Q2 2021 FPA Crescent Fund (FPACX) Webcast
July 27, 2021

Note: Items in brackets [ ] are meant to be clarifying statements but are not part of the actual audio recording of the webcast.

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You should consider FPA Crescent Fund's (the "Fund" or "Crescent") 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 the Prospectus carefully before investing. The Prospectus for the Fund dated April 30, 2021 can be accessed at: https://fpa.com/request-funds-literature, by visiting the Fund's website at www.fpa.com, by calling toll-free, 1-800-982-4372, or by contacting the Fund in writing.

(00:00:00)

Moderator: [Please reference slide 1] Hello, and welcome to today's webcast. My name is Sarah and I will be your event specialist today. All lines have been placed on mute to prevent any background noise. Please note that today's webcast is being recorded.

During the presentation, we will have a question-and-answer session. You can ask text questions at any time during the broadcast. Locate the Q&A box on the lower left-hand corner of your screen, type your question in the open area, and click New Question to submit.

For optimal viewing and participation, please disable your pop-up blockers. And finally, should you need technical assistance, as a best practice we suggest you first refresh your browser.

It is now my pleasure to turn today's program over to Ryan Leggio. Ryan, the floor is yours.

Ryan: Thanks so much. Good afternoon and thank you for joining us today. We hope this finds everyone well. We would like to welcome you to FPA Crescent's Second Quarter 2021 Webcast. My name is Ryan Leggio and I'm a partner here at FPA.

The slides, audio and visual replay of today's webcast will be made available on our website FPA.com in the coming days.

Momentarily you will hear from Steven Romick, Brian Selmo and Mark Landecker, the portfolio managers of our Contrarian Value Strategy, which includes the FPA Crescent Fund. Steven has managed the FPA Crescent Fund since its inception in 1993, with Brian and Mark joining Steven as portfolio managers in June of 2013.

Steven, Mark and Brian will review performance of the FPA Crescent Fund and its current positioning, as well as some broader views of the current investing landscape.

[Please reference slide 2] While we have the longer-term performance here, at the outset, for disclosure purposes, the team will address it more fulsomely during the course of the presentation.

[Please reference slide 3] Before I turn it over to them, we wanted to share that Brian Selmo will sit on the Future of Value Investing panel at the Morningstar Investment Conference in Chicago in late September. Please visit our website for more information.

At this time, it's my pleasure to turn the call over to Steven Romick. Steven, over to you.

(00:02:18)

Steven: [Please reference slide 4] Thank you very much, Ryan. Thank you, everybody, for joining us today.

Crescent's favorable performance in late 2020 has continued thus far into 2021. However, while the Fund's portfolio construction is different than the market, many of the companies we own are more expensive than they were a few months ago.

As we wrote in the recently published Q2 commentary, we find ourselves feeling uncomfortably comfortable. We are more invested than we have been in recent years, which therefore means that cash is somewhat lower. This should not be interpreted that we have become complacent; rather, we like what we own and believe, in the aggregate, the portfolios are [well] positioned, with good companies at not-unreasonable valuations.

The businesses in which we have invested are of a higher average quality than at any point we can recall, offering us some comfort to be more invested than in the past.

If we were to jump ahead five years and then look back, in our view, a dollar held in cash or bonds today is less likely to deliver as good a return as our portfolio. Cash is an admittedly low bar, but we expect that a more invested portfolio will allow us to better deliver on our goal of equity-like rates of return. Our goal to avoid permanent impairments of capital remains unchanged.

As Zachary Karabell wrote in his recent book on Brown Brothers Harriman, *Inside Money*, the trick is to be exposed, but not too exposed, to risk some, but not too much, to entertain uncertainty without putting everything on the line, and to test the new without relinquishing the old.

While we do not currently welcome a large drawdown for the markets, it does not mean that it will not happen. In fact, we are virtually certain at some point it will—we just can't tell you when. The portfolio will not be immune to the next selloff, whenever it will arrive. We remain committed to seeking equity-like returns over the long term while avoiding the aforementioned permanent impairment to capital. And we do have some dry powder for these inevitable pullbacks.

(00:04:23)

[Please reference slide 5] Crescent maintains the ability to invest broadly, across asset classes, in different parts of the capital structure and around the world. as discriminating buyers who live by the motto that price matters, we only invest when [we believe] favorable risk-adjusted return exists.

