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On this week's show: Finding high growth stocks in a low growth world with Baron Opportunity Fund's Michael Lippert.

Michael Lippert
Portfolio Manager
Baron Opportunity Fund

CONSUELO MACK: This week on WEALTHTRACK, Amazon is the largest position in the Baron Opportunity Fund. Long time Portfolio Manager Mike Lippert explains why and where else he is investing for high growth. Next on Consuelo Mack WEALTHTRACK.

Hello and welcome to this edition of WEALTHTRACK, I'm Consuelo Mack.
When was the last time you sat down with a portfolio manager specializing in high growth stocks? Well, I rarely do since most of the portfolio managers I talk to are value investors of the Benjamin Graham and David Dodd school of investing, the fathers of value investing with their 1934 investment classic "Security Analysis." Warren Buffett was a student of theirs at Columbia Business School and wrote the forward to the sixth edition of the book.

Traditional value managers look for bargain stocks, selling at deep discounts to their intrinsic value, often finding them in unpopular or at least overlooked places.

Over the years Buffett and his business partner Charlie Munger have developed their own style of value investing, but have consistently favored established companies with dominant market positions and products they can understand. Berkshire Hathaway's top five holdings in a recent quarter were Kraft Heinz, think macaroni and ketchup,… Wells Fargo, a big bank,… Apple, a rare tech exception,… Coca Cola, a global icon…. and American Express, a household name in financial services.

However recently and specifically at the last annual meeting of Berkshire Hathaway buffett seems to have had a change of heart. He heaped praise on Amazon founder and CEO Jeff Bezos, a high flying stock if there ever was one. And when asked on CNBC, why he hadn't purchased amazon stock answered in one word: "Stupidity."

This week's guest has not made the same mistake. His largest holding is Amazon and he has owned it for years. He is Michael Lippert, Portfolio Manager of the high growth stock oriented Baron Opportunity Fund, one of legendary growth investor Ron Baron's stable of funds. Lippert has run Opportunity since 2006, having joined Baron as a research analyst in 2001, a big career change from being a partner at a major law firm in Texas. During Lippert's 11 year tenure as sole manager, Baron Opportunity Fund has edged out the S&P 500 and handily beaten its mid-cap growth category.

Since Lippert is new to WEALTHTRACK I wanted to cover some basics. What does he mean when he describes the fund as high growth?

MICHAEL LIPPERT: Essentially high growth you can look it by numbers, and so the average revenue growth across our portfolio for the last several years has been roughly 25 percent or plus. Now you think about that. The Russell 3000 Growth Index grows four or five percent. We all know the economy grows two or three. Add a couple points of inflation, so you're talking four or five. So that's what we do. The real interesting question is, how do we get there? Right? So, I think I told you the other day we literally think about where the world's going, not where it's been, to steal a Wayne Gretzky hockey quote.

CONSUELO MACK: Skating to the puck.

MICHAEL LIPPERT: Skating to the puck.

CONSUELO MACK: Or where the puck's going to be.

MICHAEL LIPPERT: So, when you think about the overall economy or an industry growth rate, that's an average of everything that's going on, and there are parts that are growing very, very fast and parts of our economy that are shrinking. So, we try to find those parts that are growing very, very fast, and they're basically marked by disruptive change or what I call generational shifts in different industries, so that's what we look at. So, we're really secular growth investors, not cyclical growth investors.

CONSUELO MACK: So the generational shifts, I can think of where some of them are happening, but what are the areas that you've identified? Just let's say the top two or three areas that you've identified as these high-growth areas that you want to be invested in.

MICHAEL LIPPERT: So clearly one is the internet and that affects the way we communicate, the way we socialize, the way we shop. It could be cloud computing which affects the way we build IT infrastructure today and the way we use applications. It could be electric cars. It could be genetics and health care.

CONSUELO MACK: Are you investing early in the process, or do you wait till there's some kind of critical mass? How do you make that determination?

MICHAEL LIPPERT: Yeah, we try to be early but not too early. So, I mean everybody who went to business school knows that a company has a classic S-curve. Industry trends or themes have the same thing. They take a while to get off the ground. They inflect. They go up for a long time. Then everything sooner or later will slow down. We try to wait to that first inflection in the S-curve so that we know it's real, and the kind of themes or trends that we're investing in, they're long-lived. They're not going to last two or three years. They're going to last ten, 15, 20 years, so we've got plenty of time to invest in that steep part of the S-curve. So, that's what we try to do.

