

DEAR BARON SMALL CAP FUND SHAREHOLDER:

PERFORMANCE

Baron Small Cap Fund (the "Fund") did poorly in the first quarter, on both an absolute and relative basis. The Fund was down 15.68% (Institutional Shares), trailing the Russell 2000 Growth Index, which lost 12.63% and the S&P 500 Index, which fell 4.60%. The Fund's longer-term performance is still admirable as shown in the table below.... gaining 10.76% per year, on an annualized basis, over its almost 25-year history and besting the returns of its benchmark index for all relevant time periods.

Table I.
Performance

Annualized for periods ended March 31, 2022

	Baron Small Cap Fund Retail Shares ^{1,2}	Baron Small Cap Fund Institutional Shares ^{1,2,3}	Russell 2000 Growth Index ¹	S&P 500 Index ¹
Three Months ⁴	(15.72)%	(15.68)%	(12.63)%	(4.60)%
One Year	(5.11)%	(4.87)%	(14.33)%	15.65%
Three Years	14.30%	14.59%	9.88%	18.92%
Five Years	14.81%	15.10%	10.33%	15.99%
Ten Years	12.63%	12.92%	11.21%	14.64%
Fifteen Years	9.56%	9.80%	8.81%	10.26%
Since Inception (September 30, 1997)	10.62%	10.76%	6.57%	8.60%

The market was very weak in the quarter for a plethora of reasons. Early in the quarter inflation was considerably higher than expected, pushing interest rates higher. The yield on 10-year U.S. Treasuries rose from 1.5% to 2.0%, which led to the first leg down for the market, as the trading multiples of growth stocks, particularly small caps and unprofitable companies, were all negatively affected. Still, the economy seemed super strong, and the earnings outlook unaffected, so the market action felt more like a rotation than a scary fall. But then inflation accelerated, caused by an imbalance of supply and demand. Strong consumer spending was spurred by prior expansionary fiscal and monetary policies and flush consumers unleashing



CLIFF GREENBERG

PORTFOLIO MANAGER

Retail Shares: BSCFX
Institutional Shares: BSFIX
R6 Shares: BSCUX

pent-up spending desires coming out of COVID. However, supply is still constrained by persistent supply-chain issues, tight labor markets (the unemployment rate fell to 3.6%) and shortages of housing and goods, causing price spikes. This resulted in rates continuing to move higher. Then Russia invaded Ukraine, which resulted in...among other things...rising energy (oil rose to over \$100/barrel), commodity, and food prices, exacerbating an already precarious inflationary situation. The Federal Reserve changed its stance to take a much more aggressive approach to raising interest rates and cutting back its balance sheet, signaling multiple and significant rate hikes to come over the next year. The yield on 10-year U.S. Treasuries rose to nearly 2.5% late in the quarter. Recession concerns flared as higher inflation and rates, a lower stock market, and knocks to consumers' psyches have created uncertainty about the future economic trajectory.

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares and Institutional Shares as of September 30, 2021 was 1.29% and 1.03%, respectively. 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.

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. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell is a trademark of Russell Investment Group. The indexes and the Fund include reinvestment of dividends, net of withholding taxes, which positively impact the performance results. The indexes are unmanaged. Index performance is not Fund performance; one cannot invest directly into an index.

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

3 Performance for the Institutional Shares prior to May 29, 2009 is based on the performance of the Retail Shares, which have a distribution fee. The Institutional Shares do not have a distribution fee. If the annual returns for the Institutional Shares prior to May 29, 2009 did not reflect this fee, the returns would be higher.

4 Not annualized.



Baron Small Cap Fund

Most stocks declined in the market, other than those in the Energy and Materials sectors. Defensive sectors, such as Consumer Staples, Utilities, and Health Care (ex-biotechnology), did better than growth sectors like Information Technology (IT) and Consumer Discretionary. In the first part of the quarter, growth did poorly but value hung in. Larger market caps did okay, and smaller ones fell. When concerns about future economic growth became more prevalent, even those sectors that had stood their ground fell as well.

The Fund was not set up well to weather the storm. We are overweight in IT and Consumer Discretionary, the two worst performing sectors for the quarter. We are growth oriented. We own many small-cap stocks that are somewhat thinly traded and declined along with that ilk of stock. The Fund usually performs relatively well in downdrafts, since we own stocks of higher quality, more established industry leading businesses with pricing power that usually don't lose investor confidence so quickly. That hasn't been the case this year. Even those holdings, which posted good results and outlooks, declined as their multiples shrunk. Also, some concern rightfully crept in on the question of whether earnings estimates would be in question in the more uncertain economic environment. As usually is the case, our worst performing stocks on a percentage basis either missed earnings estimates or are in end markets considered most negatively affected by higher rates. We did have some gainers, which bucked the trend because their outlooks were improved by higher interest rates, energy prices, or sales to the defense industry.