So for example, at points in time when high yield isn't attractive, the Fund [typically] won't hold much, if anything, in the asset class. Or if the expectations for a particular industry don't offer a margin of safety, you [generally] won't find us invested there either. This can cause the Fund to look, at different points in time, very similar or very different to the market or other mutual funds.

[Please reference slide 6] Performance gained about 3.26% in 2021 second quarter, and 39% through the trailing 12 months. The Fund generated 97.4% of the average of the S&P and MSCI ACWI's return in the trailing 12 months, outperforming its own 77.8% average net risk exposure, driven by the 54% increase in the Fund's long equity book.[1]

[Please reference slide 7] On a trailing 12-month basis, Crescent's performance was in line with the global indices. However, looking at the Fund's long equity book, you'll have seen that—to the far left—well ahead of the illustrated indices.

[1] Pa**st performance is no guarantee, nor is it indicative, of future results.** Comparison to an index is for illustrative purposes only. The Fund does not include outperformance of any index or benchmark in its investment objectives. An investor cannot invest directly in an index.

[Please reference slide 8] As we have shared in the past, share price movement can sometimes be erratic, violent even, one quarter to another, only to reverse in subsequent periods. We therefore would like to direct attention to performance over the longer timeframes, believing that to be more informative.

(00:06:02)

This table therefore lays out the contributors and detractors to Crescent's performance over the preceding 12 months. Other than McDermott restructuring, there wasn't anything of significance that drove performance for the top and bottom five shown here. I should point out though that you won't often find contributors having [approximately] 15 times the impact of the detractors.

[Please reference slide 9] The Fund ended the quarter with about 77% net exposure, but that includes the newly disclosed 2.8% SPAC basket, something we do differently than the more typical common stock [portfolio]. Adjusted for this, the Fund's net exposure is slightly lower when compared to last quarter.

[Please reference slide 10] SPACs, or special purpose acquisition companies, for those less familiar, are what are known as blank check companies, when money is raised with the hopes of finding an acquisition target. SPAC shareholders get to decide, when they're presented with a proposed acquisition, if they would like to roll their SPAC interest into the newly de-SPACed entity or if they would like to receive trust value—generally, the price at which shares were initially offered to the public.

Investors passionately bid the average SPAC up, without an announced deal, more than 25% of its net asset value on average this past February, as you can see here in this peakiness in this chart. Interest has since waned, and prices have fallen since to levels where there is only negligible premium across the SPAC universe, with many SPACs trading at a discount.

We have been accumulating some of these busted SPACs, many of which have attached warrants. If a deal isn't announced that we don't like—I'm sorry, if a deal *is* announced that we don't like, we [expect to] redeem our shares at or above our purchase price. There may be a few deals in our SPAC basket, hopefully, that may be good. In that case, the SPAC price may rise and allow us to exit at a premium to our purchase price. We like this setup, where you make a little bit of money on the downside, yet retain an option for some good upside. [2]

(00:08:08)

[Please reference slide 11] Crescent's exposure to international stocks remains historically high, at 42% of net equities, really closer to 44% if we were to exclude the relatively riskless SPAC grade. Good-quality businesses at better valuations [we believe] than those in the U.S. explain the Fund's continued large exposure to foreign-domiciled companies.

[2] Special purpose acquisition company (SPAC) is a company with no commercial operations that is formed strictly to raise capital through an initial public offering (IPO) for the purpose of acquiring an existing company. Also known as "blank check companies." Investing in Special Purpose Acquisition Companies ("SPACS") involves risks. Because SPACs and similar entities have no operating history or ongoing business other than seeking acquisitions, the value of their securities is particularly dependent on the ability of the entity's management to identify and complete a profitable acquisition. SPACs are not required to provide the depth of disclosures or undergo the rigorous due diligence of a traditional initial public offering (IPO). Investors in SPACs may become exposed to speculative investments, foreign or domestic, in higher risk sectors/industries. SPAC investors generally pay certain fees and give the sponsor certain incentives (e.g., discounted ownership stakes) not found in traditional IPOs. Due to this, an investment in a SPAC may include potential conflicts and the potential for misalignment of incentives in the structure of the SPAC. For more information relating to the risks of investing in SPACs please refer to the Fund's Prospectus.

[Please reference slide 12] There’s not much in high yield, as this slide portrays. Crescent’s 1% net exposure to credit is at an all-time low. And spending just a minute on this slide, we’ll explain why.

