BARON CAPITAL

Baron Discovery Strategy

December 31, 2022

Dear Investor:

Performance

During the fourth quarter, Baron Discovery Strategy had flat performance compared to the Russell 2000 Growth Index (the "Benchmark"), which was up about 4%. The quarter was volatile (with a 12% change between the low and high points of the Benchmark), though not as much as the third quarter (which had a 20% spike followed by a swift decline of more than 22% during the summer months). All of these bear market rallies and subsequent "fades" have been the result of shorter-term investor psychology around whether the Federal Reserve will pivot to a more benign interest rate policy. We have already seen rates move up over 4% in 2022 from near-zero, and expectations are for another 1% of hikes before this rate cycle is complete.

For the full year, the Strategy was down 34.96%, trailing the Benchmark by 8.60%. About 2.2% of our underperformance relates specifically to our lack of exposure to Energy (1.73% of the negative relative performance), Materials (0.46%), and Utilities (0.01%). We do not typically invest in these sectors because we believe they are driven mostly by cyclicality and don't fit our fundamental investment framework. We are not pleased with our performance for the year, though given the confluence of historically bad macroeconomic headwinds to the market, the Strategy performed only slightly worse than we would have expected (smaller-growth stocks typically bear the brunt of reflexive fear-driven selling due to such conditions). Even with this disappointing 2022 performance, the Strategy annualized since inception performance of 11.35% exceeds the Benchmark by 4.81%. As we lay out in the note below, going forward, we believe we are at a point in the investing cycle where the odds stack up very well for small-capitalization growth investing, and for the Strategy in particular.

Table I.
Performance†
Annualized for periods ended December 31, 2022

	Baron Discovery Strategy (net)[1]	Baron Discovery Strategy (gross)[1]	Russell 2000 Growth Index[1]	S&P 500 Index[1]
Three Months[2]	0.21%	0.46%	4.13%	7.56%
One Year	(34.96)%	(34.32)%	(26.36)%	(18.11)%
Three Years	4.30%	5.34%	0.65%	7.66%
Five Years	7.73%	8.81%	3.51%	9.42%
Since Inception[3] (October 31, 2013)	11.35%	12.28%	6.54%	11.01%

For Strategy reporting purposes, the Firm is defined as all accounts managed by Baron Capital Management, Inc. ("BCM") and BAMCO, Inc. ("BAMCO"), registered investment advisers wholly owned by Baron Capital Group, Inc. As of December 31, 2022, total Firm assets under management are approximately $35.4 billion. Gross performance figures do not reflect the deduction of investment advisory fees and any other expenses incurred in the management of the investment advisory account. Actual client returns will be reduced by the advisory fees and any other expenses incurred in the management of the investment advisory account. A full description of investment advisory fees is supplied in the Firm's Form ADV Part 2A. Valuations and returns are computed and stated in U.S. dollars. Performance figures reflect the reinvestment of dividends and other earnings. The Strategy is currently composed of one mutual fund managed by BAMCO and a separately managed account managed by BCM. The Strategy invests mainly in small cap growth companies.

BAMCO and BCM claim compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of the Firm's strategies or a GIPS Report please contact us at 1-800-99BARON. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse, promote or warrant the accuracy or quality of the report.

Performance data quoted represents past performance. Current performance may be lower or higher than the performance data quoted. Past performance is no guarantee of future results.

† The Strategy's 3- and 5-year historical performance was impacted by gains from IPOs. There is no guarantee that these results can be repeated or that the Strategy's level of participation in IPOs will be the same.

1 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. All rights in the FTSE Russell Index (the "Index") vest in the relevant LSE Group company which owns the Index. Russell® is a trademark of the relevant LSE Group company and is used by any other LSE Group company under license. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. The indexes and the Strategy include reinvestment of dividends, net of withholding taxes, which positively impact the performance results. The indexes are unmanaged. Index performance is not Strategy performance; one cannot invest directly into an index.

