing we do that other small cap funds do: **we invest in small companies.** Baron Growth Fund only buys companies with market caps under \$2.5 billion. Over the past five years ending March 31, 2012, the average market cap of the companies in which we invested was \$1.6 billion. This includes newly established investments and additions to existing positions. We don’t buy companies that are larger than \$2.5 billion.

After that one similarity, we take a different path than most small cap funds. Below we explain how we are different and why we think our approach is better.

Baron Growth Fund is managed by Ron Baron, which is the most significant difference. Ron has over 41 years of research experience and has been at the helm of this Fund since its inception on December 31, 1994. Ron’s unique approach to “investing in people not just buildings,” focusing on a company’s long-term competitive advantages and investing

only when he thinks the price is right, has been the foundation of the Baron investment approach since Ron started his career, well before the launch of the first Baron Fund in 1987.

Ron has the benefit of a long career of small cap growth investing. He has learned to identify the smaller companies that have the potential to become larger companies, and to understand the risks that some companies may pose, although we do make mistakes.

Ron likes to invest in small cap companies because those companies have unique opportunities for growth, and they tend to be more entrepreneurial than more established companies. They may still have founders and executives with large personal investments in the business. The stocks are typically not as widely covered on Wall Street. The executives are willing to meet with analysts and explain their businesses and how they intend to grow them.

We do a deep dive. To really understand a potential investment, we research everything we can about a company. Our product is our research and our analysis of that research. We have many years of experience learning about industries, companies, and the executives who run them.

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When we think about diversifying Baron Growth Fund, we take a different approach than many other investors.

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We buy a stock when the company is small, and we continue to hold the stock while the company grows. While we invest only in small cap companies, if we think the company meets all of our requirements for future growth potential, we will keep the position in the portfolio, even if it becomes a mid-cap company. That means that if we are correct in our analysis of the company's growth prospects, the business will grow from small to mid-cap. If we still see opportunities for additional growth, we will stay invested in that company. We don't sell a stock just because the company is successful, although Ron will start selling positions when the company's market cap reaches \$7 billion to manage the Fund's average market cap.

We build our portfolio one stock at a time. We don't try to copy the stocks in an index. We don't try to match the allocations across industry groups that an index has. We invest in companies that we believe are of the highest quality, are appropriately financed, have great growth opportunities, are stable businesses, have great managements, and are inexpensive relative to what they can earn.

We look for growth companies. Many smaller companies use leverage to jump start their growth. Baron Growth Fund invests chiefly in companies that generate free cash flow, which they then re-invest in their businesses to grow them. We also tend to prefer companies that grow organically rather than by acquisition.

We invest for the long-term and have

low turnover. Baron Growth Fund's turnover for the past three years ending May 31, 2012 has averaged 14%. According to Morningstar, the more typical small cap mutual fund has a three year average turnover of 113%.* When we invest in a company we invest for the long term, and we buy stocks of businesses we believe have the potential to double in size over the next four

to five years. We continually re-assess that potential over the life of an investment, and if we believe the potential still exists, we will continue to hold the stock. Our long-term approach also enables us to get to know company executives over many years, and watch them as they implement their plans for growth.

For the 12 month period ended May 31, 2012, Baron Growth Fund established new

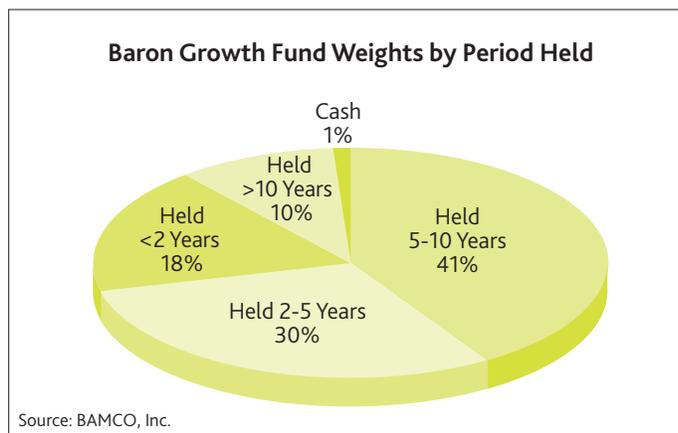
ucts in the U.S. It is the leader in the rapidly growing natural and organic foods market, with continued share gain potential. As of May 31, 2012, the stock was about 2% of the portfolio, and it has returned 34% since we first purchased it.