The blue line reflects that high yield bonds trade at a below-average spread to a risk-free rate of return. More importantly, it’s yield-to-maturity—depicted in the green line—is the more pertinent absolute measure, and that says that high yield bonds now have their lowest historic yield, at just 4.6%—actually, last month it bottomed; I think it was at 4.54%. Given some presumptive level of defaults, we suspect that this sector now offers the first negative real yield in its history. In our view, a commitment today is more likely to detract than to add value.

Taking you back two slides prior and the SPAC basket that we have, we’d rather own something like that as a substitute that offers some level of yield and a higher expected rate of return than high yield does. There's a lot more downside, in our view, in high yield.

[Please reference slide 13] “Active stock selection has driven differentiated returns” is the title of this slide. Our long equity book has performed well over its longer-term timeframe relative to both the MSCI ACWI and the S&P 500. We believe one of the reasons our strategy has been able to generate reasonable returns, particularly with respect to our invested capital, is our willingness to hold our investments for longer than the average fund.

(00:10:02)

While many equity-oriented mutual funds have an average holding period of less than one year, Crescent walks the walk with lower turnover than two-thirds of the broad equity-oriented allocation mutual funds. Of course a longer than average holding period does not guarantee higher than average returns, but it reflects how we are willing to manage your capital, with ours alongside, in a differentiated manner in our quest for differentiated after-tax returns.[3]

So I'm going to turn it over to Mark to expand on this. Mark?

Mark: [Please reference slide 14] Thanks, Steven. This slide shows the performance of the ten largest positions which we have owned for at least three years which, in aggregate, accounted for approximately 40% of our equity exposure at quarter end.

What we think is most interesting about this slide is that while 7 of the 10 names have compounded at a CAGR of 20% or more from the time of our initial purchase, 4 of those 7 experienced periods where their share price was effectively flat for at least six quarters—and in the case of TE Connectivity, over three and a half years.[4]

So if we can offer one takeaway, it is that while we can't expect our holdings to deliver metronomic type performance from one quarter to another, if we pick the right securities, we should do just fine over time. Said another way, to quote Axl Rose, "Sometimes all you need is a little patience." Elliott, next slide.

[Please reference slide 15] As for how this patience with individual securities translates to the portfolio, the strategy has produced rolling 5-year returns that generally

[3] Source: Morningstar. 'Broad equity-oriented mutual funds are represented by the "Equity" Morningstar Global Broad Category Group and equity-oriented allocation mutual funds are represented by the "Allocation" Global Broad Category Group. As of 12/31/2020, the average turnover for the funds in these categories is 73.5%. The Fund's turnover rate as of the year-ended 12/31/2020 was 29%. Please see end of transcript for definitions of key terms.

[4] **Past performance is no guarantee, nor is it indicative, of future results.**

outperformed in down-markets—as you can see on the left—while, not unsurprisingly, lagging in up-markets, as you can see on the right.

Back to the present, many of our investors have voiced concerns about our increased risk exposure, particularly at a time when valuations seem somewhat stretched. Elliott, next slide.

(00:12:03)

[Please reference slide 16] While we acknowledge market multiples are above historical averages, it's our opinion that the real froth can be found in the most expensive decile of stocks, where the price-to-sales multiple is even greater than that of the dotcom bubble of the late Nineties. Suffice to say the portfolio does not own any of the names that would fall into this top decile, which trades north of 16 times sales.

If we drop down two deciles, the valuation is still a rather rich multiple of approximately 7 times sales. As for what it takes to justify such a multiple, assume you actually have some earnings, we'll argue it is fair to assume the market expects you to deliver annual net income growth of at least 10% for the foreseeable future. While no doubt some of the 150 companies in the top three deciles will be able to pull off just such a feat, it strikes us that valuations for the group at large are setting up shareholders for more than a few disappointments. Elliott, next slide.

[Please reference slide 17] Looking at the universe of the top 1000 companies by market cap for each year from 1979 through 2020, only 353 companies managed to achieve 10% growth in a single year. Elliot, door number one.

I'll open up to the listeners to guess how many managed to achieve 10% growth over a span of three and five years, with the closest guesses for each getting some free

FPA swag delivered in the mail, subject of course to our maximum gift allowance. And yes, for those that are wondering, if the pandemic had struck when I was in grade school, pre-internet, I would have certainly been watching a lot of *The Price is Right* reruns from my parent's basement back in Canada.

Now that we've given you a chance to get in some of your guesses, Elliott, let's reveal door number two. We can see that only 74 companies over the 20-year period could deliver 10% growth for three years in a row.

