Mike Lippert: Investing in innovation in the post-pandemic market

This is an edited version of a May 13, 2021 Q&A with Mike Lippert, Portfolio Manager of Baron Opportunity Fund and Baron High Growth Strategy and Baron's Head of Technology Research. To access the full recording, please dial 800-633-8284, passcode #21993831.

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- Growth stocks we like, including RingCentral, ServiceNow, Tesla, Microsoft, and Tripadvisor

Introduction

Mike Lippert is the portfolio manager of Baron Opportunity Fund and Baron High Growth Strategy and Baron's Head of Technology Research. He has 20 years of investment research experience.

Baron Opportunity Fund has a 5-star Overall Morningstar Rating™. It is in the top 2% of its peers for the one-, three-, and five-year periods and in the top 7% for the 10-year period. It has outperformed its benchmark, the Russell 3000 Growth Index, across all standard time periods since its February 29, 2000 inception. Its recent performance is also strong. The Fund returned 104.55% for the one-year period ended March 31, 2021; 38.62% annualized for the three-year period; 33.5% annualized for the five-year period; and 18.37% annualized for the 10-year period.

As of 3/31/2021, the Morningstar Large Growth Category consisted of 1282, 1186, 1065, 788, and 1186 share classes for the 1-year, 3-year, 5-year, 10-year and overall periods, respectively. Baron Opportunity Fund Institutional Share Class received 5 stars, 5 stars, 5 stars and 5 stars for its 3-, 5-, 10-year and overall performance, respectively. This Morningstar Rating is for the Institutional share class only; other classes may have different performance characteristics. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures.

Morningstar calculates the Morningstar Large Growth Category Average performance and rankings using its Fractional Weighting methodology. Morningstar rankings are based on total returns and do not include sales charges. Total returns do account for management, administrative, and 12b-1 fees and other costs automatically deducted from fund assets.

Q&A with Mike Lippert

What is your view of the market rotation we experienced in the first quarter?

The first quarter was dominated by a growth-to-value rotation driven by expectations that the economy is reopening as well as the possibility of inflation and rising interest rates. I consider this rotation to be a result of short-term trading dynamics that have resulted in a dislocation of fundamentals. The earnings calls with our companies have been overwhelming positive.

During periods like this, we try to improve the quality and diversity of the portfolio. There are so many great growth companies that are now trading at reasonable valuations as a result of the pullback.

Could you provide an example or two of growth companies you like?

RingCentral, Inc., a provider of cloud-based communications systems for businesses, just reported 40% growth in what it calls ACV, or Annual Contract Value, which is the highest number it's had in years. We believe revenues will continue to accelerate. **Zoominfo Technologies Inc.,** a software-as-a-service company that provides aggregated business-related data, just reported 50% growth. Both these companies were traded down in this environment. **Ceridian HCM Holding Inc.,** which provides payroll and HR software and faced major headwinds during the pandemic, reported an acceleration of more than 25% in revenue growth.

To give some long-term perspective, **ServiceNow, Inc.,** which provides cloud-based digital workflow tools, experienced eight pullbacks of roughly 20% or more in its valuation multiple over an eight-year period, and yet the stock price increased by seven or eight times over that same period. When you're sitting in the middle of a significant pullback, it is hard not to react. But we believe the better approach is to find a great company, buy it early, and hold it for a long time. We still hold ServiceNow today.

Tesla, Inc. is a top 10 holding in the portfolio. Could you offer your thoughts on the spate of new entrants in the electric vehicle (EV) space?

We've never thought that Tesla would never have competition. Much more significant for Tesla’s growth prospects, we think, is the tipping point from internal combustion engine (ICE) to electric. About 100 million passenger cars are sold per year, of which more than 90% are ICE. Maybe Tesla will sell 800,000 cars this year and maybe up to two million cars in a couple of years. That’s still just 2% of its total addressable market. We think this competition will actually benefit Tesla's unit growth because they will draw attention to the advantages of EVs through advertising and press coverage. Tesla is far and away the leading EV manufacturer, despite doing no advertising. But when consumers see other companies advertising EVs – which is happening more and more -- they are going to check that car against the leader. In fact, Tesla is seeing more activity than ever on its websites and in its showrooms. Along with EV, shared mobility and autonomous driving are two other major transitions happening in the transportation industry. We believe Tesla is well positioned as a leader/pioneer in all of these disruptions. In addition, it has its battery storage business in a world increasingly moving towards renewable energy.

Our average cost in Tesla is $46/share. Today, the stock trades at $636/share. We trimmed our Tesla position to what we felt was an appropriate weighting in the portfolio, but we continue to own the stock. We think we are still in the early chapters of Tesla’s story.

We think a lot of investors initially misunderstood Tesla’s balance sheet and unit economics, which translates to profits per car. In fact, Tesla’s balance sheet has improved significantly. The company can't keep up with current demand and is building out as fast as it can. Currently, Tesla is grossing about $10,000 per car in regulatory credits. We think profits will improve as it rolls out autopilot as a subscription service.

