# Baron Discovery Strategy

September 30, 2023

## Dear Investor:

## Performance

Baron Discovery Strategy's 10-Year Anniversary

On October 31, 2023, Baron Discovery Strategy® reached its 10-year anniversary. As long-term investors, we are most focused on our alpha creation over time. While there will be years in which we underperform the market, we believe our strategy shines most during economic recoveries, and we continue to position ourselves to benefit from the stock market recovery we expect during the next economic up cycle.

**Table I.**
**Performance for annualized periods ended September 30, 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] | (5.36)% | (5.13)% | (7.32)% | (3.27)% |
| Nine Months[3] | 9.15% | 9.95% | 5.24% | 13.07% |
| One Year | 9.38% | 10.46% | 9.59% | 21.62% |
| Three Years | (2.21)% | (1.24)% | 1.09% | 10.15% |
| Five Years | 3.81% | 4.84% | 1.55% | 9.92% |
| Since Inception (October 31, 2013)[4] | 11.43% | 12.37% | 6.58% | 11.51% |

**Table II.**
**Calendar Year Performance 2018-2022 (Figures in USD)**

| | Baron Discovery Strategy (net)[2] | Baron Discovery Strategy (gross)[2] | Russell 2000 Growth Index[2] | S&P 500 Index[2] |
|---|---|---|---|---|
| 2018 | 0.71% | 1.75% | (9.31)% | (4.38)% |
| 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)% |

*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 September 30, 2023, total Firm assets under management are approximately $39.6 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.

**Table III.**
**Top contributors to performance for the quarter ended September 30, 2023**

| | Percent Impact |
|---|---|
| Kinsale Capital Group, Inc. | 0.50% |
| Clearwater Analytics Holdings, Inc. | 0.36 |
| PAR Technology Corporation | 0.31 |
| Guidewire Software, Inc. | 0.22 |
| Axonics, Inc. | 0.22 |

Third Quarter

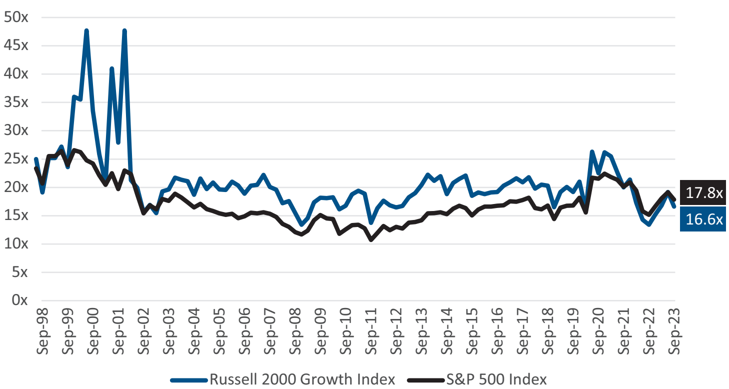
The Strategy was down 5.36% during the third quarter, which was 1.96% better than the Benchmark. Year-to-date, the Strategy appreciated 9.15%, which was 3.91% better than the Benchmark. The crosscurrents we have been writing about for the past few quarters continued into the third quarter. During the third quarter, it was the bond market that became the latest headwind to stock market performance. The stock market started the quarter on a positive note in July. However, the bond market experienced a sell-off in August and September, leading to an increase in long-term U.S. Treasury yields. This sell-off was driven by concerns about rising inflation and the potential for further rate hikes by the Federal Open Market Committee. Consequently, the stock market also saw declines in August and September, particularly affecting small-cap equities.

In our last few quarterly letters, we have focused on the crosscurrents we were seeing at both the macro and individual company levels. As we move into the fourth quarter, we continue to see some positives and some negatives impacting stock prices. On the positive side, unemployment remains low, the industrial economy has shown resiliency, and, with the exception of the lower-end consumer, overall consumer spending has remained strong. The positive aspects are being counterbalanced by signs that deflationary pressures have lessened, as evidenced by a nearly 30% increase in oil prices during the third quarter, along with concerning indicators related to consumer spending. Of course, strength in the labor market is a good thing objectively, but it is also viewed as potentially inflationary. We continue to think that these crosscurrents will continue over the next few quarters, but depressed stock prices already reflect a lot of this negativity. American Association of Individual Investors (AAII) bearish sentiment, a contrary market indicator, was at a five-month high for the week ended October 5. This is lower than the near all-time high reached last September but still reflects the fact that investors remain pessimistic. In our view, we can make the greatest profits when we buy stocks at peak pessimism, so this level of bearishness makes us more, not less, constructive on the market.

