

DEAR BARON DISCOVERY FUND SHAREHOLDER:

PERFORMANCE

"Be fearful when others are greedy and greedy when others are fearful." – Warren Buffett.

"Amid the turmoil and tumult of battle, there may be seeming disorder and yet no real disorder at all; amid confusion and chaos, your array may be without head or tail, yet it will be proof against defeat." —Sun Tzu, *The Art of War*. Common translation: "In the midst of chaos, there is also opportunity."

Table I. Performance<sup>†</sup>

Annualized for periods ended June 30, 2024

	Baron Discovery Fund Retail Shares <sup>1,2</sup>	Baron Discovery Fund Institutional Shares <sup>1,2</sup>	Russell 2000 Growth Index <sup>1</sup>	Russell 3000 Index <sup>1</sup>
Three Months <sup>3</sup>	(7.89)%	(7.78)%	(2.92)%	3.22%
Six Months <sup>3</sup>	(3.74)%	(3.57)%	4.44%	13.56%
One Year	2.34%	2.62%	9.14%	23.13%
Three Years	(11.21)%	(10.97)%	(4.86)%	8.05%
Five Years	6.68%	6.97%	6.17%	14.14%
Ten Years	9.20%	9.48%	7.39%	12.15
Since Inception (September 30, 2013) (Annualized)	11.15%	11.43%	7.86%	12.96%
Since Inception (September 30, 2013) (Cumulative) <sup>3</sup>	211.49%	220.17%	125.57%	270.60%



Baron Discovery Fund® (the Fund) fell 7.78% (Institutional Shares) this quarter, trailing the Russell 2000 Growth Index, which declined 2.92%, by 486 basis points. Our 10 worst performing stocks accounted for 6.52% of negative performance and the lion's share of negative attribution in the quarter. In only one case in this cohort of stocks did we view the negative performance as thesis changing due to fundamental issues. Rather, we believe the downside moves in these names are more technically related to macroeconomic factors and the trading environment and could reverse extremely quickly (in fact, we saw hints of this in the last week of the quarter when a few beaten down technology names rallied back meaningfully). In other words, momentum works both ways, and what goes down due to technical factors also goes up. In the past, we have experienced many instances where individual names have dropped dramatically only to recover (and then some) in later time periods. We give more detail on these situations below. This is an extremely volatile period in the markets, especially for small-cap stocks. Our strategy is to invest for the long term

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares and Institutional Shares as of September 30, 2023 was 1.33% and 1.06%, respectively. 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 may waive or reimburse certain Fund expenses pursuant to a contract expiring on August 29, 2034, 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 [BaronCapitalGroup.com](http://BaronCapitalGroup.com) or call 1-800-99-BARON.

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

<sup>1</sup> The **Russell 2000® Growth Index** measures the performance of small-sized U.S. companies that are classified as growth. The **Russell 3000® Index** measures the performance of the broad segment of the U.S. equity universe comprised of the largest 3,000 U.S. companies representing approximately 96% of the investable U.S. equity market, as of the most recent reconstitution. All rights in the FTSE Russell Index (the "Index") vest in the relevant LSE Group company which owns the Index. Russell® is a trademark of the relevant LSE Group company and is used by any other LSE Group company under license. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. The Fund includes reinvestment of dividends, net of withholding taxes, while the Russell 2000® Growth and Russell 3000® Indexes include reinvestment of dividends before taxes. Reinvestment of dividends positively impacts the performance results. The indexes are unmanaged. Index performance is not Fund performance. Investors cannot invest directly in an index.

<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> Not annualized.



# Baron Discovery Fund

and, as a result, we do not trade around short-term volatility. We continue to remain confident in the long-term prospects of our portfolio companies. We both have significant personal investments in the Fund to back that up.

Apart from stock-specific issues, the style biases that hurt relative performance the most were momentum-related factors as well as market beta. Momentum is the tendency of stocks to continue going in their current direction. Market beta measures a combination of stock volatility (variability of price movement) combined with market correlation (how closely an individual stock or portfolio moves in tandem with the overall market). A higher portfolio beta would indicate more portfolio downside than the market in a down market and more upside in an up market. The Fund strives to have a beta of about 1, meaning the Fund's excess returns should come from stock picking, not from market movements. The beta of the Fund's high growth holdings remained elevated which has been hugely influenced by volatility (as opposed to market correlation). Unusually so, particularly regarding "idiosyncratic volatility," or the events affecting individual stocks. In plain language, this means that in the second quarter when individual companies stumbled, stock prices were punished mercilessly, and this was enhanced by an overall declining market for small-cap growth stocks. A lot of this was driven by the activity of short sellers who had a huge second quarter.<sup>1</sup> It is our view that the price action in these stocks represents more of a short-term trading mania than an accurate assessment of stock valuations. Thus, from this chaos we see an enormous amount of opportunity.

