FPA Capital Fund, Inc.
Second Quarter 2018 Commentary

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus details the Fund's objective and policies and other matters of interest to the prospective investor. Please read this Prospectus carefully before investing. The Prospectus may be obtained by visiting the website at www.fpa.com, by calling toll-free, 1-800-982-4372, or by contacting the Fund in writing.

Average Annual Total Returns (%)

As of Date: 6/30/18	Since 8/1/84*	20 Years	15 Years	10 Years	5 Years	3 Years	1 Year	YTD	QTR
FPA Capital	12.83	7.28	6.89	4.44	1.80	0.58	0.55	0.67	3.41
Russell 2500	11.90	9.11	10.99	10.74	12.29	10.30	16.24	5.46	5.71

Periods greater than one year are annualized. Performance is calculated on a total return basis which includes reinvestment of all distributions.

* Inception of FPA management was July 11, 1984. A benchmark comparison is not available based on the Fund's inception date; therefore, data from August 1, 1984 is presented.

Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. This data represents past performance and investors should understand that investment returns and principal values fluctuate, so that when you redeem your investment it may be worth more or less than its original cost. The Fund's expense ratio as of its most recent prospectus is 0.80%. Current month-end performance data may be obtained at www.fpa.com or by calling toll-free, 1-800-982-4372.

Mr. Ahitov was named sole portfolio manager effective October 1, 2017. Dennis Bryan and Arik Ahitov had been co-portfolio managers since November 2007 and February 2014, respectively, and managed the Fund in a manner that is substantially similar to the prior portfolio manager, Robert Rodriguez. Mr. Rodriguez ceased serving as the Fund's portfolio manager effective December 2010.

Please see important disclosures at the end of the commentary.

FPA Capital Fund (the "Fund") was up 3.41% for the second quarter of 2018. Small capitalization indices continue to outperform large cap indices (the Russell 2500 Index was up 5.71% year-to-date vs. S&P 500 Index's 3.43% increase).[1] This major shift toward small cap stocks is likely due to the belief that smaller U.S. companies will fare better than larger U.S. companies during a trade war. It remains to be seen whether this simple reasoning will prove to be correct. But even if that premise is correct, are investors getting paid enough for the small-cap risk? The Russell 2500 Index is trading at a 33x earnings multiple vs. S&P 500 Index's 21x multiple[2]. Value remains out of favor (the Russell 2500 Growth Index up 8.04% year-to-date vs. Russell 2500 Value Index's 3% increase). Looking at a more relevant peer group as described by Morningstar[3], we were in the 39th percentile of our category year-to-date as of June 30.

Our Commitment to Fellow Shareholders

We would like to report once again on our progress on the three portfolio management initiatives we committed to after FPA announced that I would become the sole portfolio manager of the Fund at the beginning of the fourth quarter of 2017. Those commitments were to:

1. Avoid position inertia
2. Be more nimble
3. Differentiate between long-term and opportunistic investments

Avoiding Position Inertia

Our team has completed transitioning the portfolio with the exception of our energy-related positions. Since the portfolio management change announcement, we have initiated 10 new positions and eliminated 11 holdings. Some of the exited positions included names that have been in the portfolio for 10+ years.

Being More Nimble

We have increased our focus on adjusting position sizing when there are changes in our analysis and/or the risk/reward profile. We are buying more aggressively when we identify a compelling risk/reward opportunity and selling more aggressively when the margin of safety[4] starts to diminish. More importantly, we have sought to act more decisively when our investment thesis fails to play out.

Differentiating Between Long-Term and Opportunistic Investments

We remain committed to having our invested capital reflect a higher allocation to long-term core holdings in businesses that we view as having strong competitive positions in stable or growing industries at attractive valuations. In our last letter, we discussed a new step in our process that helps us in this regard. Since I became the Fund's sole portfolio manager, the positions sold have had an average quality score of 2.3, while the positions we initiated have had an average score of 1.9[5]. Furthermore, we expect our average company quality score to continue to improve as we sell down our energy positions as that market recovers.

