Baron ESG Update

March 3, 2021

Dear Baron Funds Shareholder:

Overview

To paraphrase Dickens: It was the worst of times, it was the best of times. 2020 was a year of conflicting narratives and conflicting outcomes. The COVID-19 pandemic has caused significant hardship and tragedy for millions of people and led to the sharpest economic downturn in most of our lifetimes. Social and political unrest also reached heights not seen in several generations.

In response, central banks and governments around the world flooded markets with liquidity. Nearly every business shifted gears in one way or another to adapt rapidly to the changed business environment. Many companies stepped up in aiding employees, investing in enhanced health and safety protocols, providing more financial assistance to local communities and charities, and supporting social justice initiatives by making hiring and investment commitments over the next several years. Some of the responses to the pandemic helped to cushion the blow from shutdowns and mass layoffs, and others helped create a favorable backdrop for investing and a strong recovery in stock markets. All these forces leading to a massive reallocation of capital toward digitalization, technological and healthcare innovation, energy transition, and more aggressive efforts to address issues of inequality and social justice.

Even before the pandemic, ESG (environmental, social, and governance) or sustainable investing had become a significant force within the asset management industry. Investors and asset owners have increasingly recognized the value of considering a wider set of environmental, social, and governance risks and opportunities when assessing investments. Concurrently, more companies around the globe have embraced the view, and the academic research that supports it, that while maximizing shareholder returns is still important, a wider consideration of a company's stakeholders (employees, customers, communities, etc.) can be key to longer-term success for both the company and society.

The pandemic underscored the importance of social issues and how they can impact the resiliency and sustainability of a company's business model. This was especially true as it relates to human capital management, supply chains, health & safety, innovation, access to health care, and access to communications. Investors are more focused on how companies are managing risk and the long-term impact of decisions made during the pandemic. Increased awareness of social factors also served to reveal and

JAMES STONE
DIRECTOR OF ESG RESEARCH

reinforce the severity of the challenges posed by a rapidly changing climate. While the origin of the COVID-19 virus is still being debated, climate change scientists have established that pandemics and the rapid spread of novel diseases are yet another of the potentially significant impacts from climate change, along with the negative health and economic impacts related to air quality, water availability, loss of biodiversity, severe weather, and the food supply chain. We believe businesses and investors will regard the risks associated with climate change with an enhanced seriousness following the crisis. In fact, we are already seeing this in the rising number of companies that have made climate change and emissions-related commitments in the last 12 months.

At Baron, we believe such considerations are leading many companies to step up their focus on the significant changes occurring in the economy and society and build businesses that are more dynamic and resilient. We welcome and encourage these changes as these are key characteristics of long-term sustainable competitive advantages. Strong management of these factors and strong governance have rarely been as critical as they are now, and investors are paying attention.

The Increasing Prominence of ESG Issues

The Shifting Risk Landscape

The pandemic made it clear that what have previously been characterized as "non-financial risks" by investors and academics or "non-pecuniary factors" by regulators such as the U.S. Department of Labor, can very quickly become major financial or pecuniary factors for businesses and investors. In Table 1 below, we show the progression since 2007 of the top global risks according to the World Economic Forum's Global Risks and Perception Survey. The survey categorizes risks across five broad areas and are assessed in terms of likelihood and impact.

Table 1: World Economic Forum – Top Global Risks Shifting to ESG Risks

Risk Categories	Economic	Environmental	Geopolitical	Societal	Technological
	2008	2010	2015	2018	2021
Top 5 Global Risks in Terms of Likelihood	Blow up in asset prices	Asset price collapse	Interstate conflict	Extreme weather	Extreme weather
	Middle East Instability	China economic slowdown	Extreme weather	Natural disasters	Climate action failure
	Failed and failing states	Chronic disease	Failure of national governance	Cyberattacks	Human environmental damage
	Oil Price Shock	Fiscal crises	State collapse or crisis	Data fraud or theft	Infectious diseases
	Chronic diseases	Global governance gaps	Unemployment	Climate action failure	Bio-diversity loss
	2008	2010	2015	2018	2021
Top 5 Global Risks in Terms of Impact	Blow up in asset prices	Asset price collapse	Water crises	Weapons of mass destruction	Infectious diseases
	Deglobalization (developed)	Deglobalization (developed)	Infectious diseases	Extreme weather	Climate action failure
	China hard landing	Oil price spikes	Weapons of mass destruction	Natural disasters	Weapons of mass desturction
	Oil price shock	Chronic disease	Interstate conflict	Climate action failure	Biodiversity loss
	Pandemics	Fiscal crises	Climate action failure	Water crises	Natural resources crises

Source: World Economic Forum

As this chart demonstrates, the landscape has been shifting toward risks that are more environmental and societal and less economic. While some observers continue to characterize these risks as "non-financial," the pandemic and near record financial losses related to climate events in the past several years demonstrate that the financial ramifications from these risks are significant, broad, and, in the case of environmental risks, potentially durable. Environmental risks now account for four of the top five risk categories in terms of likelihood and three of the top five in terms of impact. Infectious diseases, which shows up as fourth in likelihood and first for impact for 2021, are considered by many scientists to be closely linked to climate change and loss of biodiversity. Interestingly, "infectious diseases" or "pandemics" has only appeared on either top five list sporadically over the years and yet proved to be the biggest risk to markets and societies in 2020.

