Dear Baron Small Cap Fund Shareholder:

Performance

Baron Small Cap Fund (the "Fund") had a solid fourth quarter to 2017 and a strong year. The Fund gained 5.25% (Institutional Shares) for the quarter ended December 31, 2017, which bested the Russell 2000 Growth Index (up 4.59%) but lagged the broader S&P 500 Index (up 6.64%). For the year, the Fund gained 27.45%. This was ahead of the Russell 2000 Growth Index (up 22.17%) and the S&P 500 Index (up 21.83%).

Table I.
Performance
Annualized for periods ended December 31, 2017

	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]	5.18%	5.25%	4.59%	6.64%
One Year	27.13%	27.45%	22.17%	21.83%
Three Years	9.82%	10.10%	10.28%	11.41%
Five Years	13.16%	13.45%	15.21%	15.79%
Ten Years	7.96%	8.19%	9.19%	8.50%
Fifteen Years	11.23%	11.39%	11.57%	9.92%
Since Inception (September 30, 1997)	10.05%	10.17%	6.19%	7.25%

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

Economically, it was more of the same in the quarter. Stable and improving growth in the domestic economy – with continued employment gains, accelerating industrial production, rising consumer confidence and spending, and improving housing starts. International economies continue to recover, so now all the world seems to be in coordinated growth, which is unusual.

The Tax Cuts and Jobs Act passed in December, which drastically reduces corporate tax rates, modestly lowers personal tax rates, and allows for the repatriation of money held overseas by corporations. Corporate earnings will get a significant boost, which will positively affect the majority of our holdings, increasing their earnings about 15% on average. Our companies will now be more competitive, since their tax rates will be on more equal footing with global players. And their free cash flows will improve because after-tax income will be higher from lower taxes and more favorable depreciation deductions. We do believe this will stimulate the economy somewhat and make a rosy outlook even rosier. We are less certain that consumers will change behaviors, even though taxes will decline somewhat and maybe wages and investments will increase as a result of the changes.

Stocks rose to all-time highs in the fourth quarter, propelled by the solid economy, the promise of improved growth from the tax bill and economic momentum, and good earnings reports. During the quarter, the market leadership shifted away from tech, biotech, and industrials, which powered the rally for most of the year, towards more defensive sectors and value stocks, which had been laggards. This shift was reminiscent of how the market reacted after President Trump was elected last year. We think it is probably temporary and leadership will revert to the companies currently performing well and those with the brightest futures.

The Fund did well in the fourth quarter because of the great performance of certain holdings. These stocks spanned many industries and performed well because of strong results and recognition by the market of their long-term opportunities. Our stock picking was excellent in 2017. We outperformed because our holdings in Information Technology, Industrials, Consumer Discretionary, and Real Estate vastly exceeded the other stocks in those sectors. We did well despite being significantly underweight in biotech and pharma stocks, which were two of the best performing sub-industries last year. We did better while owning our high-quality, low beta portfolio, even though those factors weren't in vogue. Overall a good year.

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, 2017 was 1.31% and 1.05%, 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 indexes are unmanaged. 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. The indexes 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.

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.

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Table II.
Top contributors to performance for the quarter ended December 31, 2017

	Percent Impact
GTT Communications, Inc.	0.90%
Red Rock Resorts, Inc.	0.62
SiteOne Landscape Supply, Inc.	0.62
On Assignment, Inc.	0.48
FleetCor Technologies, Inc.	0.36

GTT Communications, Inc., a telecommunication provider of cloud network services, appreciated significantly this quarter. Nothing much happened new, only the market is increasingly recognizing the track record of growth and enormous potential for the company. As we detailed in our June quarterly, GTT is a differentiated operator with a high-touch, focused, capital-light business model, which we believe to be very attractive. They have grown dramatically both organically and via strategic acquisitions, which are well integrated and highly strategic. The company is just now getting big enough to get on the radar screens of institutional investors. We believe the business can be five times larger in time and command a higher trading multiple in the market or be an attractive takeover candidate for a bigger telco acquirer.