The markets are currently in a very particular phase that is driven, on the one hand, by the excitement of some truly life changing technologies such as AI and GLP-1 (glucagon-like peptide 1) weight loss drugs like Mounjaro and Ozempic, and the fear of missing out on the stock upside related thereto, and on the other hand, the simultaneous conceit that a vast swath of other companies will be disintermediated by these new modalities. At the same time, the economy is in a very precarious position, somewhere in the purgatory between recession, stagflation, and "soft landing" perfection. The uncertainty of this economic overlay has served to enhance the allure of "story investing" to the detriment of "stodgy" fundamental analysis. We are the stodgy ones.

We believe that the markets are missing some unbelievable opportunities in small-cap growth stocks due to the relentless and narrow focus on these new technologies and general fears related to the economy. In our last letter we spoke broadly about the fundamental disconnect between small-cap growth and large-cap valuations. This disconnect continues to be at near record differentials with the forward P/E multiple of the S&P 500 Index being at or greater than the Russell 2000 Growth Index for over 2 years! The persistence of this disparity has never occurred in the past 25 years. In this letter, we would like to provide a counterpoint to the prevailing market consensus on individual stocks that we own in the Fund. There are many great small-cap companies trading at historically low absolute valuations. We own a diversified portfolio of them in the Fund and we continue to execute on our fundamental investing process to uncover high quality investment opportunities at what we believe are trading at fire sale prices. Encouragingly, some green shoots are starting to appear. Inflation data seems to be softening, potentially portending a Federal Reserve rate cut which would certainly be a tailwind for smaller cap stocks. Merger and acquisition activity has picked up as well, particularly in small-cap health

care (two of our medical device companies have been bought in the last year). Chaos equals opportunity.

AI models are rapidly moving from objects of curiosity to levels of functionality that just a couple of years ago were believed to exist only in the realm of science fiction. We obviously do not invest in large-cap companies that produce AI hardware, which is where significant market attention is focused right now. Yet we continue to look for exciting small-cap ideas in AI hardware. For example, we owned a small-cap AI-oriented semiconductor company in the second quarter called **Astera Labs, Inc.** Astera Labs manufactures analog semiconductors that facilitate improved communications within a motherboard (for example between graphics processing units like what NVIDIA makes and central processing units which are made by companies like Intel), and between servers. We bought shares when the company went public, but due to the incredible hype surrounding hardware-based AI companies, the stock quickly doubled and exceeded what we believed was a reasonable long-term valuation (particularly given new competitive offerings on the horizon). Therefore, we sold our investment but continue to monitor its valuation closely for a potential re-entry point. We own **Nova Ltd.**, a semiconductor capital equipment company that helps to enable the manufacture of high-end AI chips. Over the five-plus years Nova has been held in the Fund, it has been one of the Fund's best investments, with appreciation in excess of 800%.

We are huge believers in the practical uses of AI, and we have several investments in companies that adapt AI models to enhance their products and services. These include companies like **GitLab Inc.**, **SentinelOne, Inc.**, and **Couchbase, Inc.**, which were among our top detractors at one point in the second quarter (GitLab and SentinelOne recovered significantly in the last week of the quarter). As of the second quarter at least, the market has just not been ready to reward AI companies beyond those providing "picks and shovels." This led to all three of these companies trading at or near all-time low valuation levels during the quarter. Nevertheless, we believe that in the coming quarters the market will broaden its level of interest from AI hardware to "adaptive AI" investments like GitLab, SentinelOne, and Couchbase. In that scenario, all three of these stocks have significant upside potential.

GitLab is a subscription software company that enables enterprise software developers to develop new software applications rapidly and securely for their firms. GitLab uses AI to help with code suggestions, to check for holes in security, and to automate collaboration among the many developers within an enterprise. GitLab recently launched a product called Duo that we believe will provide revenue upside for the company and enhance the competitiveness of their product of offerings. SentinelOne is a cybersecurity company that provides endpoint protection (a much more advanced version of legacy "anti-virus" software) both at customers' physical sites and in the cloud. It uses AI to detect anomalous behavior on the network and to automate the remediation of the security flaws that led to the intrusion. Both companies are recurring revenue entities, with high gross margins (78% for SentinelOne and 90% for GitLab) and are growing rapidly (revenue growth of 25% or more). Yet both are trading at or near all-time low valuation levels. SentinelOne slightly beat full-year revenue guidance but guided to an operating loss that was \$7.5 million worse than consensus (entirely accounted for by the increased operating expense pulled

<sup>1</sup> "Short Sellers Gained \$10 Billion in Second Quarter Despite S&P 500 Rally," Bloomberg, by Carmen Reinicke and Magdalena Del Valle, July 9, 2024. The "money" quote in the article came from trader Ihor Dusaniwsky at S3 Partners LLC who noted that "[t]he market velocity is almost more important than the underlying fundamentals of the company..."

in from acquisitions – including PingSafe which allows SentinelOne to scan cloud-based workloads without the need to install a software agent). This led to a one-day stock drop of as much as 31% which we attribute purely to market skittishness. By quarter end, SentinelOne's shares had fully recovered. We believe the company can grow revenues by 25% from 2024 through 2028 and that free cash flow will go up over 10-fold in this period. We see the stock at least doubling from its current price. GitLab shares dropped 14.7% in the quarter despite raising full-year revenue and earnings guidance. This was partly due to a health issue with the CEO (cancer recurrence which he believes is very treatable). We see GitLab revenues growing at a compounded rate of 26% through 2028 with free cash flow growing five-fold over current levels. Again, we see the stock doubling over this time.

