BARON
CAPITAL

Mike Lippert: Finding the best opportunities among an embarrassment of riches

This is an edited version of an October 25, 2021, Q&A with Mike Lippert, Portfolio Manager of Baron Opportunity Fund and Baron High Growth Strategy and Baron's Head of Technology Research. To access the full recording, please dial (800) 633-8284 passcode #21997773

Introduction

Overview of Fund performance

Q&A with Mike Lippert

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- How we filter to find the best of the best
- Criteria for selling a stock
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- Looking ahead

Introduction

Mike Lippert is the portfolio manager of the Baron Opportunity Fund and Baron High Growth Strategy as well as the Head of Technology Research. He has over 20 years of investment and research experience. For the past 15 years, he has been the portfolio manager of the Baron Opportunity Fund.

The Fund's 1-year performance as of September 30, 2021, was 33.91%. Its longer-term performance is equally as impressive: 34.26%, 32.96%, and 21.52% for the 3-year, 5-year, and 10-year periods, respectively, on an annualized basis. It ranked in the 6th, 2nd, 2nd, and 5th percentiles across these same time periods.

The Fund is in Morningstar's large cap growth category, which includes over 1,200 share classes. Many of these are household names in the mutual fund world. Baron Opportunity Fund is right near the top of a very large, very competitive, category.

As of 9/30/2021, the Morningstar Large Growth Category consisted of 1,235, 1,133, 1,024, 762, and 1,133 share classes for the 1-year, 3-year, 5-year, 10-year and overall periods, respectively. Baron Opportunity Fund Institutional Share Class received 5 stars, 5 stars, 5 stars and 5 stars for its 3-, 5-, 10-year and overall performance, respectively. This Morningstar Rating™ is for the Institutional share class only; other classes may have different performance characteristics. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures.

Morningstar calculates the Morningstar Large Growth Category Average performance and rankings using its Fractional Weighting methodology. Morningstar rankings are based on total returns and do not include sales charges. Total returns do account for management, administrative, and 12b-1 fees and other costs automatically deducted from fund assets.

Q&A with Mike Lippert

Tell us about managing your Fund in the current environment.

I'd like to say something new and interesting, but nothing has really changed. Our approach is consistent. We have a philosophy and a practice founded by Ron Baron 40 years ago. I've been doing it now for 20 years.

I'm thinking about big secular trends, generational shifts, tectonic shifts, finding companies that have durable growth and businesses that can generate lots of free cash flow and earnings. Those are the key determinants of long-term returns, not the short-term stuff that the market often gets caught up in.

Year-to-date, the Fund is up in the teens, which is solid performance after last year when the Fund was up around 90%. But more than the performance, I'm pleased that the themes we focus on, things like cloud computing, genetics and health care, electric vehicles, and many more, are as strong as they've ever been. I often use the term "embarrassment of riches." There are so many great companies out there and our challenge right now is to filter them to find the very best.

We've come through a period of rapid digital transformation. We were forced to entertain ourselves using streaming media. People who had been reluctant to adopt e-commerce were forced to; they had to have many products, including food, delivered to their door. Businesses had to change their architecture and the way their employees access applications, data, and interact with clients and customers because we were all working from home. We believe this was just an acceleration of changes that were already underway from both a business and a consumer perspective. In some areas, the level of digital activity we saw during the worst of the pandemic won't sustain, but I firmly believe these are real inflections.

You look for companies that can grow faster for longer. Can you share a few names?

A good example is **ServiceNow**, **Inc.**, a software investment that we've had for many, many years. In a sense, the market never understood or appreciated the duration of growth and the ability for that company to generate free cash flow. Over the seven-year period that we studied the company, it had a 30% pullback on average eight different times. So, eight 30% pullbacks over seven years. If you bought it at the beginning, held it to the end and focused on the durability of growth and ability to generate free cash flow, you had a 30% compound annual return even with all those pullbacks. This is what we look for all the time. I think every great long-term growth investment has those characteristics.

