Keeping an Eye on Long Term Fundamentals in the Face of Uncertainty

This is an edited version of an October 14, 2020 Q&A with Ron Baron, Michael Baron, and David Baron. Ron is CEO of Baron Capital and portfolio manager of Baron Partners Fund, Baron Focused Growth Fund, and Baron WealthBuilder Fund. Michael is co-portfolio manager of Baron Partners Fund and assistant portfolio manager of Baron WealthBuilder Fund. David is co-portfolio manager of Baron Focused Growth Fund.

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Key Discussion Points

Overview

Baron Focused Growth Fund
Fund performance, management of the portfolio, current outlook for the market and the Fund

Baron Partners Fund
Fund performance, management of the portfolio, volatility

Baron WealthBuilder Fund
Concept behind this Fund of Funds

Thought on Tesla

Introduction

Moderator: I'll start by stating the obvious: it has been an incredible year underscored by the pandemic that, at one point, forced a near-complete shutdown of the global economy. And now we're getting towards the end of a very contentious election cycle. So, there's been no shortage of uncertainty or volatility and the headlines certainly have provided a lot of reasons not to invest. Yet, the Funds we're focusing on for today's call — Partners, Focused Growth, and WealthBuilder — were up 74%, 68%, and 32%, respectively, year-to-date through September 30, 2020.

Today, Ron, David, and Michael will share their thoughts on the markets and the economy and also describe how our time-tested investment philosophy and process have guided their actions and led to this outstanding performance, not just year-to-date, but as you'll hear from Ron, over time.

Overview

Ron Baron: I'm very happy with how the performance is going this year. This is, for me, a career year. We've never done as well as we have this year. However, I think it's important to point out that our current dramatic outperformance is not based on decisions we made this year. It's not like we saw the pandemic coming, sold everything in February, and bought back the exact right stocks in March. That's not what happened.

The Funds we manage have very low turnover on average – probably around 10%. So in many cases the results we're achieving now are because of decisions we made years ago.

We focus on what a business is going to become, not what it is at this moment. That means we invest for the long term in businesses investing in themselves at the expense of current profitability. That's what gives us a chance in a short-term-oriented market. By looking to the future, we get to buy businesses at good prices.

Many of the businesses we own were prepared for this pandemic when it struck. They were investing in technology platforms so they could take advantage of artificial intelligence, machine learning. Most of our businesses have digital strategies that allowed them to operate as they normally did when the pandemic hit.

We are not focused on stock prices. We focus on what we think a business is worth and what it will be worth. We think about whether the business is progressing as we expected. Is it on the path to achieve the numbers we think it will achieve over five or 10 years? Most investors don't have that timeframe. We do.

When the stock market crashed in March, for the most part, we made few changes to our portfolios. We don't trade based on the short term because we can't predict what's going to happen. Neither can anyone else. All we can think about is what will happen in the long term. So we ignore short-term fluctuations.

Baron Focused Growth Fund

This Fund is differentiated from its peers in several ways. Could you describe the strategy for us?

David Baron: The Fund's strategy is to invest for the long term in a focused portfolio of appropriately capitalized, competitively advantaged, and well-managed small- and mid-cap companies at attractive prices. The portfolio will generally have less than 20 securities, so they must be high conviction ideas with long runways for growth.

For a focused fund, the risk is lower than average. Since inception, the Fund has been 80% as volatile as the market. The Fund also has extremely low turnover. We have held our companies for an average of 13 years. The stocks we've held for over 10 years have had an average annual return of 34%. The Fund's annualized alpha is 685 basis points since inception. So we continue to see a lot of value in this buy-and-hold Fund.

What have been the main drivers of recent Fund performance?

The Fund has had a strong 2020 so far, with the portfolio up just over 68% through the end of the third quarter. This compares to the Russell 2500 Growth Index, which is up just over 11.7% during the same period.

While this strong performance may be surprising with the world under so much stress, the pandemic has actually accelerated the digital conversion of many of our companies, making them stronger and more profitable in the process. This transition toward more of an asset-light business has resulted in stronger margins with lower capital requirements and higher cash flow. As a result, our companies' balance sheets are improving more quickly than previously thought, increasing liquidity and financial flexibility.