With the exception of "weapons of mass destruction," all the top risks for 2021 are ESG-related or have significant links to ESG and sustainable investing. It is our view that vetting these types of risks or understanding the opportunities that may arise from mitigating these risks is central to our fiduciary duty to our clients and neglecting these risks and opportunities would be a big mistake.

Interest and Adoption of ESG Surged in 2020

Perhaps sparked by the pandemic and the social unrest, several key statistics for 2020 point to an accelerated interest in responsible investing and ESG:

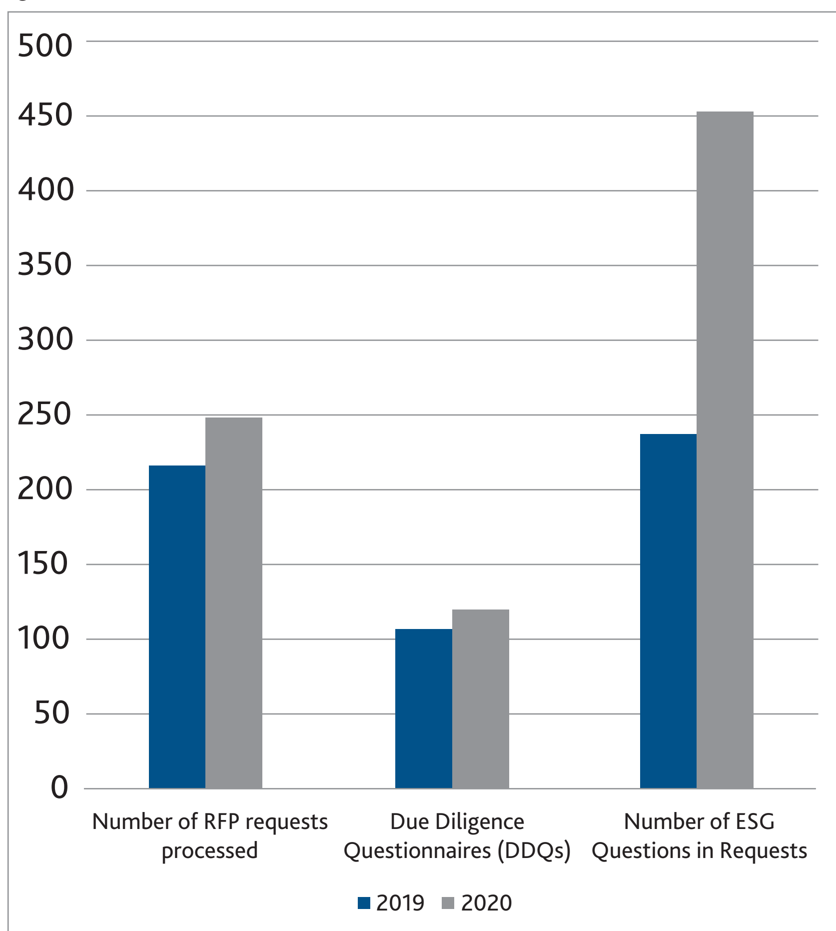
1. Flows into ESG/sustainable funds and ETFs rose sharply
2. Signatories to the Principles of Responsible Investment (PRI) and assets managed that incorporate the principles grew rapidly to record levels
3. Our own client inquiries regarding our ESG policies and approach almost doubled
4. The investment benefits of focusing on companies with strong sustainability characteristics became even clearer as ESG/sustainability equity funds significantly outperformed category peers.

Flows into ESG/sustainability funds rose sharply Morningstar has tracked fund flows and assets under management for U.S. sustainable funds for several years and began publishing that data on a global basis at the end of 2020. In that report, Morningstar counted almost $350 billion in inflows for the full year, $152 billion of which occurred in the fourth quarter. This compares to $155 billion of inflows for all of 2019. Assets under management increased to $1.65 trillion from $1.06 trillion at year-end 2019. By comparison, industry estimates for cumulative global flows for non-ESG equity funds showed only modest inflows for the year, largely because of a fourth quarter surge of over $100 billion, which appeared to have reversed negative flow trends for the first three quarters of the year.

Signatories to the PRI and AUM covered by signatories surged As interest in ESG and sustainability grows, more asset managers and asset owners (pension funds, endowments, and family offices) are incorporating ESG into their mandates, and the number of signatories to the PRI and the amount of assets under management covered by signatories surged in 2020. PRI signatories rose by 28% last year to over 3,000, double what it was five years ago. The number of asset owners that have signed on is up to 521 from under 300 five years ago. Total assets managed by PRI signatories rose 21% in 2020 and is now over $103 trillion, nearly double the level of 2015. The substantial growth in signatories and assets in recent years is perhaps the strongest example of how ESG and responsible investment have moved from the fringes of the investment landscape firmly into the mainstream.