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

	Percent Impact
HealthEquity, Inc.	0.40%
Aspen Technology, Inc.	0.21
WEX Inc.	0.20
Nuvei Corporation	0.20
Mercury Systems, Inc.	0.19

Generally, fundamental company-specific results and developments are the most important drivers to stock performance in each period. That was not the case this past quarter when, for the most part, market, macro, and geopolitical considerations were more relevant to price action.

HealthEquity, Inc. is a leading administrator of Health Savings Accounts (HSA) and other consumer directed employee benefits. Shares rose in the quarter after the company reported strong results, especially in the core HSA business (accounts were up 25%) where they are taking market share. There is a long runway of growth as the HSA market grows around 10%, and HealthEquity expects to outperform. Shares of HealthEquity traded down last year because the sizeable acquisition of WageWorks stumbled out of the gate, as COVID negatively affected some of its products. Now we think the company is seeing success with cross-selling efforts and the deal will turn out to be a winner. Higher interest rates should also boost earnings, possibly in a meaningful way.

Shares of **Aspen Technology, Inc.**, a leader in process automation software, rose in the quarter after reporting a 6% acceleration in organic growth. Aspen should close its transformative deal with industrial equipment manufacturer Emerson before mid-year, after which Aspen will take over management of Emerson's undermanaged software offerings. We believe that Aspen management is uniquely qualified to run those products, convert them to recurring revenue offerings, and, over time, significantly improve

their growth trajectory and profitability. We also believe that the new entity will be more acquisitive, which we think will drive additional shareholder value...so we are psyched for Aspen 2.0.

WEX Inc. is a diversified business service company, which provides fuel cards, payments services, and benefits administration services. The shares rose this quarter after the company reported strong results that beat on the top and bottom line. Higher fuel prices benefited reported earnings, which was a big driver of improved stock performance. The company hosted an investor day during which management reiterated its long-term targets of 10% to 15% revenue growth and 15% to 20% earnings growth. The stock trades at under 15 times earnings. Management also outlined how the business can transition to serve electric vehicles over time and how the payments business should prosper with the expected uptick in travel.

Shares of **Nuvei Corporation**, a global payments provider, rebounded in the quarter after reporting strong results. The company reported strong organic revenue growth of 55% and earnings growth of 43%, which flew in the face of a prior short report that predicted the demise of the business. At Nuvei's recent analyst day, management guided for near-term organic revenue growth of 30% and EBITDA margins that could climb from 43% to 50%, which is extraordinary. We are impressed by the quality and depth of the management team, the glowing testimonials of customers, and the logic and execution of the acquisition program.

Mercury Systems, Inc., a leading Tier 2 defense electronics contractor, bounced back, along with the broader defense industry, after the Russian invasion of Ukraine and a larger-than-expected U.S. defense budget for fiscal 2023. As Mercury is involved in all the key priorities of the current U.S. defense strategy, we believe that growth will accelerate in the future. Mercury has been struggling with program delays and supply-chain issues for much of the last year, and the stock has been under pressure for some time. Activists bought stakes recently, which we view as an indication of value in the stock. We are hopeful that the company will revert to its historic growth algorithm or high single-digit organic revenue growth, faster profit growth, and strategic and accretive acquisitions, which would drive much higher EBITDA and a higher valuation, in line with past norms.

Table III.
Top detractors from performance for the quarter ended March 31, 2022

	Percent Impact
Vertiv Holdings, LLC	-1.52%
Installed Building Products, Inc.	-1.46
Floor & Decor Holdings, Inc.	-1.16
SiteOne Landscape Supply, Inc.	-1.12
Trex Company, Inc.	-1.00

Our biggest losers were stocks that fell because of earnings misses (about 8% of the portfolio) or traded down because interest rates rose (around 11% of the portfolio). We believe both types were overly punished, causing the stocks to trade down to very cheap levels from which we expect to make strong returns over time.