Several of our companies have taken the opportunity to offer additional shares to the market, adding cash to their balance sheet and additional flexibility to invest in their business or acquire other companies. We think these capital raises, along with the digital conversion of the businesses, should further improve the long-term prospects of these companies.

For example, electric vehicle manufacturer **Tesla, Inc. (TSLA)** has added robots to its manufacturing floors, reducing its production costs and increasing efficiencies, while building new factories in Shanghai, Berlin and, most recently, Austin, Texas. In addition, all Tesla sales are conducted online, where it takes five minutes to buy a car. This is a major difference from the painstaking process of going to a dealership.

Penn National Gaming, Inc. (PENN) is in the process of converting its brick-and-mortar casinos to cashless, making it easier for customers to transact. In addition, Penn has moved its marketing from more traditional, more expensive channels like snail mail, TV, and radio to more efficient digital channels, allowing it to target more profitable customers. This is especially important when you have capacity restrictions at casinos due to COVID-19. Penn also has benefited from its emerging sports betting opportunity with Barstool Sports as the pandemic has moved everyone online. Barstool Sports has enabled the company to target a new and younger customer and potentially convince them to visit its casinos.

Finally, **CoStar Group, Inc. (CSGP)**, the leading provider of information and marketing services to the commercial real estate industry, has hired additional people to update its database while adding new services with high barriers to entry.

Not surprisingly, year-to-date through the end of the third quarter, Tesla, Penn, and CoStar have been the Fund's top three performers.

On the negative side, the Fund has been hurt by its travel and leisure investments. Despite recoveries from the March lows, many of these stocks are still down between 10% and 40% year to date. However, we still believe

most of these stocks should start to outperform as we believe the bad news is already priced in and all of them have enough liquidity to survive the pandemic. We think these companies should grow their earnings back to 2019 levels over the next two to three years.

For instance, **Hyatt Hotels Corp. (H)** is still down over 40% this year as there continues to be concerns around the company's owned portfolio, which is 40% of its business. Skepticism about how quickly profits would rebound is widespread given Hyatt's significant exposure to business and group travel. We believe Hyatt should fully recover from the pandemic over the next two years, assuming a vaccine or effective therapeutic is developed and business meetings and group travel return. In the meantime, Hyatt has an extremely sound balance sheet and liquidity profile, and we continue to find Hyatt's valuation attractive. We believe the company's owned assets are trading at significant discount to what they are worth in the private market.

What is your current outlook for the economy, the markets, and the Fund?

David Baron: Clearly, there is still a ton of uncertainty regarding the pandemic and the impact to the economy. But we remain confident in the names in the portfolio. I think they should rebound as the pandemic subsides and a vaccine is established. Massive government monetary and fiscal stimulus should begin to work well as the economy ramps and should help companies rebound. Historically low interest rates are a positive for stock multiples. Despite our strong year-to-date performance, we still see significant upside in years to come.

Baron Partners Fund

Could you describe the strategy for the Fund and how it differs from Baron Focused Growth Fund?

Michael Baron: Like all Baron Funds, both Partners and Focused Growth take the same investment approach: investing for the long term in appropriately capitalized, competitively advantaged, and well-managed companies at attractive prices. Both Funds are focused: the top 10 positions account for 94.2% of overall net assets of Baron Partners Fund.

In terms of differences, Focused Growth is a small- and mid-cap fund, while Partners is an all-cap fund, although we tend to find many of our companies in the mid-cap range, because they tend to have the right blend of growth and stability that we like. We also have the ability to use leverage to enhance returns. The Fund was 15% leveraged at the end of the third quarter, but that has flexed to 20% to 25% when we find particularly compelling opportunities.

How has the Fund performed during the pandemic?

Michael Baron: The performance we've achieved this past year has truly been extraordinary. In the third quarter, the Fund was up more than 47%, outpacing the Russell Midcap Index at 9.3%. Year-to-date, we're up 74%, versus the Index at 13.9%. Over the trailing 12-month period, the Fund has almost doubled.

But what we're most proud of is not how we're doing right now. It's how we've done over the past three, five, and 10 years. It's the average annual outperformance of 400 to 500 basis points during those time periods that allows our investors to compound their money.

What's been driving recent Fund performance?

