

# Baron Asset Fund

## DEAR BARON ASSET FUND SHAREHOLDER:

### PERFORMANCE

Several of the major U.S. market indexes reached all-time highs during the first quarter. Investors appeared to shrug off concerns about the impact of the ongoing budgetary disagreements on the broader U.S. economy. Instead, they focused on generally positive fourth quarter earnings results and continued signs that the U.S. economy is improving, notably the rise in existing home prices and new home construction activity. In addition, positive money flows continued into equity mutual funds, indicating that investors' long-awaited shift away from fixed income and cash finally might be occurring.

Baron Asset Fund (the "Fund") gained 14.20% during the three-month period ended March 31, 2013. The Russell Midcap Growth Index gained 11.51% and the S&P 500 Index gained 10.61% during this same period.

We are pleased by the Fund's continued improvement in performance. In recognition of this trend, as of April 1, 2013, the Fund's retail and institutional share classes both were assigned a four star rating by Morningstar in its Mid-Cap Growth Category.\*

**Table I.**  
**Performance (Retail Shares)**  
**Annualized for periods ended March 31, 2013**

	Baron Asset Fund <sup>1,2</sup>	Russell Midcap Growth Index <sup>1</sup>	S&P 500 Index <sup>1</sup>
Three Months <sup>4</sup>	14.20%	11.51%	10.61%
One Year	15.20%	12.76%	13.96%
Three Years	13.43%	14.23%	12.67%
Five Years	6.51%	7.98%	5.81%
Ten Years	11.59%	11.53%	8.53%
Since Inception (June 12, 1987)	11.16%	9.53% <sup>3</sup>	9.05%

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares as of September 30, 2012 was 1.33%. *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](http://www.BaronFunds.com) or call 1-800-99BARON.*

\*For the period ended 3/13/13, Baron Asset Fund was named a 4 star fund overall and for the 10 year period (out of 417 funds), and a Morningstar 3 star fund for the 5 year period (out of 564 funds) and for the 3 year period (out of 645 funds). Morningstar ratings are based on risk adjusted returns of funds in the US OE Mid-Cap Growth category. For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk- Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.)

<sup>1</sup> 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. The indexes and the Fund are with dividends, which positively impact the performance results.

<sup>2</sup> The performance data in the table does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.

<sup>3</sup> For the period June 30, 1987 to March 31, 2013.

<sup>4</sup> Not annualized.



ANDREW PECK  
PORTFOLIO MANAGER

Retail Shares: BARAX  
Institutional Shares: BARIX

In assessing the Fund's results during the past five years, we believe it is important to note the financial impact caused by two investments in private companies. The Fund invested alongside the management of **Kerzner International Holdings Ltd.** and **Windy City Investments Holdings, L.L.C.** (the holding company for John Nuveen) when those companies were taken private in leveraged buyouts in 2006 and 2007, respectively. As part of these transactions, both companies assumed large debt burdens, which resulted in substantial reductions to their equity values during the recent financial crisis. As a consequence, these two investments had a significant negative impact of -7.69% on the Fund's overall performance during the five year period ended March 31, 2013. However, during the most recent quarter, the prospects of these two companies improved and their valuations increased. As a result, they contributed +0.26% to the Fund's results. We are optimistic that these two investments, which currently represent just 1.5% of the Fund's portfolio, will continue to have a modest, positive impact to the Fund's overall results.

Nevertheless, we are acutely aware of the negative impact that these private investments have had on the Fund's performance. The Fund has no intention of making any further investments in private companies.