2 Not annualized.

3 The Strategy has a different inception date than its underlying portfolio, which is 9/30/2013.

"The riskiest thing in the world is the belief that there's no risk. By the same token, the safest (and most rewarding) time to buy usually comes when everyone is convinced there's no hope." Mastering the Market Cycle *by Howard Marks, p. 142.*

"It's important to note that exiting the market after a decline – and thus failing to participate in a cyclical rebound – is truly the cardinal sin in investing. Experiencing a mark to market loss in the downward phase of the cycle isn't fatal in and of itself, as long as you hold through the beneficial upward parts as well. It's converting that downward fluctuation into a permanent loss by selling out at the bottom that's really terrible." Mastering the Market Cycle *by Howard Marks, p. 247.*

"I still walk through this life like a little boy in a museum, surrounded by the exhibits I've spent a lifetime studying, and when I finally come face-to-face with something or someone that has inspired me along the way, I am thankful. I am grateful." The Storyteller *by Dave Grohl, p. 313.*

As is my habit, I spend a lot of time reading during the holiday break. It's a great way to relax and it gives me an opportunity to reflect. I had the opportunity to read two terrific books this year, each very different, but together they give some much needed perspective on life, objectivity, and where we stand in the current market.

First, *A Short History of Nearly Everything* by Bill Bryson literally starts at the beginning of the world, even before the "Big Bang" that scientists believe created the universe. When judged by this cosmic standard, it's incredible to think that our "long-term investing" strategy still pales in comparison to the history of the universe–thought to be something like 13.7 billion years old. The longest existing species on earth is thought to be only 4 million years old, with the earth itself having taken 400 million years or so to form. Within this context, it feels like our four- to five-year holding period might not seem so long after all! Our long-term perspective contrasts with the exceedingly short attention span of most investors, which ranges from seconds to possibly the next year. As a side note, another interesting factoid from Bryson's book is that scientists believe there are 140 billion galaxies like ours in the universe, and that there could be around 4 million other advanced civilizations like Earth in the universe (living on 10 billion trillion planets according to Carl Sagan)! UFOs anyone?

The second book couldn't be more different, but as a pair, these two are in a sense the microscope and telescope when looking at the world. *Mastering the Market Cycle* by Howard Marks turns the focus inward from cosmic inquiry to the here and now of examining today's financial markets. Howard Marks is the co-founder of Oaktree Capital Management. He's been investing for many decades and has earned a deserved reputation as a phenomenal investor and a scholar of the markets. In his book, Marks lays out the importance of market cycles (including credit cycles where the availability of credit, or lack thereof, can have a dramatic impact on equity markets).

The overarching theme in the book is that it is not possible to perfectly time the tops and bottoms of markets, but investors can clearly tilt the odds in their favor by being cognizant of major macro cycles that affect everything. Over the course of history, market cycles have repeated their boom-and-bust pendulum swings. This, in addition to the amplifying influence of investor psychology, generates market pricing swings that tend to be far more extreme (both in upside and downside) than objective fundamental factors would suggest.

Active, fundamental investors like us make money by buying stocks when their intrinsic value (the sum of the present value of all future cash flows) is higher than their current trading price. In the same manner, our current portfolio's net asset value (or the trading price of all of our investments as a whole) is nothing more than today's clearing price rather than the measure of intrinsic value. We believe the underperformance of the stock market in 2022 was driven more by macro factors, mainly inflation and the rate cycle of the Federal Reserve and negative changes in investor psychology as opposed to micro factors at the individual company level. We try to be more objective and focus on individual company fundamentals while avoiding becoming *macro tourists* who get whipsawed by every macroeconomic data point.

So where are we in the market cycle as we enter 2023 and what does it mean with regard to the desirability of small-cap growth stocks in particular as an asset class? In down markets like we experienced in 2022, growth stocks generally underperform value stocks since more of the intrinsic value embedded in a growth stock is based on earnings further out into the future. It is also important to make a distinction here between growth and momentum investing. By growth investing, we mean measuring the intrinsic value of companies that can grow cash flows organically over a number of years and buying them, when in our opinion, the market is not properly valuing them. Momentum investing, which we do not practice, relates to the more psychological process of buying securities that seem to be going up (and just for that very reason), with little regard if any for valuation. Unfortunately, momentum is a manifestation of market psychology and the manic-depressive nature of market participants. In this respect it magnifies the cyclicality of equity markets and tends to overwhelm stock valuations up and down thereby carrying rational investors along with it. This effect is exaggerated in small-cap growth companies such as the ones we own in the Strategy.