One of our poorest performers in the quarter was Couchbase, which provides software allowing the creation of unstructured databases. Couchbase is enabling AI applications via new "vector" database modalities. Vector databases help to sort rapidly and efficiently through data. Couchbase raised its full-year revenue guidance and lowered its expected operating loss (we believe the company will be breakeven in 2025), yet shares dropped 30.6% in the quarter. The issue was that net new average recurring revenue was slightly lower than the Street expected. In our opinion, this was due to the timing of contract signings over the course of the year. We believe that full-year guidance is still intact, and the company has already indicated a particularly good start to the second quarter. Revenue growth should compound at 20% from 2024 to 2028, with free cash flow growing meaningfully. The stock could triple over this time as it continues to execute. Chaos equals opportunity.

GLP-1 drugs (originally used to control type 2 diabetes) have become the biggest class of therapeutics in history with expected 2024 sales of close to \$50 billion now that they are approved for weight loss. Sales of these drugs could climb to \$100 billion in 2029. And it seems that every day studies are uncovering new benefits of the drugs (including reduction of sleep apnea and lowered risk of heart disease).

Fear of displacement by GLP-1's has hurt **Inspire Medical Systems, Inc.**, which treats sleep apnea with its proprietary medical devices. Inspire was a new purchase in the quarter, but our timing was unfortunate. A recent study called SURMOUNT-OSA that read out in June 2024 showed unexpectedly better sleep apnea control for obese patients that have lost weight using GLP-1's. This was slightly better than the preliminary study data released in April, upon which we based our initial investment. We discuss Inspire in more detail below.

We do have investments with positive exposure to GLP-1 trends, but the near-term macro environment has led to setbacks. **Stevanato Group S.p.A** manufacturers specialized glass vials and cartridges used for injectable drugs. The company is a market leader in these high value components. It is building out manufacturing capacity for what we believe will be significant volumes of components for GLP-1 drugs. Unfortunately, while investors wait for that capacity to come online, the company had excess inventory of other products in its distribution channel, leading to a 4.6% reduction in full-year 2024 revenue guidance. This modest reduction in guidance and the return of Franco Stevanato as CEO caused shares to drop 42.8%. Currently, shares trade at close to their lowest Enterprise Value to Sales (EV/Sales) multiple in years (about 4.3 times compared to an average of 5.5 times). Enterprise value combines the market value of the stock with net debt on the balance sheet to give a representation of the cost to fully purchase the company. In addition, the stock trades at only 13 times next

year's cash flow (which we believe will double from 2024 to 2028 as new capacity ramps up). The company is most of the way through the capital expenditure needed to ramp up its plant capacity. Therefore, we believe that as inventory issues ease over the next couple of quarters and new products launch, we will see a nice recovery. Chaos equals opportunity.

**Repligen Corporation** is another company benefitting from the massive growth in approvals of biologic drugs (including GLP-1's). It manufactures equipment that drug companies use to produce these drugs. Like other suppliers to the biologics industry, Repligen has experienced demand headwinds this year from Chinese buyers (now only 5% of sales), the loss of COVID-19 revenue (now insignificant), and a reduction in protein sales due to the loss of a customer and excess channel inventory. These challenges combined for about \$75 million in revenues (or about an 11.5% headwind to 2024 sales). Sales were down 20% in 2023 (which we had anticipated when we bought the stock in mid-2023). Unfortunately, shares fell after the company's very well-liked CEO Tony Hunt decided to step down. Fortunately, Mr. Hunt has agreed to stay on as Chairperson for at least another three years. The timing of this decision was not received well by investors given the bumpy macro environment. We still believe in the long-term prospects for Repligen and its newly appointed CEO, Oliver Loeillot. Mr. Loeillot has been the COO of the company for nine months and was hand-picked by Mr. Hunt to succeed him. We spoke to both men after the announcement and are confident that the current strategic plan will continue to be executed by Mr. Loeillot. In the meantime, Repligen trades at its lowest valuation multiple in five years. Chaos equals opportunity.

Beyond the specifics of GLP-1s, the Health Care sector has generally been a minefield in small cap. Valuations for all segments in which we invest have compressed significantly. This can be seen in diagnostics. For example, since 2021 (COVID era) the multiple for **Veracyte, Inc.** (a specialty cancer diagnostic company) has compressed from around 5 to 6 times EV/Sales to around 3.5 to 4 times. Veracyte has met or beat its quarterly financial guidance every quarter since the third quarter of 2020 (the prior two quarters were during peak COVID). And the company has raised full-year guidance in most of those quarters.

