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GROWTH INVESTING | Q&A

Amazon and Nvidia Stock Have a Lot More Growth Ahead, This Manager Says

By Lauren Foster

Michael Lippert.

Like most portfolio managers at Baron Capital, Michael Lippert buys growth stocks with sustainable competitive advantages. He looks for companies shaped by durable secular trends that will play out over many years. His investment maxim: faster for longer.

It has been a winning strategy for Lippert, a former lawyer who joined Baron in December 2001 as an analyst, and took the helm of the Baron Opportunity fund in 2006. The fund, which now has $1.1 billion in assets, has notched an average annual return of 17.6% in the past 15 years, outperforming 93% of its large-growth-category peers, according to Morningstar.

Baron Opportunity has an all-cap mandate, although its five biggest holdings— Microsoft, Nvidia, Tesla, Amazon.com, and Meta Platforms —are megacaps. But lesser-known companies, including Gartner, CoStar Group, Rocket Pharmaceuticals, Guidewire Software, and Trade Desk, drive returns, as well.

Barron's recently spoke with Lippert, who also co-manages the $9 million Baron Technology fund, about his investment philosophy, secular growth trends, and the outlook for Amazon, Nvidia, and other holdings. An edited version of the conversation follows.

***Barron's*: Describe your investment approach.**

Michael Lippert: We are long-term investors. We invest in what I call secular growth, as opposed to cyclical growth. These are bigger trends or themes separate from the ups and downs in economic, industry, and geopolitical cycles.

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I often talk about these trends as generational, tectonic shifts. They're big things. They're undeniable. They're going to play out for a very long time. These themes are common—we aren't the only ones who think of them. It's the stock-picking within these themes, the weight of these themes within the portfolio, that drives success.

What are some of these themes?

Cloud computing; software as a service, or SaaS; artificial intelligence; cybersecurity; autonomous driving; genomics; genetic medicine; digital media; and connected TV, among others. The themes have been consistent for many years.

AI feels new to a lot of people, and generative AI became known only when ChatGPT came on the scene just over a year ago. But we have been investing in AI for many years. It used to be called big data. The biggest inflection point over the past year was generative AI.

What do you look for in companies?

We own fewer than 50 companies, so Baron Opportunity is a high-conviction fund. I look for where the growth will be. I've long thought that the best companies in the world—the best investments—are businesses that can grow faster for longer.

The key characteristic is whether a company has a durable, competitive advantage that it can lean into. It also has to have the right management team. Companies that have grown faster for longer include Amazon.com, Alphabet's Google, Microsoft, and Apple.

Amazon started life as an online bookseller. We were worried about competition from Barnes & Noble. It took many years before Amazon became the online-everything store. It then differentiated itself not only on product assortment and price, but also on logistics or delivery, getting the product to your door the next day or the same day. Half of U.S. households have Amazon Prime.

Today, more than half of Amazon's value comes from Amazon Web Services. It is the world's leading provider of cloud computing, and one of the most—if not the most—influential businesses in information technology.

We like companies that can do more than one thing. The first act might be a single product or service. You need a good first act, but the best companies in the world have a second act, a third act. They continue to expand.

Amazon shares gained more than 80% in 2023, to about $150. Is this a good entry point for investors who missed that rally?

Solid returns are in the picture for the next three-to-four years. We value Amazon on three methodologies: GAAP [generally accepted accounting principles] earnings; free cash flow less principal repayments; and sum-of-the parts, including advertising, the international retail business, and AWS. Our 2024 expected year-end return is in the mid-single digits. Our longer-term return analysis gets us more into the mid-double digits, a little bit less than 15%.

What is an example of a multiple-act company you own that isn't a household name?

I've been an investor in CoStar Group, a provider of information, marketing, and related services to the commercial and residential real estate industries, for more than 20 years. When I joined Baron Capital, one of the first companies I was asked to analyze was CoStar. It was already in the portfolio, and it is still a top 10 position in the fund. We've made a roughly 20% annualized return on our investment.

CoStar is a poster child for second, third, fourth, fifth acts. It sold information—big data—in commercial real estate. Then it moved into other areas of the real estate world and expanded to marketing. It now owns apartments.com and is getting into residential real estate with homes.com and trying to compete with Zillow, which has been the dominant player for 10 to 15 years. The CEO, Andy Florance, is focused on finding the next opportunity.

The stock had a volatile year. Why?

It has often been a roller-coaster ride, but the long-term trend is up and to the right. Pretty much every time Andy and his management team have announced a new investment, the stock has gone down. Investors overreact to the possibility that the company will penalize short-term profits, when in fact it is maximizing long-term profits. When we measure the total addressable markets, or TAMs, the company is going to be at least a mid-to-high double-digit top-line grower for the next five years, and potentially longer.

Future Ebitda [earnings before interest, taxes, depreciation, and amortization] margins—a measure of a company's operating profit as a percentage of its revenue—will reach the mid-40% range. The business has low capital intensity, so most of the Ebitda will yield free cash flow. CoStar has a strong balance sheet.