---

[1] Note that references to any benchmark or index are for illustrative purposes only. The Fund does not include outperformance of any benchmark in its investment objectives.
[2] Both the Russell 2500 Index & S&P 500 Index P/Es are sourced from Bloomberg and do not exclude money-losing companies.
[3] http://www.morningstar.com/funds/xnas/fpptx/quote.html
[4] Margin of safety is a principle of investing in which an investor only purchases securities when their market price is significantly below their intrinsic value.
[5] The lower the score, the higher the stock's 'quality' as determined by the Fund's portfolio management team.
https://fpa.com/docs/default-source/funds/fpa-capital-fund/literature/quarterly-commentaries/fcap-q1-letter_vfinal.pdf?sfvrsn=10

We continue to hold opportunistic investments. We characterize our investments in energy equities as opportunistic, and we therefore need to be vigilant when it comes to trading these positions. In January and April 2018, energy equities performed well and provided a short window of opportunity to decrease our exposure. The table below summarizes what we did with our energy equities during the first half of the year.

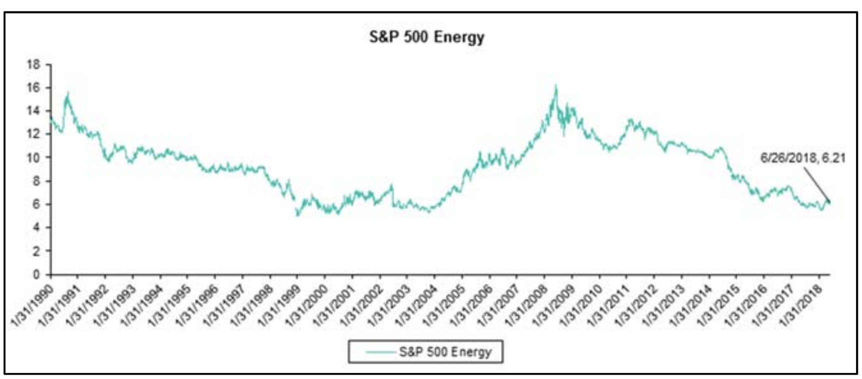
Investment	Change in share count
HP	-100%
Noble Energy	-54%
Patterson UTI Energy	-37%
Rowan Companies	-21%
SM Energy	-7%
Cimarex Energy	-4%

Contributors and Detractors[6]

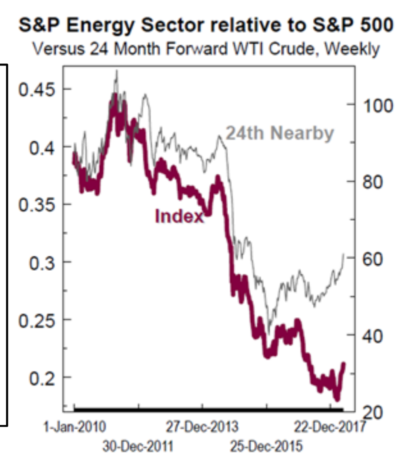
Winners	Performance Contribution	Losers	Performance Contribution
Q2 2018			
SM Energy Company	2.19%	Allegiant Travel	-1.01%
Rowan Companies	1.49%	Western Digital	-0.96%
Undisclosed	0.66%	Tenneco	-0.46%
Noble Energy	0.63%	Arris International	-0.42%
Interdigital	0.56%	Veeco Instruments	-0.38%
	5.52%		**-3.23%**

More on Our Energy-Related Investments

Despite an improving oil price environment, many investors are still shunning the energy sector, which represented just 6% of the S&P 500 Index at the end of the second quarter. Our energy equities as a whole (and the entire sector, for that matter) are still widely disconnected from what the underlying spot and 24-month futures prices would imply. For instance, our portfolio has just one Energy and Exploration (E&P) company whose share price reflects an oil price of $55 per barrel or more (NBL).