We have increased our exposure to diagnostics companies, including existing positions in Veracyte and **CareDx, Inc.** (which rebounded dramatically this quarter as the company re-accelerated its top-line growth). We even added two new investments in the segment. First, we bought shares of **Exact Sciences Corporation** after the stock fell from a recent peak of \$100 per share to the low \$40's at the end of the second quarter. We have a detailed discussion below of our purchase rationale for Exact Sciences but note that it is trading at about three times forward EV/Sales, its lowest level in five years. We also established a small initial position in **Tempus AI, Inc.**, which came public in June 2024. This is another cancer diagnostics company which also has a unique database of its own, as well as third party cancer testing and patient data surrounding testing results. In the current environment, the IPO did not fare well, and within days shares dropped as much as 38% from the initial offering price of \$37 (driven by enormous short-selling activity). We viewed this as an opportunity, so we have been carefully adding small purchases to the initial position at far lower prices. At one point, Tempus traded at four times next year's EV/Sales which values the business more in line with more mundane, slower growing, "testing only" companies, without ascribing any premium to the unique database asset. By the end of the quarter, Tempus had rebounded back to the low \$30's and we were in a net profit position on our investment. Chaos equals opportunity.

# Baron Discovery Fund

**Table II.**  
Top contributors to performance for the quarter ended June 30, 2024

	Percent Impact
Silk Road Medical, Inc.	0.73%
CareDx, Inc.	0.58
Nova Ltd.	0.53
Guidewire Software, Inc.	0.37
Montrose Environmental Group, Inc.	0.28

The Health Care sector was not all bad. During the year, we have seen many of our Health Care holdings rebound, showing that long-term fundamentals rather than short-term trading volatility is what truly matters. **Silk Road Medical, Inc.**, a manufacturer of devices to provide minimally invasive treatment of carotid arteries to prevent strokes, agreed in June 2024 to be acquired by Boston Scientific (right on the heels of Boston Scientific's March 2024 acquisition of Axonics, Inc., which we also owned). Last year Silk Road was down over 75%. This year it is up over 120% and was up 47.8% in the second quarter. Similarly, breast implant manufacturer **Establishment Labs Holdings Inc.** is up over 75% this year (we believe it is close to receiving FDA approval so that it can launch implants in the U.S.). Last year Establishment Labs was down over 60%. **CareDx, Inc.**, which is the leading diagnostic testing lab serving the organ transplant industry, is up over 29% this year and 47.2% in the second quarter. This was due to the return of positive testing volume growth after a difficult period in 2023 precipitated by a proposed Medicare billing change. We believe these billing outcomes will be far better for CareDx than does the market, which is why we re-initiated our investment at purchases averaging under \$10 per share (shares closed the quarter at \$15.53) earlier this year. This was after shares dropped 74% from the beginning of 2022 to the end of 2023. As painful as it would have been for one to own these stocks in 2023, we are glad we stepped back to look at the longer-term picture with these companies. It would have been easy to sell at the bottom. Our process prevented that. Chaos equals opportunity.

**Nova Ltd.** is a semiconductor capital equipment company focused on the metrology (measurement) market. The stock rose during the quarter on the expectation that robust growth in chips for AI applications will drive accelerating adoption and growth across Nova's product portfolio, including specifically high bandwidth memory, advanced packaging, and leading-edge chip production. Nova is the only supplier of materials metrology tools that are increasingly required for leading edge chips. Its superior capabilities in optical inspection tools are driving share gains, and it is also benefiting from adoption of its chemical metrology portfolio (which categorizes material qualities). We believe Nova is well positioned to continue outgrowing underlying wafer fabrication equipment industry trends.

Shares of property and casualty (P&C) insurance software vendor **Guidewire Software Inc** contributed to performance for the quarter. After a multi-year transition period, we believe the company's cloud transition is substantially complete. We believe that cloud subscriptions will be the sole path forward, with annualized recurring revenue (ARR) benefitting from new customer wins and migrations of the existing customer base to its InsuranceSuit Cloud product. We also expect the company to shift research and development resources to product development from infrastructure investment, which will help to drive cross-sales into its sticky installed base and potentially accelerate ARR over time. We are also encouraged by Guidewire's subscription gross margin expansion, which improved by more

than 10% in its most recently reported quarter. We believe that Guidewire will be the critical software vendor for the \$2 trillion global P&C insurance industry, capturing 30% to 50% of its \$15 to \$30 billion total addressable market and generating margins above 40%.

**Montrose Environmental Group, Inc.** a leading environmental solutions provider (consulting, testing and remediation), outperformed during the quarter. The company reported a solid quarter driven by strong organic growth as the company is benefiting from both secular trends as well as regulatory tailwinds. During the quarter, the EPA finalized the maximum contaminant levels for PFAS (a so-called "forever chemical") in water supplies which is expected to be a catalyst for increased remediation spending. Montrose is likely to benefit as it has proprietary equipment to enable PFAS remediation. Adding to organic growth prospects, Montrose sees a robust market for acquisitions and the company did a small equity raise early in the quarter to execute on opportunities. We believe that Montrose can generate over 20% cash flow growth per year for the next several years.