We believe today's environment is different from that of the Global Financial Crisis (GFC). During the 2008 GFC, the entire financial system was at a non-trivial risk of implosion due to the collapse of a number of large financial institutions. We believe today's environment is different. In contrast to the GFC, this is a more normal economic/market cycle where excessive valuations ultimately foundered on the shoals of a rapidly accelerating inflationary environment. The current inflationary backdrop has been the result of an extreme liquidity injection (over $4.4 trillion) provided by the federal government, combined with a near-zero Federal Reserve interest rate policy commonly known as ZIRP that kept the economy over heated for too long.[1] The three-month change in M2, a measure of the growth in money supply (a good proxy for inflation) hit records with 16% growth in 2020 (the prior record was about 6% in the early 1980s). But with the Fed raising rates dramatically through 2022 (by about 4.25% through December 2022) this massive liquidity injection has reversed, and the change in M2 is now meaningfully negative.

Where are we in the market cycle and have we bottomed? This is the key question and the most unknowable. We believe that many of the key inflationary components of CPI are in the process of bottoming, including the housing market (representing about 40% of CPI), company orders (as

[1] Since the start of the COVID-19 public health emergency, the federal government has enacted trillions in spending outside of normal budgetary channels, including the $1.8 trillion CARES Act of 2020, the $1.9 trillion American Rescue Plan in March 2021, and the ironically named Inflation Reduction Act of 2022, which added another $740 billion of spending.

measured by the Purchasing Managers Index), and earnings. We believe that the guidance for full-year 2023 earnings given by companies in February 2023 will help to "clear the decks" on the negative earnings revision cycle. Employment is the last domino, and we believe there are indications that this is softening as well. If that's the case, then the Fed will be closer than many expect to completing their rate hiking cycle. But this is a tricky issue, as the Fed really is trying to balance lessening inflation without obliterating the employment market. Given the history of prior cycles, markets will take off when, or even before, it is clear that these inflationary factors are under control.

While we can't definitively say we have reached market bottoms, we absolutely can state that the probabilities have started to skew dramatically in favor of investing in riskier assets, including small-cap growth. To paraphrase Howard Marks, when markets are at extremes, it's not forecasting to say that you have a high probability to profit by being contrarian. After assessing where we are in the macro inflationary cycle, the keys are looking at valuations (small-cap valuations are historically low both objectively and relatively, as are the individual valuations of our portfolio holdings) and at investor behavior (there is extreme market negativity). Here's the problem. You can't know when the bottom will occur or has occurred. As a result, our playbook is to buy when probabilities are heavily in our favor and when we believe prices are below (maybe even massively so) intrinsic value. Investing in small-cap growth stocks is inherently risky, but at the same time can be much more rewarding, particularly when the cycle odds are more in the investor's favor, such as now.

We strive for a target return of at least 15% annually (obviously this is not a guarantee), in order to compensate for the risk of funding earlier stage companies. We also strive to compensate for the risk within the small-cap space by diversifying among industries, limiting position sizes, using objective and time-based valuation metrics to continually evaluate our investments, and balancing what we believe are the relative riskiness of different types of growth investments. Some of our portfolio characteristics illustrate what we believe is the higher overall quality of our portfolio versus the Benchmark. For example, our debt-to-capital ratio is 27.1% versus 39.5% in the Benchmark. On the margin front, our weighted average gross margins are 47.3% versus 43.0% in the Benchmark. Though our operating profitability metrics are below the Benchmark's, our companies tend to be earlier stage, meaning they are reinvesting gross profits for increased growth. This shows up in our projected three- to five-year earnings growth of 28.9% versus 19.8% for the Benchmark (with projected three-year sales growth of 19.3% versus 14.3% in the Benchmark). We also believe that all of our companies are adequately funded through breakeven cashflow and that around 16% of our assets are invested in companies with negative cash flow. While we underperformed the Benchmark in 2022, we believe our overall risk-adjusted track record across the cycle (including 11.37% annualized returns since inception and 4.68% annualized alpha) shows superior stock selection. In the words of Howard Marks, "The holdings of a habitually aggressive investor who is capable of superior selection will go up more than the market when the market goes up and may go down more than the market when it goes down. But his margin of superiority on the upside will exceed his degree of inferiority on the downside, as it comes from his ability to select assets that deliver upside potential without entailing commensurate downside risk. As a result he'll do better than the market when it goes up, but not as badly when the market goes down as his aggressiveness would suggest. That's an example of the asymmetry that marks the superior investor." *Mastering the Market Cycle* p.269. For these reasons, we remain bullish on the Strategy's prospects over the medium term.