Then there are the household names: **Apple, Inc., Alphabet, Inc.** (Google), and **Amazon.com, Inc.** are still great investments. Think how they have changed. Amazon went from an online bookseller in the early days to selling everything online and also disrupting the IT industry with Amazon Web Services. Apple struggled to gain market share from Microsoft in the early days, then ushered in the digital mobile age with iPods, then the iPhone, the iPad, the app store, all of that. Google had a huge total addressable market [TAM] with search but think of what they are today. A media company with YouTube, a software company with Gmail and Chrome, and a cloud company. So those are examples from the past.

Think about **Tesla, Inc.**, which started by selling a super high-end sports car, the Roadster. That was their initial way of proving out their technology and manufacturing electric vehicles. They went from the Roadster to the Model S and Model X -- sedans and SUVs -- and then exploded the mass market with Model 3 and Model Y. There are 100 million cars sold per year, and Elon Musk's goal is to get to 20 million, or 20% share. No one on the Street believes that. But he's steadily increased his TAM, not just addressing the high-end of the automotive market but all of it. In the future they're going to have a $25,000 model and they'll penetrate the entire market. Beyond that, they have what we call second or third acts. We also call them multiple TAMs. When you think about autopilot, if it's successful, it will not just help generate revenues for Tesla cars themselves but through licensing to other car companies. That's obviously a longer-term opportunity for an electric, autonomous-driven kind of Uber model.

The best long-term investments always grow faster for longer than the market believes. Of course, you need business models that can generate profits and cash flow as they scale. And then the market will simply put a multiple on that. That's what the stock price will be. We try to invest in the early days of a company's growth trajectory. Sometimes the market is trying to guess that as well, but they are generally so focused on the coming quarter or year that they miss the boat on what a business can become over the long term. But that's what we're laser focused on at Baron.

Can you talk about your mapping effort and new ideas that are getting your attention?

Whether you think of them as trends or themes, or industry verticals, it's all just a way of segmenting our investment opportunities. From cloud computing and software, digital media, genomics, payments, electric vehicles, 3D printing — we have all these different areas to find long-term growth. To organize and structure what we're going against to ultimately find the right targets, we did an exercise we called "mapping." It's basically grouping companies by their place in the growth structure:

- **Proven winners:** Companies that have proven that they're the leader, some of which may still have great growth opportunities ahead. ServiceNow, which I talked about, would be a proven winner.
- **Developing winners:** At Baron Capital, our history has been in small and medium-sized growth companies. The Fund, while it is considered large cap by Morningstar, has the flexibility to invest in companies across the range of market caps. For example, many mid-sized growth companies are great opportunities. They're not quite proven, but they're proving it out. We divide those into A and B Team groups where A-Team companies are on the cusp of proving it out. Those could be companies like **Ceridian HCM Holdings, Inc.,** a payroll and HR software vendor.
- **Solid compounders:** These companies may be a bit more mature. They're not as fast growing but they can generate high single-digit, low double-digit returns. Those have a small role in my portfolio but a bigger role in others.
- **The "Scout Team":** These are companies that are really young and haven't yet qualified as a developing winner. In a sense, we're scouting who's going to be a draft choice. Sometimes it's a company that's going through a transition or a challenging moment and we want to see if they can emerge as a developing growth company.

One example that emerged this year through this mapping process is a company called **HubSpot, Inc.** They're a software company that started out doing something called inbound marketing. Basically, when a visitor comes to a company's website or app, they will collect some data on the visitor that they will use to try to deliver a personalized marketing message. These tools are for business-to-business [B2B] customers who are seeking to learn more about potential customers by having them register, sign up for a trial, and ultimately buy a product or service. Over the years HubSpot has expanded to become a full platform like a mini Salesforce.com. They also facilitate digital payments, an area where B2B is really a laggard.

HubSpot ranked high in our mapping, basically a developing winner. We did a lot more work and made an investment. It's proven to be a great decision because of 1) accelerating revenue growth, and 2) expanding TAM, which we think should allow continued growth of at least 30% for years to come.

We're known as long-term investors here at Baron. Why do you sell a company? Can you give examples?

Mostly I sell a company because our investment premise turned out to be wrong. In investing you're never going to bat 1,000. We're going to make mistakes. If we make a mistake in our initial research or something changes with respect to a business, we'll sell.