CONSUELO MACK: So give me an example, and actually I'm going to give you an example of a company that I want to discuss that is your largest holding, and that's Amazon. So, is Amazon emblematic of the kinds of companies that you would love to be investing in, or is it kind of just so extraordinary? Is it really kind of a one-off?

MICHAEL LIPPERT: Well, I mean it's both. I think it is emblematic of some of these big trends, first ecommerce, then cloud computing. It's got several others in there as well, and it's a unique company. It's one of the best, and so ecommerce has been happening since the '90s. We're now in 2017 and it's still ten to 15 percent of our economy, and it's going to grow. It's going to be much bigger. We're now reading articles about people shutting down physical stores, and we're entering the age of kind of where the digital companies are going to have real world stores. Amazon just bought Whole Foods, and they're going to completely change the way we shop even in the real world. So, this is going to continue for a very, very long time. When it comes to cloud computing, the Amazon Web Services business, that business today is seven or eight years old, but it's probably going to last for 20 or 30 years and maybe there will be cloud 2.0 and cloud 3.0. We're definitely in 1.0, and so those are the kind of things that we want to invest in because we're generally long-term investors, and we want to invest in these bigger, massive trends rather than trying to figure out where the economic cycle is going to go next or who's going to win in Washington.

CONSUELO MACK: I was looking back at an article that actually was written about you in 2009, and you've been running the Baron Opportunity Fund since 2006, and at that time you had reduced your position in Amazon because the values had gotten too rich at that point. Now it's your largest holding. So, tell me how you approach a company that has appreciated as much as an Amazon does. Are you constantly trimming so it doesn't reach a really large position in your portfolio?

MICHAEL LIPPERT: I don't constantly trim, but I always do think about weightings for companies. So, at Baron Capital we try to invest in businesses that we believe can double in value in four or five years. You do the math on that. That's 15 or 20 percent. It would be very nice if that was a straight line up, but it's never going to be. Some years they're up 30 percent. Some years they're up five. Some years they're down ten. So, we're constantly looking at can we make our long-term return, and so what do we do? We model out what we think the company's going to earn and how much cash flow they're going to generate. We use a historically average conservative multiple on that stream of earnings or cash flow, and we see what we get. There are times when the market gets a little bit frothy where you could say, hmm, these valuations are now where we think it really should be worth in four years. We don't have any up side on those. You may exit the company, and somewhere in the middle you're kind of making a judgment on your qualitative assessment of the business, the likelihood that they will grab a very big opportunity, the management team, the margin profile, all of those things against what you think the up side is. You're making judgment calls. When I look at a company like Amazon, any time you've ever interviewed somebody, they would always tell you Amazon's expensive. It's always been expensive.

CONSUELO MACK: So what is it now in your view?

MICHAEL LIPPERT: Amazon's always expensive because they're investing so much. So when you're investing so much, you're penalizing real-time earnings or cash flow because you're trying to open up a big prize. There's not a lot of companies that I know out there that have kind of bigger, long-term prizes than Amazon. All of commerce for one, all computing infrastructure. Now they're getting into media. Now they're getting into voice intelligent search and assistance with the Amazon Echo. These are just massive markets, so the right thing for them to do is to keep investing, but one difference with Amazon today is for so long they never generated any free cash flow. They generate meaningful free cash flow today. It's a healthy free cash flow multiple, but they generate it, so now everything that they do, they could sell finance. They don't need the markets. They're going to finance it all on their own, all this growth.

CONSUELO MACK: So therefore, it's your largest position. You're sticking with Amazon in the size that it is? You're going to kind of let it run? I mean do you have a sense? Do you have a strategy?

MICHAEL LIPPERT: Things could always change, but as long-term investors we're constantly doing research, so we want to make sure against what we believe as the opportunity for the company what are the challenges. What are the chances it's going to realize that? How are their current operations? What's the competitive environment? What's the regulatory environment? We're making those assessments, and sometimes things change. When things change, you have to alter your investment view. Today I just see Amazon having what we call TAM, total adjustable market, massive TAMs both in ecommerce and cloud chiefly but also other things as well. Not a lot of significant competition in those areas, and we can talk about this, but I believe in the world that we live in today of technology with the direct and continuous persistent relationships with customers or users you're going to have a winner-take-most or winner-take-all world. It's not going to be only one winner, but the winner's going to take a lot.