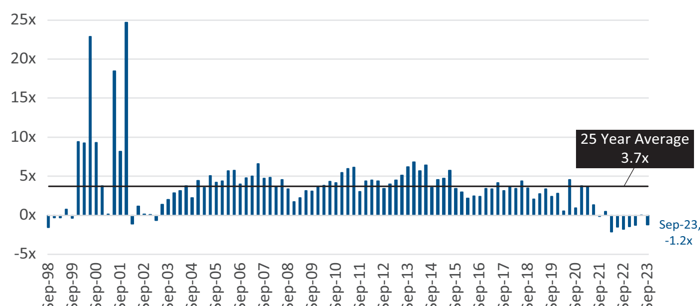
Valuations remain compelling both on an absolute and relative basis (see charts below). Despite the Benchmark still being about a third below where it peaked two and a half years ago, our individual company 2023 revenue and profit estimates have, on average, remained relatively unchanged from what we thought at the beginning of the year. Our *goldilocks* scenario for making outsized investment returns is an environment where investors are extremely bearish, valuations are inexpensive, and future revenue and earnings estimates are understated. Today we have the first two elements in place. The crosscurrents we have been writing about for the past few quarters are, for the time being, delaying the upward revision to revenue and earnings estimates that we expect to come eventually. While we don't know when upward revenue and earnings revisions will happen, we do believe that *they will eventually happen* and we believe we have positioned the portfolio to outperform when they do.

**Russell 2000 Growth Index vs. S&P 500 Index**

**Historical Valuation Comparison using Forward P/E Estimates**




**Difference in Forward P/E Estimates**




*Sources: The Bank of New York Mellon Corporation using I/B/E/S 1 Year Forward EPS and FactSet Market Aggregates.*

Specialty insurer **Kinsale Capital Group, Inc.** contributed to performance after reporting consensus-beating quarterly results. Gross written premiums grew 58%, and earnings per share increased 50%. Market conditions remained favorable, with rising premium rates and more business shifting from the standard lines market to the excess and surplus lines market where Kinsale operates. The company is also capitalizing on disruption in the property market, where rates are rising rapidly after years of industry losses and a reduction in reinsurance capacity. 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.

**Clearwater Analytics Holdings, Inc.** provides portfolio accounting and reporting software. Shares rose after the company reported solid second quarter earnings, demonstrating strong underlying business trends, and raised its full-year guidance for 2023. The company also hosted an upbeat Investor Day where it gave strong medium-term guidance calling for 20%-plus revenue growth and an annual margin expansion of 200 basis points. We believe Clearwater has robust competitive advantages and the potential to compound revenue at more than 20%. The company has an efficient business model that should drive 40%-plus adjusted EBITDA margins over time.

**PAR Technology Corporation** is a leading software-as-a-service provider to the restaurant industry. Shares rose during the quarter on news that the company is on the verge of potentially winning some contracts with large quick-service restaurants and table service customers. The restaurant industry has historically under-invested in technology, and PAR is building an all-in-one platform for enterprise restaurants to run the most critical portions of their technology stacks. PAR benefits from limited industry competition, accelerating restaurant adoption of cloud platforms, a renewed focus on R&D, and sales efficiency. As its new payments and online ordering products continue to ramp, we believe PAR will deliver on its 20% to 30% subscription revenue growth targets for the next several years. We believe the company will become profitable in the quarters ahead as it controls operating expenses while delivering strong growth and continues to bolt on targets.