Vertiv Holdings, LLC, a global provider of critical digital infrastructure, reported a terrible quarter and very weak guidance. The stock got obliterated. For the quarter, revenues were in line, but profits were much worse than expected. And earnings guidance for 2022 was \$0.70 per share versus the \$1.30 per share expected. The company suffered from a severe execution misstep related to insufficient price increases against significantly

higher costs from inflation and supply-chain issues. We believe that the company has addressed the issue, raising selling prices ahead of cost increases, but mispriced orders taken late last year will penalize earnings in the first half of the upcoming year. The stock traded down to about 8 times our expectations for the earnings run rate in the back half of 2022. This is less than half the trading multiple of comparable industrials. If you recall, Vertiv came public by merging into a SPAC that was led by a highly respected executive of a leading industrial company, and his involvement gives us more confidence that this situation has been righted.

Installed Building Products, Inc. (IBP), the leading installer of insulation and complementary products for the residential housing industry, fell in the quarter over concerns that rising interest rates would change the housing outlook. IBP reported good results, featuring strong organic sales, a record year of acquisitions, positive price/mix and a robust demand environment. However, profit margins were negatively affected by continued supply-chain challenges, primarily the lack of availability of spray foam. But as mortgage rates have climbed toward 5%, the stock is trading like the party is over. We don't think it is. We believe this will be a strong year for IBP, since backlogs of homes already sold is so high, and completions will continue to grow. The outlook is foggy for next year and beyond, but we think that, even if housing development stalls, or home prices stop escalating because of higher rates, housing demand will remain strong due to a substantial lack of inventory. The stock has traded down to around 8 times our estimate for this year's EBITDA, which is cheap. Management agrees and has installed an opportunistic repurchase plan.

Floor & Decor Holdings, Inc., the category killing retailer of hard surface flooring, fell this quarter because of concern that higher interest rates would hurt its near-term results and because the stock had traded at a premium valuation (well deserved, in our opinion). Floor & Decor reported strong results for the fourth quarter and 2021, as EBITDA grew 50% and earnings grew 44%. Same-store sales grew 27%, some of which was aided by increased prices to pass on higher costs. The company is guiding to more modest growth this year but for very strong long-term growth of about 25% per year, as the store base grows from 160 today towards a goal of over 400. We are cognizant of market concerns that consumers will spend more on services than goods in the near future and that higher rates could negatively impact sales on the margin, but we don't think the affect will be significant. Floor & Decor is taking massive market share, should be able to continue to pass on higher costs, and has major competitive advantages. We certainly do not believe that the near-term headwinds will change the long-term growth path of the company. The stock has traded down to just over 20 times our estimate for earnings in 2023, which is half its historical trading multiple. The stock is trading at 10 times what we project the company will earn in five years. And there should be lots of growth from that point.

Shares of **SiteOne Landscape Supply, Inc.**, the largest distributor of wholesale landscape supplies, fell for similar reason as Floor & Decor.... concern about the possible impact of rising interest rates and multiple compression. The company reported strong results and had a blowout year in 2021...organic revenue growth of 20%, EBITDA growth of 60%, and free cash flow per share up 90%. SiteOne, too, is projecting more modest growth this year against the tough comparisons and flat margins after superb cost management last year. Maybe growth will be slower than expected this year because of the macro environment...maybe... but the stock has traded to a valuation level that is a discount to where we think it should trade on our estimates for 2022 results. We think this is a special company and management team. We think EBITDA will grow at about 15% a year from

this base through organic growth and acquisitions, and the company will generate significant free cash flow to fund future growth.

Trex Company, Inc. is the leading provider of composite decking materials, which are taking market share from wood. Like SiteOne and Floor & Decor, the stock fell significantly this quarter over concerns about the impact higher mortgage rates could have on sales and because the stock has been a darling, trading at a high multiple. The company reported great results for 2021, with revenues, EBITDA, and EPS up 36%, 40%, and 38%, respectively. The demand outlook for composite decking remains strong, as the product continues to take market share and Trex leads the industry with 50% market share. Trex has added significant new capacity to support growth for the next five years, but startup costs and some other logistical challenges have modestly dampened margins. We acknowledge that if the economy were to slow and consumers radically reorient spending away from fixing their homes, that growth might slow, but the stock is now trading at 18 times our earnings estimate for next year, which is really low for a business of this quality, with this track record, and this opportunity for future growth.

PORTFOLIO STRUCTURE & RECENT ACTIVITY

As of March 31, 2022, the Fund had \$4.6 billion under management. We owned 74 stocks. The top 10 holdings made up 30.9% of the Fund, in line with historical norms.

Table IV.