Nearly all the Fund's holdings rose during the quarter. Its best performers included companies in the Information Technology (**Gartner, Inc.**) and Industrials (**Verisk Analytics, Inc.** and **Nielsen Holdings N.V.**) sectors that own proprietary databases sold largely through recurring annual subscriptions. These businesses benefitted from high incremental margins, their ability to raise prices, and generally improved global end markets. The Fund's Financials sector investments also did well. The rising stock market and investors' increased allocations to equities benefitted asset managers (**T. Rowe Price Group, Inc.** and **Eaton Vance Corp.**) and discount brokerage **The Charles Schwab Corp.** Firming prices on insurance policy renewals benefitted **Arch Capital Group Ltd.** Companies with exposure to the recovering housing and commercial real estate markets also performed well. Finally, travel and leisure companies in the Consumer Discretionary sector rose, including hotels, resorts, cruise



lines and Internet-based travel agents. We expect to see ongoing improvement in global travel demand, which would likely result in meaningfully increased profitability for these companies, stemming from higher occupancy levels and increased pricing. Additional strong performers included the Fund's two investments in subscription-based Internet businesses – professional network **LinkedIn Corp.** and vacation home rental site **HomeAway, Inc.**

**Table II.**  
Top contributors to performance for the quarter ended March 31, 2013

	Year Acquired	Percent Impact
FleetCor Technologies, Inc.	2012	0.78%
Verisk Analytics, Inc.	2009	0.78
Gartner, Inc.	2007	0.75
Discovery Communications, Inc.	2009	0.65
LinkedIn Corp.	2011	0.61

**FleetCor Technologies, Inc.** is a niche provider of payment processing technology and private label fuel credit cards to companies that operate vehicle fleets and to gas station operators. Its cards allow fleet owners to monitor and control their fuel spend while reducing fraud. FleetCor also manages the fuel card businesses for major oil companies, such as BP and Chevron. The company's shares rose as its organic revenue growth rate increased, and its overall growth rate accelerated even faster as a result of several accretive acquisitions. We expect FleetCor to continue its successful expansion into fast-growing emerging markets, including Russia and Brazil, where fuel cards have low existing penetration rates. In addition, we believe that FleetCor will continue to sign partnerships with major international oil companies to outsource their fuel card programs.

**Verisk Analytics, Inc.** provides proprietary databases and analytics to companies in the insurance, health care, and mortgage industries that are used to manage and assess various business risks. Verisk's shares rose as the company announced strong quarterly earnings growth, with particularly robust results from its expanding portfolio of health care-related analytical and fraud-prevention tools. As players throughout the health care system continue to focus on reducing their costs, we believe Verisk's products should continue to attract a large audience. In addition, we expect that revenues in Verisk's core insurance business should accelerate as pricing trends in the property and casualty insurance market move higher.

**Gartner, Inc.** is the leading independent provider of research and analysis on the information technology (IT) industry, generating most of its revenues from annual subscriptions to its analysts' research commentary. Its shares performed well, as Gartner delivered solid financial results among uneven global end markets. The company generated record new bookings in its research business, with the contract value of its subscription revenues increasing 14%. We expect the company to maintain its sales momentum through 2013 and beyond as it grows its sales force, raises prices, and expands its efforts to services for Chief Marketing Officers, who are rapidly becoming an important constituent in setting and executing corporate IT strategy.

**Discovery Communications, Inc.** owns and operates several cable networks, including Discovery Channel, Animal Planet and the Learning Channel. Its networks have achieved ongoing increases in their viewership levels, which have allowed the company to charge higher rates to advertisers

and to the cable systems that deliver their networks. We expect Discovery to continue to profit from lucrative deals with distributors that would like to offer the company's content through Internet-based platforms.

**LinkedIn Corp.** is the leading online professional network with more than 200 million registered members. Members utilize the network to connect with professional contacts and to create an "online professional identity;" professional recruiters use the network to locate talent; and, advertisers come to the network to target users with particularly attractive demographics. Its shares rose during the quarter as the company exceeded its earnings expectations and issued strong forward earnings guidance. In addition, the company showed encouraging improvements in various metrics that indicate its users are spending more time engaged with its network. Although LinkedIn appears expensive based on its near-term results, we hold the shares because we believe it is a unique platform asset, which has significant opportunity to capture a greater share of a \$27 billion global market for talent acquisition and a \$25 billion market for business to business advertising.