**Table IV.**

**Top detractors from performance for the quarter ended September 30, 2023**

| | Percent Impact |
|---|---|
| Silk Road Medical, Inc. | –0.81% |
| Montrose Environmental Group, Inc. | –0.70 |
| Navitas Semiconductor Corporation | –0.68 |
| indie Semiconductor, Inc. | –0.65 |
| Revance Therapeutics, Inc. | –0.62 |

**Silk Road Medical, Inc.** sells medical devices used in minimally invasive transcarotid artery revascularization (TCAR) procedures. The company's TCAR device allows placement of a stent in the carotid artery to provide better blood flow to the brain, while reducing the risk of stroke during the procedure due to its innovative reverse blood flow system. The stock detracted from performance as Medicare is updating reimbursement for an alternative carotid procedure (TF-CAS) to be equivalent to TCAR and investors are debating the competitive impact. We retain conviction as TCAR is less invasive, has an easier recovery, and causes fewer periprocedural strokes than other options, including TF-CAS and carotid endarterectomy surgery (CEA),the traditional and far more invasive method of clearing and stenting carotid arteries. Following last summer's FDA approval of Silk Road devices in the treatment of standard surgical risk carotid stenosis patients, which expanded the company's market, Silk Road saw rising numbers of eligible patients, accelerated use of its products, reduced reimbursement uncertainty, as well as further legitimization of TCAR in the eyes of more conservative surgeons who had been holding off switching from CEA. We think TCAR is fundamentally safer, easier to perform, and more scalable than either of the alternative procedures. Currently accounting for nearly 15% of carotid stenosis interventions, we believe the TCAR should become the standard of care for treating carotid artery disease over the long term. The company now trades for an exceedingly cheap 2 times its enterprise value/sales ratio for 2024, has significant net cash on the balance sheet, and will be cash flow breakeven by our estimates in 2024. We believe that even with conservative overall market and competitive procedure share assumptions, the company will be able to double revenues over the next five years.

**Montrose Environmental Group, Inc.** is a services company that provides environmental analysis, testing, and remediation consulting as well as technology solutions. Shares were weak in the quarter along with a broader decline in small-cap stocks and due to concerns that infrastructure investments could get pushed out while waiting for the finalization of certain government rules. We continue to believe that Montrose's patented technology positions them well to benefit from the billions of dollars of upcoming spending by both government and industrial customers related to the clean-up of PFAS (polyfluoroalkyl substances, sometimes known as forever chemicals). In addition, Montrose's methane emissions monitoring and detection business is poised to ramp up as the Inflation Reduction Act spurs corporate compliance by imposing a waste emissions charge. We continue to be confident around the long-term opportunity for Montrose as well as its management's ability to execute on the company's growth strategy.

**Navitas Semiconductor Corporation** is a leader in gallium nitride (GaN) power semiconductors and a smaller player in silicon carbide (SiC) power semiconductors. These are both new materials used as a substrate for printing power-oriented chip circuits. Shares fell during the quarter as the stock was trading at a premium valuation heading into the quarter, and investors were broadly concerned about underlying demand conditions in key end-markets like smartphones. Despite near-term concerns, the company reiterated its outlook to double revenues in 2023, reported strong design win momentum, and indicated opportunity pipeline growth. Navitas sells monolithically integrated GaN power integrated circuit chips, which offer greater reliability and performance compared to competitors supplying discrete power devices. It recently purchased a silicon control company to drive integration and performance even further, and its SiC products offer high performance across many different applications. The company's high-power GaN product launches remain on track for data center, solar, and electric vehicle applications. We expect Navitas to gain share in the rapidly growing GaN and SiC power semiconductor markets over time, driven by its superior technology.

## Portfolio Structure

**Table V.**
**Top 10 holdings as of September 30, 2023**

| | Year Acquired | Quarter End Investment Value (millions) | Percent of Net Assets |
|---|---|---|---|
| Kinsale Capital Group, Inc. | 2016 | $62.1 | 4.9% |
| Advanced Energy Industries, Inc. | 2019 | 40.8 | 3.2 |
| Chart Industries, Inc. | 2022 | 38.1 | 3.0 |
| Axonics, Inc. | 2020 | 35.8 | 2.8 |
| Boyd Gaming Corporation | 2021 | 35.6 | 2.8 |
| GitLab Inc. | 2022 | 35.2 | 2.8 |
| Axon Enterprise, Inc. | 2022 | 33.1 | 2.6 |
| SiteOne Landscape Supply, Inc. | 2016 | 32.7 | 2.6 |
| PAR Technology Corporation | 2018 | 32.6 | 2.6 |
| Rexford Industrial Realty, Inc. | 2019 | 32.1 | 2.5 |

Our top 10 holdings represented 29.6% of our net assets, which is in line with historical levels.