Source: Bloomberg



Source: Cornerstone Analytics

[6] Reflects the top contributors and top detractors to the Fund's performance based on contribution to return for the quarter. Contribution is presented gross of investment management fees, transactions costs, and Fund operating expenses, which if included, would reduce the returns presented.

We believe that there are two subjects of intense debate that have recently kept a lid on energy equity prices.

First, even though inventory levels have fallen back below long-run averages, there is widespread concern that OPEC[7] and Russia will turn on the taps again and send spot and forward oil prices much lower. Here, we would once again point out that higher oil prices have dramatically boosted the national incomes of both countries. Assuming they have the requisite spare capacity (and it isn't clear that they do), why would they flood the market and shoot themselves in the foot?

At the same time, the world needs more oil to avoid a disruptive price spike. Back in April of 2017, Organization for Economic Cooperation and Development (OECD) crude inventories were around 3.05 billion barrels, and since then, that figure has been draining at an average rate of around 600,000 barrels per day. That has put worldwide inventories below normal, which would imply a $70-$80 a barrel Brent price based on historical data. OPEC, Russia, and other partner countries originally committed to take 1.8 million barrels per day off the market in November 2016, but output has fallen further than that. According to May figures, oil production declines totaled 128% of the original pledge (162% from OPEC nations and 54% from other countries).[8]

This above-and-beyond performance was not a result of the cartel's generosity but rather from involuntary declines. While we see material reductions in other relevant producing countries, the elephant in the room is Venezuela, which has involuntarily cut nearly as many barrels as Saudi Arabia, and yet its oil production continues to decrease at a very concerning rate. At the same time, the Trump administration's decision to pull out of the Iran nuclear deal could conservatively take 200,000 barrels a day off the market (or potentially multiples of this depending on how the sanctions are implemented).[9] Meanwhile, global crude consumption continues to surge, with the typically conservative International Energy Agency expecting demand growth of another 1.4 million b/d in 2018.[10]

If you look at the math conservatively, we find that OPEC must increase production to offset these sources of supply disruption, moderate climbing oil prices, and avoid a damaging price spike. Interestingly, we believe the amended agreement from the June 23 OPEC meeting was designed to help the cartel control an increasingly precarious deficit so they don't dramatically overshoot what we believe (based on consistent OPEC commentary) is an inventory target that's still roughly 100-150 million barrels below where we stand today. So, to recap, if you're Saudi Arabia or Russia (the world's top two suppliers of crude) and you're aiming to achieve the goals discussed above, it becomes very risky to hold back production on the belief that U.S. shale alone can offset a growing deficit.

This then leads to the second major concern and topic of debate, which revolves around the recent amplification of logistical constraints in the Permian basin; namely, the ability to get gas and crude to market in the face of short term pipeline limitations and limited alternative takeaway capacity (trucking, railway, etc.).

This development was the primary reason for share price volatility for companies heavily exposed to the basin during the quarter. Before diving into the specific weakness in our Permian-weighted holdings, it is important to note that this is a temporary issue due to the timing of new pipelines coming online through 2019, and that regional price differentials from supply/demand imbalances naturally incentivize midstream construction to alleviate chokepoints.

Our two Permian weighted E&Ps, SM Energy (SM) and Cimarex Energy (XEC), were particularly volatile during the quarter (down in May, with a recovery in June). Assuming a long term gas price of $2 per thousand cubic feet (well below current Nymex pricing of $2.93), we estimate that the companies' share prices are baking in oil realizations of between $47 and $52 per barrel in perpetuity. At a high level, we believe that the current share prices are asserting that the pipeline issues will not be resolved (despite scheduled construction through 2019) or that some producing wells will need to be shut in. In our view, the former is highly unlikely given the scheduled construction and incentivized supply response, while SM and

[7] Cornerstone Analytics, June 4, 2018.
[8] https://www.bloomberg.com/graphics/opec-production-targets/
[9] Cornerstone Analytics, June 4, 2018.
[10] IEA Oil Market Report, June 13, 2018.