Client inquiries regarding our ESG philosophy and approach nearly doubled Growing interest in sustainability and ESG is also reflected in the requests for proposals (RFPs) and due diligence questionnaires (DDQs) we are getting from clients and prospects. As Chart 1 demonstrates, the number of ESG-related questions in those requests rose by over 90% in 2020 compared to a year earlier. We believe this tremendous surge in interest in our ESG policies and the approach we are taking to integrate ESG into our investment process is emblematic of the significance our clients and prospects are placing on ESG and sustainability.

Chart 1: ESG Questions from Clients Surged in 2020



Source: Baron Capital

ESG/sustainability funds significantly outperformed peers In past years, the debate that ESG may have an impact on investment returns had been one of the hotter topics among investors, investment analysts, and the financial media. While there have been numerous studies that point to ESG as having a modestly positive impact on returns, it has always been easy to find other studies that contradict this conclusion. We think this is changing. We believe that a look at the performance of ESG funds or indexes over the last five years can help inform how integrating ESG into the investment process can positively impact returns.

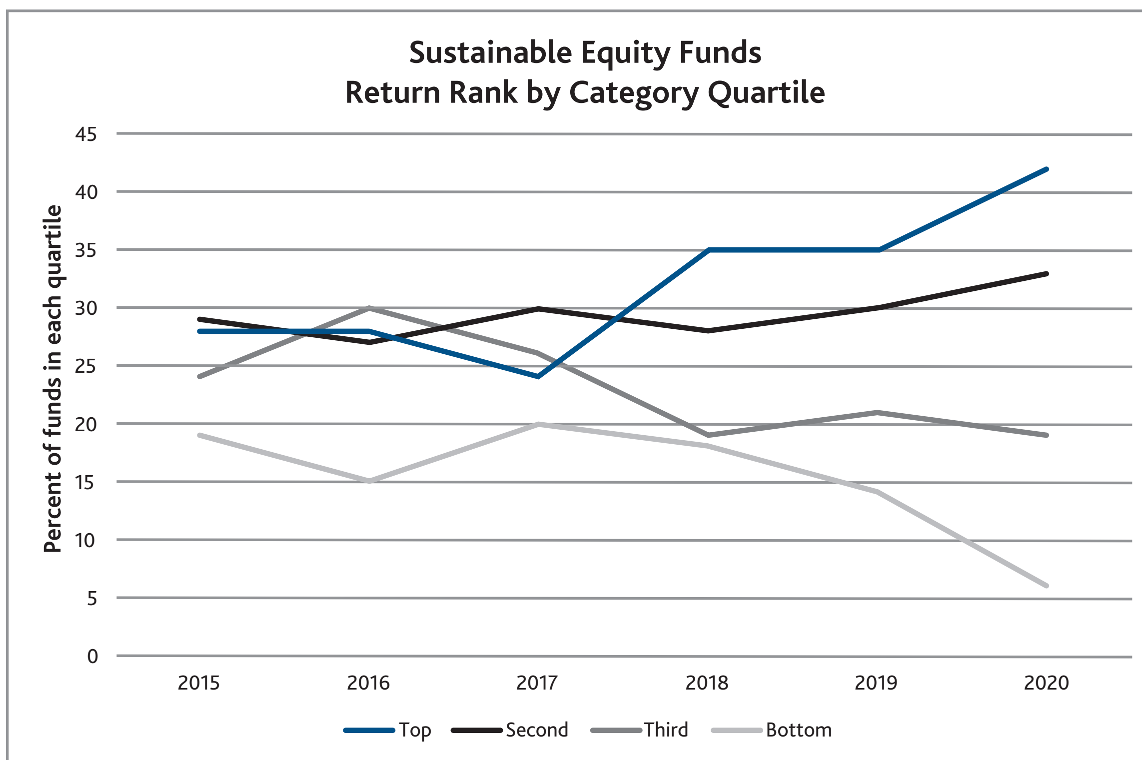
The responsible investment movement reached critical mass and adoption in the last couple years, leading to a tipping point in the influence of ESG and sustainability on investment returns. The growth in the number of investors and AUM that incorporate ESG or are committed to responsible investing are also creating a positive feedback loop, in our view.

Companies with strong ESG/sustainability practices or showing improvement are more likely to be bid up or garner a valuation premium compared to companies that are deemed weaker on this issue. Research by

Goldman Sachs and others in the last year have demonstrated this phenomenon in equities. We have also seen a "greenium" in the discounted interest rates that companies have been able to achieve by selling "green bonds" and other sustainability-linked fixed-income instruments. Higher equity valuations and lower interest costs both contribute positively to a lower cost of capital, driving firm values higher over the long term.

We think this is one reason the relative performance of ESG/sustainability funds has shown such a positive trend in the past five years. The chart below tracks Morningstar data that shows the number and percent of ESG funds ranked by performance quartile (Chart 2). For example, in 2015, 28% of sustainable equity funds ranked in the top quartile of their fund category. In 2020, that figure had risen to 42%, and three out of four sustainable equity funds placed in their category's top half in terms of performance and only 6% were in the bottom quartile. The trend of improving performance of sustainable equity funds, especially in the last three years, tracks the increased interest in ESG noted above.