**Table III.**  
Top detractors from performance for the quarter ended June 30, 2024

	Percent Impact
SiteOne Landscape Supply, Inc.	-0.85%
Stevanato Group S.p.A	-0.82
Kinsale Capital Group, Inc.	-0.80
Couchbase, Inc.	-0.79
Floor & Decor Holdings, Inc.	-0.61

**SiteOne Landscape Supply, Inc.** is the largest distributor of wholesale landscape supplies in North America. SiteOne sells irrigation, hardscapes, agronomics, and nursery products to professional contractors through its network of branches for residential and commercial maintenance, upgrade/repair, and new construction applications. Shares of SiteOne fell during the quarter as the company provided a negative intra-quarter update, with demand weaker than expected in upgrade/repair product categories and commodity deflation stronger than expected, which combined are likely to lead to lower full-year guidance when the company officially reports its second quarter results. Despite the weaker-than-expected near-term results, we believe SiteOne remains well positioned for the long term. It benefits from its investments in operational efficiency, technology, and product category management allowing it to take share of the fragmented wholesale landscape supplies distribution industry. And it is filling out its product offering and geographic footprint through consistent acquisition activity. We think that SiteOne can drive its EBITDA (adjusted cash flow) margins over time towards its 13% to 15% targeted range.

We discussed the reasons for **Stevanato Group S.p.A's** underperformance above.

Following strong performance in the first quarter, specialty insurance company **Kinsale Capital Group, Inc.** gave back some of its gains in the June quarter. The company reported mixed first quarter earnings with earnings per share that was ahead of consensus estimates but with premium growth that missed Street estimates. Gross premium growth slowed to 25%, due to slower growth in property premiums (we estimate about 25% growth, down from 54% last quarter) while casualty premium growth likely remained steady at about 26%. We lowered our premium growth expectations for the full year and, combined with a more conservative loss ratio estimate, also lowered our earnings expectations. Nevertheless, the



company's return on equity remains best in class at 29%. At current levels, the valuation is also undemanding at about 21 times our 2025 earnings estimate. While we acknowledge the excess and surplus lines market (where Kinsale focuses) is slowing as compared to the fast growth we saw during and immediately after the COVID pandemic, we still believe Kinsale can grow premiums in the low teens for the foreseeable future. It should grow earnings faster than that.

**Floor & Decor Holdings, Inc.** is a specialty retailer of hard-surface flooring and accessories in the U.S. While the company continues to open new stores and consolidate the hard surface flooring market through its large format stores with everyday low prices, the decline in housing turnover has put pressure on shorter-term sales trends. We maintain our long-term conviction. We view Floor & Decor as a differentiated, high-growth retailer offering a broader assortment of low-cost products than competitors. The company holds an 8% market share in the highly fragmented \$21 billion U.S. hard-surface flooring market where we believe it will continue to gain share. We think the replacement of carpet with hard-surface flooring, which we see as a secular shift in the flooring industry, will aid growth. We believe Floor & Decor can continue to grow its store count in the 15% to 20% range annually.

**PORTFOLIO STRUCTURE**

**Table IV.**  
Top 10 holdings as of June 30, 2024

	Year Acquired	Quarter End Investment Value (millions)	Percent of Net Assets
DraftKings Inc.	2023	\$47.1	3.4%
CyberArk Software Ltd.	2022	43.8	3.1
Advanced Energy Industries, Inc.	2019	43.0	3.1
Axon Enterprise, Inc.	2022	42.4	3.0
Kratos Defense & Security Solutions, Inc.	2020	38.9	2.8
Montrose Environmental Group, Inc.	2020	38.7	2.8
Chart Industries, Inc.	2022	36.1	2.6
PAR Technology Corporation	2018	35.3	2.5
Texas Roadhouse, Inc.	2022	34.3	2.5
GitLab Inc.	2022	33.7	2.4

Our top 10 holdings comprised about 28% of the Fund's net assets, consistent with long-term levels. Our cash position as of June 30, 2024 was 2.8%, also in line with historical levels. The Fund has significant capital loss carryforwards from prior years to offset current year capital gains.