CONSUELO MACK: So, let's talk about that because that's intriguing.

MICHAEL LIPPERT: We think Amazon is that.

CONSUELO MACK: So Amazon is that, and there are others as well. So, what are the other companies in your portfolio for instance that you've identified that are going to be kind of in that winners-take-all more or less category?

MICHAEL LIPPERT: People will know at home clearly Facebook with Facebook and Instagram as one of those. I think Netflix will be not a winner-take-all in media but will be a winner-take-a-lot in the way media is shifting from what we call over the top, basically media delivered over the Internet. Then I have plenty of smaller companies that people haven't heard about, Guidewire Software which sells software to the property and casualty insurance industry. They have dominant market share there.

CONSUELO MACK: That's a niche.

MICHAEL LIPPERT: A niche company. A company called CoStar Group which someone could think of a Bloomberg for the commercial real estate industry. They dominate that industry. There's really no number two. So, we look for companies against these massive opportunities like ecommerce that might be brand names that everyone knows at home as well as other companies that, unless you're doing the research that we do, no one would know but they're also as dominant in their verticals and in their industries.

CONSUELO MACK: Again looking at the valuations of those two companies, how do they look to you? Again, when do you make a decision to significantly trim or possibly sell a company?

MICHAEL LIPPERT: So you can do a couple things. You can trim and sell when you're getting inflows into your portfolio. You can therefore not buy and it dilutes down. My lawyers would never let me tell you what I've done in the quarter, but when a quarterly report comes out, people will see that there are certain companies that I've allowed to get smaller in the portfolio because of inflows or that I've reduced a little bit, but those two companies are interesting, and I think they really go to why we're long-term investors at Baron Capital. Last year Guidewire won this incredible deal to take their software which used to be loaded what we call behind the firewall and offered it in a cloud to a very, very big insurance company. Because that was new, the accountants wouldn't allow them to recognize the revenue, both the software revenue as well as the services revenue. They had to defer it. Now they received the cash from their customer but they couldn't put it on the income statement that they were reporting to Wall Street. So, the stock really suffered because of that even though once this customer went live, which I believe they did in April or May, all of that was going to reverse. So, the stock traded down last year on that as well as what happened after the election where tech sold off, and we essentially maxed out that position. We did the same thing for CoStar which has its own reasons, but it was also other short-term reasons that we thought Wall Street can't look through a quarter or two and look towards the big picture, and we try to look towards the big picture.

CONSUELO MACK: When you say you maxed out the position, you invested as much as you kind of allow yourself comfortably to do.

MICHAEL LIPPERT: Our rules are five percent at cost, so in the fourth quarter last year I took both Guidewire and CoStar, because of these short-term issues and as well as the market dynamics, up to five percent positions in my portfolio, and so they both had great years. I think each one is up 40 percent plus this year. So, they've been big contributors to my portfolio.

CONSUELO MACK: Let me ask you about the risk factor as well just in high growth, in tech that Morningstar considers you in your mid cap growth category to be a high risk compared to your category and your peers. Do you consider your portfolio to be a high-risk portfolio? I guess that means it's very volatile.

MICHAEL LIPPERT: Look. Again, it depends on how you measure risk.

CONSUELO MACK: So how do you measure risk?

MICHAEL LIPPERT: There's lots of different ... I mean so we'll measure risk basically on the chance that we're going to have a realized loss in that investment, not necessarily so much on volatility because, if you want to use a metaphor, the market is like a sea. The waves go up and down, but you're trying to literally sail from one place to the other. So, when you're on the peak of the wave, it feels great. When you're at the bottom of the wave and you think it's going to crash down on you, it feels terrible, but you're trying to go from one place.
I could give you countless companies that have been ten or 20-baggers in the market over the last ten years, Salesforce.com, Google, and each year the high and the low on those stocks are significant. For the first ten years as a public company, Salesforce had basically a 30 percent move from its high to its low. I think it was up 20 plus times from its IPO, and even if it had a boost on the IPO, it was 12 and a half times over ten years even the day after the IPO, but it was up and down. So, a lot of room for traders and a lot of room for long-term investors, so we're the long-term investors that are trying to go from point A to point B, and so ...

CONSUELO MACK: When I look ... go ahead.