Obviously the phenomenal run-up in Tesla has driven much of the Fund's recent performance. I think it's important to point out that we have owned Tesla for many years. We last purchased Tesla stock back in February 2016, or 4½ years ago. At that time, it was trading at $152, prior to its 5-for-1 split. That translates to an adjusted share price of $30. When we bought it, it comprised about 9% of Fund assets. So our stake in Tesla, like other positions we hold and have held in the past, has expanded as a result of being right, being successful, and holding onto winners.

How are you managing the portfolio?

Michael Baron: We categorize the holdings in the Fund into four buckets: disruptive growth, core growth, financials, and real and irreplaceable assets. Much of the year-to-date performance has been driven by the disruptive and core growth categories.

Disruptive growth: The disruptive category includes companies like Tesla, **Zillow Group, Inc. (ZG), Guidewire**

Software, Inc. (GWRE), Shopify Inc. (SHOP), and **SpaceX,** which is a private company. All these companies are leaders in their category, with compelling products or services. They are all benefiting from the digitization of the economy, a trend the pandemic has accelerated. For example, Zillow is making it possible to research and even buy homes online. Shopify ensures that brands can sell directly online to consumers without intermediaries such as Amazon.

Core growth: This category has also been a strong performer so far this year. It includes companies like **Adyen N.V. (ADYEN.NA)** and **IDEXX Laboratories, Inc. (IDXX)**. These are consistent growers that have not really been impacted by the economic slowdown.

Financials: Holdings within our Financials category have been harder hit in the downturn. However, we are seeing a divergence in performance between financial services companies and companies more tied to the macro environment. Companies in the former category, such as **FactSet Research Systems, Inc. (FDS)** and **MSCI, Inc. (MSCI)**, are doing well. Their clients are actually increasing their usage. These companies are heavily integrated into their clients' businesses through their SaaS business model, and their services are easily accessed in the current work-from-home environment.

Financials that investors view as more tied to macro-economic conditions have been more challenged. This category includes **The Charles Schwab Corp. (SCHW)**, **Brookfield Asset Management, Inc. (BAM)**, and **Arch Capital Group Ltd. (ACGL).** Investors tend to value these stocks based on market conditions, interest rates, and their balance sheets. We look at these companies differently. We focus on their organic growth prospects, the stickiness of their clients, the efficiencies they're able to realize, and product development. We believe some of these companies could even capitalize on market volatility to get new customers onto their platform.

Schwab is a good example. For instance, we think Schwab's recent acquisition of TD Ameritrade will help boost Schwab's leadership in the RIA space. The economies of scale of the combined companies should also serve to lower Schwab's costs. We are also seeing an acceleration in growth so far this year as the volatile market has prompted people to seek more investment advice.

Real assets: Real assets comprise about 20% of the portfolio. Although they have bounced back a bit, they are still down year-to-date. Nonetheless, we remain confident that these companies will come back when the economy recovers and should be better positioned than smaller competitors once we emerge from this crisis.

Valuations seem high for many of the higher flying stocks year-to-date. Do you have a perspective on that?

Michael Baron: Most people view valuation according to a stock's P/E ratio. That's not the way we look at valuation.

It's certainly true that looking at price versus earnings, many stocks seem expensive. But we value companies based on what we think they will be earning down the road. From that perspective, the companies we own are cheap. We expect them to grow on a top line basis and, more importantly and often overlooked, from a profitability standpoint.

For example, Tesla is figuring out how produce its vehicles much more efficiently without sacrificing quality. How it can lower the cost of its batteries. We see this across all of our businesses. A lot of our disruptive businesses are extending their margins as they add more revenue and improve scale.

As for companies that have been hurt the most as a result of a slowdown in business in the pandemic, travel companies are getting rid of extra costs they probably won't have to put back. Financial businesses have been consolidating, which should reduce the cost of operating per dollar of assets.

Baron WealthBuilder Fund

Baron WealthBuilder Fund is a Fund of Fund comprised exclusively of other Baron Funds. Could you talk about the concept behind that strategy?

Michael Baron: WealthBuilder will turn three years old this December. Its annualized return through September 30, 2020 is just over 21% versus the S&P 500 Index at 10.84%. The Fund has about 435 underlying holdings, so it is highly diversified yet has produced outstanding returns, which is not something that people normally associate with high diversification. And I think it comes down to the overall investment philosophy

and process that is consistent across all 17 of our Funds. It's just applied in different market caps, sectors, and geographies. For instance, when you look at WealthBuilder's international holdings, which comprise about 20% of assets, it looks very different than what you see in the indexes, which heavily favor developed economies such as Europe and Japan and megacaps. In this Fund, the international sleeve is much more weighted toward the emerging markets, particularly China and India.