Red Rock Resorts, Inc., the operator of local casinos in Las Vegas, rose meaningfully this quarter as its trading multiple expanded, in our mind, in recognition of its market position and growth opportunities. The company reported stronger-than-expected revenues and margins in the quarter and pointed to an improving outlook for the Las Vegas economy. The company unveiled its plans to renovate the recently purchased Palms Casino, which are bolder and more expansive than anticipated, and which we find exciting and the market applauded. Contributing to the rise in the stock was the passage of the tax bill, which will benefit this domestic, high tax paying, consumer business and maybe its customers as well.

Shares of **SiteOne Landscape Supply, Inc.**, the largest distributor of wholesale supplies to the professional landscape trade, was strong in the period even after reporting a soft quarter, in which sales and earnings were short of estimates. Results were negatively impacted by hurricane-related store closures and from incremental spending on systems and salespeople. It is unusual for a stock to perform well in conjunction with a miss, but we chalk it up to an appreciation of management's execution and growth path. I believe the company can grow to do $5 billion in revenues, $600 million plus in EBITDA (earnings before interest, taxes, depreciation and amortization), and be worth $10 billion in time, which would be more than three times its present $3 billion enterprise value, so now deservedly sells at a high multiple.

On Assignment, Inc., a leading temporary staffing firm focused on providing employees to technology companies, posted strong results in the third quarter that handily beat street estimates. The company also announced that it repurchased a slug of its shares back, at an attractive price, just as they had signaled it would do when leverage ticked lower. We continue to greatly admire this business and management. Staffing fundamentals are solid and as the unemployment rate continues to decline, the need for staff augmentation increases. We think that the use of temp labor will continue to gain share, and proposed legislation to make it harder for foreign workers to come to the U.S. on high-skilled visas, will add additional fuel to demand. The company is a major beneficiary of the new tax bill, making the stock reasonable to cheap based on our outlook for organic growth and the potential of the management to do a significant accretive acquisition, as they have done in the past.

Other stocks that rose over 20% this quarter but provided less to our performance were **FleetCor Technologies, Inc.**, **WEX Inc.**, **Beacon Roofing Supply, Inc.**, **Altair Engineering Inc.**, **Nordson Corp.** and **Floor & Décor Holdings, Inc.**

Table III.
Top detractors from performance for the quarter ended December 31, 2017

	Percent Impact
Electronics For Imaging, Inc.	–0.36%
Wix.com Ltd.	–0.27
The Trade Desk	–0.26
Liberty Expedia Holdings, Inc.	–0.25
MACOM Technology Solutions Holdings, Inc.	–0.22

Shares of **Electronics for Imaging, Inc.**, a provider of products and services for digital imaging, fell after the company released third quarter results which missed street revenue and earnings forecasts. The commercial printing market remains soft and sales of their high margin front-end Fiery product have not recovered as we expected. Another strike against the company, which had previously announced operational mishaps and accounting issues. We sold some of our holdings. We still appreciate the company's leadership position in the transformation from analog to digital printing in textiles, and we believe the company could realize significant sales by enabling such a transition in the much larger, corrugated packaging market through the introduction of their new Nozomi product line.

Wix.com Ltd., a leading cloud-based web development platform enabling users to create a digital presence, declined in the quarter after the company announced higher-than-anticipated spending on R&D, new product development, and salespeople, so near-term free cash flow was lower than expected. We used the fall in the stock to add to our position. We believe Wix has evolved beyond a website builder to a full digital business service provider for small businesses. The company's recent rollout of Wix Code enables advanced web application development and gets Wix into the developer market, which could be a meaningful market extension. We expect the company to maintain revenue growth of 30% plus for the next few years and for margins to expand significantly so that EBITDA and Free Cash Flow will compound at over 50% per year.

The Trade Desk is a leading independent technology platform for digital ad buyers. Shares fell in the quarter after the company issued a cautious outlook for the upcoming quarter based on a softer advertising environment. We increased our position. We believe that programmatic advertising, the use of software and machines to purchase digital ads, will take significant share of the global advertising market, and that Trade Desk will continue to grow its presence. Trade Desk is already very profitable with a 30% EBITDA margin. We believe revenue will grow at 30% plus and margins can expand, leading to 40% growth in cash flow going forward.