**Table III.**  
Top detractors from performance for the quarter ended March 31, 2013

	Year Acquired	Percent Impact
Illumina, Inc.	2012	-0.08%
C.H. Robinson Worldwide, Inc.	2003	-0.07
United Natural Foods, Inc.	2013	-0.05
Workday, Inc.	2012	-0.01

**Illumina, Inc.** is a leading provider of genetic analysis tools, including DNA sequencing instruments and consumables. Its shares increased in December 2012 on press reports that Roche Holdings AG, a large Swiss pharmaceutical and diagnostic company, was in discussions to purchase Illumina. In early January, Illumina's shares fell after Roche's CEO was quoted in the press stating that the companies could not reach an agreement on price, and Roche was abandoning its efforts to acquire Illumina. Our investment in Illumina was not predicated on its being acquired, and we remain confident in the company's long-term prospects in the large, fast-growing market for DNA sequencing and genetic analysis.

**C.H. Robinson Worldwide, Inc.** is the largest U.S. truck brokerage service. Its shares declined during the quarter after it reported disappointing earnings. Although the economic recovery led to increased truck shipments, the company experienced margin pressure because the cost of its purchased trucking capacity increased faster than the rates it could charge to its shipping clients. We are hopeful that this will prove to be a short-term issue that will reverse itself during the remainder of 2013.

**United Natural Foods, Inc.** is the largest distributor of natural and organic products in North America. The Fund established a position in the shares during the quarter at levels nearly 15% below their peak levels reached in late 2012. The shares then fell further, despite a quarterly report that we considered encouraging. We believe the company will continue to benefit from positive secular trends in the organic food sector, including Americans' greater focus on their health, organic food increasing its share of consumers' overall grocery spend, and conventional supermarkets devoting more shelf space to the organic category.

# Baron Asset Fund

## PORTFOLIO STRUCTURE

At March 31, 2013, Baron Asset Fund held 63 positions. The Fund's 10 largest holdings represented 32.4% of assets, and the 20 largest represented 55.1% of assets. The Fund's largest weighting was the Consumer Discretionary sector at 26.1% of assets. This sector includes the Fund's investments in retailers, gaming companies, hotels, cruise lines, and broadcasters. The Fund held 20.2% of its assets in the Industrials sector, which includes investments in manufacturers, distributors, and information services firms. The Fund also had significant weightings in Information Technology at 17.1% of assets, which includes investments in a technology research firm, a data center operator, software companies, and a payment processor; and Financials at 13.4% of assets, including asset managers, brokerages and insurers.

**Table IV.**  
Top 10 holdings as of March 31, 2013

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap (billions)	Amount (millions)	Percent of Net Assets
Gartner, Inc.	2007	\$2.9	\$5.1	\$96.6	4.1%
Verisk Analytics, Inc.	2009	4.0	10.4	92.4	3.9
SBA Communications Corp.	2007	3.8	9.1	79.2	3.4
Arch Capital Group Ltd.	2003	0.9	7.0	78.9	3.3
IDEXX Laboratories, Inc.	2006	2.5	5.0	74.8	3.2
Fastenal Co.	2006	5.8	15.2	71.9	3.1
Ralph Lauren Corp.	1997	1.6	15.4	70.3	3.0
Discovery Communications, Inc.	2009	6.2	18.5	68.9	2.9
The Charles Schwab Corp.	1992	1.0	22.6	66.3	2.8
Mettler-Toledo International, Inc.	2008	2.4	6.5	64.0	2.7

## RECENT ACTIVITY

During the past quarter, the Fund established seven new positions and added to six others. The Fund also sold three positions and reduced its holdings of 24 others.

**Table V.**  
Top net purchases for the quarter ended March 31, 2013

	Quarter End Market Cap (billions)	Amount (millions)
Pall Corp.	\$7.6	\$26.0
VeriSign, Inc.	7.2	24.1
Clean Harbors, Inc.	3.5	18.2
United Natural Foods, Inc.	2.4	14.6
Universal Health Services, Inc.	6.2	11.4

During the quarter, we initiated a position in **Pall Corp.**, a leading supplier of filtration, separation and purification technologies. Pall's products are used by companies in the life sciences and industrial industries in a wide variety of applications. For example, biotechnology companies use Pall's products to remove contaminants during the biotechnology drug manufacturing process. Industrial customers use Pall's products in oil and

gas production, municipal water filtration, aircraft fluid systems and semiconductor manufacturing, among other applications.