**RECENT ACTIVITY**

**Table V.**  
Top net purchases for the quarter ended June 30, 2024

	Year Acquired	Quarter End Market Cap (billions)	Net Amount Purchased (millions)
Inspire Medical Systems, Inc.	2024	\$4.0	\$22.3
Procore Technologies, Inc.	2024	9.7	21.2
Exact Sciences Corporation	2024	7.8	20.9
Tempus AI, Inc.	2024	5.8	19.2
Integer Holdings Corporation	2024	3.9	18.4

We bought shares of **Inspire Medical Systems, Inc.**, a medical device company which offers a treatment for moderate to severe obstructive sleep apnea called hypoglossal nerve stimulation. Obstructive sleep apnea (OSA) is a common sleep disorder caused by relaxation of the airway muscles and obstruction of the airway, which interrupts normal breathing during sleep. First line therapy for OSA is continuous positive airway pressure (CPAP), which requires the patient to wear a mask and an air flow generator delivers air pressure to the patient's throat to keep the airway open. Compliance rates with CPAP are low because many patients find the mask cumbersome or cannot tolerate the pressure. Inspire offers a small surgically implantable device that delivers mild stimulation to the patient's hypoglossal nerve which causes the patient's tongue to move forward, opening the airway. Since receiving FDA approval in 2014, Inspire's device has gained rapid adoption, growing from \$8 million in sales in 2015 to an estimated \$783 to \$793 million in 2024. For context of the market opportunity for Inspire, there are 8 million CPAP users in the U.S., and only 24,000 Inspire procedures were done in 2023 (with 60,000 done since the product launched).

During the quarter, the stock came under pressure due to final data published in June from Eli Lilly and Company's SURMOUNT-OSA trial. The trial showed that Lilly's GLP-1 drug (tirzepatide) reduced OSA in adults with obesity by up to 62.8%, and up to 51.5% of participants met the criteria for disease resolution. In our view, Lilly's tirzepatide and other GLP-1 medicines will have an impact on the OSA treatment paradigm. However, we think that even if some patients fall out of Inspire's sales funnel after taking a GLP-1, many new patients will enter the funnel. This is because patients who have an extremely high body mass index (BMI) are not currently considered candidates for Inspire therapy, and if those patients lose enough weight with a GLP-1, they can become candidates for Inspire. We also think the total addressable market (TAM) opportunity for Inspire is large and underpenetrated. One of the principal investigators in the SURMOUNT-OSA study estimated that 1 billion people around the world have OSA. Inspire management has estimated its TAM to be at least 500,000 patients in the U.S. alone, and the company's penetration rate is less than 10%. Finally, we also note that not everyone can tolerate a GLP-1 medicine (particularly the high doses used in the study), and to maintain the effect on OSA patients would need to stay on the drug forever. Given their high costs, insurance companies could place limits on their use. Inspire trades at a compelling valuation (under four times 2025 EV/Sales). Axonics and Silk Road were acquired for far higher multiples. This is too cheap for a company growing revenues rapidly (over 20%) in a hugely underpenetrated market with high (84%) gross margins. Given all these factors, we think Inspire offers a terrific investment opportunity.

We initiated an investment in **Procore Technologies, Inc.** during the quarter. Founded in 2002, Procore provides cloud-based construction management software that helps general contractors, subcontractors, and asset owners manage every step of the construction process. Procore's product suite includes project execution (storing and updating blueprints, designs, work orders and project schedules in a single system of record), pre-construction (managing bids, permitting, and approvals), workforce management (scheduling worker hours and recording safety compliance), financial management (budgeting and invoicing), and data analytics. Together these products help contractors execute projects more efficiently, plan more accurately, avoid costly rework, improve worker safety, and generate better margins. This has led to exceptionally low customer churn.

# Baron Discovery Fund

Procore serves a large and growing addressable market – annual construction volume exceeds \$2 trillion in the U.S. alone – that is still in the early innings of digitization and technology adoption. The company has a leading market share in the sector, with more than 16,500 construction firms and asset owners using its software to manage billions of dollars of annual project volume. Yet Procore is still only 12% penetrated in terms of U.S. construction volume and 2% penetrated internationally. We believe the company has several competitive advantages that will drive further share capture and strong growth. First, Procore is the only cloud-native technology vendor that addresses all stages of the project life cycle with a single, integrated interface and data model. Second, Procore was the first vendor to price its platform using a “take-rate” model, charging a percentage fee against its customers’ total construction volume. Compared to seat-based license models offered by many competitors, this approach has encouraged far more industry practitioners to trial and use Procore products. As of last year, over 500,000 collaborator companies were interacting with its product, driving a strong pipeline for new customer wins.

We see a long runway for growth through new customer additions and expansion in existing accounts. The company has maintained low to mid-double-digit revenue expansion rates for existing customers by managing more project volume and by cross-selling additional product modules. Recent product innovations like Procore Pay (managing payments for the various vendors and subcontractors on a given project) and geospatial mapping (for larger civil engineering projects) should improve the company’s wallet share over time. Procore is cash flow positive today and has been increasing its margins meaningfully over the past two years. We think the business can continue to grow at a healthy rate while further expanding free cash flow margins to north of 20% as it benefits from market share capture, higher take rates, and operating leverage. This should lead to good earnings growth and bode well for the stock long term.

**Exact Sciences Corporation** has the best-in-class non-invasive colorectal cancer (CRC) diagnostic test. It is a stool-based test called Cologuard which produces \$2 billion in revenue (over 70% of the company’s 2024 revenue). Cologuard is second in accuracy only to having a colonoscopy, which is the gold standard in diagnostics. However, many people dislike the uncomfortable colonoscopy prep (if you have done it, you know) and the invasive nature of the procedure. Exact Sciences is also the market leader in breast cancer recurrence testing with its Oncotype DX genetic test (used by 90% of U.S. oncologists due to its robust clinical evidence). We initiated an investment in the stock in the low \$40’s during the second quarter (shares peaked at \$158 in 2021 and traded as high as \$100 in July 2023).