Liberty Expedia Holdings, Inc., which owns 16% of Expedia, Inc., fell in the quarter after the company announced that room night stays decelerated in the quarter. Additional investments in marketing, infrastructure, and hotel supply led to lower guidance for the upcoming year. Expedia now trades at nine times EBITDA, which we believe underestimates the value of the business, its growth opportunities in Europe, and its revitalized HomeAway brand.

Other stocks that declined about 20% or more in the quarter were **MACOM Technology Solutions Holdings, Inc.** and **INC Research Holdings, Inc.**

Portfolio Structure

As of December 31, 2017, the Fund had $4.3 billion under management. The top 10 positions represented 29.8% of the Fund.

Table IV.
Top 10 holdings as of December 31, 2017

	Year Acquired	Quarter End Investment Value (millions)	Percent of Net Assets
Gartner, Inc.	2007	$172.4	4.0%
Waste Connections, Inc.	2016	141.9	3.3
TransDigm Group, Inc.	2006	130.4	3.0
Guidewire Software, Inc.	2012	130.0	3.0
Bright Horizons Family Solutions, Inc.	2013	126.9	3.0
On Assignment, Inc.	2012	118.9	2.8
GTT Communications, Inc.	2017	117.4	2.7
IDEXX Laboratories, Inc.	2008	117.3	2.7
Cognex Corp.	2011	116.2	2.7
SBA Communications Corp.	2004	110.3	2.6

We ended the year with 76 stocks in the Fund, which is in line with our desire to keep the number of holdings in check, even with a larger asset base. The top 10 is lower than the last few years, as we add new small-cap names and sell down some of our higher market cap holdings.

Turnover was up for the year, which we also set out to do. We invested $936 million in the year: $726 million into 18 new names and $210 million into existing holdings. The average market cap for the investment in new names was $1.9 billion and the average market cap for all investments was $2.1 billion. The overall market cap of the Fund tilted lower with these increased investments in small-cap stocks.

At year end, the Fund's largest concentration is in Information Technology (IT) at about 30% of assets. We are overweight IT compared to the Russell 2000 Growth Index. Our IT stocks were particularly strong in 2017, and we continue to find new ideas in the sector. The sector also seems to bleed into other sectors, as technology continues to affect and change all businesses. Industrials are the second area of emphasis, and we are similarly overweight compared to the Russell 2000 Growth Index. Our Industrial holdings are benefiting from the renewed global growth rates and, to a lesser degree, by the lower value of the U.S. dollar. We are overweight Consumer Discretionary and our consumer stocks also acted very well in 2017, even as many companies in the sector suffered from competition (real or perceived) from Amazon or other internet players. We are underweight Health Care, primarily because we own virtually no biotech and pharma stocks, as usual. This worked against us in 2017, since these stocks were very strong.

Recent Activity

After a flurry of activity in the previous quarter, we were less busy buying in this period. We established two new positions in the quarter and added to 12 existing holdings.

Table V.
Top net purchases for the quarter ended December 31, 2017

	Year Acquired	Quarter End Market Cap (billions)	Amount Purchased (millions)
Installed Building Products, Inc.	2017	$2.4	$22.2
Altair Engineering Inc.	2017	1.5	19.5
MACOM Technology Solutions Holdings, Inc.	2017	2.1	16.2
Teladoc, Inc.	2017	2.1	12.9
GTT Communications, Inc.	2017	2.0	8.0

Installed Business Products, Inc. is one of the nation's largest installers of insulation in new residential housing. The family-run business has grown from a single branch in Columbus, Ohio to a national chain, having completed over 120 acquisitions over the last 20 years and grown its national market share to about 20%. Over this period of time, the company has grown its revenues to over $1 billion and EBITDA to $150 million from scratch.