Maybe a company proves not to be a solid long-term investment. **RingCentral, Inc.**, for example, is a company that I've talked about for a long time. They're going after the communication space to take our phones, video communications, and messaging from legacy old-fashioned, equipment-based system to modern cloud systems. While we are still confident in the company's growth potential, some new issues emerged recently regarding the size of their TAM and the competitive environment. We decided that we wanted to continue to own the stock while we research these issues. But there were other great software ideas, like HubSpot, which we increased this year, and Ceridian, which we wanted to increase, so I decided it was prudent to reduce our position in RingCentral.

The last reason to sell is when the valuation of a great investment gets really high and we don't see a path to a solid long-term return. Last year we invested in a company called **Pacific Biosciences of California, Inc.**, a competitor with **Illumina, Inc.** in the genomics space, selling machines that can do the gene sequencing and then all the consumables. At one point, in one year, it was a five or six bagger. We thought we could earn that kind of return over four or five years, so we sold the shares. The stock is pulling back. We recently met with the management team and we're looking at it again, but at a lower level where we're confident we can get a solid long-term return.

Given the high valuations we see in the market, what are your thoughts on growth versus value?

When you simplify either the market or a stock, you have earnings, and you have the P/E multiple. So how is the stock going to increase in value? Either earnings grow or the P/E grows. The P/E goes up or down depending upon investor sentiment, while we're thinking about future growth. Certainly, interest rates play a role. There are lots of other factors. You can plot the market's P/E, or the P/E for an industry. Over the long term you arrive at a median or a mean.

Value businesses tend to be much lower growth. Since you're not going to get much from earnings in and of itself, you have to get growth from the P/E. In a period where value has lagged and is trading below the mean or a median P/E, value stocks work for a while. But what's next? How are you going to grow earnings? That's where it comes back to growth. There will be short-term periods where so-called value stocks will outperform growth stocks. But we're long-term investors. You need some growth in earnings over the long term. And that growth is mostly going to be driven by top-line revenue growth.

Can you give some thoughts on inflation?

We try to invest in businesses that will be able to grow regardless of the macroeconomic background. If the business has pricing power and there is inflation, they'll simply be able to raise their prices. We invest in businesses that have pricing power because they're delivering a product or service that has significant, differentiated, and sustainable value for their customers.

It's hard to know what's going to happen over the short term as we emerge from the pandemic, the so-called reopening, and what's going on in the supply chain. For longer-term inflation to break out, you need a change in longer-term underlying economic growth. When I look at the underlying economy, I'm not sure I see factors that will change the environment that we were in pre-COVID.

If you think about nominal GDP with a couple of points of inflation, even if we're wrong on both of those numbers, inflation is 3% and real growth is 3%, which adds up to 6%. We're investing in companies that are growing long-term 20% plus.

Do you have any concerns as you look ahead?

I can't find an area in which we are invested where the long-term trends are not positive. Fundamentals are strong. All the areas of our economy where we invest are still growing and in some places they're accelerating.

In health care, when we see a pickup in COVID patients, it impacts certain types of procedures. A company like **Intuitive Surgical, Inc.,** which does minimally invasive surgery, may have a weak quarter. But nothing is changing for the long term. For some of our genomics companies, when COVID picked up and some of the scientists were not in the labs, they had a weaker quarter. But the scientists are now back in the lab, trying to catch up on their research. When it comes to clinical research, they're trying to catch up on different types of tests, not just COVID-related tests. All these trends are continuing.

Some areas are seeing shortages. Some retailers and e-commerce companies can't find all the merchandise they want to sell to their customers. In software and cloud computing there's a shortage of skilled developers and cybersecurity professionals. We have investments in companies trying to enhance the productivity of these workers because there are not enough of them, such as **Atlassian Corporation, plc** in software development and **CrowdStrike, Inc.** in cybersecurity.

Across the automotive landscape, we don't only talk to Tesla or **Rivian Automotive, Inc.** in the EV space, we talk to Ford, GM, all the other car companies. It's now commonly accepted that the world is going to EVs. The challenge will be whether these automotive manufacturers can make enough good EV cars because we've crossed the chasm. We're not going back.

