



Ron Baron and Michael Baron: The Coronavirus pandemic, its impact on the markets, and how we are positioning our portfolios in the current environment

This is an edited version of a March 23, 2020 Q&A with Ron Baron and Michael Baron, portfolio managers of Baron Partners Fund. Ron Baron is the CEO and Founder of Baron Capital.

To access the full recording, please dial 866-595-5357, passcode 5052296#.

Key Discussion Points

Current market conditions

General thoughts on the COVID-19 pandemic

Baron Partners Fund

Fund performance, management of the portfolio, impact of pandemic on Vail, Tesla, Schwab, diversification, advantages of long-term investing

Market outlook

Current Market Conditions

- *What are your general thoughts on the coronavirus pandemic and its impact on the markets?*

Ron Baron: I've been in this business since 1969. I have experienced a number of unusual market environments along the way, including the 1973 oil shock, interest rates of 17% in 1982 (the year we founded the Firm), the 1987 market crash, the terrorist attacks of 9/11, the 2008-09 financial panic, and now this.

Before the 2008-'09 financial panic, there was little government response to disruptions like these. This has changed. The government is planning a "shock and awe" stimulus, spending enormous amounts of money to take care of both people and businesses. Democrats and Republicans may feel the need to posture, but they all understand they have to get this done and it has to be all at once. I'm sure that they will, and that it will happen shortly.

The Federal Reserve has been doing everything it can to manage this. About a week ago, the markets for commercial paper froze. Repurposing a tool from the 2008-'09 crisis, the Fed, with the cooperation of the Treasury Department, announced it was invoking emergency powers to establish lending facilities that, in turn, can extend credit to corporations. As a result, the commercial paper market is functioning again. I expect to see the Fed do the same sort of thing with small businesses. You can't have all these businesses closing down and employees losing their jobs. It will figure out a way to support these businesses with quantitative easing and other measures. Now that we have learned how these programs worked to restore the economy and the markets after the 2008-'09 financial panic, we will be able to implement them again.

Baron Partners Fund

- *How has the Fund performed during the crisis?*

Ron Baron: We had a very strong first two months of the year. However, we have had very weak performance since the middle of February when the crisis hit. This is because we had 20% of our assets invested in travel and leisure companies, in particular Hyatt Hotels Corp. and Vail Resorts, Inc., both of which are big positions in the portfolio. When travel stopped, those businesses were adversely affected.

In the case of Hyatt, we've been an investor since 2009 when it went public. The stock has been incredibly volatile in the crisis, dropping from \$90 to \$22 a share then back up to \$46 or \$47 a share. We added to our position at about \$37 a share. At that price, the company had a market value of roughly \$3.7 billion. In its filings, Hyatt has stated that it has real estate worth \$5 billion. It also has a rapidly growing management fee business which is presently worth \$1.5 billion-\$2 billion. This means that for \$3.7 billion, you are able to buy into a company worth roughly \$7 billion, or at half price, and with a growing business and a great balance sheet. We see these opportunities throughout the portfolio, and whenever we see them we try to take advantage of them.

In prior bear markets, we have outperformed, but in a crash, we perform just like everyone else. We think we're going to make as much in the next 10 years as we made in the last 10 years. Of course, there are no guarantees.

- ***How are you managing the portfolio?***

Ron Baron: We are spending much of our time talking to our companies. If we find that fundamentals are not as strong as we expected them to be, we will sell the stock and reinvest the assets in companies in which we have greater conviction. We've made about six purchases and five sales in the past two months. We did the same thing in 2008, but we don't have as many losses this time.

- ***Consumer spending is taking a big hit here. Has that influenced your financial estimates and valuations for the more economically sensitive businesses like Vail?***

Ron Baron: In the case of Vail, the company gets about \$800 million a year of cash flow from selling advance season passes. When we first invested in Vail in 1997, the market cap was \$730 million. This means they would have made their entire 1997 market cap this past year were it not for the disruption they experienced in the last three weeks. We think that going forward it will get to \$800 million of cash flow again. Not immediately, but it will recover. It has a strong recurring revenue base from advance season passes. At the rate it is growing, we think that it is going to be able to make 50% more over the next five or six years. And when it does, the company's going to be worth twice what it is worth now.

- ***You have a big position in the portfolio in Tesla, Inc. How do you expect the company to weather the slower consumer spending environment and lower oil prices?***

Ron Baron: Tesla has about \$8.9 billion of cash on its balance sheet. We think value of the company is about \$80 billion now. Is a lower oil price going to stop the company? No. The demand for electric cars is enormous. Its ability to make as many cars as it can sell continues to be strained. It has opened its first plant in China and is building a second one. We think that plant is going to produce 150,000 cars or more and make \$1.5 billion a year. Demand was very strong for the Model 3. The business earned \$2.5 billion of EBITDA last year. We think it can earn \$4.5 billion this year. It has a tremendous advantage over everyone else in technology for batteries and electric cars. People want to buy these cars, they're better than gas combustion engine cars, which are going to be dinosaurs. No, this disruption is not going to kill Tesla.