(00:14:05)

Elliott, door number three. You can see only 21 out of 1000 companies were able to achieve at least 10% growth consecutively over a 5-year period. So again, we aren't saying that there are not companies out there that will be able to generate fantastic earnings growth every year from here through mid-2026. But history would suggest it's more difficult than implied by the valuation on a wide swathe of equities currently trading at rather elevated multiples. Elliott, next slide.

[Please reference slide 18] As for the current valuation metrics for your portfolio, you can see not only are the Fund's long equities trading at a discount to both the S&P 500 and ACWI, but our companies have delivered greater earnings growth over the past three years than both, and are also forecast to do so prospectively over the coming three-year period based on consensus estimates.

We managed to achieve this arbitrage by investing with a blank slate, as Steven mentioned earlier, and not allocating capital in line with any benchmarks or indices in mind.

As mentioned in the letter, I'll now take you through a few examples that were bought back in the early 2020 but we have yet to publicly profile.[5] Elliott?

[Please reference slide 19] First, LG Corp, which is one of the larger Korean chaebols or conglomerates. The company has a varied collection of businesses, though the key exposures are LG Chemical, LG H&H and LG Electronics.

LG Chem is Korea's largest petrochemical company, manufacturing both basic and specialty chemicals. The company is also the world's largest manufacturer of rechargeable batteries for electronic vehicles, and it's the only supplier with a global footprint across Asia, Europe and North America.

(00:16:03)

LG H&H is a consumer products company that is analogous to a combination of P&G and Estee Lauder with a local Coke bottler thrown in for good measure. Seventy-five percent of the company's cosmetic sales come from high-margin luxury sector, and the company is favorably exposed to the growing Chinese market. Under the oversight of CEO Mr. Cha for the past 17 years, who was formerly actually the local president of P&G Korea, LG H&H has grown sales and EBIT for a very impressive 60 consecutive quarters.

As for LG Electronics, it is the number one home appliance brand globally, has a product portfolio that heavily emphasizes leading technology and premiumization, with exposure to both developed and emerging markets.

[5] Portfolio composition will change due to ongoing management of the Fund. The companies discussed herein may not be in the Fund at the time of this presentation. Discussions relating to individual securities or sectors is for informational purposes only and does not constitute an offer or solicitation for purchase or sale of such securities and should not be construed as a recommendation to invest such securities or sectors.

On the smaller side, we have Uplus, which is the number three wireless carrier in Korea, and LG CNS, that is akin to a mini Accenture with a domestic focus. The company also has a variety of other assets and income streams, but of lesser significance to those I've already reviewed. Next slide, Elliott.

[Please reference slide 20] Looking at valuation, starting from largest to smallest, you can see that LG trades at a discount to NAV of approximately two-thirds, with its stake in just LG Chem, on the left, eclipsing that of the parent company. We also think the shares are very cheap in relation to lookthrough earnings, trading at an enterprise value of less than five times. Lastly, we have a young CEO for the total group, who is US-educated at Stanford GSB and has wasted little time in optimizing the portfolio since his appointment in 2018. Next slide, Elliott.

[Please reference slide 21] Sticking with Korea, we also own another chaebol, Samsung C&T, which serves as the holding company for the Lee family that controls Samsung Electronics. Samsung C&T has a 4.4% stake in Samsung Electronics and also owns a 43% stake in Samsung Biologics.

(00:18:10)

As most of you are probably aware, Samsung Electronics is one of the world's leading technology companies, with exposure to smartphones, semiconductors and other electric components.

Biologics is the world's largest contract drug manufacturing organization, and benefits from sector growth and big pharma's continued trend towards dual [sourcing] and outsourcing. Next slide, Elliott.

[Please reference slide 22] Interestingly, C&T also trades at a discount of roughly two-thirds of our estimate of net asset value, just as LG does. But we should point out in this case, Biologics trades at a very punchy multiple given its attractive growth prospects. Nonetheless, though we would not personally underwrite the valuation currently being placed on Biologics by the market, the shares are not expensive, at an enterprise value to lookthrough earnings multiple of around 6 or 7 times, which we consider to be inexpensive given the quality of the underlying businesses. Elliott, next slide.

[Please reference slide 23] SoftBank is an investment holding company run by the infamous Masa Son, who went from being one of the richest people in the world to seeing his share price drop by over 90% when the dotcom bubble burst. As you are likely aware, Masa has reinvented himself and the company, and SoftBank now owns a large collection of what are primarily forward-looking technology assets.