Chart 2: Sustainable Equity Funds Rankings Rising



Source: Morningstar

A separate analysis in Table 2 compares the performance of the S&P 500 Index and MSCI ACWI Index to each index's ESG counterpart on a one-, three-, and five-year basis. In all three periods, the ESG versions of each index generated superior performance. This is especially true for the MSCI ACWI ESG, which is the ESG version of MSCI's flagship, free float weighted, global equity index that incorporates stocks from both developed and emerging world markets.

Table 2: Return Comparison Shows ESG Indexes Outperforming Conventional Counterparts

Period	S&P 500 Index	S&P 500 ESG Index	MSCI ACWI Index	MSCI ACWI ESG Index
1Yr	16.3%	17.6%	14.3%	16.0%
3Yr	40.5%	44.5%	26.0%	34.8%
5Yr	83.8%	88.5%	61.8%	78.9%

Source: Bloomberg. Index returns are calculated solely on the basis of price changes over the period analyzed and do not include the impact of dividends paid or reinvested.

The indexes are unmanaged. The index performance is not fund performance; one cannot invest directly into an index.

We believe the outperformance of ESG/sustainability funds as demonstrated above helps make a case for the benefits of integrating ESG into the investment process, which we have been doing implicitly for years and explicitly for the past two years. ESG integration gives us an additional set of lenses and criteria to help better evaluate the risks companies may face or the opportunities that they may be able to capture over the next several years.

Issues That Mattered in 2020 and Those That Will Likely Matter in 2021

In recent years, we do not think there is any argument that the top issues for ESG or sustainability-oriented investors have been related to climate change and the environment. Heading into 2020, it was broadly accepted this would continue to be the case. Momentum on climate change had been building for several years, and 2020 figured to be an important milestone as the 26th UN Climate Change Conference (COP26) scheduled for November 2020 was expected to be the biggest and most important COP event since COP21 in

2015, when the Paris Agreement was signed. However, few things in life go as planned, and, given the unknowns surrounding the pandemic, COP26 was rescheduled for November 2021.

While the importance of "S" or social factors clearly increased in 2020, that did not diminish the importance of climate change and other environmental issues. The pandemic combined with an alarming number of natural disasters (tropical storms, floods, forest fires) reinforced the severity of the economic and social risks that can be expected if we fail to address climate change. Investors and governments now recognize that climate change potentially poses even greater economic and health risks than pandemics. At the same time, it is a problem that is more difficult and will take longer and require significantly more investment to solve.

For these reasons and more, investing to mitigate the risks related to climate change became central to pandemic recovery plans promulgated by governments in the EU, U.S., and China. The EU announced its "European Green Deal" and committed billions of dollars to new investment in green energy and energy transition. The EU is also implementing new rules to stimulate and regulate sustainable finance and investing (i.e., EU Taxonomy and EU Action Plan on sustainable finance). In the U.S., the new Biden Administration campaigned on a theme of "Build Back Better," which centered on investments in infrastructure and renewable energy. In China, the government's 14th Five-Year Plan committed to accelerating its investment in green energy/technology and reducing carbon emissions more quickly than in prior plans.

According to a 2019 report by the International Renewable Energy Agency (IRENA), a cumulative investment of $110 trillion into the global energy system will be needed to meet the growth in global energy demand and a reduction in carbon dioxide emissions significant enough to meet the Paris Agreement goal of limiting the rise of global temperatures to 2 degrees Celsius by 2100. With this much at stake, we are not surprised that some of the biggest investment trends in 2020 revolved around clean energy, electrification of transport, hydrogen and fuel cells, and carbon capture. The theme of investing in climate change was a popular choice among many Special Purpose Acquisition Companies (SPACs) that went public and closed acquisitions in 2020, and this trend is continuing into 2021.

The Progression of Baron's ESG Journey

Like virtually every other office-based business, the pandemic caused significant disruption in our day-to-day operations as we shifted overnight from working at our New York headquarters to working remotely from all over the place. Based on the exceptional returns of so many Baron Funds last year (Baron 4Q20 Quarterly Report), we can safely say our Firm managed this transition exceptionally well. We continued to progress in our commitment to ESG in 2020, alongside our research and investment responsibilities and everything else we do at the Firm.

As a PRI Signatory, we are committed to the following principles:

1) We will incorporate ESG issues into investment analysis and decision-making processes.
2) We will be active owners and incorporate ESG issues into our ownership policies and practices.
3) We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4) We will promote acceptance and implementation of the Principles within the investment industry.
5) We will work together to enhance our effectiveness in implementing the Principles.
6) We will each report on our activities and progress toward implementing the Principles, which tracks all our interactions and engagements with companies in which we are invested or may seek to invest.

Despite the disruption and the challenges encountered, we continued to progress in our efforts to integrate ESG into our investment process on a more fulsome and everyday basis. We continued along the path we began in 2019 and implemented several new initiatives in 2020. The two most prominent initiatives focused on continuing the education process of our investment teams and other constituents in our Firm and enhancing our shareholder engagement efforts. Key to these efforts were the launch of a weekly internal ESG research report that is distributed Firm-wide and our ESG Engagement Survey.