2022 may have been a challenging year, but we remain bullish on our ability to outperform in the next market recovery. Laird and I want to wish all of you and your families happiness, wealth and health in the new year.

Randy Gwirtzman – January 2023

Table II.
Top contributors to performance for the quarter ended December 31, 2022

	Percent Impact
Axon Enterprise, Inc.	1.06%
Montrose Environmental Group, Inc.	0.53
ForgeRock, Inc.	0.47
Allegro MicroSystems, Inc.	0.47
Boyd Gaming Corporation	0.44

Shares of **Axon Enterprise, Inc.**, a public safety-focused technology company, rose during the quarter following a strong earnings report in which full-year revenue guidance was raised. Notable strength in the Axon Cloud segment reflects increased domestic demand for software-heavy premium integrated bundles. We believe the company has a line of sight to a more than 20% average annual revenue growth, an improving margin profile with software solutions growth, and the potential to become the dominant ecosystem in the public safety space.

Montrose Environmental Group, Inc., a leading environmental services company, outperformed as the stock rallied back from weakness earlier in the quarter. The company continues to execute and benefits from strong growth drivers including methane emissions monitoring, biogas solutions, and PFAS (pen- and polyfluoroalkyl substances) remediation. We continue to be holders of the stock, as we think the company will benefit from strong secular trends, which include increasing environmental regulation as well as corporate focus on sustainability. We remain confident in Montrose's plan to grow revenues organically and through acquisitions in excess of 20%.

ForgeRock, Inc. offers identity and access management security software that enterprises use to authenticate their customers and employees. Following a drop in software valuations this year, private equity and strategic buyers have been active in the small-cap cybersecurity space due to the sector's secular growth and its relative demand resilience compared to other IT budget items in economic downturns. On October 11, 2022, private equity firm Thoma Bravo announced a definitive agreement to acquire ForgeRock for $23.25 per share in a transaction valued at $2.3 billion. The acquisition represented a 53% premium to ForgeRock's last share price prior to the announcement, driving outperformance for the quarter. We estimate the acquisition value represented 7.5 times ForgeRock's forecasted revenue for 2023. This deal followed Thoma Bravo's purchases of our two former identity security portfolio companies Ping Identity and SailPoint. We believe the identity security category remains a high priority spending category and expect further consolidation to take place in the industry.

Shares of **Allegro MicroSystems, Inc.**, a fabless designer and manufacturer of integrated circuit (IC)-based sensors and application-specific analog power ICs for automotive and industrial markets, rose in the quarter. The company reported strong quarterly earnings results and raised its full fiscal year financial outlook despite investor concerns for a potential downcycle in the industry. The company continues to benefit from its focus on electrification and Advanced Driving Assistance System applications in automobiles as well as data center cooling applications, which are driving continued growth in higher-margin newer products. We believe Allegro continues to have a large opportunity for growth in electronic content in vehicles and as industrial applications continue to grow due to megatrends in electrification, increased safety standards, and automation.

Shares of U.S. regional casino operator **Boyd Gaming Corporation**, increased in the fourth quarter due to stable consumer visitation and spending levels despite an uncertain macro environment. The company continued to generate strong free cash flow that it is using to invest into its casinos, pay out dividends, and buy back shares. The company has repurchased 8% of its shares over the past year while paying out a 1% dividend. We believe Boyd can withstand any bumps in the economy given its strong balance sheet and free cash flow. We also don't think Boyd's share price reflects its 5% ownership in online bookmaker FanDuel. We continue to be positive on the company's long-term prospects.

Table III.