Exact Sciences’ stock price has fallen for multiple reasons including: (1) a surprise FDA advisory committee panel recommendation of approval of competitor Guardant Health’s blood based CRC test in June 2024 (label yet to be disclosed); and (2) the company’s increase in marketing expense beyond expected levels (which people fear will compress profit margins). It is not guaranteed that the Guardant test will receive FDA approval (the panel decision is a non-binding recommendation), and we do not yet know what the label for the test will be (how will it be allowed to be marketed for use for clinical diagnosis). We believe the threat of blood-based tests is overblown given they are far less accurate than stool tests (stage 1 cancer sensitivity for blood tests in the mid-50%’s versus Cologuard at about 90% for stage 1 (92% for all stages), and AA sensitivity in the low teens versus Cologuard at 42%). Should Guardant’s test gain full FDA approval, we suspect its label will warn that it is inferior on early-stage CRC detection to stool tests and colonoscopy. Moreover, the blood-based tests are far more expensive to run using NGS (next generation sequencers) versus Cologuard,

which uses a cheaper technology called PCR. If the blood tests only gain reimbursement at the same level as Cologuard (for a three-year interval test), they might not be very profitable to run. The tests might be entirely unprofitable if they are needed every year (due to the lower accuracy) but reimbursed at only one-third of the level of Cologuard (to keep the overall costs at parity). We also believe that it is prudent for the company to increase its marketing spend to compete with blood tests and to capture as much of the greenfield CRC opportunity as it can. The additional benefit to Exact Sciences will be a robust nationwide salesforce to market additional tests in its pipeline including Cologuard Plus, Oncodetect (which is a cancer recurrence test that uses a new technology called MRD (minimal residual disease)), and potentially Exact Sciences’ own blood based CRC test (data is to be presented this year).

The market for CRC testing is huge, with about 110 million people in the U.S. eligible for CRC screening. Approximately 35 million eligible people get no testing at all (equivalent to 12 million Cologuard tests at a three-year frequency). About 5 to 6 million people do a colonoscopy (which equates to about 50 to 60 million of the eligible individuals since colonoscopy frequency is every 10 years). The rest get stool tests (including Cologuard which is 4 million tests per year – equivalent to 12 million eligibles because the test is done on a three-year frequency) and an older technology called FIT (about 8 to 10 million tests done every year so covering 8 to 10 million eligible individuals). FIT is a similar test to Cologuard in terms of the sample collection, but it is far less accurate (74% CRC sensitivity and only 24% AA sensitivity, versus 92% and 42% for Cologuard). FIT’s only advantage is it is a cheaper test (which we believe is negated by its lower accuracy). So Cologuard’s greenfield opportunity is 15 million tests (12 million tests for people not getting any CRC screening, plus another 3 million tests that could be taken from FIT at a 3-year frequency). This opportunity is worth \$7.5 billion in annualized revenues at \$500 per test on top of the \$2 billion Exact Sciences does now (so \$9.5 billion total potential). An updated version of Exact Sciences’ test called Cologuard Plus is expected to launch in 2025 (that reduces “false positives” in the test by 30%, so is much more accurate). The test will cost less to process than the original test (in other words it will be higher margin to Exact Sciences) and is likely to be reimbursed at a higher rate (some analysts believe 30% more, or about \$650 per test). This would equate to \$600 million in incremental high margin revenue on the existing 4 million test base at Exact Sciences and \$2.25 billion more on the greenfield new tests that the company could obtain, bringing the total potential revenue on all of these tests to over \$12 billion (over six times Exact Sciences’ current revenue level for CRC testing).

At our investment basis, we believe that we are buying the company at only three times its EV/Sales multiple in 2025 (very cheap historically for a diagnostic company with mid-teens top-line growth and low 30% cash flow growth). We believe we will realize at least a double on our investment over the next five years.

We established a position in **Tempus AI, Inc.**, which is an intelligent diagnostics and health care data company. Tempus has two synergistic business units: Genomics and Data & Other. Within the Genomics business, Tempus provides diagnostic tests, particularly for cancer treatment selection. The company’s labs sequence the tumor’s genome (the DNA “encyclopedia” of the tumor) and transcriptome (which measures what parts of that DNA is expressed by sequencing the messenger RNA that will be translated to protein expression). This can help oncologists select the best treatment for each individual patient. We think the cancer treatment selection sequencing market is underpenetrated and poised to continue to grow rapidly, and Tempus is well positioned as one of the leaders in this

field. The genomics testing data also feeds into Tempus' value as a data company. Tempus has amassed a large (over 200 petabytes) proprietary multimodal dataset that combines clinical patient data (which includes clinical records, imaging data and other information, mostly from two-way collaborations with health systems) with genomic testing data from Tempus' Genomics business as well as testing data from other test providers. In total, the company's dataset includes about 7.7 million clinical records, over 1 million imaging records, about 900,000 matched clinical and molecular dataset profiles, and nearly 1 million sequenced samples. In addition to using this data to empower more intelligent diagnostics, Tempus also licenses this data to biopharmaceutical companies that use it to design smarter clinical trials and identify potential new drug targets. Tempus works with 19 of the top 20 pharmaceutical companies in this capacity and has disclosed nine-figure deals with three biopharmaceutical companies. We think this proprietary dataset is unique with meaningful barriers to entry and brings meaningful value to biopharmaceutical research and development.