XEC have disclosed that they have sufficient agreements in place to avoid the latter.

SM is also a stock that screens as having above-average leverage (slightly above 3x net leverage when accounting for divestitures), despite an improving cash flow profile, $1.6 billion in liquidity, and no debt maturities until 2021. Cognizant of the company's balance sheet and the near-term pressure on price realizations, management has also layered on a relatively large derivatives position through 2019 that will help offset pricing discounts on SM's Permian oil deliveries.

XEC has historically been a price taker that favors flexibility in order to sustain corporate-level returns above its cost of capital, and as such, has minimal hedging on the books to offset wide price differentials over the next year. The stock has been under pressure for this reason and because management has opted to defer returning capital to shareholders in favor of investing in higher-return growth opportunities (which they stress test for 10%+ corporate level ROICs at $40 per barrel oil). This came at a time when E&P's were (rightfully) being chastised for destroying shareholder value with overinvestment (or poorly timed investments?) and asked to prioritize dividends and share repurchases over volume growth. Although we understand this rationale quite well, we do not believe in putting every E&P in the same bucket, especially one like XEC, which we believe is a top-tier capital allocator compared to its peers.

Tenneco

Tenneco is one of the cheapest auto parts supplier stocks in the market today, trading at about 4.0x next 12-month EBITDA. Peers trade at much higher multiples -- nearly 7x next 12-month EBITDA, reflecting investor fear that Tenneco's exposure to the internal combustion engine (ICE) will ultimately send its business into a long-term secular decline.

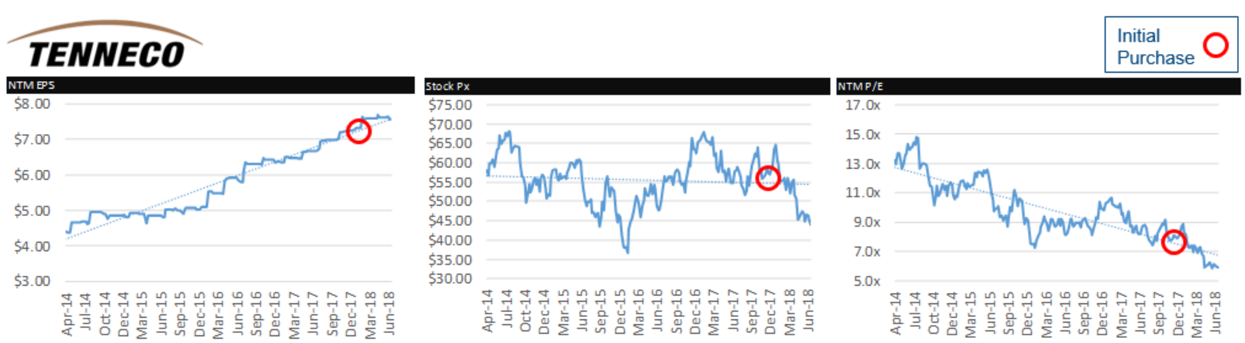
We believe investors are missing a few critical points:

- Many market participants worry about pure battery-based powertrains (where TEN has no content) taking market share. But even if those vehicles garner a 10% market share, Tenneco could still have content on 90% of vehicles sold.

- More stringent regulation (already in place) will continue to increase Tenneco's content per vehicle each year over the next decade.

- Tenneco's Ride Performance & Aftermarket businesses (nearly 40% of EBIT) are largely agnostic to powertrain choice.

Over the last three years, management expressed confidence in the business by buying back stock (nearly 20% of shares outstanding) and routinely reiterated the points we made above. But the market continued to focus on secular decline worries, ignored content/vehicle growth, and would not assign a higher multiple to the secularly growing and less cyclical Ride Performance & Aftermarket businesses. We were left with a situation where earnings were expanding, but the multiple was contracting.