SoftBank initiated a $41 billion asset sale and $22.5 billion share repurchase commencing in March 2020, in the midst of the pandemic. We believe this repurchase of approximately 17% of the company was the largest share count reduction completed, on a global basis, among big-cap companies since the pandemic began. At current prices, as you can see from this slide, one is effectively purchasing the company’s publicly traded and privately held assets at 50% discounts to either their latest market price or most recent funding round.

(00:20:14)

Moreover, SoftBank’s balance sheet has the capacity to make either incremental investments or to fund continued share repurchases at meaningful discounts to net asset value.

Of course SoftBank is not without controversy. While Warren Buffett runs Berkshire Hathaway believing the first rule is not to lose money, and his second rule is not to forget the first, Masa Son’s first rule seems to be to ignore all of Buffett’s. Instead, the enigmatic Masa Son effectively pursues a strategy of seeking out asymmetric but very wide payoff, albeit with admittedly limited visibility and the occasional high-profile flameout.

Nonetheless, SoftBank has created significant value for shareholders via this strategy of prioritizing slugging percentage over batting average, and we believe there continues to be latent unrecognized value residing in the portfolio.

Steven, back to you.

Steven: [Please reference slide 24] Thank you, Mark. Appreciate that. We’re going to turn to Q&A now. Well, first we’re going to address the presubmitted questions, and then we’re going to go to those questions that are currently coming over the transom, of which there's only a few, so it might be relatively short today.

I do want to ask your patience to give Mark, Brian and myself a little bit of leeway because we’re taking this call from three different locations. So we hope we can execute smoothly.

To take the first couple of questions that I’m actually going to merge together, do you believe inflation is transitory? It’s been a while since we've been through a financial depression. If we’re headed towards an extended period of financial depression now, can it change anything for the Fund’s approach? How is business pricing power when you purchase (inaudible @ 00:22:06) last couple of decades and vice versa?

(00:22:03)

So naturally, if we knew for sure what the future level of inflation might be, what interest rates might do, what economic growth might be, etc., we would certainly move the portfolio round to protect, as well as take advantage. However, we do not think we are uniquely qualified to predict the future. We've never given any indication that we have that capability. We do try and create a portfolio that's robust to multiple outcomes, and do our best to be ready in advance of what the market may offer in the future, rather than scrambling after the fact.

And to that end, we are constantly evolving in terms of the way we—the kinds of businesses that we look at and how we go about our processes, and seeking this continuous improvement.

Another question is: can the U.S., or global economy for that matter, run effectively without government stimulus? Let me talk a little bit to the prior in terms of not knowing; it's a fair question, but we just don't have the answer. It's an experiment whose results have yet to be published.

Over the past several years, Crescent has increased its allocation of holdings domiciled outside of the United States. Does the valuation gap between the U.S. and foreign markets suggest a further increase in foreign securities? And there was another question that had come over the transom as well which asked: given the fact that our U.S. stocks are low as a percentage of our geographic allocation, is that simply a matter of finding more value abroad and entering U.S. stocks that have risen to a greater degree overall?

(00:23:52)

What we do is we go to wherever [we believe] the best combination of quality and value is. In recent couple of years, that's brough us to more foreign-domiciled companies and Mark just went through a couple of those. We don't—as I said before, it might happen in the future, but you can expect us to shift capital to wherever there might be the most attractive risk/rewards in the public markets. That might be foreign stocks, as it has been in the recent couple of years, or it might be a shift back to the U.S. should there be a difference in performance in international versus—that might one day mean high yield, but that seems like a little bit too much to ask for in the foreseeable future given where high yield valuations are [today].

Merging a couple of other questions: what percentage of the Fund is in private equity or debt? Private lending updates if possible, and commentary. What would you be liquidating - any private equities this year?

It's really important, you know, this is not a meaningful part of [the Fund's] portfolio, has never been a meaningful part of [the Fund's] portfolio. We currently have less than 2% invested in private investments, whether they be debt or equity. We are mindful of liquidity, given our fund structure. So, no matter how much we like a partnered opportunity, it will have to be small.

There have been a number, in recent months, of monetizations in both the debt and equity space, and we expect a little bit more to be continuing to happen as the year progresses.

I'm going to—we had a host of questions come in on China. I'm going to recite them, and give me a second because I'm trying to assemble them, those that have come over the transom, but, so the presubmitted—

Mark: Steven, I can, why don't we go, you know, why don't we—

Steven: Let's turn it over to you, Mark, to address it.