Of the 101 positions in the Fund, 36 have been held for over five years, which represents 51% of the portfolio. An example of a company we have held for over five years is Edwards Lifesciences Corp., which was only about 1% of the portfolio as of May 31, 2012, although it was higher previously. Ron has been selling the position since its market cap is now over \$10 billion. When the Fund first purchased the stock, the company's market value was \$1.5 billion. We think this is a great example of a long-term investment. Edwards Lifesciences is the global leader in the science of heart valves and in the growing market for surgical heart valves. The investment has returned over

230% in the past five years, 505% since our initial purchase in 2003, and 22% on an annualized basis, through May 31, 2012. Another standout is SBA Communications Corp., one of the largest independent owners of wireless communications infrastructure in North

America. SBA is about 1% of the portfolio, and has returned 1,272% since we first purchased it in 2003 through May 31, 2012, which is 35% on an annualized basis.

Seven positions, about 10% of the portfolio, have been held for over 10 years, all of which have outperformed the Fund's benchmark, the Russell 2000 Growth Index, over the past 10 years ending May 31, 2012, and on average have almost tripled during the same period. Some of these investments include Arch Capital Group Ltd., an insurance and reinsurance company (almost 3% of the portfolio); Choice Hotels (about 2% of



positions in 18 companies, representing about 7% of the portfolio. For example, we invested in Cymer, Inc., which manufactures and sells highly engineered laser products into the semiconductor capital equipment industry and has strong recurring revenue streams. At May 31, 2012, Cymer was about 1% of the portfolio.

About 18% of the portfolio, 34 stocks, have been held for less than two years. Baron Growth Fund first invested in United Natural Foods, Inc. in January of 2011. United Natural Foods is the largest wholesale distributor of natural and organic prod-

the portfolio), one of the largest hotel franchisors in the world; and Alexanders, Inc., a REIT that owns six properties in New York City (about 1% of the portfolio).

Baron Growth Fund is widely diversified. When we think about diversifying Baron Growth Fund, we take a different approach than many other investors. Instead of trying to match the diversification of the Russell 2000 Growth Index, we look at the characteristics of each investment. We look at things such as growth opportunities, regulatory impact, business lines, addressable markets, and the types of customers or consumers for a particular business. To keep the Fund widely diversified, Ron typically looks to invest approximately 10-15% of its assets in a single sector, although some sectors may have a higher allocation. The sector or industry diversification that we achieve is a result of our investment process rather than an objective.

We build
our portfolio
one stock
at a time.

We source ideas by asking a lot of questions. How do we find investment ideas? Not by using quantitative screens. Instead, we go to meetings, attend conferences, meet with as many people as we can. We are well known for our long-term approach to investing. Our analysts have developed ex-

pertise in the industries they cover, and this allows them to understand the companies, the executives, and the experts in their industries. We also find new investment ideas from our existing investments. For example, in speaking with a *supplier* of a company we own, we might find that the supplier is an interesting investment opportunity.

Our research helps us manage risk. Investing in smaller companies may be riskier than investing in larger companies. We manage risk by diligently and thoroughly researching these companies. By talking to vendors, suppliers, customers, and competitors. By visiting the companies, talking to executives, trying their products even. By our rigorous process of understanding the businesses we are investing in.

We invest in people. Over our many years of investing in small cap businesses we have learned what makes a successful management team. We look for passion, commitment, integrity. We look for executives dedicated to both their customers and their employees. We look for managers who have long-term vision and the ability to execute that vision. There is a level of excitement that the executives have in the future opportunities they see for their companies. We share their enthusiasm and we hope you will share our enthusiasm for Baron Growth Fund. ■

Except where noted, the portfolio data referenced in the article is as of May 31, 2012. For the period ended June 30, 2012, the one-, five-, ten-year and since inception (12/31/94) annualized returns for the Retail Shares of the Baron Growth Fund were -0.89%, 1.92%, 7.79% and 12.90%, respectively.