Top 10 holdings as of March 31, 2022

	Year Acquired	Quarter End Investment Value (millions)	Percent of Net Assets
Gartner, Inc.	2007	\$260.3	5.7%
ASGN Incorporated	2012	180.9	3.9
ICON Plc	2013	170.3	3.7
Aspen Technology, Inc.	2015	132.3	2.9
SiteOne Landscape Supply, Inc.	2016	121.3	2.6
Installed Building Products, Inc.	2017	116.2	2.5
Guidewire Software, Inc.	2012	115.9	2.5
Kinsale Capital Group, Inc.	2019	114.0	2.5
Red Rock Resorts, Inc.	2016	109.3	2.4
Floor & Decor Holdings, Inc.	2017	101.3	2.2

As has been the case for some time, the Fund is most heavily invested in four sectors.... IT (25.5% of net assets at the end of the quarter), Industrials (23.8%), Consumer Discretionary (15.6%), and Health Care (14.5%). We build the portfolio on a bottom-up/stock by stock basis, so we differ materially from the composition of the Russell 2000 Growth Index, our benchmark index and the index to which we are most often compared. We are overweight in IT and Consumer Discretionary, well overweight in Industrials and significantly underweight in Health Care. We don't own Energy stocks, which worked against us this quarter, and are also underweight in Consumer Staples, Materials, and Utilities, which also held up better this quarter. Our cash position was about 3% on average during the quarter, which is somewhat higher than usual. With the market volatile and trending lower, we think this will enable us to take advantage of potential mispriced securities.

Baron Small Cap Fund

We are long-term investors, which we believe is a key differentiator. About half the assets we manage are in stocks that we have owned for over five years... 19% in stocks we have held for over 10 years. The annualized total return for these long-term holdings is about 24%, which we think is impressive and a proof statement to the long-term nature of our approach. Many of these long-held investments have had enormous returns. 31% of the assets under management are in stocks that have appreciated five times or more since their initial purchase price. Another 35% have gone up between two and five times. So, about two-thirds of the Fund is invested in stocks that have doubled or more since their initial purchase price. We are proud of this. It is gratifying that our "winners" continue to appreciate at high rates.

Holding onto our winners as they grow is another key differentiator. We don't necessarily sell when our holdings appreciate beyond small-cap market capitalizations. We believe that would detract from our absolute returns. After about 25 years of actively and carefully managing the portfolio to make sure we water our flowers and pull our weeds, 31% of our assets are in stocks that are over \$10 billion in market cap. These stocks as a group have been held for 11 years on average and have returned 31% per year, on an annualized basis. And many of these stocks have been top performers for us in recent periods. We do, however, tactically reduce our holdings in our larger-cap positions to stay true to our small-cap mandate and manage position sizes.

We own on average 21% of our original position of the 10 largest cap positions. This past quarter, the weighted average market cap of stocks we purchased, both new positions and additions to existing positions was \$3.2 billion. We sold out of or trimmed stocks with a weighted average market cap of \$10.5 billion.

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

	Year Acquired	Quarter End Market Cap (billions)	Amount Purchased (millions)
The Beauty Health Company	2021	\$2.5	\$25.2
Progyny, Inc.	2022	4.7	21.2
The AZEK Company Inc.	2020	3.9	12.6
Janus International Group, Inc.	2021	1.3	9.1
Mercury Systems, Inc.	2016	3.7	6.3

More of our investments this quarter went into adding to existing positions, as opposed to buying new ideas. We found ourselves adding to names we felt were mispriced yet had confidence in their long-term prospects. There were very few IPOs in the quarter, with the market falling and valuation levels declining. IPOs have traditionally been a source of fresh ideas.

We recently established a position in **Progyny, Inc.**, a benefits management company specializing in fertility and family benefits solutions to large, self-insured employers in the U.S. We believe that such benefits provide access to clinically effective treatments, ensure healthier outcomes for employees, and lower an employer's overall health care spending. We believe the fertility benefit's uptake is accelerating, as companies seek to gain an edge in the war for talent and employee retention.

Launched in 2016, Progyny has become the brand of choice in the \$7 billion fertility treatment market, amassing over 265 employer clients (including Google, Microsoft, 3M, and Unilever), up from 80 at its IPO in 2019, representing 4 million covered lives. Yet this represents a mere 3% of Progyny's target market, which is poorly served by managed care providers, giving the company a considerable growth runway. Since inception, its revenues are up five-fold, from \$105 million to \$500 million in 2021, with positive EBITDA, steady margin expansion, and a high rate of cash flow conversion.