Michael Baron: In addition, you've seen other competitors announce that they're now trying to catch up with Tesla. Tesla has had a long runway of advantage and now others are finally waking up to the fact that electric vehicles are the future. In early March, General Motors CEO Mary Barra announced that the company will be spending \$20 billion over the next five years on electric vehicles. As a result of this crisis, you are seeing capex budgets being eradicated across industries. I am highly doubtful that GM will be able to invest \$20 billion over the next five years in this kind of environment, which means that Tesla's advantage should actually grow as a result of this crisis as opposed to diminish.

- ***Given your optimistic view on Tesla, do you see energy stocks having value?***

Ron Baron: I have not owned an oil stock for six or seven or eight years. First, with shale technology in the U.S., I think the supply is more or less infinite. When you have an incremental increase in supply - you've just seen what happens to the price of oil. Several years ago, when OPEC increased supply by 2% or 3%, the price went down to below \$30/barrel from over \$100/barrel. A few weeks ago, when Saudi Arabia and Russia announced they were going to increase supply, the price cratered again. To get shale

oil out of the ground in the U.S. may cost \$50/barrel. This latest move was an intentional effort on the part of Russia and Saudi Arabia to put our country's shale oil out of business. And if their cost is \$5/barrel to get it out of the ground, and ours is \$50, we can't compete.

On the demand side, I think that over time we will need a lot less oil. We are going to be much more efficient. We're going to use alternative sources and demand is going to go down naturally. So I don't want to invest in energy.

- *Can you give an example of how this dislocation has peak-rated an investment thesis on a particular business and how you've handled that?*

Ron Baron: I think it's going to be a longer road for cruise businesses to do well again. On the other hand, some of these stocks are down 80%, and so it is possible that at current prices, if there is a recovery in the business, which we think there will, then it will become a very attractive investment. But we will see. We do not have a lot of exposure to cruise businesses in any event.

- *When the market gets volatile, many investors to seek broad diversification. Could you comment on diversification as a risk management tool for this Fund?*

Michael Baron: We look at diversification a bit differently than most. It's not just a diversifying across number of holdings. We manage a fairly concentrated portfolio with 30 holdings with the top 10 positions accounting for a majority of the net assets. The way we look at diversification is in terms of businesses that don't act the same way in different environments. We divide the portfolio into four main groups: core growth stocks, disruptive businesses, irreplaceable assets, and financial services. In this environment I think irreplaceable assets, such as Hyatt and Vail, have been hit harder. People are not utilizing them and as a result they have sold off. We do not think that is always going to be the case. We have confidence that this crisis will end. We don't know when or how but it will eventually come to an end. And once again people will go to Vail Resorts, people will go to Hyatt Hotels, people will watch Manchester United soccer matches. So we're confident that all these businesses will rebound.

- *Short-term investing depends in part on earnings visibility, which has decreased across the board due to the halt in global economic activity. Could you provide an example where maintaining a long-term investment horizon has enabled you to gain conviction in an investment idea where others could not get past some sort of near-term variable?*

Ron Baron: SpaceX [Space Exploration Technologies Corp.] is one example. SpaceX is a private company that is revolutionizing space technology with its reusable orbital launch systems. It is now in the process of leveraging its new satellite constellation to launch a broadband service called Starlink. Launch is a \$2 billion dollar business and satellite communications is about a \$30 billion business. We invested in SpaceX when the estimated market cap was \$12 billion. It is now \$22 billion, and we think it is on the verge of a breakout year.

Boeing and Lockheed were charging the government \$200-\$300 million, and if you add an allocated cost, it was probably \$500 million per launch. SpaceX is able to launch for less than \$100 million. If you factor in that these rockets are reusable, it is ultimately going to be able to launch for much less -- \$50 million or maybe even \$5 million-\$10 million per launch.

This is not investing in stair-step growth. This is not investing in IBM or General Electric back in the day when every year it would increase its earnings a certain percentage. This is about investing in businesses that are changing the world. We're trying to double our money every six years, where the markets doubles every 10 or 12 years.

Michael Baron: There has been tremendous volatility in the market. During this time, The Charles Schwab Corp., which is a leading brokerage firm, has seen a surge in client engagement with clients seeking advice on how to navigate. This engagement will do two things: first, it creates a stickier client. And second, these clients should utilize more of Schwab's proprietary products and services.

Additionally, Schwab has seen a record amount of net new asset flows during the first two months of the year. We believe those strong flows should continue as clients seek stability and safety. Advisors are also growing their businesses during this unsteady time as individuals fear investing on their own. And finally, new competitors have had difficulty handling the surge in trading volume. Many of the competitors' disappointed customers will join the Schwab platform. Schwab had organic growth in 2019 of 6%. Organic growth in 2020 could be greater if these trends continue.