A Special Note

We are excited to announce that we are redesigning our newsletter. We expect the design and content of the letter to continue evolving over the next several quarters.

*Morningstar Small Growth Average. Morningstar moved the Fund from the Small Growth Category effective May 31, 2011 to the Mid-Cap Growth Category. We intend to continue to provide comparative data for the Small Growth Category because we strongly disagreed with Morningstar's reclassification of the Fund. As of 3/31/12, the category consisted of 664 funds for the 3 year period. © 2012 Morningstar, Inc. All Rights Reserved. The Morningstar information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

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 or call 1-800-99BARON. Investing in the stock market is risky. Current and future portfolio holdings are subject to risk.

Baron Events

Baron Investment Conference

Our 21st Annual Baron Investment conference will be held **Friday, October 12, in New York City at the Metropolitan Opera House at Lincoln Center.** Our new registration requirements can be viewed at www.BaronFunds.com/register. Advance registration is required and seating is first come, first served. For your free registration, visit www.BaronFunds.com/register. Or call **800-99-BARON, option 1.** Our conference features guest speakers from the companies in which we invest and our own portfolio managers. *Seating is limited.*

Retail Shares Performance as of June 30, 2012¹

		YTD	Average Annualized Returns			Since Inception		Inception	Expense Ratio	Interest
			1-Year	5-Years	10-Years	Annualized	Cumulative	Date		Expense
Small Cap	Baron Growth Fund	7.63%	-0.89%	1.92%	7.79%	12.90%	735.30%	12/31/94	1.32% ²	
	Baron Small Cap Fund	9.00%	-3.99%	1.64%	7.52%	8.79%	246.51%	9/30/97	1.31% ²	
Smid Cap	Baron Focused Growth Fund⁴	1.24%	-5.66%	2.39%	11.98%	10.71%	413.41%	5/31/96	1.48%/1.35% ³	
Mid Cap	Baron Asset Fund	7.33%	-3.45%	-0.01%	6.40%	10.61%	1150.63%	6/12/87	1.33% ²	
	Baron Opportunity Fund	8.92%	-5.56%	3.85%	13.43%	3.24%	48.23%	2/29/00	1.41% ²	
Large Cap	Baron 5th Ave. Growth Fund	13.43%	3.72%	-0.02%	N/A	3.79%	35.54%	4/30/04	1.59%/1.30% ²	
All Cap	Baron Partners Fund⁴	6.45%	-5.02%	-1.19%	8.57%	11.74%	864.87%	1/31/92	1.35% ³	0.36% ³
Int'l	Baron Emerging Markets Fund	6.88%	-10.79%	N/A	N/A	-7.82%	-11.50%	12/31/10	4.49%/1.50% ³	
	Baron Global Advantage Fund	N/A	N/A	N/A	N/A	N/A	-8.30%	4/30/12	4.50%/1.50% ³	
	Baron Int'l Growth Fund	8.18%	-10.80%	N/A	N/A	14.91%	62.65%	12/31/08	1.73%/1.50% ³	
Specialty	Baron Energy and Rsrcs Fund	-12.90%	N/A	N/A	N/A	N/A	-12.90%	12/30/11	4.25%/1.35% ³	
	Baron Real Estate Fund	17.83%	10.37%	N/A	N/A	17.64%	50.11%	12/31/09	2.33%/1.35% ³	

¹For Institutional Shares, visit www.BaronFunds.com/performance.

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. Current performance may be lower or higher than the performance data quoted above. For performance information current to the most recent month end, visit www.BaronFunds.com/performance or call 800-99-BARON. The Adviser has reimbursed certain fund expenses for Baron Opportunity, Baron Fifth Avenue Growth, Baron Focused Growth, Baron International Growth, Baron Real Estate, Baron Emerging Markets, Baron Energy and Resources, and Baron Global Advantage Funds and all Funds' transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower.

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The Baron Funds' prospectuses contain this and other information about the Funds. Please read it carefully before investing. You can obtain one from its distributor, Baron Capital, Inc., by calling 800-99-BARON or visiting www.BaronFunds.com/prospectus.

