Baron Discovery Strategy

BARON CAPITAL

December 31, 2023

Dear Investor:

Performance

Baron Discovery Strategy® (the Strategy) returned 22.80% in 2023, which was 4.14% better than the 18.66% return of the Russell 2000 Growth Index (the Index). In the fourth quarter, the Strategy returned 12.50%, in line with the Index. Since its inception, investors in the Strategy have seen a return of 12.43% on an annualized basis. This is 4.75% higher than the Russell 2000 Growth Index during that same time period. Beating the market in any given quarter is random. Beating it consistently over longer time periods requires patience, judgment, and experience.

Table I.

Performance for annualized periods ended December 31, 2023 (Figures in USD)†1

	Baron Discovery Strategy (net)[2]	Baron Discovery Strategy (gross)[2]	Russell 2000 Growth Index[2]	S&P 500 Index[2]
Three Months[3]	12.50%	12.78%	12.75%	11.69%
One Year	22.80%	24.00%	18.66%	26.29%
Three Years	(5.72)%	(4.79)%	(3.50)%	10.00%
Five Years	12.08%	13.20%	9.22%	15.69%
Ten Years	11.29%	12.26%	7.16%	12.03%
Since Inception (October 31, 2013)[4]	12.43%	13.38%	7.68%	12.43%

Table II.

Calendar Year Performance 2019-2023 (Figures in USD)

	Baron Discovery Strategy (net)[2]	Baron Discovery Strategy (gross)[2]	Russell 2000 Growth Index[2]	S&P 500 Index[2]
2019	26.97%	28.24%	28.48%	31.49%
2020	66.25%	67.93%	34.63%	18.40%
2021	4.92%	5.97%	2.83%	28.71%
2022	(34.96)%	(34.32)%	(26.36)%	(18.11)%
2023	22.80%	24.00%	18.66%	26.29%

For Strategy reporting purposes, the Firm is defined as all accounts managed by Baron Capital Management, Inc. ("BCM") and BAMCO, Inc. ("BAMCO"), registered investment advisers wholly owned by Baron Capital Group, Inc. As of December 31, 2023, total Firm assets under management are approximately $43.1 billion. Gross performance figures do not reflect the deduction of investment advisory fees and any other expenses incurred in the management of the investment advisory account. Actual client returns will be reduced by the advisory fees and any other expenses incurred in the management of the investment advisory account. A full description of investment advisory fees is supplied in the Firm's Form ADV Part 2A. Valuations and returns are computed and stated in U.S. dollars. Performance figures reflect the reinvestment of dividends and other earnings. The Strategy is currently composed of one mutual fund managed by BAMCO and a separately managed account managed by BCM. The Strategy invests mainly in small cap growth companies. BAMCO and BCM claim compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of the Firm's strategies or a GIPS Report please contact us at 1-800-99BARON. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse, promote or warrant the accuracy or quality of the report.

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

† The Strategy's 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 Strategy's level of participation in IPOs will be the same in the future.

1 With the exception of performance data, most of the data is based on a representative account. Such data may vary for each client in the Strategy due to asset size, market conditions, client guidelines, and diversity of portfolio holdings. The representative account is the account in the Strategy that we believe most closely reflects the current portfolio management style for the Strategy. Representative account data is supplemental information.

2 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. All rights in the FTSE Russell Index (the "Index") vest in the relevant LSE Group company which owns the Index. Russell® is a trademark of the relevant LSE Group company and is used by any other LSE Group company under license. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. The Strategy includes reinvestment of dividends, net of foreign withholding taxes, while the Russell 2000® Growth Index and the S&P 500 Index includes reinvestment of dividends before taxes. Reinvestment of dividends positively impacts performance results. The indexes are unmanaged. Index performance is not Strategy performance; one cannot invest directly into an index.

