

Talking With Andrew Peck

Portfolio Manager
Baron Asset Fund

Intent On Value

by Leslie P. Norton

History doesn't repeat itself, but it often rhymes. So said Mark Twain, in an observation frequently applied to the stock market. That's why things arrive at the same spot by different paths, or why things that look like they should be the same aren't. It's also why the market can be full of hazards and opportunities at the same time.

Discerning the strengths and weaknesses of companies that make up the stock market is the job of a fund manager. Andrew Peck, 44, who runs the Baron Asset Fund (BARAX), is a particularly perceptive one. In 2013, his fund returned 38.88%, besting both the Standard & Poor's 500 Index and the Russell

Mid-Cap Growth Index. Peck believes the coming year again will play to his fund's strengths. Even if they rise, interest rates remain low, flows into equities (for now) are positive, market multiples have room to expand, and Washington is making progress on budget issues. In this environment, "a long-term fundamental investor like we are can find great growth companies and watch them compound," he says.

Similar to all the managers at the firm run by investor Ron Baron, Peck looks for companies he can own for five to 10 years that have growing market opportunities, with sustainable competitive advantages—say, unique assets such as Vail Resorts [MTN], which owns thousands of acres in the Rockies, or a benign regulatory framework. These companies must have recurring revenue streams visible well into the future, and an ability to raise prices and convert strong free cash flows into earnings. At some point, they should also return capital to shareholders. Since he owns a stock for so long—the fund's annual turnover is 16%—Peck regards himself as a partner to management. He has to like and trust them, and they must have personal financial stakes that make him confident they won't fritter his money away. Baron Asset Fund is one of the firm's mid-cap offerings, though holdings like Wynn Resorts (WYNN) and Charles Schwab (SCHW) have grown into large



Peter Murphy for Barron's

companies while it's owned their shares.

One favorite, for example, is IDEXX Laboratories (IDXX), purchased seven years ago at around \$40 a share. IDEXX is a leading provider of testing and diagnostic services to veterinarians. Today, it trades for \$122.68. More gains lie ahead, according to Peck.

Peck has lived most of his life in New York City, where his father was a corporate lawyer and his mother a home-

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 prior to 5/29/2009 did not reflect this fee, the returns would be higher.

As of 12/31/2013, for the Retail share class, Baron Asset Fund's annualized returns are 38.88%, 15.84%, 19.95% and 11.65%, for the 1-year, 3-year, 5-year and since inception periods, respectively. For the Institutional share class, returns are 39.25%, 16.15%, 20.24% and 11.70% for the 1-year, 3-year, 5-year and since inception periods, respectively. As of the last fiscal year ended 9/30/13, annual operating expense ratio for the Retail shares was 1.32%, and for the Institutional shares the expense ratio was 1.05%. As of 12/31/13, the Fund's net assets totaled \$2.76 billion, and the 3-year average turnover was 15.56%.

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.

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Baron Asset Fund

| | Total Returns* | | |
|------------------------------|----------------|------------------|--------|
| | 1-Yr | 3-Yr | 5-Yr |
| BARAX | 25.91% | 13.14% | 21.91% |
| S&P 500 | 22.35% | 13.47% | 19.40% |
| Top-10 Holdings | Ticker | % of Portfolio** | |
| Gartner | IT | 4.3% | |
| IDEXX Laboratories | IDXX | 3.6% | |
| illumina | ILMN | 3.6% | |
| Verisk Analytics | VRSK | 3.2% | |
| Wynn Resorts | WYNN | 3.0% | |
| priceline.com | PCLN | 3.0% | |
| Arch Capital Group | ACGL | 2.9% | |
| SBA Communications | SBAC | 2.9% | |
| Charles Schwab | SCHW | 2.8% | |
| FleetCor Technologies | FLT | 2.6% | |
| Total: | | 31.9% | |

*All returns are as of 2/12/14; three- and five-year returns are annualized.** As of 1/31/14. Sources: Morningstar; Baron Capital Management

maker. He studied diplomatic history at Yale University, graduating magna cum laude. While working as an underling in Salomon Brothers' equity capital markets division, he realized that investment managers were the people who decided how capital should be allocated. Not long afterward, he decided to apply to Stanford, where he gained both a law degree and an M.B.A.