At some point, if there is nothing left to acquire, there will be a significant amount of cash flow they can return to shareholders. The best example of a company doing that is Apple. It consistently buys back shares with the cash flow it generates.

Apple was the first stock to hit a $3 trillion market capitalization. You sold your Apple shares in 2018 and don't own any. Do you regret that?

The regret is simply the returns they have been able to generate. I thought Apple had gotten to a point where it was no longer a leading innovator, and therefore no longer a leading growth company, but making more incremental innovations and having lower growth. The one thing I missed was how they have been taking advantage of their balance sheet and cash flow to buy back a lot of stock.

Apple is no longer a particularly innovative company. But it has the most important platform. It controls that platform soup to nuts, selling the hardware and the software. That ecosystem is growing, but at a slower rate. Most people are replacing an Apple device with another: You get a new Mac or iPhone. But most of the significant innovation in the mobile ecosystem, frankly, they missed. For example, music is dominated by Spotify.

Netflix has also been on a winning streak, but you don't own it. Why?

I owned Netflix for a long time and achieved solid returns after it shifted to streaming video and original programming. I sold the stock in April 2022. I believed that streaming video had won, but that the competitive landscape was different. Everybody else was getting into the business.

Apple and Amazon are spending an inordinate amount of money in media and don't need to create a business there. They can run it as a loss leader. Most people have multiple apps on their TVs, like we have multiple apps on our iPhones or iPads. People pick the show, they don't say, "I'm going to watch Netflix." Netflix will be the winner in streaming video. It is the No. 1 pure play. But growth is far slower than it had been.

Yet, the stock was up nearly 70% last year.

Netflix did well because of "paid sharing" for U.S. subscribers. But paid sharing sounds like a one-time change. What's next for the company?

Netflix isn't a cheap stock on consensus numbers, trading at 37 times 2024 estimated enterprise value to free cash flow, and 31 times non-GAAP earnings. It is collecting free cash flow and will return capital to shareholders. Were I running more of a durable-type fund, as opposed to the Opportunity fund, which is more laser-focused on secular growth and higher-growth-type companies, I would consider owning companies like Netflix and Apple. I own Apple in the Baron Technology fund.

Nvidia is your second-largest holding, up 240% in 2023. Are you still bullish on the stock?

Absolutely. Nvidia is trading at mid-20 times one-year-forward estimated earnings. It isn't an expensive stock. The business has exploded, and everyone is trying to focus on the sustainability of that new level of business. We don't think AI is a hype cycle. There is a fundamental change in the way computing is being done and the way we're able to use generative AI to take even further advantage of our data. We have been investors in Nvidia since 2018. It is one of the most amazing companies I've ever seen. If you asked me to rank the top CEO I've dealt with in my career, I would put Jensen Huang at the top of that list.

What is another stock you like?

We have invested in Guidewire Software since its initial public offering in 2012. It is the leading software provider to the property and casualty insurance industry. It is a large but slower-moving industry, certainly in adopting new technology.

When Guidewire first came public, it sold on-premise software and converted a lot of P&C insurers from old software. The stock did well. But the company realized it had to migrate to the cloud, which took longer than expected. In 2019, Guidewire hired Mike Rosenbaum from Salesforce as CEO. Today, it is a cloud vendor. The competitive market environment is favorable because a few of the other cloud vendors have been bought by private-equity players, and you don't see the same investment there. We believe that Guidewire's stock will be a high-teens, low-20% returner over the next three-to-five years.

Thanks, Michael.

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Portfolio holdings as a percentage of net assets as of December 31, 2023 for securities mentioned are as follows: Gartner, Inc. - Baron Opportunity Fund (3.1%), Baron Technology Fund (2.0%); CoStar Group, Inc. - Baron Opportunity Fund (2.9%), Baron Technology Fund (1.6%); Rocket Pharmaceuticals, Inc. - Baron Opportunity Fund (2.0%); Guidewire Software, Inc. - Baron Opportunity Fund (1.7%); The Trade Desk - Baron Opportunity Fund (1.8%), Baron Technology Fund (2.8%).

Baron Opportunity Fund

Top 10 Holdings as of December 31, 2023

Holding Name	% of Net Assets
Microsoft Corporation	14.2
NVIDIA Corporation	8.6
Amazon.com, Inc.	6.5
Tesla, Inc.	5.7
Meta Platforms, Inc.	3.8
Gartner, Inc.	3.1
CoStar Group, Inc.	2.9
Space Exploration Technologies Corp.	2.8
Visa Inc.	2.8
Alphabet Inc.	2.8
Total	**53.1**

Baron Technology Fund

Top 10 Holdings as of December 31, 2023

Holding Name	% of Net Assets
Microsoft Corporation	10
NVIDIA Corporation	9.3
Amazon.com, Inc.	7.9
Tesla, Inc.	4.9
Advanced Micro Devices, Inc.	4.4
Apple Inc.	4.3
Lam Research Corporation	3
Meta Platforms, Inc.	3
Intuit Inc.	3
The Trade Desk	2.8
Total	**52.5**

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

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