Baron Growth and **Small Cap Funds** invest primarily in small-cap securities, **Baron Asset Fund** in mid-cap securities, **Baron Focused Growth** and **International Growth Funds** in both. Small and mid-cap securities may be thinly traded and more difficult to sell during market downturns. **Baron Opportunity Fund** emphasizes mid-sized companies that we believe will benefit from innovations and advances in technology, which present the risk of rapid change and product obsolescence and their successes may be difficult to predict for the long term. **Baron Partners, Focused Growth, Real Estate** and **Energy and Resources Funds** are non-diversified and **Partners Fund** uses leverage, which increase volatility of the Funds' returns and expose the Funds to greater loss in any given period. In addition, the value of **Baron Real Estate Fund** is affected by the strength of the real estate markets. **Baron Fifth Avenue Growth Fund** invests primarily in large-cap securities, which like all equities are subject to price fluctuations in the stock market. **Baron International Growth, Emerging Markets** and **Global Advantage Funds** invest primarily in non-U.S. securities, which 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. These risks are heightened for the **Baron Emerging Markets Fund**. **Baron Energy and Resources Fund** invests in energy companies, which can be affected by fluctuations in energy prices and supply and demand of energy fuels, and in resources industries, which can be affected by international political and economic developments, the success of exploration projects, and meteorological events.

²As of September 30, 2011 for Baron Asset, Baron Growth, Baron Small Cap, Baron Opportunity and Baron Fifth Avenue Growth Funds. For Baron Fifth Avenue Growth Fund, the total expense ratio was 1.59%, but the net annual expense ratio is 1.30% (net of the Adviser's fee waivers).

³As of December 31, 2011 for Baron Partners, Baron Focused Growth, Baron International Growth, Baron Real Estate and Baron Emerging Markets Funds. Total expense ratio shown for Baron Partners Fund was comprised of operating expenses of 1.35% and interest expense of 0.36%. For Baron Focused Growth Fund, the total expense ratio was 1.48%, but the net annual expense ratio was 1.35% (net of the Adviser's fee waivers). For Baron International Growth Fund, the total expense ratio was 1.73%, but the net annual expense ratio was 1.50% (net of the Adviser's fee waivers). For Baron Real Estate Fund, the total expense ratio was 2.33% but the net annual expense ratio was 1.35% (net of the Adviser's fee waivers). For Baron Emerging Markets Fund, the total expense ratio was 4.49%, but the net annual expense ratio was 1.50% (net of the Adviser's fee waivers). For Baron Energy and Resources Fund, the estimated total expense ratio is 4.25%, but the net annual expense ratio is 1.35% (net of the Adviser's fee waivers). For Baron Global Advantage Fund, the estimated annual operating expense is 4.50%, but the net annual expense ratio is 1.50% (net of the Adviser's fee waivers).

⁴Reflects the actual fees and expenses that were charged when the Funds were partnerships. The predecessor partnerships charged a 20% performance fee (Baron Partners Fund) or a 15% performance fee (Baron Focused Growth Fund) after reaching a certain performance benchmark. If the annual returns for the Funds did not reflect the performance fee for the years the predecessor partnerships charged a performance fee, returns would be higher. The Funds' shareholders are not charged a performance fee. The predecessor partnerships' performance is only for periods before the Funds' registration statements were effective (4/30/03 for BPF and 6/30/08 for BFGF). During those periods, the predecessor partnerships were not registered under the Investment Company Act of 1940 and were not subject to its requirements or the requirements of the Internal Revenue Code relating to registered investment companies, which, if they were, might have adversely affected their performance.

HOW TO CONTACT US: Call 800-99-BARON (800-992-2766) and select Option 1 to register for our Annual Conference or to speak with a Fund representative; Option 2 if you are a financial advisor and would like to speak to an investment specialist; Option 3 for the current net asset value of our Funds; Option 4 for information about your account or to place a trade; or Option 5 for a prospectus, fund literature, applications and t-shirts. Visit www.BaronFunds.com for detailed price, performance and holdings information for each of our Funds. ■