During Peck's time at Stanford, in 1997, a teacher at Horace Mann, a New York private school Ron Baron's children were attending, called the money manager. "A young man is going to apply for a job with you. He's the smartest and

best student we've had," the teacher said. Baron offered Peck a summer internship. When Peck graduated, Baron hired him.

It's worked out well for Peck. He wanted "to learn at the knee of a well-regarded person," and Baron is a successful money manager who started out analyzing stocks for legendary investors including George Soros and Julian Robertson. Peck also "had the luxury of starting at an exciting time. I was very quickly able to look at a wide range of ideas," he says. He quickly learned to think about stocks as businesses, "not just pieces of paper to be bought and sold at a particular price." The firm grew and grew. In 2003, Peck became co-manager of Baron Asset Fund with his boss. By 2008, Baron stepped down and Peck became sole manager.

Not all has gone his way. From 2004 to 2008, the fund posted strong returns, then dropped to the bottom rung of performance in 2009 and 2010 as companies with balance sheet and liquidity problems—the kinds of stocks he avoided—did best. But from 2012 on, performance improved sharply. Even if rates rise, the sorts of high quality companies he buys—with strong earnings growth—should do well.

Peck found IDEXX at a conference, where he went to hear a presentation by Jonathan Ayers, its CEO who happened to be a fellow Yale graduate. Animals, after all, weren't affected by Obamacare. Moreover, IDEXX's market appeared to be growing, thanks to empty nesters and singles delaying marriage who wanted pets. The veterinary market is completely private and unregulated, he thought. And the company had substantial competi-

tive advantages. IDEXX sold veterinary instruments and the consumables, or accessories, that go with them. Some 85% of revenues are recurring, producing a 70% margin. Today, revenues are poised to "accelerate meaningfully." Earnings probably clocked in at \$3.58 a share for 2013, and could double, to \$7, by 2017. All things being equal, that means the stock could double to \$226 in a couple of years.

Another favorite that fits Peck's fondness for companies with proprietary data, is Gartner (IT), a leading provider of IT research and analytics, which helps clients formulate their IT purchasing strategy. It's likely to grow more popular as tech grows "more pervasive and complex," even if corporate resources for IT don't expand. Gartner sells subscriptions to its products for \$28,000 a year, Peck says. It has a 98% client retention rate and is able to push through 3% to 6% price increases each year—even during recession. "Selling data makes the incremental margins very high," he says. Research accounts for 70% to 80% of the business. It's also buying back shares. Since 2004, the company has retired 26% of its stock. Peck sees earnings zooming to \$4.65 a share in 2017 from \$1.93 in the year just ended.

With all his experience, there are still plenty of lessons to learn. "The big challenge for me and our firm as long-term relative-growth investors is to determine when a company is cyclically, and not secularly, challenged. If you're lucky enough to find a unique, differentiated company, remember that no business grows in a straight line, and ride your winners." ■

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

The discussions of companies and stock prices are not intended as advice to any person regarding the advisability of investing in any particular security. The companies discussed herein are based on the Firm's internal analysis and reflect its opinions only. Some of its comments are "forward-looking statements." Actual future results, however, may prove to be different from expectations. The Firm cannot promise future returns and its opinions are a reflection of its best judgment at the time of this article.

Investing in the stock market is always risky. Current and future portfolio holdings are subject to risk. Specific risk associated with investing in Baron Asset Fund is that securities issued by medium sized companies may be thinly traded and may be more difficult to sell during market downturns. Even though the Fund is diversified, it may establish significant positions where the Adviser has the greatest conviction. This could increase volatility of the Fund's returns. The Fund may not achieve its objectives.

Percent ownership of securities mentioned in the article and Top 10 Holdings of Baron Asset Fund as of 12/31/13: Gartner, Inc., 4.3%; Verisk Analytics, Inc., 3.3%; IDEXX Laboratories, Inc., 3.3%; Arch Capital Group Ltd., 3.2%; FleetCor Technologies, Inc., 3.1%; The Charles Schwab Corp., 3.1%; priceline.com, Inc., 2.9%; Vail Resorts, Inc., 2.7%; SBA Communications Corp. 2.7%; Wynn Resorts Ltd., 2.6%.

The indexes are unmanaged. 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.