Some of the TAM expanders are responding to the changing environment by doing something new. We saw that with Tripadvisor Plus, which is **Tripadvisor, Inc.**'s subscription offering. To get more hotels to sign on -- particularly the big hotel chains -- they had to change that program a little. But the market was impatient. So, a stock that was a very healthy performer early in the year had a big pullback. To us, that's just part of the process of launching a new product or service. Sometimes that could be a cause for a company to pull back after earnings. If we hear about something that may impact the long-term fundamentals, that will raise yellow or red flags. We will focus our research on that to determine whether things are okay or if we should trim or sell that business.

Any last comments?

I go back to this embarrassment of riches. For Baron Opportunity Fund there's no shortage of ideas in the public markets, which is why we do our mapping exercise. That gives us a lot to work with, determining targets for companies that we don't own or that we own in a small way but might increase. Meanwhile, the deal calendar for IPOs, SPACs, and PIPEs [private investment in public equity] is as busy as ever. There are too many deals to cover. So, we do some preliminary work and then prioritize to focus on the ones that we think are the very best.

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectuses contain this and other information about the Funds. You may obtain them from the Funds' distributor, Baron Capital, Inc., by calling 1-800- 99BARON or visiting www.BaronFunds.com. Please read them carefully before investing.

Baron Opportunity Fund's annualized returns for the Institutional Shares as of September 30, 2021: 1-year, 33.91%; 5-years, 32.95%; 10-years, 21.52%; Since Inception (2/29/2000), 10.77%. Annual expense ratio for the Institutional Shares as of September 30, 2020, was 1.08%.

The performance data quoted represents past performance. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost. The Adviser reimburses certain Baron Fund expenses pursuant to a contract expiring on August 29, 2032, unless renewed for another 11-year term and the Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit www.BaronFunds.com or call 1-800-99BARON.

Performance for the Institutional Shares prior to 5/29/2009 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 5/29/2009 did not reflect this fee, the returns would be higher.

The Fund's 3Q 2021, 3-, 5- and 10-year historical performance was impacted by gains from IPOs and there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs will be the same in the future.

Risks: Securities issued by small and medium sized companies may be thinly traded and may be more difficult to sell during market downturns. Companies propelled by innovation, including technology advances and new business models, may present the risk of rapid change and product obsolescence, and their success may be difficult to predict for the long term. 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 discussion of market trends is not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this document reflect those of the respective writer. Some of our comments are based on management expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

The **Morningstar Rating™** for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star.

The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

Portfolio holdings as a percentage of net assets as of September 30, 2021 for securities mentioned are as follows: **ServiceNow, Inc.,** - 1.5%; **ServiceNow, Inc.,** - 1.5%; **RingCentral, Inc.** - 1.8%; **Alphabet Inc.** – 6.5%; **Amazon.com, Inc.** – 4.9%; **Tesla, Inc.** – 3.3%; **Ceridian HCM Holding Inc.,** - 2.7%; **HubSpot, Inc.** – 1.0%; **RingCentral, Inc.** – 1.5%; **Illumina, Inc.** – 0.6%; **Intuitive Surgical, Inc.,** - 1.1%; **Atlassian Corporation, plc** – 1.2%; **CrowdStrike Holdings, Inc**.- 0.9%; **Rivian Automotive** – 1.4%; **Tripadvisor, Inc.** – 1.5%.

The Fund did not hold shares of **Apple, Inc.** or **Pacific Biosciences of California, Inc.** as of September 30, 2021.

Top 10 holdings as of September 30, 2021

Holding	% Assets

Microsoft Corporation	8.6
Alphabet Inc.	6.5
Amazon.com, Inc.	4.9
Tesla, Inc.	3.3
ZoomInfo Technologies Inc.	3.0
Acceleron Pharma Inc.	2.8
Ceridian HCM Holding Inc.	2.7
NVIDIA Corporation	2.6
Gartner, Inc.	2.5
argenx SE	2.1
Total	39.0

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

Non-mutual fund products are available to institutional investors only.

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