Tesla is the biggest holding in both Focused Growth and Partners. The stock is up about 450% year to date. Why are we seeing this type of appreciation now and why wasn't it appreciated earlier on?

Ron Baron: My assessment is very simple. The stock was very risky five years ago when we purchased it. Now that Tesla is doing as well as it is, it's dramatically less risky to invest in this company with a $450 billion market cap than it was at a $50 billion market cap.

Back then, there was a chance of failure. When Tesla built its first factory in Freemont, it was incredibly inefficient. It was wrong in every way. They didn't know what they were doing. And then they learned and kept changing it and kept innovating and kept being agile. Today, Freemont could produce 400,000 or 500,000 cars a year. And Tesla's overhead is paid for by Freemont.

Then they built their first factory in China, and it was completed in less than a year. That factory cost $800 or $900 million. It's producing 4,000 cars a week and earning $2 billion a year. They have another factory in China that is almost completed, which will also cost $800 or $900 million and also earn $2 billion a year.

An industrial company typically hopes to make a 15% return on capital. If you invest $1 billion, you hope to make $150 million a year before taxes. Tesla is investing $1 billion and making $2 billion a year instead of $150 million. Amazing.

In Germany, Tesla is building its factory on a river. Its putting in jogging trails and rebuilding a forest. It is showing that the company is environmentally aware and its factories serve the community, and not just by employing workers. They are doing the same thing with the factory in Austin, Texas -- on a river, jogging trails, environmentally friendly, trees, parks, and welcomed by the community.

Back then, people said, Oh, they've got this factory in Freemont, and I don't know, it's not that great a factory. The quality's not as good. The paint shop is not as good as it should be. How are they ever going to make millions of cars a year? How are they going to compete with General Motors and Ford and Toyota?

Now, people recognize these new factories they're building are better than any factories the other car companies have. They're suddenly realizing this company sold 400,000 cars last year and will sell 500,000 this year despite the pandemic. And then next year, probably 750,000. They will also have capacity in place of 2 million cars a year. And they're going to keep growing at that kind of pace for a long time. So people are recognizing the increase in capacity from 400,000 to 2 million and not stopping there. And the same time, people are beginning to recognize how profitable these cars are.

Tesla's also been able to raise about $10 billion of capital over the past year. So, the balance sheet is in much better shape than it was this time last year. Lots of cash.

I think people are soon going to see how profitable Tesla's battery business will be. I think the investments they're making in batteries will allow them to make as much capacity as they did in Reno in 10% of the space and at a fraction of the cost. And the batteries will cost half as much, and they'll be 50% more powerful.

Other car companies could do these things, but they have hundreds of billions of dollars invested in plants that make internal combustion engines. They've been dragging their feet. The only other car company that is actively investing in electric cars is Volkswagen, and Volkswagen's way behind.

90 million cars are sold a year. Elon Musk says he's going to sell 20 million, and I'm sure that's not the end of his dream. He's got autonomous driving coming after that. And car sharing after that.

So, one thing after another after another. People see the increased capacity. They recognize how profitable they are. And they're recognizing that everyone else is going to try to do electric. And they will be successful. But we think Tesla will be the most successful.

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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 September 30, 2020: 1-year, 105.35%; 5-years, 28.65%; 10-years, 21.67%; Since Inception (1/31/1992), 15.24%. Annual expense ratio for the Institutional Shares as of December 31, 2019 was 1.96% (comprised of operating expenses of 1.06% and interest expense of 0.90%). The **Russell Midcap Growth Index**'s annualized returns as of September 30, 2020: 1-year, 23.23%; 5-years, 15.53%; 10-years, 14.55%; Since Fund Inception (1/31/1992), 10.27%.

Baron Focused Growth Fund's annualized returns for the Institutional Shares as of September 30, 2020: 1-year, 94.32%; 5-years, 25.42%; 10-years, 17.41%; Since Inception (5/31/1996), 13.52%. Annual expense ratio for the Institutional Shares as of December 31, 2019 was 1.10%. The **Russell 2500 Growth Index**'s annualized returns as of September 30, 2020: 1-year, 23.37%; 5-years, 14.19%; 10-years, 14.06%; Since Fund Inception (5/31/1996), 8.49%.