3 Not annualized

4 The Strategy has a different inception date than its representative account, which is 9/30/2013.

The market landscape has undergone a significant transformation over the last two decades, presenting new challenges to maintaining a competitive edge. This "informational democracy" is fueled by the unprecedented accessibility of crucial data—financial statements, pricing information, and real-time news—often at no cost. Stricter regulations, such as Reg FD, ensure equal access to market-moving news, further leveling the playing field. Additionally, a proliferation of investment options, from ETFs and index funds to diverse public and private vehicles, empowers investors with broader strategic flexibility. And on the horizon, the democratization of trading is poised to accelerate with the widespread adoption of powerful artificial intelligence tools. And yet, Baron Discovery Strategy has consistently outperformed its principal benchmarks over the past decade. Why have our returns been meaningfully better than benchmark averages? What is it that we see that others don't? In other words, why should you consider investing with us for the future?

We believe our advantage is rooted in two key areas. Firstly, we adopt a long-term, fundamental approach to investing. Rather than attempt to time the market, we commit to investing in companies with strong management, secure business models, and unrealized growth potential. This approach allows us to capitalize on the intrinsic value of businesses over time, rather than relying on market fluctuations. Secondly, we have the experience to recognize these opportunities. We believe we have a deep understanding of our business that helps us maintain our positions even in the face of temporary challenges. We believe that while AI can provide valuable assistance to investors, it cannot replicate or replace our experiential judgment when it comes to evaluating management teams and the competitive environments they operate in.

The theme of experiential judgment has captured our attention in recent months. Two books shed light on the human factor's importance in navigating the markets: *Elon Musk* by Walter Isaacson (2023) and *Blink: The Power of Thinking Without Thinking* (2005) by Malcolm Gladwell.

Isaacson's fascinating biography delves into the mind and motivations of Elon Musk, a controversial yet undeniably game-changing inventor, entrepreneur, and "speciesist." This new term, coined by the author, describes Elon's belief in prioritizing human consciousness over artificial intelligence. While seemingly obvious, this conviction stands in opposition to others' visions for the future. It becomes particularly relevant when considering the "singularity," the hypothetical point where machines surpass human intelligence. Elon adamantly disagrees with those who favor AI dominance, and this belief fuels his Mars colonization mission, aiming to secure a future for humanity.

However, we believe the singularity is a distant event, even in the age of advanced AI. In the realm of investing, the human element—intuition informed by experience—remains the ultimate edge. Even a genius like Elon Musk relies on years of trial and error to push the boundaries of what's considered possible. He iterates on rocket engine designs through explosive tests, famously stating, "If we're not blowing up engines, we're not trying hard enough." Similarly, relentless part reductions in Tesla cars, sometimes leading to recalls, reflect his "best part is no part" philosophy. His unconventional approach to engineering NeuraLink brain interfaces exemplifies his iterative learning process.

These examples highlight how Elon's relentless pursuit of knowledge, fueled by experience, propels him forward. Even with his genius, it's the human ability to learn and adapt that ultimately drives his success. This holds true in the markets as well, where intuition informed by experience often trumps pure analytical power.

At Baron, our investment process hinges on rigorous due diligence, extending beyond financial metrics to stress-test the integrity of management teams, investment theses, and portfolio construction. We visit companies, and we talk to customers, competitors, and suppliers. We interview experts in the field whether they are surgeons, semiconductor engineers, or insurance executives. Then we circle back to the management teams in which we invest, to ask follow-up questions to solidify our initial investment theses and assessments of their character. This meticulous approach resonates with the substantial experience of our 17 portfolio managers, averaging 27 years in the industry. We believe our research team's years of experience differentiates Baron Capital and contributes to our consistent long-term outperformance.