## Recent Activity

**Table VI.**
**Top net purchases for the quarter ended September 30, 2023**

| | Quarter End Market Cap (billions) | Net Amount Purchased (millions) |
|---|---|---|
| SentinelOne, Inc. | $5.0 | $20.9 |
| Liberty Media Corporation – Liberty Live | 2.9 | 16.7 |
| Repligen Corporation | 8.9 | 12.1 |
| European Wax Center, Inc. | 1.0 | 10.9 |
| 10x Genomics, Inc. | 4.8 | 6.9 |

We initiated a position in **SentinelOne, Inc.** this quarter after the stock fell sharply on its March 2023 quarterly results. The company lowered its full-year guidance for revenue growth by about 10%, but we anticipate that it will still achieve an annualized recurring revenue growth rate in the mid-30s. We believe that the market overreacted to the update, and we had already witnessed a positive development in its June 2023 results, which boosted full-year revenue growth to 43%. This is a classic *fallen angel* investment for the Strategy.

SentinelOne is a cybersecurity vendor with a primary focus on endpoint protection, safeguarding corporate laptops, mobile devices, and servers from malicious attacks. The company collects petabytes of data from over 15 million endpoints across its customer base and uses artificial intelligence (AI) to learn behavior patterns, detect suspicious activity, proactively hunt threats, and roll-back devices to their pre-breach states to mitigate damage when attacks occur. SentinelOne is widely recognized as a technology leader in the $27 billion endpoint and cloud security industry due to its AI-powered detection and its ease of use. As a result, the business has been winning market share away from legacy antivirus vendors who struggle to keep up with the rapidly evolving threat environment. More than 11,000 organizations have adopted SentinelOne, with customers including half the Fortune 10, government agencies, and many of the world's largest managed security service providers (MSSPs). MSSPs, which represent 20% to 30% of SentinelOne's revenue, extend the company's reach to thousands of small businesses who lack adequate IT resources to defend against cyberattacks.

SentinelOne has leveraged its extensive security dataset from customers to introduce new products, such as cloud security to safeguard virtual machines and cloud-based applications, identity-based threat protection, and extended detection and response. This comprehensive approach involves collecting data from sources like network scans and IT logs to provide a holistic view of security. These emerging solutions represent more than a third of bookings, are growing faster than core endpoint protection, and drive much higher long-term contract values. As SentinelOne has scaled its business across these products, the company has delivered significant improvement in its free-cash-flow (FCF) margins, which have expanded by an average of 24% year-over-year every quarter since becoming a public company. We expect the business to generate positive cash flow next year and healthy 20%-plus margins longer term. As the threat environment continues to get worse, with more frequent and severe ransomware attacks, heightened geopolitical tension, and increased sophistication of hackers, we see ample runway for growth through both new customer acquisition and existing customer expansion. The combination of resilient end-market demand, new product traction, and margin expansion should all bode well for the stock long term.

**Liberty Media Corporation-Liberty Live** is a tracking stock created on 8/4/2023 representing Liberty Media Corporation's holdings in Live Nation shares. Those holdings were previously attributed to Liberty SiriusXM and reattributed to a the newly created Liberty Live Group vehicle to reduce the complexity of the Liberty SiriusXM structure and make way for its potential combination with the underlying SiriusXM business. We believe the separation created some selling pressure on Liberty Live, creating an attractive discount of over 40% to the underlying value of its Live Nation holdings, and we took advantage of that discount to build a position. The Liberty Live Group is a small-cap vehicle through which we can own the underlying Live Nation business, which we have followed and liked for years. Live Nation has significant competitive advantages in the live entertainment industry due to its unique combination of concert promotion, ticketing, venue management, and sponsorship businesses, which create a market share flywheel and margin structure that is difficult for competitors in any one of these underlying sub-segments to replicate independently. In addition to the upside we see in Live Nation, we think Liberty Live Group could eventually transition from a tracking stock to an asset-backed vehicle, which would pave the way for a structure consolidation with Live Nation and allow us to capture the current wide NAV discount.

We continued to build our **Repligen Corporation** position, which we initially purchased in the second quarter. For more detailed information, please refer to last quarter's commentary on the company.