Top detractors from performance for the quarter ended December 31, 2022

	Percent Impact
Revance Therapeutics, Inc.	–0.76%
CareDx, Inc.	–0.74
Chart Industries, Inc.	–0.64
Definitive Healthcare Corp.	–0.61
Qualys, Inc.	–0.42

Shares of **Revance Therapeutics, Inc.**, an aesthetics-oriented biotechnology company, detracted from performance in the fourth quarter. Shares had meaningfully outperformed in the third quarter, after the FDA approved Daxxify, the company's longer-acting competitor to Botox that lasts about six months versus Botox's three to four months. The stock is in somewhat of a news vacuum as Revance is training injectors and smartly implementing a tightly managed preview program ahead of a broader launch in the second quarter of 2023. Early feedback on Daxxify has been positive. Part of the stock weakness may also be due to concerns around the impact of macro headwinds on discretionary consumer spending. Although we expect some near-term impact to Revance's RHA dermal filler portfolio, we think the impact will be temporary and shouldn't be the focus given the imminent broader Daxxify launch. More importantly, we think Daxxify's longer-lasting result is a key selling point for consumers, and we expect to see meaningful uptake of the product in late 2023 and beyond. Ultimately, we see Daxxify and the already-launched RHA fillers capturing significant share in the fast-growing $4 billion facial injectables market and supporting more than triple the company's current valuation.

CareDx, Inc. is a diagnostic company that facilitates organ donor matches pre-transplant and rejection monitoring post-transplant. Transplant rejection testing is recurring and can help ensure the right immunosuppressant treatment to avoid overdosage or organ loss. As was the case in the third quarter, shares also underperformed in the fourth quarter. The reimbursement headwinds seen in the third quarter have continued. Some testing volume is moving beyond traditional Medicare and into Medicare Advantage as well as to commercial payers due to market shifts and an effort to seed new markets and products. In addition, the fourth quarter brought a bit of an unexpected curveball when one of the entities that regulates Medicare payments for the diagnostic industry held a meeting with a panel of experts to determine the usefulness and ideal frequency of testing for dd-cfDNA tests (donor derived, cell-free DNA – or looking at DNA from the donated organ to determine if an organ is being rejected). This is of significance to CareDx as well as its market competitors, particularly in the heart and kidney transplant markets. Our read after the meeting was that there was a strong belief that dd-cfDNA tests are useful and are actually moving toward becoming the gold standard in testing for rejection (displacing physical biopsies as the new first-line diagnostic). The issues that have yet to be determined are whether tests are being used too frequently (we don't believe so) and whether all organ recipients should be eligible for testing or just the higher risk cohort (we believe all should be eligible as the tests can provide much better overall outcomes as measured by post-transplant survival years).

This is an extreme example of a company that is trading below intrinsic value. Were CareDx to collect for all of the tests it ran in 2022, it would have earned $180 million more revenue in 2022 than the $321 million it officially logged. So, it would be a $500 million revenue company, which at 20% cash flow margins equates to $100 million in cash flow just on existing testing volume. The company has no debt, has about $300 million in cash on its balance sheet and should be free-cash-flow breakeven or positive in 2023. We believe that the kidney testing market (the largest with a $2 billion opportunity) is barely penetrated (all competitors' market share combined represent less than 20% of the total opportunity), and CareDx is by far the dominant provider with enormous first mover and relationship advantages. On our current estimates, CareDx trades at under one times its 2023 enterprise value (market value plus net debt) to sales ratio (EV/Sales). Effectively, at a 25% mature cash-flow margin (reasonable for a company with 75% targeted gross margins) this would equate to four times cash flow. Because it will generate free-cash-flow going forward and will continue to grow as well, it's actually trading at a negative EV/Sales ratio for 2027. Based on various positive and negative scenarios, we see limited downside with even the worst set of circumstances. We believe that the stock in a base case is nearly a triple, and in a bull case could be worth six times its current value! Perhaps this is why management announced a $50 million share repurchase program in early December 2022.