While vast experience is crucial for investment success, knowing when to trust your gut and not overthink is equally important. This is the core message of Blink, Malcolm Gladwell's book that argues unconscious thinking can outperform conscious analysis in certain situations, particularly when overloaded with information in complex settings. This phenomenon is especially relevant in AI, where "hallucinations"—conclusions drawn from logically synthesizing vast amounts of data, yet ultimately incorrect—can masquerade as truth. In public market investing, information overload is a constant risk. It can occur when a CEO's statement raises red flags, or when a rapid market shift demands immediate action, either adding to or reducing an investment based on strong conviction. In such scenarios, investors must strike a balance between in-depth analysis and information gathering on the one hand, and instinctual decision-making on the other.

SentinelOne, Inc. is a cybersecurity software company that specializes in endpoint protection, cloud security, and security data analytics. Shares rose on outstanding quarterly financial results and strong guidance. SentinelOne is one of the fastest growing public cybersecurity companies, with revenue expected to grow more than 46% this fiscal year. Growth has been driven by a combination of: 1) market share capture from legacy endpoint vendors that struggle to compete against SentinelOne's AI-enabled platform; 2) an ongoing shift of Information Technology (IT) infrastructure to the cloud driving demand for cloud application protection (growing triple digits); and 3) cybersecurity vendor consolidation favoring end-to-end platforms with comprehensive security portfolios over single-point solutions. The company is also leveraging its single data store and AI capabilities to cross-sell more products into its existing customer base and increase average sale prices. Between larger deal sizes and improving operating efficiencies, we believe the company can continue to expand margins at a significant rate and begin generating positive free cash flow in the next fiscal year.

Table III.
Top contributors to performance for the quarter ended December 31, 2023

	Percent Impact
SentinelOne, Inc.	1.37%
GitLab Inc.	1.14
Varonis Systems, Inc.	1.02
CyberArk Software Ltd.	0.93
Kratos Defense & Security Solutions, Inc.	0.90

GitLab Inc. is an end-to-end software development and IT operations platform that enterprises use to create, secure, and deploy programming code. The stock rose after GitLab delivered strong quarterly results driven by improving win rates in enterprise deals, solid seat growth, and higher average selling prices. In recent years, GitLab has delivered more than 400 feature enhancements to its platform, enabling its customers to consolidate more software development steps into GitLab, lowering total IT costs and achieving faster software delivery times. As a result, GitLab has realized higher average revenue per user (ARPU) through a combination of price increases and upgrades to its Ultimate Tier product. These ARPU increases, coupled with consistent user growth, bode well for future sales and margin expansion. GitLab also has several exciting new growth levers, including a monetizable generative AI product that helps developers write code, detect vulnerabilities automatically, and remediate bottlenecks in the coding process, a new enterprise planning SKU that brings non-developers onto the platform, and a Dedicated Tier for clients in regulated industries.

Varonis Systems, Inc. is a cybersecurity vendor that helps organizations classify, locate, and protect sensitive data across on-premise and cloud environments. Shares of Varonis increased on strong quarterly results with annual recurring revenue (ARR) growth and free cash flow beating consensus. Last year, Varonis began transitioning to a Subscription as a Service (SaaS) model, which will benefit clients via lower maintenance costs, better automation, and faster remediations of data vulnerabilities. Throughout 2023, demand for the SaaS model has been much higher than investors anticipated, and SaaS already accounts for over 15% of ARR. SaaS customers are landing with more licenses, paying 30% higher prices per license, and signing deals faster. As this mix shift progresses, we anticipate improved sales efficiency and higher margins. Varonis remains a competitively advantaged business in the data security industry, which we believe can accelerate in 2024 as recent SEC disclosure requirements for security breaches drive industry awareness, and regulated companies look to invest in data security as a prerequisite for adopting generative AI.