MICHAEL LIPPERT: That's what I mean by risk, but Wall Street often measures risk. They compare you against an index. My portfolio is completely different than an index, so some quarters this year I look great, and some quarters I look terrible, and so I'm very different than the index so it looks like there's more volatility against an index.

CONSUELO MACK: Speaking of risk, I mean one of your top five holdings is Tesla. You either kind of love Tesla or you hate Tesla, and clearly you love it or you're a believer in Elon Musk and the future of Tesla. Now that strikes me as a very high-risk company. Tell me if you agree or what's your assessment of Tesla and why it has such a big position in your portfolio.

MICHAEL LIPPERT: In the short term is Tesla risky? Yes, it is. They're just producing their first Model 3s. They have plans to get to 20,000 cars per month in December. It's a big ramp. Nobody believes it's going to happen, but if they're successful with the Model 3, by successful I mean customers really like that car ...

CONSUELO MACK: The Model 3 is the less expensive?

MICHAEL LIPPERT: That's the less expensive. That's their first mass market car.

CONSUELO MACK: That Elon Musk just bought himself or something.

MICHAEL LIPPERT: Correct. He just rolled off. He got it for his 46th birthday according to Twitter. It's a base model, $35,000 car. We believe the average selling price will be higher.

Plenty of people will put on extras just like the base of a ...

CONSUELO MACK: Oh, sure. Options are where you make your money.

MICHAEL LIPPERT:... 3 Series BMW is probably 35 or 40 thousand dollars. That's not their average price, but that's where we're really going to change the market. I mean if they try to establish their technology, their manufacturing, their brand at the high end, they'll sell roughly 100,000 cars this year at the luxury end, the Model S, the Model X, but the real change, the real disruption is going to be if they're successful in the mass market. Wall Street is so focused on, will they hit that number by December, 20,000-car run rate? For us it doesn't really matter. I mean we'd like it to be December. If it's March, does it really change the long term? So, by long term we really believe there's going to be massive disruption change in the automotive industry. Electric cars, autonomous driving which is the auto pilot of Tesla and self-driving cars and shared mobility, and so I say this all the time. My kids will laugh at me that I owned a gasoline-powered car. They may not own a car in the future. They may just subscribe to a bunch of miles in an electric car, because when you're going not 12,000 miles a year but maybe 30 or 40,000, an electric car is so much more efficient, and the cost per mile will be so much lower. So, we're in not even the first generation. To use a baseball metaphor, we're in the first inning of this change toward electric. It's a tiny percentage of total cars sold in the world, and Tesla's going to sell 100,000 SX this year. Maybe they'll get to 20 or 30 thousand Model 3s. There are 90 to 100 million cars sold in the world, so we're just scratching the surface.

CONSUELO MACK: But what I don't get quite honestly is I mean there was just an announcement by Volvo that they're all in in the electric cars as well, and that they're predicting that it's going to be kind of sooner rather than later. It's not something way in the future. So, I look at a Tesla which is dependent upon private capital and it doesn't have the revenues and the earnings or the cash flow to support the kind of investment it's going to take to go up against the big guys. I mean what's the competitive edge that Tesla has to compete against a Volvo for instance?

MICHAEL LIPPERT: I mean I can answer this question in a lot of ways. One of those is just to use an example from history. If we were sitting down having this interview the day that Apple came out with the iPhone, you'd be asking me, "Really? They're going to compete with Motorola?" Remember the StarTAC back then? "They're going to compete with Blackberry? They're going to compete with Nokia? How are they going to compete with these companies?" None of them are even in the phone business anymore. They're gone because there was a disruptive change from our initial cell phones to what's now called the smart phone where it wasn't simply the device that made it important. It was the software and the ecosystem that you build.

CONSUELO MACK: No, the ecosystem. So, does Tesla have that kind of an ecosystem?

MICHAEL LIPPERT: Yeah. I mean today they're the only ones that are not only building the car, the battery, totally vertically integrated. They're also building their own charging network. No one else has a charging network out there. They really want to be the world's first diversified sustainable energy company which is why they're also doing solar roofs and battery storage. So, they're doing all these things. I mean our investment, however, is predicated on the car opportunity.

CONSUELO MACK: It is.

MICHAEL LIPPERT: Yeah, that's what we believe is really the massive opportunity here. Look. They're very far ahead. They have two cars that people love that are great. They're coming out with a third car right now. I think they've learned a lot from launching the Model S and the Model X which is the one that has the falcon wing doors which Elon ...