Education and Engagement

We believe a key part of our ESG journey is education and providing our teams with a regular stream of this type of information can only serve to enhance their knowledge and their ability to make ESG a regular and integral part of their research process.

To that end, we introduced an internal research weekly this past year. The weekly ***"ESG Research Compendium"*** is curated and edited by our Director of ESG Research and contains a mix of research and news related to ESG. The weekly compendium often includes notable examples of academic or Street research or proprietary internal research intended to help inform and educate our investment teams. This research highlights the importance of certain topics or key issues, helps our research team in evaluating related risks or understanding of opportunities, and helps define or refine best practices for integrating ESG into our process. News items can include anything related to specific Environment, Social, or Governance topics or issues, data updates on fund flows and performance, regulatory developments as they relate to ESG, and/or stories focused on ESG issues as they pertain to companies of interest to our teams.

Of course, living up to our commitment to ESG principles also requires incorporating analysis of material ESG issues, risks, and opportunities into our investment framework. To do this properly, it is important to engage with our portfolio companies and others we are researching on a regular basis. In doing so, we seek to understand how they can be successful in building businesses, how they are dealing with the changing risk landscape, and how they are seeking to capture new opportunities that result from a changing business landscape. To this end, we recently wrote and published a "Baron Stewardship Policy" for the Firm, which formally recognizes that ESG integration, shareholder engagement, and proxy voting are all key elements of our investment process and part of fulfilling our fiduciary duty to clients and better describes our process for engagement and proxy voting.

The term "engagement" in the context of ESG can have multiple meanings. In its broadest context we believe it is the act of interacting with companies to understand their businesses, strategies, opportunities, and risks. It also enables us to share our views, opinions, and suggestions (where warranted), with company management and, at times, the directors to achieve a desired outcome. As long-only, long-term equity-focused investors, we have always done this, and it is what we for years have simply called "research" as we have sought to generate superior shareholder returns over a period of at least three to five years. We believe that, for companies to be consistently successful over this timespan or longer, they typically will also be good

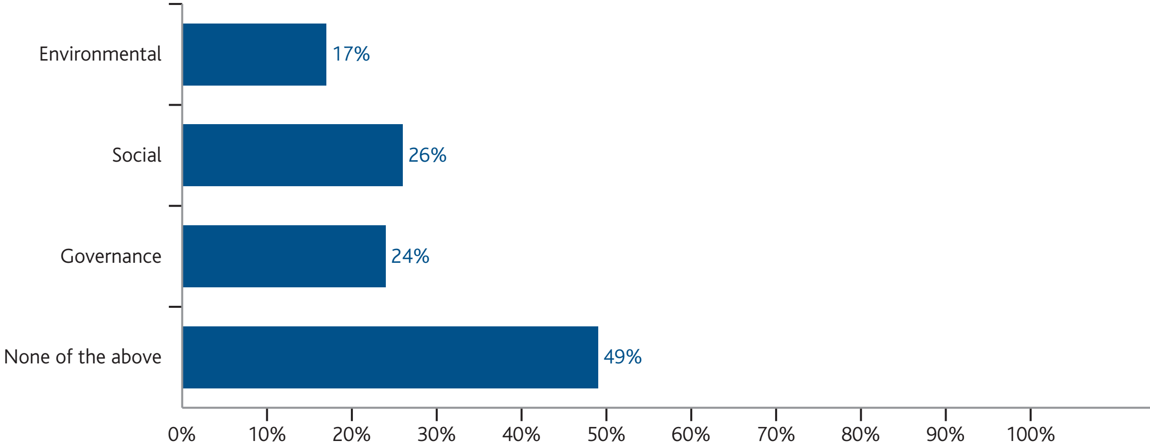
stewards of the environment, their customers, their employees, and their communities. Therefore, understanding how companies view ESG issues and sustainability, and incorporate them into their business strategy is important today, and, in our opinion, will be even more important in the future.

We typically conduct these engagements through one-on-one and group meetings, conferences, conference calls, and site visits. Obviously since the onset of the pandemic, nearly all our interactions and engagements have moved to the virtual world of voice and video (thank you Zoom, Webex, and Teams). As you would expect, the range of topics that we discuss with companies is broad and vary from meeting to meeting and time to time and may also depend on who within our Firm is conducting the engagement. For example, our analysts may spend less time discussing ESG issues in a post-earnings follow-up call than our Director of ESG Research will spend during a call to review a proxy or a governance topic or to specifically discuss ESG strategy.

To improve our efforts to track these interactions or engagements and to gather better data on the topics discussed during these meetings, particularly topics related to ESG, we implemented our "***Baron ESG Engagement Survey***" in May 2020. This online tool asks the lead participant in every meeting to answer a series of questions about the company and whether E, S, or G topics were discussed, and if anyone from Baron advocated for a particular action related to E, S, or G issues. From the time we implemented the survey in early May through the end of 2020, we logged nearly 800 interactions with companies. In nearly 500 of these meetings, we engaged with either C-suite executives and/or members of the Board of Directors. As the two charts below illustrate, we discussed ESG issues in at least 51% of those meetings, while we advocated for companies to make ESG-related changes in only about 8% of our meetings (Charts 3 and 4). This latter statistic is one that requires more study on our part and is an area in which we should show improvement over time as our ESG efforts become more deeply ingrained into our investment process.