Doing more of the same was not an option. In order for each business to be appropriately valued, Tenneco needed to be split up so the secularly growing and stickier Ride Performance & Aftermarket businesses would be valued separately from the Clean Air business. Furthermore, with a simpler story, the Clean Air business could focus on returning its very strong cash flows to shareholders, potentially attracting a more value-oriented investor base.

Unfortunately, each business was too small to independently support its own public company cost structure, so alternatives needed to be explored. The recently announced Federal Mogul transaction allowed the separate businesses to get enough scale to profitably operate independently. Tenneco paid 5.4x EBITDA (including synergies), which we view as a fair price. While the deal does add leverage above levels we like to see from an auto parts supplier, management is focused on reducing leverage rapidly and has established reasonable targets for each business. Furthermore, we take solace in the debt term structure, which avoids material maturities until 2022.

In our view, the Federal Mogul transaction provides an opportunity for a substantial multiple rerating of both businesses, as capital allocation decisions to maximize FCF and shareholder returns can be prioritized in one business, while reinvestment in growth can be prioritized in the other.

As with any deal, we would always like to see a cheaper purchase price and less advantage used, but we believe this deal is a stepping stone toward long-term value creation.

New Investment Highlight: Cision Ltd.

As part of our effort to improve portfolio quality without sacrificing our conservative standards on valuation, we initiated a position in Cision Ltd. (CISN) during the first quarter. At the time of underwriting, CISN was just six months removed from its IPO, poorly covered by the street, and was trading at a significant discount to other vertical software peers.

The company is the clear leader in an otherwise fragmented (point solution driven) market and provides the only comprehensive SaaS platform for public relations and marketing communication professionals at 91 of the top 100 worldwide brands and 96 of the top 100 PR companies in the U.S. Our research suggests that CISN can generate attractive long-term organic cash flow growth by converting customers away from a typical infrastructure of disparate point solutions, to its closed-loop SaaS platform, allowing it to grow well beyond its 20% share of the PR Software and Services market. Further, the company recently launched the first monitoring tools that truly quantify ROI on earned media campaigns (i.e. Nike can track spending online and at retail stores that stems from a marketing campaign coordinated with a widely followed Instagrammer). Our survey work covering current and potential customers clearly indicates that this could make CISN's software offering more of a necessity. It could also significantly increase the company's total addressable market by enabling it to enter the much larger Marketing Software market. It's important to understand that there's a clear consensus view that earned media generates significantly higher ROIs than the dominant paid media category (i.e. banner ads, etc.), yet earned media marketing budgets remain very small because reliable attribution tools were previously unavailable.

Finally, we believe that CISN has a great cash-flow profile. The company has predominantly recurring revenues, EBITDA margins gravitating to the high 30s, and the majority of that EBITDA is converted to free cash flow because of low capital investment requirements.

In Conclusion

We believe our investment process is working well and that the tweaks we have implemented position us to deliver strong performance going forward. The team has been working very well together since the transition and we are now uncovering new ideas more quickly and with greater efficiency. We are also high-grading the portfolio to better quality companies and being more nimble around position sizing.

As a reminder, all members of the team believe in what we do and are shareholders alongside you. And we commit to staying true to our mandate and true to our core values.

We thank you for your support and appreciate the trust you have placed in us.

Sincerely,

Arik Ahitov, Portfolio Manager

Important Disclosures

The views expressed herein and any forward-looking statements are as of the date of the publication and are those of the portfolio management team. Future events or results may vary significantly from those expressed and are subject to change at any time in response to changing circumstances and industry developments. This information and data has been prepared from sources believed reliable, but the accuracy and completeness of the information cannot be guaranteed and is not a complete summary or statement of all available data.