Our investment thesis has two components. First, we believe that Pall's business has attractive characteristics and good growth prospects. We particularly like Pall's life sciences business, in which Pall supplies a broad range of filtration products to the biotechnology industry. We think Pall is an attractive way to participate in the growth of the biotechnology sector without assuming the risks associated with the success or failure of any one particular biotechnology drug. Because of regulatory requirements, once Pall's products are incorporated into a biotech customer's manufacturing process, Pall's products are likely to be sold during the life cycle of the product, which provides an annuity-like revenue stream. Beyond the biotech business, Pall is well positioned to benefit from secular growth drivers that include stricter environmental regulations and growing demand for clean water and energy. Across the company's different end markets, Pall's products are largely non-discretionary for customers and represent a small portion of operating costs even though they perform critical roles. As a result, Pall has an ability to maintain stable pricing. In addition, most revenue comes from the sale of consumable products that need to be replaced, resulting in relatively predictable, recurring revenue. Pall's competitive advantages include close working relationships with customers; global distribution, service and support; and scientific, engineering and applications expertise.

The second element of our investment thesis is based on the transformation taking place at the company with a new management team at the helm. Pall's new CEO, Larry Kingsley, assumed the CEO role in October 2011 and has been implementing changes to improve business performance, expand margins and increase cash flow generation. Kingsley's long-term objective is to generate organic sales growth at over twice the rate of GDP and incremental operating profit margins of 30-40%. Kingsley also plans to utilize the company's balance sheet, which is underleveraged relative to the company's cash flow, to make acquisitions to enhance top line growth and generate attractive returns on invested capital. Through acquisitions and/or share repurchases, we believe that Pall should be able to generate mid-teens or better earnings growth. We think the company's valuation is attractive relative to our estimate of the company's future growth potential. (Neal Kaufman)

**Table VI.**  
Top net sales for the quarter ended March 31, 2013

	Amount (millions)
Intuitive Surgical, Inc.	\$-19.8
Equinix, Inc.	-19.3
Rackspace Hosting, Inc.	-17.5
Whiting Petroleum Corp.	-16.9
priceline.com, Inc.	-11.6

The Fund continued to reduce its stake in a few of its largest holdings, such as **Equinix, Inc.** and **priceline.com**. These sales were generally made after the stocks had appreciated considerably from their initial purchase price in order to maintain appropriate position sizes. The Fund also reduced its investment in **Intuitive Surgical, Inc.** after several parties raised concerns about the cost effectiveness of certain surgical procedures when performed with the company's DaVinci robotic device.

## OUTLOOK

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We believe that stock market valuations remain attractive. U.S. interest rates are still near historically low levels, and the fixed income markets offer limited inflation-adjusted returns. Although investors have begun to deploy some funds back into equities, they continue to hold substantial sums on the sidelines. We believe that the Fund will continue to benefit in a market environment that we believe will continue to reward high-quality companies with predictable and fast-growing earnings streams.

### Thank you for investing in Baron Asset Fund.

Our entire firm and our research department, in particular, are committed to justifying your ongoing confidence and support. I remain a significant investor in the Fund alongside you.

Sincerely,



Andrew Peck  
Portfolio Manager  
April 9, 2013

For more information about this Fund  
please scan this QR code with any  
bar code reader on your mobile device.



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The Adviser believes that there is more potential for capital appreciation in mid-sized companies, but there also may be more risk. Specific risks associated with investing in mid-sized companies include that the securities may be thinly traded and they may be more difficult to sell during market downturns. Prior to February 15, 2007, the Fund's strategy was to invest primarily in small and mid-sized growth companies. Since then, the Fund's investment strategy has shifted to mid-sized companies. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

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

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