Shares of **Chart Industries, Inc.**, a leader in cryogenic technology and process/storage equipment, declined during the quarter. The company announced the large acquisition of Howden, a leading manufacturer of compressors, fans, and blowers, using a large amount of debt. We believe the benefits of the acquisition (cost and revenue synergies with improved margins, increased recurring aftermarket percentage, improved global footprint, and bigger "nexus of clean" exposure) outweigh the execution risks, with the market currently punishing the company for elevated leverage at a time of elevated macroeconomic uncertainty. We believe that the combined company's financial results will be better than expectations currently embedded in the stock price and that after integration, the company will be a best-in-class industrial compounder deserving of a valuation well above current levels.

Shares of **Definitive Healthcare Corp.**, a commercial intelligence software-provider for health care companies, underperformed as management highlighted intensifying macro headwinds and talked about expectations for 2023 revenue growth to be about 15% opposed to investor expectations for mid-20% revenue growth. Definitive first discussed the macro headwinds in the previous quarter, but the headwinds have intensified and are expected to persist. The slowing of the sales cycle has broadened beyond new logos to upsells to existing customers, and it is particularly pronounced among biotechnology and provider clients. Recognizing the wide error bars around 2023 results, management wanted to wait to see the rest of the fourth quarter selling season play out before providing formal 2023 guidance, which they should provide when the company reports in February. We believe that these macro-related headwinds are temporary in nature, and we continue to see Definitive as a high-quality, profitable company with a differentiated offering and a long runway of growth. We think the current valuation implies significantly lower long-term growth expectations than the company is capable of producing. Therefore, there could be meaningful upside as macro conditions improve and revenue growth re-accelerates.

Qualys, Inc., a cloud-based vulnerability management cybersecurity platform, detracted from performance. While third quarter revenue and profit beat consensus expectations, billings–a forward growth indicator based on contracts–decelerated slightly as the tough macro environment caused deal scrutiny, longer sales cycles among new customers, and a slower productivity ramp-up for newly hired sales reps. Despite near-term challenges, we think Qualys can continue compounding revenue and free-cash-flow-per-share growth for several reasons. First, cybersecurity is a more defensible software spending category in downturns as organizations need to continue investing in protecting their assets. Second, Qualys has made good progress in cross-selling newer products like patch management (automated remediation of known IT vulnerabilities) and cybersecurity asset management (detection of company servers where cybersecurity protection is absent or near end-of-life). New product adoption and secular growth in IT assets have led to net expansion rates (a measure of growth at existing customers) improving to 111%, compared to 104% last year. Third, management reprioritized go-to-market investments over the past year, including building better relationships with channel partners and hiring more direct sales reps in 2022, which should help drive more brand awareness and growth going forward. Lastly, management is focused on preserving Qualys' best-in-class profitability (35% cash-flow margins) and returning capital to shareholders through share repurchases. While we acknowledge there is less certainty around near-term growth, we think this is reflected in the stock's current valuation, and we maintain conviction in Qualys due to its solid compounding growth profile, fantastic cash-flow margins, and end-market resilience.

Portfolio Structure[1]

Table IV.
Top 10 holdings as of December 31, 2022

	Year Acquired	Quarter End Investment Value (millions)	Percent of Net Assets
Kinsale Capital Group, Inc.	2016	$52.3	4.6%
Axon Enterprise, Inc.	2022	41.7	3.6
Boyd Gaming Corporation	2021	40.1	3.5
Axonics, Inc.	2020	39.9	3.5
Advanced Energy Industries, Inc.	2019	36.5	3.2
Rexford Industrial Realty, Inc.	2019	35.5	3.1
Silk Road Medical, Inc.	2019	33.8	2.9
Mercury Systems, Inc.	2015	31.2	2.7
SiteOne Landscape Supply, Inc.	2016	29.3	2.6
Floor & Decor Holdings, Inc.	2019	27.5	2.4

Our top 10 holdings represented 32.1% of the portfolio versus 25.6% in December 2021. This is within our typical 25% to 35% range. Cash holdings were 4.3%.