Portfolio composition will change due to ongoing management of the Fund. References to individual securities are for informational purposes only and should not be construed as recommendations by the Fund, the portfolio manager, or the Distributor. It should not be assumed that future investments will be profitable or will equal the performance of the security examples discussed. The portfolio holdings as of the most recent quarter-end may be obtained at www.fpa.com.

Investments in mutual funds carry risks and investors may lose principal value. Stock markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. The Fund may purchase foreign securities, including American Depository Receipts (ADRs) and other depository receipts, which are subject to interest rate, currency exchange rate, economic and political risks; this may be enhanced when investing in emerging markets. Small and mid-cap stocks involve greater risks and they can fluctuate in price more than larger company stocks.

Value stocks, including those selected by the Fund's portfolio manager, are subject to the risk that their intrinsic value may never be realized by the market and that their prices may go down. Securities selected by the portfolio manager using a value strategy may never reach their intrinsic value because the market fails to recognize what the portfolio manager considers to be the true business value or because the portfolio manager has misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other styles of investing during given periods.

Definitions

The Russell 2500 Index consists of the 2,500 smallest companies in the Russell 3000 total capitalization universe offers investors access to the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Russell 2500 Value Index measures the performance of those Russell 2500 companies with lower price-to-book-ratios and lower forecasted growth values.

The S&P 500 Index includes a representative sample of 500 companies in leading industries of the U.S. economy. The Index focuses on the large-cap segment of the market, with over 80% coverage of U.S. equities, but is also considered a proxy for the total market.

Indices are unmanaged, do not reflect any commissions or fees which would be incurred by an investor purchasing the underlying securities. Investors cannot invest directly in an index.

An **exploration & production (E&P)** company is in a specific sector within the oil and gas industry — companies involved in the high-risk/high-reward area of exploration and production focused on finding, augmenting, producing and merchandising different types of oil and gas.

EBITA (Earnings before interest, taxes and amortization) is a financial indicator used widely as a measure of efficiency and profitability.

Margin of safety - Buying with a "margin of safety" is when a security is purchased at a discount to the portfolio manager's estimate of its intrinsic value. Buying a security with a margin of safety is designed to protect against permanent capital loss in the case of an unexpected event or analytical mistake. A purchase made with a margin of safety does not guarantee the security will not decline in price.

Price/Earnings ratio (P/E) is the price of a stock divided by its earnings per share.

West Texas Intermediate (WTI) - crude oil is the underlying commodity of the New York Mercantile Exchange's oil futures contracts.

The FPA Funds are distributed by UMB Distribution Services, LLC, 235 W. Galena Street, Milwaukee, WI, 53212.