Table IV.
Top detractors from performance for the quarter ended December 31, 2023

	Percent Impact
Kinsale Capital Group, Inc.	-1.22%
Chart Industries, Inc.	-0.87
Establishment Labs Holdings Inc.	-0.56
The Beauty Health Company	-0.51
European Wax Center, Inc.	-0.23

Shares of specialty insurer **Kinsale Capital Group, Inc.** gave back some gains from earlier this year after the company reported slower premium growth in the third quarter. Earnings beat Street expectations with EPS doubling and ROE exceeding 34%. However, investors focused on the slowdown in gross written premiums to 33% growth from 58% growth in the prior quarter, which management attributed to normal seasonality for property insurance. Additionally, we believe some of the share price weakness resulted from a market rotation away from defensive stocks to more speculative stocks following a decline in interest rates. We continue to own the stock because we believe Kinsale is well managed and has a long runway for growth in an attractive segment of the insurance market.

Chart Industries, Inc. is a global leader in design, engineering, and manufacturing of process and storage technologies and equipment for gas and liquid handling. Shares fell after the company missed analyst earnings forecasts on project revenue recognition timing. Chart also held an Investor Day in which it provided mid-term financial targets instead of further detail on its 2024 outlook, falling short of some analyst expectations. We remain bullish on the company's prospects. Business fundamentals are strong, with management seeing solid demand across the portfolio and cost synergies from the Howden acquisition are ahead of company targets. Chart also has a much larger than normal backlog supporting growth in 2024, providing good visibility. We believe the integration of Howden is proceeding well, with the combined company on track to become a globally diversified, high-quality, high-growth industrial business with proprietary technology and solutions serving the growing hydrogen, carbon capture, liquid natural gas, and other end markets. Chart's valuation remains attractive relative to its growth and margin profile, in our view.

Establishment Labs Holdings Inc. sells next-generation breast implants that have meaningfully lower safety risks compared to competitor products. The company's implants have captured significant share in many international markets, and the upcoming U.S. and China launches will more than double the addressable market. Shares fell in the quarter. The near-term issue is that breast augmentations are expensive discretionary cash-pay procedures, and macroeconomic headwinds are leading to weaker global demand. Compounding this, distributors in Asia-Pacific are working down inventory as they run leaner in uncertain economic times. This weakness also creates uncertainty as to whether Establishment Labs can achieve certain milestones needed to access additional tranches of debt, absent which the company will likely need to raise capital. Longer term, we think Establishment Labs will capture significant share in the U.S. and China and will launch a unique minimally invasive implant product that will accelerate revenue growth and profitability.

Portfolio Structure

Table V.
Top 10 holdings as of December 31, 2023

	Year Acquired	Quarter End Investment Value (millions)	Percent of Net Assets
GitLab Inc.	2022	$49.0	3.4%
DraftKings Inc.	2023	43.5	3.0
SentinelOne, Inc.	2023	43.2	3.0
Advanced Energy Industries, Inc.	2019	43.1	3.0
Axon Enterprise, Inc.	2022	42.9	3.0
CyberArk Software Ltd.	2022	41.7	2.9
Axonics, Inc.	2020	39.7	2.8
Floor & Decor Holdings, Inc.	2019	39.0	2.7
Rexford Industrial Realty, Inc.	2019	36.5	2.6
Couchbase, Inc.	2021	35.9	2.5

Our top 10 holdings represented 29.0% of the portfolio, versus 32.1% at December 31, 2022 and 25.6% at December 31, 2021. This is within our typical 25% to 35% range. Cash holdings were 5.8%, which is also a typical mid-single digit level. As of September 30, 2023, the Strategy had capital loss carryforwards of about $205 million representing cumulative short and long-term losses that may be applied against future capital gains. We have no expectation of distributable gains in the near future, and we are always attuned to the tax position of the Strategy.