Our sector exposures are generally in line with the Russell 2000 Growth Index, although we are overweight Information Technology (IT) (we believe the disconnect between market price and intrinsic value is extreme in this category) and Industrials. Industrials includes 4.4% exposure to defense, which should not be as affected by a recession and will benefit from the tailwinds of increased defense spending laid out in the defense budget passed in December 2022. We do not have exposure to Energy, Materials, or Utilities as we believe these are cyclical and/or lower-growth sectors that do not fit our secular growth strategy particularly well. While underexposure to the latter categories can hurt our relative performance during periods like this one (where the market is exceedingly defensive and influenced by significant moves in commodity prices), we believe that such periods are more the exception than the rule and believe long-term performance favors exposure to secular growth. Finally, our portfolio turnover was 31.8% for the year and was 36.7% on a three-year average basis. This is significantly lower than our small-cap growth peers which reflects our long-term strategic investment focus.

[1] Top 10 holdings, sector weights, portfolio characteristics, top net purchases, and top net sales are based on a representative account. Such data may vary for each client in the Strategy due to asset size, market conditions, client guidelines, and diversity of portfolio holdings. The representative account is the account in the Strategy that we believe most closely reflects the current portfolio management style for the Strategy. Representative account data is supplemental information.

Recent Activity

Table V.
Top net purchases for the quarter ended December 31, 2022

	Year Acquired	Quarter End Market Cap (billions)	Amount Purchased (millions)
Chart Industries, Inc.	2022	$4.9	$12.0
Smartsheet Inc.	2022	5.2	8.7
CyberArk Software Ltd.	2022	5.3	8.5
CareDx, Inc.	2018	0.6	7.0
PAR Technology Corporation	2018	0.7	6.7

We added to our position in **Chart Industries, Inc.**, a manufacturer of cryogenic equipment for LNG and other industrial gases, most notably hydrogen, which allows the company to sell picks and shovels to the quickly growing LNG and hydrogen industries. We took advantage of recent share price weakness related to the announced acquisition of Howden to increase our position. As previously mentioned, we believe the benefits of the acquisition (cost synergies and improved margins, increased aftermarket percentage, and enhanced manufacturing footprint to serve the world's clean energy needs) outweigh the execution risks. Furthermore, we believe the deal creates a best-in-class industrial compounder that is positioned to benefit from increasing demand for LNG and clean energy solutions driven by the supply consequences of the Russian-Ukrainian conflict.

We added to our position in **Smartsheet Inc.**, a cloud-based collaboration and work management software platform that customers use to plan, visualize, manage, and automate business projects. Smartsheet reported a strong quarter, where revenue grew 38% and operating profit came in ahead of expectations. Growth was driven by strong new user additions (total users grew 23% year-over-year to 11.7 million), good cross-selling of premium add-on products (which grew 70% year-over-year and now account for over $200 million in annual recurring revenue), and continued license expansion at large customers (Smartsheet now has 40 enterprise customers spending more than $1 million each annually). Management remains focused on growing profitably–they expect Smartsheet to be free-cash-flow positive for the year in 2022 and to expand margins further in 2023. Longer term, we maintain conviction in Smartsheet due to its differentiated project management solutions, its long runway for license growth, and new product penetration at existing large customers, as well as its improving unit economics.

We initiated a position in **CyberArk Software Ltd.**, an identity security platform focused primarily on privileged access management (PAM). CyberArk's PAM technology prevents bad actors from stealing and exploiting the credentials of superuser accounts like IT administrators, cybersecurity managers, and network administrators. These privileged accounts can access a company's most critical IT systems–domain directory servers (all passwords, profiles, and data on employees), firewalls, code repositories, and database servers–making the credentials a high-value target in ransomware attacks (consulting firm Forrester estimates that 80% of security breaches involve privileged credentials). CyberArk technology detects, stores, and manages all the privileged credentials in an organization, monitors the critical IT systems, and helps contain the damage hackers can cause if they breach a corporate network. The increasing frequency and severity of ransomware attacks, heightening geopolitical tension, and stricter requirements of cyber insurance policies have all made PAM a higher priority spending category among security teams.