Baron WealthBuilder Fund's annualized returns for the Institutional Shares as of September 30, 2020: 1-year, 46.60%; Since Inception (12/29/2017), 21.03%. Annual expense ratio for the Institutional Shares as of December 31, 2019 was 1.33%, but the net annual expense ratio was 1.23% (includes acquired fund fees, net of the Adviser's fee waivers). The **Russell 2500 Growth Index**'s annualized returns as of September 30, 2020: 1-year, 15.15%; Since Fund Inception (12/29/2017), 10.84%.

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, 2031, unless renewed for another 11-year term and the Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit www.BaronFunds.com or call 1-800-99BARON.

Performance for **Baron Partners Fund** 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. The predecessor partnership's performance is only for periods before the Fund's registration statement was effective, which was April 30, 2003. Performance for **Baron Focused Growth Fund** reflects the actual fees and expenses that were charged when the Fund was a partnership. The predecessor partnership charged a 15% performance fee through 2003 after reaching a certain performance benchmark. The performance is only for the periods before the Fund's registration statement was effective, which was June 30, 2008. During these periods, the predecessor partnerships were not registered under the Investment Company Act of 1940 and were 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 their performance. If the annual returns for the Funds did not reflect the performance fees the returns would be higher. The Funds' shareholders will not be charged a performance fee.

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. Specific risks associated with investing in small and medium-sized companies include that the securities may be thinly traded and more difficult to sell during market downturns. **Baron WealthBuilder Fund** invests in other Baron funds and the selection of the underlying funds and the allocation of the Fund's assets among the various market sectors could cause the Fund to underperform in comparison to other funds with a similar investment objective. In addition to the general stock market risk that securities may fluctuate in value, investments in developing

countries may have increased risks due to a greater possibility of: settlement delays; currency and capital controls; interest rate sensitivity; corruption and crime; exchange rate volatility; and inflation or deflation.

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 net assets as of September 30, 2020 for securities mentioned are as follows: **Guidewire Software, Inc.** - Baron Partners Fund (1.7%*), Baron Focused Growth Fund (2.2%); **Shopify Inc.** - Baron Partners Fund (1.3%*); **Adyen N.V.** - Baron Partners Fund (2.0%*), Baron Focused Growth Fund (2.3%); **MSCI, Inc.** - Baron Partners Fund (0.8%*); **Brookfield Asset Management, Inc.** - Baron Partners Fund (0.7%*); **Arch Capital Group Ltd.** - Baron Partners Fund (3.5%*), Baron Focused Growth Fund (1.8%).

*% of Long Positions.

Top 10 holdings as of September 30, 2020

Baron Partners Fund

Holding	% Assets
Tesla, Inc.	39.4
CoStar Group, Inc.	11.6
IDEXX Laboratories, Inc.	5.7
Zillow Group, Inc.	5.1
FactSet Research Systems, Inc.	4.3
Vail Resorts, Inc.	3.6
Space Exploration Technologies Corp.	3.5
Arch Capital Group Ltd.	3.5
Hyatt Hotels Corp.	2.8
The Charles Schwab Corp.	2.6
Total	82.1
Long Equity Exposure	114.9
Cash & Equivalents	-14.9

Baron Focused Growth Fund

Holding	% Assets
Tesla, Inc.	35.9
CoStar Group, Inc.	11.0
Penn National Gaming, Inc.	9.1
Vail Resorts, Inc.	6.0
FactSet Research Systems, Inc.	5.3
Hyatt Hotels Corp.	3.8
Space Exploration Technologies Corp.	3.2
Choice Hotels International, Inc.	2.8
Adyen N.V.	2.3
Guidewire Software, Inc.	2.2
Total	81.6

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. **Russell 2500® Growth Index** measures the performance of small to medium-sized U.S. companies that are classified as growth. The indexes and the Funds 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.

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

Alpha measures the difference between a fund's actual returns and its expected performance, given its level of risk as measured by beta. **Beta** measures a fund's sensitivity to market movements. The beta of the market is 1.00 by definition.

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