TICKER	SHARES / PRINCIPAL	SECURITY	COUPON RATE (%)	MATURITY DATE	MKT PRICE ($)	MKT VALUE ($)	% OF NET ASSET VALUE
		COMMON STOCKS					
AAN	256,873	AARON'S INC			43.45	11,161,132	3.2%
AGCO	130,254	AGCO CORP			60.72	7,909,023	2.3%
ALGT	125,225	ALLEGIANT TRAVEL CO			138.95	17,400,014	5.0%
ARRS	698,470	ARRIS INTERNATIONAL PLC			24.45	17,074,099	4.9%
AVT	408,535	AVNET INC			42.89	17,522,066	5.0%
CFFN	639,711	CAPITOL FEDERAL FINANCIAL			13.16	8,418,597	2.4%
XEC	205,098	CIMAREX ENERGY CO			101.74	20,866,671	6.0%
CISN	337,772	CISION LTD			14.95	5,049,691	1.5%
GNTX	224,867	GENTEX CORP			23.02	5,176,438	1.5%
GPK	656,397	GRAPHIC PACKAGING HOLDING CO			14.51	9,524,320	2.7%
HMHC	56,774	HOUGHTON MIFFLIN HARCOURT CO			7.65	434,321	0.1%
IDCC	236,520	INTERDIGITAL INC			80.90	19,134,468	5.5%
MATX	53,604	MATSON INC			38.38	2,057,322	0.6%
NBL	374,326	NOBLE ENERGY INC			35.28	13,206,221	3.8%
		OTHER				9,581,918	2.7%
PTEN	511,504	PATTERSON UTI ENERGY INC			18.00	9,207,072	2.6%
RDC	836,609	ROWAN COMPANIES PLC			16.22	13,569,798	3.9%
SM	802,903	SM ENERGY CO			25.69	20,626,578	5.9%
SAVE	296,644	SPIRIT AIRLINES INC			36.35	10,783,009	3.1%
TEN	190,944	TENNECO INC			43.96	8,393,898	2.4%
VECO	477,084	VEECO INSTRUMENTS INC			14.25	6,798,447	2.0%
WDC	232,354	WESTERN DIGITAL CORP			77.41	17,986,523	5.2%
		TOTAL EQUITIES				**251,881,627**	**72.3%**
		U.S GOVERNMENT AND AGENCIES					
	7,500,000	US TREASURY NOTE	0.750	07/31/2018	99.90	7,492,676	2.2%
	7,500,000	US TREASURY NOTE	0.750	08/31/2018	99.80	7,485,323	2.2%
	10,000,000	US TREASURY NOTE	0.750	09/30/2018	99.70	9,970,312	2.9%
	10,000,000	US TREASURY NOTE	1.250	10/31/2018	99.74	9,974,219	2.9%
	7,500,000	US TREASURY NOTE	1.250	11/30/2018	99.65	7,474,043	2.1%
	7,500,000	US TREASURY NOTE	1.500	12/31/2018	99.67	7,475,069	2.1%
	7,500,000	US TREASURY NOTE	1.500	01/31/2019	99.59	7,469,209	2.1%
	7,500,000	US TREASURY NOTE	1.500	02/28/2019	99.51	7,463,408	2.1%
	10,000,000	US TREASURY NOTE	1.620	03/31/2019	99.51	9,951,133	2.9%
	10,000,000	US TREASURY NOTE	1.250	04/30/2019	99.12	9,912,461	2.8%
		TOTAL US GOVT AND AGENCIES				**84,667,852**	**24.3%**
		REPURCHASE AGREEMENTS					
	9,622,000	STATE STREET BANK/FICC REPO	0.350	07/02/2018		9,622,000	2.7%
		TOTAL REPURCHASE AGREEMENTS				**9,622,000**	**2.7%**
		CASH & EQUIVALENTS (NET OF LIABILITIES)				2,640,406	0.7%
		TOTAL CASH & EQUIVALENTS				**96,930,258**	**27.7%**
		TOTAL NET ASSETS				**$ 348,811,885**	**100.0%**
		NO. OF EQUITY POSITIONS				**21**	

Portfolio Holding Submission Disclosure

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus details the Fund's objective and policies, sales charges, and other matters of interest to the prospective investor. Please read this Prospectus carefully before investing. The Prospectus may be obtained by visiting the website at www.fpa.com, by email at crm@fpa.com, toll-free by calling 1-800-982-4372 or by contacting the Fund in writing.

Investments in mutual funds carry risks and investors may lose principal value. Stock markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. The Fund may purchase foreign securities including American Depository Receipts (ADRs) and other depository receipts, which are subject to interest rate, currency exchange rate, economic and political risks; this may be enhanced when investing in emerging markets. Small and mid- cap stocks involve greater risks and they can fluctuate in price more than larger company stocks. Groups of stocks, such as value and growth, go in and out of favor which may cause certain funds to underperform other equity funds.

Portfolio composition will change due to ongoing management of the fund. References to individual securities are for informational purposes only and should not be construed as recommendations by the Funds, the Portfolio Managers or Distributor.

The FPA Funds are distributed by UMB Distribution Services, LLC, 235 W. Galena Street, Milwaukee, WI, 53212.