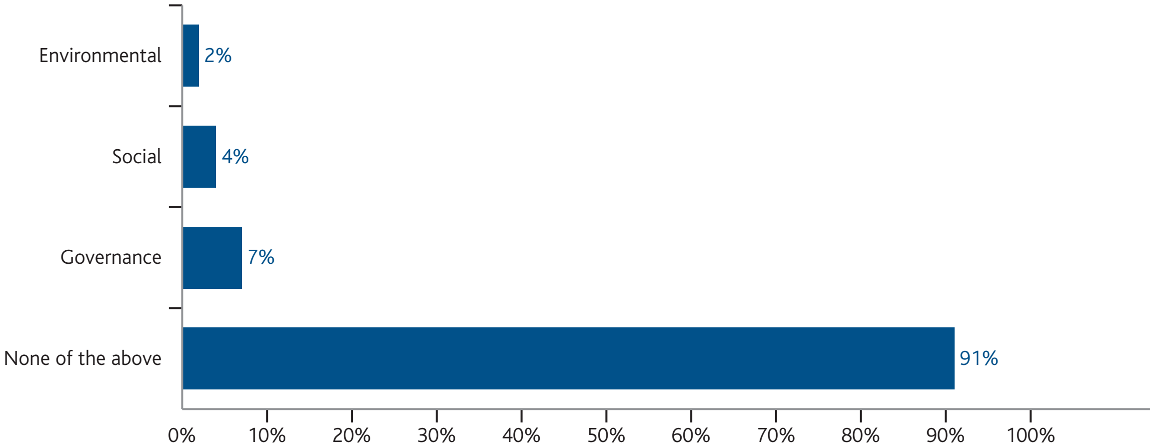
In 2020, our Director of ESG Research, often in concert with other members of our Proxy Review Committee and our research analysts, conducted about 25 more in-depth engagement meetings with companies, which was up sharply from 2019. Many of those discussions were triggered by companies seeking our comments or feedback on specific issues related to governance issues, but nearly all resulted in wider ranging ESG conversations. These conversations proved to be great opportunities for us to advocate for additional disclosures and better ESG practices across a wide variety of issues and it is our goal to expand this practice in 2021. This is consistent with our recently adopted "Stewardship Policy," the 2021 priorities of which are discussed in more detail below.