We generally don't expect our sector exposures to vary greatly from the Index, but the Strategy is presently overweight IT by about 16% due to our belief that small-cap IT has continued to show compelling valuations coupled with strong business growth characteristics. Our overweight position in IT stems from our investment in **Advanced Energy Industries, Inc.** We perceive Advanced Energy as more of an Industrials company. In the Industrials sector, the Strategy is 1.7% overweight, totaling 4.4% when reallocating Advanced Energy. This allocation encompasses a 4.5% exposure to defense-oriented names. The Strategy is 7.8% underweight in Health Care, but this is mostly due to our lack of exposure to biotechnology stocks, which represent over 10% of the Index. Finally, the Strategy does not have exposure to more cyclical/value-oriented sectors comprising over 10% of the Index including Energy (4.5% of the Index), Materials (4.1%), and Utilities (1.5%). While this latter allocation decision can hurt the Strategy's relative performance during periods when the market is exceedingly defensive and commodities are in an inflationary cycle, we believe that such periods are more the exception than the rule.

Recent Activity

Table VI.
Top net purchases for the quarter ended December 31, 2023

	Year Acquired	Quarter End Market Cap (billions)	Net Amount Purchased (millions)
AAON, Inc.	2023	$ 6.0	$12.9
Mercury Systems, Inc.	2015	2.2	5.3
DraftKings Inc.	2023	16.4	5.2
SentinelOne, Inc.	2023	8.2	4.0
Maravai LifeSciences Holdings, Inc.	2022	1.6	3.9

AAON, Inc. is a high-quality manufacturer of HVAC equipment based in Tulsa, OK. It is a leader in providing premium, semi-custom HVAC equipment to the non-residential market with products that are more energy efficient, have longer life spans, and overall are better customized than peers to fit customers' needs. This has driven significant outperformance over the past decade with organic growth in the high single-digit to low double-digit range compared to a low to mid-single-digit range for its peers.

Driven by both the rise of environmental consciousness and stricter ESG regulations, demand for AAON's specialized products, especially energy-efficient HVAC equipment with advanced air filtration, is experiencing a significant, organic surge. Unlike competitors facing challenges in updating their offerings and justifying price hikes to meet new standards, AAON already boasts products compliant with all requirements. This strategic foresight has eroded the historical price premium between AAON and industry standards, shrinking it from 15% to 20% to a high single-digit range. This narrowing price gap not only fuels volume growth but also strategically positions AAON to capture significant market share.

In December 2021, AAON further expanded its reach through the acquisition of BasX Solutions, a leader in data center, cleanroom systems, and custom HVAC units. This strategic move significantly increased AAON's addressable market by approximately 50%, reaching over $30 billion in segments where its focus on energy-efficient units holds particular value. Under AAON's ownership, BasX's adjusted cash flow (EBITDA) has nearly doubled in the past two years.

Under CEO Gary Fields' leadership, a multi-year restructuring has reinvigorated AAON's management team, fostering a heightened focus on promoting and advancing the AAON solution from niche to mainstream. A striking example of this transformation is the opening of its 28,000-square-foot exploration center in April, featuring over 10,000 square feet dedicated to exhibits and AAON products. During our visit at the company's Analyst Day in May, we witnessed AAON units showcased side-by-side with competitor solutions. By proactively purchasing and deconstructing competitors' products, the team effectively demonstrated the superior durability and efficiency of AAON's offerings. The exploration center, initially expected to attract one to two potential customers a week, has far exceeded expectations, seeing a strong conversion rate from visits to confirmed orders.

Looking ahead, with a run-rate revenue slightly above $1 billion in a $30 billion market, AAON is well-positioned for growth and market share expansion. Anticipating mid-single-digit price increases across its product range and coupled with mid-single-digit volume growth, the company remains focused on aggressive investment. Approximately 65% of its business pertains to replacement, with the remaining 35% in new construction, covering a diverse mix of end-markets and limited exposure to new office construction. Our projections suggest that AAON will drive gross margins from the low 30% to the mid-high 30% levels, with EBITDA margins expanding from the low to high 20% levels over our five-year investment horizon. We estimate that this combination of above-market growth and significant margin expansion has the potential to double our investment over the next five years.