We initiated a position in **Integer Holdings Corporation**, the largest medical device outsourcer (MDO) manufacturer. Integer helps design and manufacture components, sub-assemblies, and full devices for a range of companies, including the five largest med-tech companies. We think this is an attractive business with high barriers to entry and high switching costs. It takes a lot of time and money to design, qualify, and study new med-tech devices and components, and Integer is often specced into their customers' devices. Compared with other MDOs, Integer has a number of differentiated capabilities (particularly in battery related technologies), the most comprehensive offering in their space, and strong relationships with its large customers. Customers prioritize speed-to-market, ability-to-scale, and reliability/quality of manufacturing. Integer performs extremely well on all these metrics. Larger customers are also trying to consolidate vendors and Integer has the most comprehensive offering available. Integer is exposed to several of the most interesting ongoing med-tech launches (including neurostimulation, pulsed field ablation, and structural heart), and we think that the company is poised to grow faster than the market given its focus on collaborating with med-tech on innovative devices. On top of its organic revenue growth, Integer continues to invest inorganically via acquisitions to augment its technological capabilities and manufacturing scale. All of this should lead to top-line growth of about 10% per year.

We sold our position in **Axonics, Inc.** after it agreed to be acquired by Boston Scientific. We sold our investment in **Allegro MicroSystems, Inc.** based on what we view as a high valuation and ongoing difficulties for the automotive industry. We have automotive semiconductor exposure via our holding in **indie Semiconductor, Inc.**, which is growing far faster than Allegro, is trading at a lower valuation, and has visibility to a huge multi-billion-dollar pipeline supporting our estimates for years to come. We exited our position in **Boyd Gaming Corporation** as we believe the company will experience challenging macro conditions for an extended period (this was our only top 10 detractor that we believe missed our thesis expectations). We sold our position in **Smartsheet Inc.** during the quarter to allocate the capital to higher conviction ideas.

**OUTLOOK**

The second quarter was certainly challenging for us. We hope that the details we have provided in this letter offer a meaningful substantive update of some of the major crosscurrents in the market. We are in a period of rapid technological change in nearly every industry. The Fund is embracing this change and is finding investments that we believe will benefit from it over the next few years. Until the economy fully recovers (and it will), volatility will continue to be a standard feature of the investment landscape, particularly in small cap. When investors do finally sense recovery is near, we believe the market (and our investments) will rebound rapidly (following the historical context of small-cap performance). We own significant holdings in the Fund because we are confident this will occur and that we will reap the rewards. We thank you for investing along with us and we are glad you have chosen Baron Discovery Fund as an investment.



Randy Gwartzman  
Portfolio Manager



Laird Bieger  
Portfolio Manager

**Table VI.**  
**Top net sales for the quarter ended June 30, 2024**

	Year Acquired	Market Cap When Acquired (billions)	Market Cap When Sold (billions)	Net Amount Sold (millions)
Axonics, Inc.	2020	\$1.1	\$ 3.4	\$37.7
Boyd Gaming Corporation	2021	7.3	4.8	28.6
Smartsheet Inc.	2022	4.5	5.2	22.5
Allegro MicroSystems, Inc.	2020	0.4	5.3	15.9
Astera Labs, Inc.	2024	9.3	10.8	12.3

# Baron Discovery Fund

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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 prospectus contain this and other information about the Funds. You may obtain them from the Funds' distributor, Baron Capital, Inc., by calling 1-800-99-BARON or visiting [BaronCapitalGroup.com](http://BaronCapitalGroup.com). Please read them carefully before investing.*

**Risks:** Specific risks associated with investing in smaller companies include that the securities may be thinly traded and 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. 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 manager only through the end of the period stated in this report. The portfolio managers' 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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**Beta** explains common variation in stock returns due to different stock sensitivities to market or systematic risk that cannot be explained by the US Country factor. Positive exposure indicates high beta stock. Negative exposure indicates low beta stock.

**Enterprise value (EV)** is a measure of a company's total value, often used as a more comprehensive alternative to equity market capitalization. EV includes in its calculation the market capitalization of a company but also short-term and long-term debt as well as any cash on the company's balance sheet. **Free cash flow (FCF)** represents the cash that a company generates after accounting for cash outflows to support operations and maintain its capital assets.

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