Chart 3: Percent of Baron Interactions Discussing ESG



Source: Baron Capital

Chart 4: Percent of Meetings in Which We Advocated for Changes

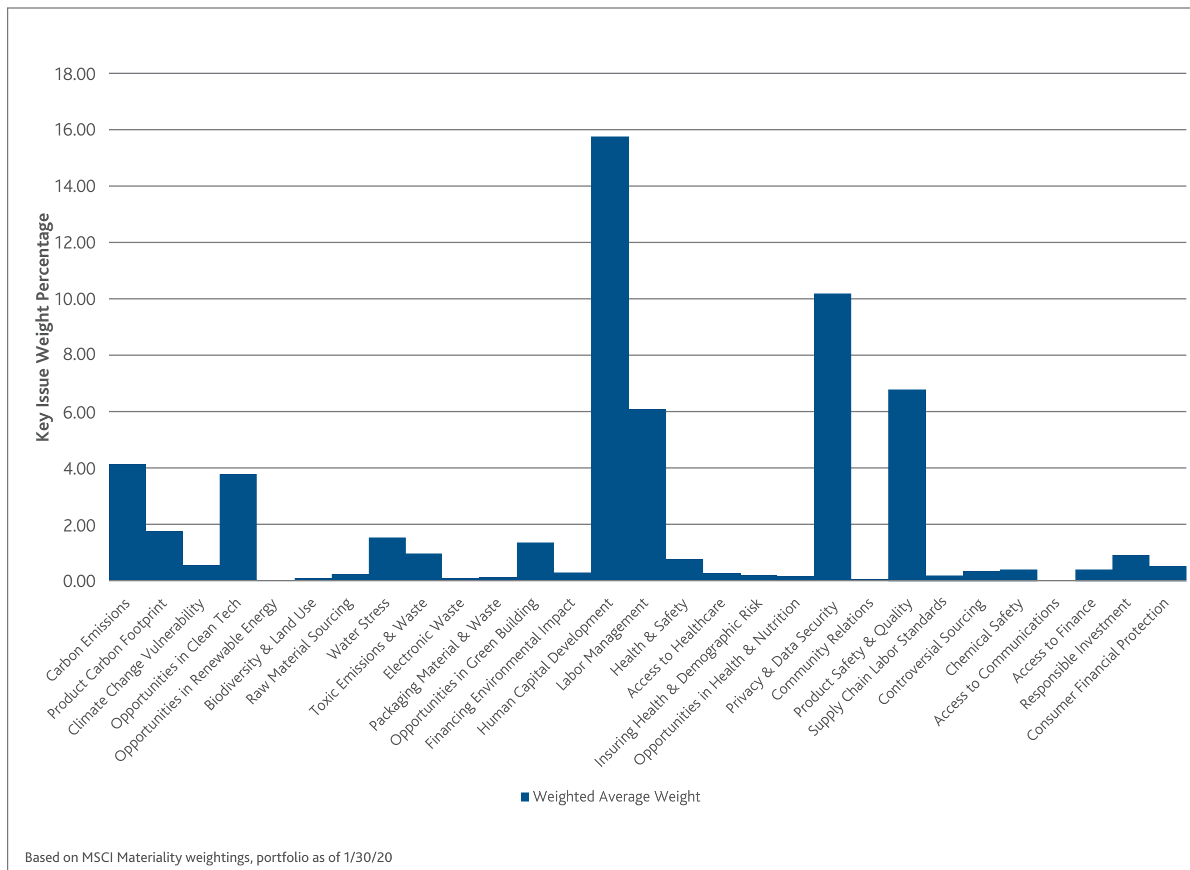


Source: Baron Capital

It is interesting, but not surprising, given the composition of our Funds, that the most-often discussed topics were related to Social issues, followed by Governance. Our Funds lean heavily toward Consumer Discretionary, Information Technology, Health Care, and Financials, and the importance of environmental issues for companies in these sectors compared to social issues is relatively low.

In Chart 5, we show a mapping of the weighted average exposure to key ESG issues that is derived from cross referencing our holdings across all funds with MSCI's materiality map and standard issue weightings for Environmental and Social categories. MSCI's map is based on standardizing key issue weightings across 11 industry groups and 158 sub-industry groups. This analysis shows that the higher weighting in our portfolios toward the sectors mentioned above results in much greater exposure to issues that are routinely categorized as Social issues, including human capital development, privacy & data security, and product safety & quality, among others. With a weighted average across our holdings of about 43%, Governance issues such as board diversity and structure, executive compensation, the importance of ESG and sustainability to the board also figured prominently.

Chart 5: Breakdown of Baron Capital Group Holdings by MSCI's Materiality Map



Stewardship Priorities for 2021

Most of our interactions or "engagements" with companies are focused on deepening our understanding of the business and management's strategy ability to execute and create value. However, as part of our new Stewardship Policy, we are also committed to improving our advocacy of specific ESG issues and to reviewing those issues on at least an annual basis. For 2021, our top stewardship priorities are focused on enhanced disclosure of data that helps to improve the comparability of material ESG risks and opportunities.

We believe SASB has produced the most comprehensive set of standards for companies to follow in making sustainability disclosures, and we became an Alliance Member of SASB to show our support of these standards and encourage companies to look to SASB to drive decisions on disclosing more information. We are also carefully monitoring the work being done by several other entities including the World Economic Forum's International Business Council (IBC) and the International Financial Reporting Standards Foundation (IFRS). The IBC partnered with the "Big 4" accounting firms to create the reporting framework for 21 ESG standards. Those standards were released in September 2020 and over 60 global companies have already agreed to adopt this new reporting framework. The IFRS, which governs accounting rules and disclosures for companies across the globe, has been studying the formation of its own Sustainability Standards Board (SSB) and seems poised to take a bigger role in this area.

In 2020, we saw the beginning phase of growing cooperation among a number of entities that have been working on sustainability standards and reporting frameworks, and we believe that over the next several years there will be a convergence of standards by which companies report ESG-related data and this will result in greater availability, consistency, and comparability data. This should also make it easier for investors and other stakeholders to evaluate a company's exposure to and management of sustainability risks and opportunities.

We think it is critically important that companies do not approach ESG as a compliance or “box-ticking” exercise and instead should work to understand and communicate how ESG and sustainability integrate with their business strategy and purpose. We think that these companies will benefit by integrating ESG into their businesses and by being able to demonstrate this integration with good metrics. Lastly, we also think it is a good idea for companies to integrate sustainability reporting with financial reporting, at least on an annual basis, as this practice can provide shareholders and other stakeholders with a more complete picture of a company’s risks, opportunities, and competitive positioning.

As for specific issues on our agenda for 2021, we clearly see a need for improved and expanded disclosures from all companies as to the risks and opportunities related to climate change. Disclosure frameworks such as Task Force for Climate-related Financial Disclosures (TCFD) and CDP (Carbon Disclosure Project) offer useful guides for best practices when it comes to data disclosure, risks, and action plans.

Even though corporate disclosure rates for environmental issues still have significant room for improvement in terms of compliance and data quality, it is far better than it is for social issues. We believe more data is needed to properly evaluate how companies manage human capital, including recruiting and retaining talent, workforce diversity, and pay equity. The acceleration of the digitalization of our economy is also making us more focused on how companies are managing risks and opportunities related to data privacy and cybersecurity.

From a governance perspective, our focus is ensuring that management incentives align with shareholder/stakeholder priorities. This includes evaluating executive and board diversity initiatives and pay structures to make sure they are focused not only on long-term value creation but also on linking sustainability performance metrics to a portion of long-term incentive compensation. As part of our ongoing efforts to enhance our ESG practices and be better positioned to work with others and become more effective in implementing the responsible investment principles, we recently became members of both the Investor Stewardship Group (ISG) and the International Corporate Governance Network (ICGN). Both organizations are well known for working to promote effective standards of corporate governance and investor stewardship, and they should be helpful in keeping us informed and active in promoting best practices.