We added to our position in **Mercury Systems, Inc.**, the leading U.S. Tier 2 defense electronics manufacturer and integrator, as we believe that the new management team put in place in August 2023 has made meaningful progress in their turnaround efforts, and that shares remain meaningfully undervalued. We also added a small amount to our **SentinelOne, Inc.** investment as we are excited about valuation and the acceleration in its business fundamentals.

We added to our position in **DraftKings Inc.**, the leading mobile sportsbook and gaming operator in the U.S. While we revised our fourth-quarter estimates downward due to a lower hold (the percentage of total bets that a sportsbook expects to retain as profit) in November, it's crucial to remember that hold can fluctuate from quarter to quarter. DraftKings has also consistently shown a gradual upward trend in hold over time, primarily driven by a shift towards higher-hold "parlay" bets. We remain drawn to DraftKings' dominant market share and the inherent scale advantages it offers.

While **Maravai LifeSciences Holdings, Inc.** remains a relatively small position in the Strategy, we believe that better days are ahead for this mRNA-oriented drug development technology company. We think that over the coming years its pipeline will start to bear fruit, and we can be patient as it is already cash-flow positive with net cash on its balance sheet.

Table VII.
Top net sales for the quarter ended December 31, 2023

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap or Market Cap When Sold (billions)	Net Amount Sold (millions)
Kinsale Capital Group, Inc.	2016	$0.4	$7.8	$17.5
European Wax Center, Inc.	2023	1.2	0.9	13.1
ACV Auctions Inc.	2021	0.5	2.4	8.3
Ichor Holdings, Ltd.	2016	0.2	1.0	6.9
Kratos Defense & Security Solutions, Inc.	2020	2.2	2.6	6.1

We trimmed our position in **Kinsale Capital Group, Inc.** in an effort to risk manage the position size. That being said, we continue to like the company's longer-term prospects and opportunities to take share in the excess and surplus lines insurance market.

We sold our position in **European Wax Center, Inc.** due to what we viewed as an appropriate valuation given the recent macroeconomic slowdown in visits from the company's episodic guests.

We trimmed our position in **ACV Auctions Inc.** during the quarter. While we continue to believe in the company's longer-term growth opportunities, we believe the current valuation reflects the challenging near-term economic environment.

We sold some of our position in **Ichor Holdings, Ltd.**, which is a manufacturer of semiconductor capital equipment. We like Ichor and its management team, but with the semiconductor equipment cycle at a low point, we believed there were better opportunities to deploy capital within the IT sector.

Outlook

In our 2022 fourth quarter letter, we posited that there were already signs that inflation, which was driven by massive monetary and fiscal stimulus and COVID-related supply-chain issues, was starting to ease. During 2023 our message to investors was that markets will rally as participants start to discount a pause in interest rate increases by the Federal Reserve, and will ultimately discount rate decreases by the Fed. While they did not move in a straight line, markets played to type and rallied in what we viewed as a typical economic cycle reaction. That being said, large-cap stocks, and particularly a small set of these, rallied higher than small caps in 2023. We believe that 2024 will be the *year of small cap* as relative valuations return to more normalized levels, with small caps garnering bigger multiples than large caps. We also believe that our style of stock picking—active management driven by fundamental analysis—will be amply rewarded.

Randy Gwirtzman
Portfolio Manager

Laird Bieger
Portfolio Manager

The performance of accounts in the Strategy may be materially different at any given time. Differences that may affect investment performance include cash flows, inception dates, and historical prices. Positions may not be the same or may be traded at different times. In addition, accounts in the Strategy may be pursuing similar investment strategies but may have different investment restrictions.

Risks: Past performance is not a guide to future performance. The value of investments and income from them may go down as well as up. Your capital is at risk. Specific risks associated with investing in smaller companies include that the securities may be thinly traded and more difficult to sell during market downturns. Even though the Strategy is diversified, it may establish significant positions where the Adviser has the greatest conviction. This could increase volatility of the Strategy's returns. Past performance is not a guide to future performance. The value of investments and income from them may go down as well as up. Your capital is at risk.

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 managers' 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.