CyberArk is the market leader in the PAM category, with over 20% market share. The company has successfully leveraged its foothold to expand into complementary markets like identity and access management (authentication of a company's employees and vendors), secrets management (detection of credentials used for machine-to-machine communications), and endpoint management. These newer solutions now account for over 45% of annual subscription recurring revenue and are growing over 100% annually. CyberArk is also making good progress in its business model transition from on-premise (one-time perpetual license payment plus some recurring maintenance payments) to a recurring subscription revenue model. The new model expands CyberArk's addressable market, enables it to cross-sell products more efficiently, increases the lifetime value of its customers, and improves revenue predictability. Recurring revenue now accounts for more than 84% of total sales and annualized recurring revenue has been growing over 40% for the past four quarters. As subscription contracts come up for renewal in the next two to three years, we expect cash-flow margins to increase from mid-single digits today to CyberArk's healthy historical margin levels of 20%-plus. Long term, the combination of resilient end-market growth, better recurring revenue mix, and margin expansion should bode well for the stock.

We added to our position in **CareDx, Inc.** for the reasons stated above. We believe the company is misunderstood, and given the valuation and the strength of the company's balance sheet, investors will be handsomely rewarded for their patience.

During the quarter, we added to our position in **PAR Technology Corporation**, a provider of software to the restaurant industry. The company continues to grow software revenues at over 30% annually, and we believe it can continue to do so over the next couple of years. The company had pulled back with the rest of the software sector creating what we believe is a great entry point to purchase more stock. We believe the stock can more than triple over the next five years and remain bullish on its prospects.

Table VI.
Top net sales for the quarter ended December 31, 2022

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap or Market Cap When Sold (billions)	Amount Sold (millions)
Ping Identity Corporation	2019	$1.6	$2.5	$21.6
Kinsale Capital Group, Inc.	2016	0.4	6.0	15.1
ForgeRock, Inc.	2021	2.9	2.0	9.3
Revance Therapeutics, Inc.	2019	0.7	1.5	7.7
Progyny, Inc.	2019	1.3	2.9	7.4

We sold our holdings in **Ping Identity Corporation** and most of our holdings in **ForgeRock, Inc.** after announcements of their acquisitions (in separate deals) by Thoma Bravo, a private equity firm. The multiples paid for these companies, in the context of their market sizes, margins, and growth rates, indicate that our other software holdings are significantly undervalued in the current public markets. We trimmed our position in **Kinsale Capital Group, Inc.** in order to manage the position size. We trimmed our position in **Revance Therapeutics, Inc.** after FDA approval for Daxxify led to a huge runup in the stock in the third quarter (by over 106% from the start of the quarter to the peak). We still think Revance will be a huge winner for the Strategy over the next few years as the company accelerates the rollout of Daxiffy starting in 2023. We reduced our position in **Progyny, Inc.**, the leading provider of fertility benefits management in the U.S., due to a combination of valuation and economic headwind concerns.

Outlook

Small-cap stocks remain in a bear market and investor sentiment remains pessimistic. That said, we are seeing an increase in data points that indicate inflation is on the downswing. These include significant drops in indices measuring housing, product orders, food commodities, and energy prices. In addition, we are seeing a normalization of the COVID-related supply-chain challenges that were present over the last two years. Lastly, we are starting to see cracks in the stickiness of demand in the labor market, which is the last domino the Fed needs to see fall before it pivots from its rate hiking regime. While we may not know exactly where we are in this cycle, to crib Winston Churchill, we feel we are beyond the “end of the beginning” and are actually closer to the “beginning of the end.” As a result, we are bullish on the prospects for our portfolio companies and, therefore, our ability to outperform when we begin the next cycle.

Randy Gwirtzman & Laird Bieger
Portfolio Managers

The performance of accounts in the Strategy may be materially different at any given time. Differences that may affect investment performance include cash flows, inception dates, and historical prices. Positions may not be the same or may be traded at different times. In addition, accounts in the Strategy may be pursuing similar investment strategies but may have different investment restrictions.

Risks: Past performance is not a guide to future performance. The value of investments and income from them may go down as well as up. Your capital is at risk. Specific risks associated with investing in smaller companies include that the securities may be thinly traded and more difficult to sell during market downturns. Even though the Strategy is diversified, it may establish significant positions where the Adviser has the greatest conviction. This could increase volatility of the Strategy’s returns. Past performance is not a guide to future performance. The value of investments and income from them may go down as well as up. Your capital is at risk.

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 manager only through the end of the period stated in this report. The portfolio managers’ 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.