During the quarter, we added to our position in **European Wax Center, Inc.** European Wax Center is the largest and fastest-growing franchisor and operator of out-of-home waxing services in the U.S. with more than 1,000 locations. We believe European Wax Center's scale, high-quality service, and differentiated waxing experience will enable the company to take share in the $18 billion hair removal market. As a franchisor, European Wax Center offers compelling new unit economics for franchisees with 60% cash-on-cash returns after five years. This healthy return, along with a relatively low initial investment and economic resiliency has led to a multi-year pipeline of over 400 franchisees. We believe that over time European Wax Center can grow units 10% annually with longer-term potential for over 3,000 units, roughly 3 times the current unit count. As the company's valuation compressed during the quarter, we took advantage of this pullback to increase our position. We believe the combination of double-digit unit growth and high single-digit same-store sales growth will lead to a more than doubling of the stock price over the next five years.

We initiated a position in **10x Genomics, Inc.,** a company that sells innovative instruments and reagents for life sciences research. The company's first platform, the Chromium, is dominant within the single-cell space. The Chromium utilizes advanced microfluidics to separate a sample into individual cells. Each cell is enveloped in its own droplet, where an individual reaction occurs to detect the expression profile of that cell. This occurs in parallel across tens of thousands of droplets, enabling high-throughput and granular characterization of a sample. 10x Genomics' second platform is the Visium platform for spatial analysis. Visium employs a slide with many small dots (55 microns in diameter), each of which has a unique barcode. The barcodes are read by next-generation sequencing equipment. This capability allows researchers to identify expression patterns, which are indicative of genetic behavior, across different geographic regions of a tissue sample. Finally, the company is launching its third major platform, the Xenium for in-situ analysis. The in-situ platform allows researchers to visualize biomarkers of interest right on the tissue slide, in real time. The images are processed on-instrument versus Visium, which requires barcodes that a separate sequencer reads.

Our conviction in 10x Genomics is driven by multiple growth drivers over the next several years. First, for the single-cell platform, the company has a new kit called Flex that enables sample multiplexing and working with FFPE (preserved) samples. We think this opens up translational studies that rely on archival samples. This presents an opportunity for expansion into the biopharmaceutical sector, whereas historically, the company has primarily focused on basic research. Second, we think there is upside from the new product cycle with the in-situ Xenium. We believe the platform is differentiated by its throughput, paired with a panel approach that allows customers to add customization to their research projects. In the near term,10X Genomics' margins may be pressured by the bolus of Xenium boxes being placed, which are generally, lower-margin *razors*. This will eventually lead to a stream of consumables *(razor blades)* sales at much higher margins. We like 10x Genomics as a high-quality life science research company with *multiple shots on goal*. The company has a strong balance sheet with $400 million in cash and no debt, and with visibility to FCF breakeven in the near term. We see 10x Genomics as a consistent double-digit grower, with over 80% of revenues coming from high-margin and recurring consumables, roughly 70% gross margins, and a path to over 30% EBITDA margins longer term.

**Table VII.**
**Top net sales for the quarter ended September 30, 2023**

| | Market Cap When Acquired (billions) | Quarter End Market Cap or Market Cap When Sold (billions) | Net Amount Sold (millions) |
|---|---|---|---|
| Kinsale Capital Group, Inc. | $0.4 | $9.6 | $12.4 |
| Allegro MicroSystems, Inc. | 0.4 | 6.1 | 11.5 |
| Boyd Gaming Corporation | 7.3 | 6.1 | 9.7 |
| Qualys, Inc. | 0.7 | 5.6 | 7.3 |
| Abcam plc | 3.6 | 4.9 | 7.3 |

We trimmed our positions in **Kinsale Capital Group, Inc**. and **Boyd Gaming Corporation** to manage their respective position sizes as part of our risk management efforts. We continue to remain positive about both companies' long-term prospects. We trimmed our positions in **Allegro MicroSystems, Inc.** and in **Qualys, Inc.** based upon our longer-term valuation estimates. During the quarter, we divested our investment in Abcam plc, a prominent provider of customized antibodies for biologic research and drug development. After a tumultuous round of public squabbling between the company and one of its founders, Danaher Corp. ultimately made an acquisition bid for the company that was accepted by Abcam's board of directors. We believe that even though the founder continues to agitate for a higher price, the bid from Danaher was fair.

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.