CONSUELO MACK: Which is gorgeous.

MICHAEL LIPPERT: ... Musk admits was a little bit overcomplicated. They significantly simplified the Model 3. I think it'll be a much easier car to make. They're not the only car manufacturer ever that's tried to scale up a mass market vehicle. They have lots of experienced people to do that now. Again, they've learned from their past, and they got a big lead. The other cars, even the Volvo, gets in the market 2020, 2021. We're in 2017. Four or five years from now, so it's a long, long time.

CONSUELO MACK: Is there another kind of breakthrough either major consumer product or trend that hasn't really hit the headlines yet that you're looking at?

MICHAEL LIPPERT: I think there's one. We're starting to think about it a lot. At Baron, we're long-term investors. We talk about four or five years. This may take longer. I think the new user interface of the future is going to be voice. It's not going to be you tapping on your phone, and so we're seeing the early stages of that with Apple, with Siri, with Google, with their Google Assistant, with Amazon, with Echo.

CONSUELO MACK: And Alexa and Echo.

MICHAEL LIPPERT: Alexa, and I think that's really going to be a change. I remember as I guess a kid watching *2001: A Space Odyssey* where you talked to HAL. I think the world of the future we're going to be talking to our digital services. We're not going to be tapping in it. I think that's going to be a big race and probably, if I had to bet today, one of the three winners will come from Apple, Amazon and Google. I think Amazon is ahead. They have the most market share in the home assistant with the Echo, but it's going to be a race. Honestly can I tell you today who's going to win that race? I can't, but I think that's going to be a big change.

CONSUELO MACK: The fees on your fund and other Baron funds, I think it's like 1.4 percent, again Morningstar. That's a high fee. What's the justification for that fee, and is there any talk at Baron about bringing the fees down to be more competitive?

MICHAEL LIPPERT: You should ask that question of Ron. I don't set the fees. I just do my job. I have not heard talk that we're going to take the fees down, and any investor should measure our performance after fees. If we don't outperform after fees, or you don't believe we're going to outperform some other options after fees, don't buy us. No one's forced to buy us. If you believe that we're going to do better for you for what you want, how you want to invest ... if you just want an index, buy an index. If you want the Baron Opportunity Fund because you think that offers something different in your personal portfolio, then we need to beat some other option after fees. That's what we try to do.

CONSUELO MACK: Okay, one investment for a long-term diversified portfolio. What would you have one of your sons or my son own long term?

MICHAEL LIPPERT: Look. It's so easy for me to have answered Amazon and Google. You well know that Amazon's the largest position in my portfolio. The company that I mentioned before, Guidewire Software, is maybe my second or third largest position today. It's one of those companies that's not a household name that I have very, very high conviction in for a number of reasons. Fantastic management team capitalizing on big changes in their industry in the software that's going to be used by the property and casualty insurance industry, the fact that they need to do data and analytics today. They need to engage with their customers in a digital format, so they sell digital portals. They have dominant market share. They're just early on against their total addressable market. It's a very high-margin business that generates great free cash flow already. So, while yes it's been a great stock this year, someone looks at it and says, "It seems pricey," if you want to invest for four or five years and you don't want to pick a household name, that's one that we think is really terrific.

CONSUELO MACK: Michael Lippert, thanks so much for being with us on WEALTHTRACK.

MICHAEL LIPPERT: Thank you for having me.

CONSUELO MACK At the close of every WEALTHTRACK we try to give you one suggestion to help you build and protect your wealth over the long term. Constantly learning is one way to do that. So this week's Action Point is: Read *Elon Musk: Telsa, Space X, and the Quest for a Fantastic Future* by Ashlee Vance. This authorized biography of Elon Musk was published in 2015, but it remains a favorite among reviewers for a reason. It is chock full of insider stories and insights from friends, business associates, competitors and the tech titan himself. Musk is a doer and dreamer who is determined to change how and where we live and travel. It remains to be seen if he succeeds but he deserves full credit for trying.

Speaking of the future, this week's guest Mike Lippert elaborates on the new on-demand world his children now live in and what it means for consumers. That's in our EXTRA feature on our website. In the meantime tell us what you are thinking about by reaching out to us on Facebook and Twitter.

Thank you for watching. Have a great weekend and make the week ahead a profitable and a productive one.