The installation of insulation is "nuisance work" for builders and is normally outsourced to local contractors to ensure timeliness and quality and to save money. IBP is in a unique position within the building products value chain in that it can streamline the normal supply chain and benefit from economies of scale, providing great value and service to the builders while still making strong profit margins. They can also significantly improve acquired businesses by buying the insulation better, integrating and operating the business more efficiently, and enhancing the profit of the acquired companies. Overtime, IBP has expanded its products and end markets to include garage doors and shelving. It has recently entered the commercial building segment to do insulation and waterproofing.

The U.S. housing market continues to recover, and we expect housing completions to grow mid single-digits going forward, providing a tailwind for IBP. The company has been able to, and we expect will continue to, grow market share and raise prices, which we think will result in double-digit organic growth. Acquisitions add significantly to the top-line, and revenues have grown about 30% per year for the last three years. Though we don't expect the same pace of growth, we do expect acquisitions to continue to play an important role in the company's growth of profits. The acquisitions are highly accretive, with the company normally paying six times run rate EBITDA, which will grow under their management, and the stock trading at over twice that multiple. The balance sheet is strong and free cash flow generation is significant, providing funds to continue to deploy.

The company's stock has been a big winner, and the present multiple has expanded, as with most successful companies, but we still see much opportunity for growth.

Table VI.
Top net sales for the quarter ended December 31, 2017

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap or Market Cap When Sold (billions)	Amount Sold (millions)
Glaukos Corporation	2017	$1.3	$0.9	$32.9
The Chefs' Warehouse, Inc.	2011	0.3	0.6	18.7
Electronics For Imaging, Inc.	2015	1.9	1.3	14.2
Bright Horizons Family Solutions, Inc.	2013	1.8	5.6	13.7
Flotek Industries, Inc.	2013	1.1	0.3	9.0

During the quarter, we exited three positions: **Glaukos Corporation**, **PT Sarana Menara Nusantara Tbk.** and **Flotek Industries, Inc.**. Glaukos, a recent purchase, was sold after further due diligence made us less certain about both the near-term issues facing the business and long-term prospects for the company. Sarana Menara was a long-held position that was a nice investment, but we were disappointed with recent growth trends. Flotek didn't work out, and we moved on.

We reduced our position in **The Chefs' Warehouse, Inc.** after the company reported much improved results and the stock moved up and traded at a better multiple. We trimmed our large holdings in **Bright Horizons Family Solutions, Inc.**, **Cognex Corp.** and **FleetCor Technologies, Inc.** into strength, in keeping with our approach to reduce our winners that have higher market caps when they are up and redeploy the capital to new exciting small-cap ideas.

Outlook

The market continues to be strong in January. The move seems sensible to us. Companies are doing very well. For the vast majority of our companies, the tax bill will increase earnings by about 15%. The economy is strong and maybe the excess profits will stimulate the economy even further, through higher wages and/or more spending. Interest rates remain very low and inflation modest.

The prospects for high-quality growth companies, which characterize our portfolio, are bright, and we foresee a path to years of continued strong growth. The multiples of our stocks have expanded, which we view as justified. However, compared to the last few years, these levels are extended. It's possible we are stealing some returns from future periods, but who knows. The positive thing about investing in growth companies is that even if the multiple expansion stalls earnings and values continue to compound, so the stocks will grow into their valuation if the businesses perform. And with the tax changes, earnings are compounding off a higher base.

We are mindful that if the economy grows too fast and inflation is stoked, then the Fed might raise rates faster than contemplated and cause the economy to contract, which would be negative for the market.

Thanks for investing in the Fund. We remain dedicated to investing in high-quality small growth companies with strong market positions, superior managements, and great growth opportunities. We are heartened by the fact that our approach and the performance of our holdings led to strong investment returns in 2017. Let's hope for more of the same in 2018.

Cliff Greenberg
Portfolio Manager

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

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. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

The discussions of the companies herein are not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this report reflect those of the respective portfolio manager only through the end of the period stated in this report. The portfolio manager's views are not intended as recommendations or investment advice to any person reading this report and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

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Beta: measures a fund's sensitivity to market movements. The beta of the market is 1.00 by definition.