When many people think of innovation, they think of tech. Yet, as the makeup of your portfolio attests, innovative companies can be found in multiple sectors. Could you give an example?

Tripadvisor, Inc., the leading hotel meta-search website, is one. It is obviously a recovery play, but we invested for other reasons. The way the travel industry works, if a customer books a hotel on Expedia, the hotel pays a commission of 10% to 15% to Expedia. Tripadvisor is launching a subscription service called Tripadvisor Plus in which it is waiving its commission fee if the hotel agrees to provide discounts and perks to subscribers. The initial data suggests that a subscriber booking a vacation on Tripadvisor Plus can save an average of $300 against a $99 annual subscription. Tripadvisor currently has over 460 million monthly unique visitors. If just 2% subscribe to Tripadvisor Plus, Tripadvisor can add nearly 10 million subscribers and approximately $1 billion in high-margin recurring subscription revenue. We also think there are great opportunities for partnerships with credit card companies that could offer a Tripadvisor Plus subscription as a perk for cardholders.

Microsoft Corporation is your biggest position. What are your views on the company’s growth prospects?

Our exposure to Microsoft actually mirrors its weighting in our benchmark, the Russell 3000 Growth Index. We also like the company’s fundamentals. Microsoft is one of the rare instances in which a leader of one generation crosses the chasm to the next, by its successful pivot from PCs and on-premise servers to the cloud. It’s taken its Office application platform to the cloud and is the leader in infrastructure as a service with its Azure platform. We believe Microsoft is one of the long-term leaders in the cloud, from both an application and infrastructure perspective. The two go hand-in-hand. If you use a lot of Microsoft applications, and you're building additional applications, you may want to build it on Microsoft infrastructure as well. Lastly, given its strong growth rate and pre-cash-flow and earnings profile, we think Microsoft stock is not expensive to own.

The first quarter saw a sharp selloff in high-growth technology stocks. What is driving your optimism that these stocks will recover and, in fact, outperform in the future?

This morning, on the ServiceNow Investor Day, CEO Bill McDermott started the call by stating "digital transformation is the opportunity of this generation." The world is going digital. Even as we return to a physical world – to stores, concerts, vacations – the world becoming more and more digital. This has been happening for the last two decades. The pandemic simply accelerated this trend, and there's nothing we see across our entire investment base that suggests this digital transformation is slowing down. Fundamentals for our businesses are as strong as they've ever been.

We had a great 2020. But the market never simply marches up and to the right. You get a plateau; you have a pullback. As a result of the pullback, we have what I describe as embarrassment of riches. However, we can't own everybody, so our challenge is to prioritize the best long-term investments.

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 Opportunity Fund's annualized returns for the Institutional Shares as of March 31, 2021: 1-year, 104.55%; 5-years, 33.50%; 10-years, 18.37%; Since Inception (2/29/2000), 10.64%. Annual expense ratio for the Institutional Shares as of September 30, 2020 was 1.08%. The **Russell 3000 Growth Index**'s annualized returns as of March 31, 2021: 1-year, 64.31%; 5-years, 20.87%; 10-years, 16.35%; Since Fund Inception (2/29/2000), 6.55%.

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 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.

The Fund's 1Q 2021, 3-, 5- and 10-year historical performance was impacted by gains from IPOs and/or secondary offerings, and there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs and secondary offerings will be the same in the future.

Risks: Securities issued by small and medium sized companies may be thinly traded and may be more difficult to sell during market downturns. Companies propelled by innovation, including technology advances and new business models, may present the risk of rapid change and product obsolescence, and their success may be difficult to predict for the long term. 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 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.

The **Morningstar Rating™** for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product 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. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10- year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

Portfolio holdings as a percentage of net assets as of March 31, 2021 for securities mentioned are as follows: **RingCentral, Inc.** - 1.8%; **Zoominfo Technologies Inc.** - 2.3%; **Ceridian HCM Holding Inc.,** - 1.7%; **ServiceNow, Inc.,** - 0.9%; **Tesla, Inc.** – 2.9%; **Tripadvisor, Inc.** – 3.4%.

Top 10 holdings as of March 31, 2021

Holding	% Assets
Microsoft Corporation	8.8
Alphabet Inc.	5.2
Amazon.com, Inc.	4.8
Tripadvisor, Inc.	3.4
Tesla, Inc.	2.9
Facebook, Inc.	2.3
ZoomInfo Technologies Inc.	2.3
Pinterest, Inc.	2.2
Visa, Inc.	2.0
PayPal Holdings, Inc.	1.9
Total	35.8

Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

The **Russell 3000® Growth Index** measures the performance of the broad growth segment of the U.S. equity universe comprised of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market, the **S&P 500 Index** of 500 widely held large-cap U.S. companies. 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 and the Fund include reinvestment of dividends, net of withholding taxes, which positively impact the performance results. The indexes are unmanaged. Index performance is not fund performance. Investors cannot invest directly in an index.

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

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