Infertility is a significant societal/workforce issue, affecting one in eight U.S. couples according to the CDC. Its incidence is growing with the rising age of women pursuing pregnancy. Progyny allows a company to offer all its employees, regardless of sexual orientation or marital status, a more comprehensive fertility benefit than that afforded by traditional insurance. Among Progyny's many advantages is a network of independent fertility clinics that, utilizing the most current diagnostics and technology, consistently achieve better outcomes than national averages. A proprietary and differentiated treatment bundle, called the "Smart Cycle," is designed to give a doctor and patient the most appropriate and tailored approach to treatment choices rather than the more typical one-size-fits-all step therapy (where patient's benefits often run out before a pregnancy is achieved). An integrated pharmacy, with now over 90% client take rate, provides both lower costs and greater convenience, and high touch concierge support and counseling rounds out Progyny's value proposition. Progyny has high patient satisfaction, nearly 100% client retention rates, and healthier live singleton birthrates, while lowering the riskier, costlier multiple births frequently associated with fertility treatments. With greater adoption of the benefit and further market penetration, including recent expansion into Canada, we see potential for Progyny to grow its top line CAGR at approximately 35% for the next three to four years, scaling the business both rapidly and profitably, with EBITDA margins expanding from current low teens to around 20%.

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

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap or Market Cap When Sold (billions)	Amount Sold (millions)
Americold Realty Trust	2018	\$2.4	\$ 7.5	\$20.2
Clarivate Plc	2019	0.9	11.5	19.2
Paya Holdings Inc.	2020	1.3	0.8	15.1
Shift4 Payments, Inc.	2020	1.4	3.3	12.3
WEX Inc.	2013	2.9	8.0	11.4

During the quarter, we sold out of **Shift4 Payments, Inc.**, a fast-growing payments company. The business is not yet profitable and is somewhat capital intensive. We also sold most of our position in **Paya Holdings Inc.**, another fintech operator, as we were less impressed by its growth and positioning than our other holdings in the same industry, Repay and Nuvei.

We reduced our positions in **Americold Realty Trust** and **Clarivate Plc** when business trends disappointed. **WEX Inc.** rallied on higher gas prices, and we took some profits. We sold some of our larger-cap positions, **IDEXX Laboratories, Inc.**, **DexCom, Inc.**, and **Waste Connections, Inc.**, as is our practice to sell down these holdings at what we deem a prudent time.

OUTLOOK

We are writing this in early April, and it feels like the weight of the world is overhanging the market. Inflation is raging, with the last reading up 8.5%. Oil is over \$100 per barrel. The unemployment rate is 3.6%, and wages are rising 5.6%. Interest rates are up significantly, with 10-year Treasuries now above 2.9%, and the Fed has signaled that it could raise the Fed Funds rate 10 times over the next year and a half, with 50 bp bumps likely. It seemed like COVID was under control, but new and highly contagious variants are causing lockdowns in China. And the war in Ukraine continues, with a new phase of heavy combat in the offing.

The Fed is in a tough position, as it needs to significantly tighten monetary policy to tame inflation without slowing growth too much. Though our economy remains strong, we are starting to see some signs of consumer slowdown. And European and global economies are bound to slow considerably, as energy and food inflation is more severe abroad.

We believe that we are entering a period of slower economic growth, secularly higher interest rates, and higher risks. However, though this is unnerving, and causing the market to trade down, there is a lot that is not certain. Concerning inflation/interest rates, we are seeing easing congestion in supply chains and declines in shipping costs and some inputs. As the economy softens, we think inflation will moderate as it will be harder to pass along higher prices in that environment. We very well could be at peak inflation now. And if this is the case, we will probably have fewer interest rate hikes than presently contemplated.

Against this, we believe that for the most part, the businesses in which we are invested will be able to weather the potentially more difficult conditions ahead. They are well-managed, high-quality businesses, in strong financial condition, with major competitive advantages, and business momentum coming into this period. They are market share gainers with ample pricing power. We would expect businesses of our market-leading secular growers to excel, gain share, and emerge stronger if times get tough, as they have in the past.

We are continuously speaking with management teams, and we remain confident in their growth plans and future earnings prospects. Many of the stocks we hold are down significantly already. We think we are well into this correction. Importantly, our stocks are cheap relative to our projections, especially in our years, which bodes well for long-term returns. Investor sentiment is terrible, which, by the way, is a good thing.

Thanks for investing in the Fund and your confidence in us as managers. We appreciate it.



Cliff Greenberg
Portfolio Manager

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Risks: The Adviser believes that there is more potential for capital appreciation in smaller companies, but there also may be more risk. Specific risks associated with investing in smaller companies include that the securities may be thinly traded and they may be more difficult to sell during market downturns. Even though the Fund is diversified, it may establish significant positions where the Adviser has the greatest conviction. This could increase volatility of the Fund's returns. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

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