Near term net interest margin could be lower. But a move to cash by clients should alleviate some of these pressures on earnings. As long-term investors, we are most focused on client retention and asset gathering. These metrics are positive indicators that Schwab should emerge from this health crisis in a superior position compared to its competitors and should return to healthy margins with larger asset levels in the future.

- **Given what's going on right now, what is your outlook for the economy and the markets?**

Ron Baron: Last night I was speaking to Chris Dodds, who is the former CFO and COO of Charles Schwab and an advisor to the board of Baron Capital. He lives in San Francisco and at 7:01pm, I hear this clamoring -- banging and rattling -- in the background. I said, what was that? He said that every day at 7:01pm, all the neighborhoods in San Francisco stand outside and bang their pots and pans to show support for each other. And that reminded me of one of my friends who is the ambassador to Italy. A few days ago, he sent me a video of people in Rome standing outside every evening and singing on their balconies. A couple of weeks ago, my daughter-in-law showed me a video of everyone in Tel Aviv standing outside at the appointed hour singing to each other. What all this shows me is our indomitable human spirit. Everyone is working together to defeat this crisis.

We don't know when the bottom will be, but as time has proven, when things calms down, the market will start going up again. I'm optimistic about the prices of securities and the process we use to make investments. We invest in companies when they are building their businesses -- investing in factories to make electric cars or batteries, launching satellites, building out cloud-based software-as-a-service. When they're doing this, they're not making money. That's like all businesses now. We never anticipated that there would be come a time when every hotel in the country would have 2% occupancy and eight people and a dog or something like that and restaurants and dry cleaners and every brick and mortar retail store would be closed except for a supermarket and a pharmacy. We didn't think that, and no one else did, I guess. Maybe someone did. But these things do happen and what we have learned from dealing with past crises is how to deal with the current crisis.

It will soon be - if it is not already -- a great time to invest. Interest rates have never been lower. Fiscal stimulus is about to begin. Quantitative easing is starting again. The value of money falls by half every 17 or 18 years. When you invest in stocks, you keep ahead of inflation and the value of your money over the long term. Not short term necessarily, but over the long term.

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 Partners Fund's annualized returns for the Institutional Shares as of December 31, 2019: 1-year, 45.38%; 5-years, 13.90%; 10-years, 16.40%; Since Inception (1/31/1992), 13.39%. Annual expense ratio for the Institutional Shares as of December 31, 2018 was 1.77% (comprised of operating expenses of 1.06% and interest expense of 0.71%). The **Russell Midcap Growth Index's** annualized returns as of December 31, 2019: 1-year, 35.47%; 5-years, 11.60%; 10-years, 14.24%; Since Fund Inception (1/31/1992), 10.05%.

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, 2030, 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.

Reflects the actual fees and expenses that were charged when the Fund was a partnership. The predecessor partnership charged a 20% performance fee after reaching a certain performance benchmark. If the annual returns for the Fund did not reflect the performance fees the returns would be higher. The Fund's shareholders will not be charged a performance fee. The predecessor partnership's performance is only for periods before the Fund's registration statement was effective, which was April 30, 2003. During those periods, the predecessor partnership was not registered under the Investment Company Act of 1940 and was not subject to its requirements or the requirements of the Internal Revenue Code relating to registered investment companies, which, if it were, might have adversely affected its performance.

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.

Risks: Specific risks associated with non-diversification and leverage include increased volatility of the Fund's returns and exposure of the Fund to greater risk of loss in any given period. The Fund invests in companies of all sizes, including small and medium sized companies whose securities may be thinly traded and more difficult to sell during market downturns.

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.

Diversification does not guarantee a profit or protect against a loss.

Portfolio holdings as a percentage of total investments as of December 31, 2019 for securities mentioned are as follows: **Hyatt Hotels Corp.** – 6.7%; **Vail Resorts, Inc.** – 6.4%; **Tesla, Inc.** – 13.3%; **Space Exploration Technologies Corp.** – 4.1%; **The Charles Schwab Corp.** – 4.0%.

Top 10 holdings as of December 31, 2019

Holding	% Holding
CoStar Group, Inc.	14.5
Tesla, Inc.	13.3
Arch Capital Group Ltd.	8.5
IDEXX Laboratories, Inc.	6.8
Hyatt Hotels Corp.	6.7
Vail Resorts, Inc.	6.4
FactSet Research Systems, Inc.	6.0
Space Exploration Technologies Corp.	4.1
The Charles Schwab Corp.	4.0
Guidewire Software, Inc.	3.8
Total	74.1
Long Equity Exposure	127.0
Cash & Equivalents	(27.0)

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

The **Russell Midcap® Growth Index** measures the performance of medium-sized U.S. companies that are classified as growth and the S&P 500 Index of 500 widely held large cap U.S. companies. The Russell Midcap Growth Index, the **S&P 500 Index** and the Fund are with dividends, which positively impact the performance results. 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 are unmanaged. The index performance is not Fund performance; one cannot invest directly into an index.

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