Examples of ESG Analysis Impacting Our Investments

As part of our ongoing effort to integrate ESG into our investment process, we asked our research analysts to provide examples of how their evaluation of ESG issues impacted our investment decisions in 2020. Below are several of those examples:

Array Technologies, Inc.

A recent investment decision for which ESG considerations played a significant role was our investment in the IPO of Array Technologies, which has a patented tracker technology that increases the efficiency and reduces the cost of solar energy systems. We have increasingly sought to invest in companies that are well-positioned to benefit from the transition to a low-carbon economy. We do not, however, seek to invest in companies that are “plays” on a particular ESG theme or issue–we also require that each company meet our investment criteria, such as being leading industry players and the beneficiaries of strong secular tailwinds and possessing what we believe to be sustainable competitive advantages and long-term growth opportunities. We think that Array meets these requirements, and specifically, is competitively advantaged to capitalize on the ongoing growth of utility-scale solar electricity generation, which is being driven by the combined factors of soaring demand for renewable energy and the falling costs and increased efficiency of solar systems with the use of tracker technology. Array’s technology benefits from less labor needed for installation, lower operating and maintenance costs, and a 7% lower levelized cost of energy versus the competition. The company continues to invest in innovation, such as its new technology for stowing individual rows of panels in response to excess wind. While the company has been wholly owned by a private equity firm, it is transitioning to a majority independent board, and we expect the influence of its PE sponsor to decline significantly over time.

Vital Farms, Inc.

We initially invested in Vital Farms, a producer of pasture-raised eggs and butter, during its IPO in July 2020. With over 75% market share in the fast-growing pasture-raised egg sub-segment, Vital Farms is a trusted brand by consumers who are increasingly focused on natural, ethically produced, great-tasting, and nutritious foods. The founder cares deeply about “conscious capitalism” and structured Vital Farms as a B-Corp, with a stakeholder model focused on customers, community, environment, employees, and shareholders. The board and the executive team are comprised of diverse individuals who add unique perspectives to running the company and meeting the goals and needs of all the company’s key stakeholders. The board composition and size were chosen to provide the needed expertise and experience to build a company with sustainability at its center. Based on our conversations with management, we believe Vital Farms is working to formally integrate ESG initiatives into more decision-making processes and might even link executive compensation to sustainability goals in the future.

Building on its vision to promote healthy eating, the company has direct relationships with 200 small family farms and focuses on delivering high standards of animal welfare and environmental sustainability. Every farm goes through a rigorous process of vetting and onboarding, including character references and training farmers from scratch. All eggs are pasture raised versus the industry standard of cages or “cage-free”, which still traps chickens in dark warehouses. Its butter comes from pasture-raised cows versus conventional butter which typically comes from cows that are tightly packed into warehouses with zero access to the outdoors. Its state-of-the-art egg processing facility conforms to indoor environmental standards with fresh air and sunlight for crew members. Vital Farms pays employees 25% above a living wage and offers full benefits. Rather than adjusting labor hours to volume, Vital Farms re-deploys workers to additional projects to keep everyone engaged with the mission. This drives lower employee turnover and reduces hiring costs over time. We continue to be investors because we believe its unique production process and company culture resonate strongly with consumers and would be difficult for another company to replicate.

Suzano SA

In the third quarter of 2020, we initiated a position in Suzano, the world’s largest and lowest cost producer of pulp, which is primarily used in paper, tissue, and packaging. Suzano holds the world’s largest land holding of eucalyptus plantations. They are all commercial plantations, not native vegetation, and do not contribute to deforestation. Suzano’s pulp production removes more greenhouse gas emissions from the atmosphere than it emits. The company also has a goal to remove 40 million tons of carbon dioxide

over the next decade, and we see an opportunity for the company to monetize these carbon credits in the future. In addition, the company is working on new usage applications for pulp that could contribute to a global reduction of carbon emissions such as fossil-to-fiber substitution for textiles, plastics, fuels, and chemicals.

Conclusion

There is no doubt that 2020 was a challenging year on nearly every front, including our efforts to fully integrate ESG into our investment process. However, we are pleased to have moved the ball forward in significant ways that have raised the level of our discourse and our analysis, building on the foundations that we established last year. We look forward to continuing to build out our efforts, including making better, independent assessments of the ESG issues the companies in which we are invested face. We also look forward to helping guide these companies to build better, stronger, and more sustainable businesses that create value for our clients and their own stakeholders over the long term.

Thank you for investing in Baron Funds.

Sincerely,

James Stone
Director of ESG Research

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

Risks: All investments are subject to risk and may lose value.

There is no guarantee that the objectives discussed will be met.

Portfolio holdings as a percentage of net assets as of December 31, 2020 for securities mentioned are as follows: **Array Technologies, Inc.** – Baron Small Cap Fund (1.4%), Baron Discovery Fund (1.2%); **Vital Farms, Inc.** – Baron Discovery Fund (0.6%); **Suzano S.A.** – Baron International Growth Fund (0.8%), Baron Emerging Markets Fund (1.1%).

Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

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