Mark: Why don't you offer that first presubmitted questions, and then I'll knock off the ones in the live box afterwards?

Steven: Sure. Discussion of Chinese investments and the risks of dictatorship, regulatory issues versus the opportunity of cheaper valuations. Any fear around Chinese holdings is a second one, and turning it over to you, Mark.

Mark: Sure, thanks, Steven. So before jumping into the topic, I think it will be useful to level-set how our Chinese exposure fits into the portfolio on a broader basis.

(00:26:16)

Firstly, as much as we focus on completing bottom-up research on a name-by-name basis, we are also cognizant of our aggregate exposures by sector. In that regard, at quarter end, our largest weights were digital advertising at a little under 10%, financials around 8%, 7% in semiconductors, cable and diversified family-controlled holding companies both around 6%, then Chinese internet at slightly more than 5%, followed by cement at about 4%.[6]

So, stepping back, we describe our Chinese exposure as meaningful but by no means a bet-the-farm type weighting.

That said, we remain comfortable with our investments into the Chinese tech platforms.

[6] The percentages referenced in this section reflect the Fund's exposure as a percentage of total net assets of the Fund. The sectors noted do not reflect GICS sectors, but are internal FPA sectors. For Q2 2021 holdings information by GICS sector, please reference slide 16 of the webcast.

Owning securities that are in the news for uncomfortable reasons is not something new to us. So, looking back over the past decade, we've not shied away from situations of uncertainty, whether that be establishing a position in Facebook in the midst of the Cambridge Analytica fiasco, wading into Russia at the time of the annexation of Crimea, buying Puerto Rican debt as the state was in the midst of restructuring, or just last year, picking up hospitality exposure when it felt as though many of us would never again leave our homes.

Now in all of the above examples, we do not invest based on a precision estimate of intrinsic value but rather, we employed our previously discussed low/base/high scenario analysis.

Pulling on that string for a moment, just last week, the Invest Like the Best podcast featured Steven Mandel, the founder of the well-regarded investment firm Lone Pine.[7] During the interview, Mr. Mandel noted, "We are always dealing with shades of gray, probabilities. If somebody has to know *the* answer to a math problem or whatever, if they have to know *the* answer, there is never *the* answer in our world. Those people can be incredibly smart and might be winning Nobel Prizes or whatever. But they can't work in our world because our world is all about probabilities and weighing outcomes. If that makes you uncomfortable, it's just not going to work."

(00:28:30)

So, regarding what's happening in China, I want to state upfront that we don't know the answer, but we also think that's okay because we genuinely don't believe

[7] July 20, 2021. *Steve Mandel – Investing Beyond Change*. https://podcasts.apple.com/us/podcast/steve-mandel-investing-behind-change/id1154105909?i=1000529443256

anybody else knows *the* answer either. And while one never wants to be contrarian for contrarian's sake, in a John Templeton type manner, one can do quite well over time by having exposure to opportunities where pessimism is more prevalent than optimism.

Now, as it relates to our Chinese tech companies, we try and take a balanced view just as we do for any other industry or region. So, we didn't panic sell Alphabet or Facebook earlier this month when the White House released an executive order stating that big tech platforms are getting too much personal information and that big tech is unfairly competing with small businesses. We similarly have not panic sold Alibaba, Baidu or Prosus because the Chinese government is pursuing similar measures. It's also important to remember that, unlike [the Fund's] U.S. tech holdings, each of our Chinese companies was actually founded before antitrust rules in China were even created. Even once rules were introduced, they were rarely enforced during their early existence. And as such, newly private companies tended to act much like my children—deciding it would be easier to ask for forgiveness than permission.

Now, going into specific questions, I think we'll touch first on, I think a general question and then we'll get more specific. And so, there's a view, how do we view—a question: how do we view the governance changes and the like?

(00:30:09)

And so, from our vantage point, it is clear [to us] that domestic antitrust policies are going to change going forward, and we think that's actually clear not just in China but also in the U.S. and Europe.

With respect to China specifically, the government is interested in creating and enforcing a regulatory regime for digital companies focused on data, security, consumer welfare, and generally acting in the best interests of the public. Some of the rules now being enforced, such as eliminating the ability for platforms such as Baba to require exclusivity from marketplace merchants, already exist and are enforced in North America. Other rules, such as say eliminating the opportunity for Didi to exercise price discrimination amongst new and existing users, is perhaps unique to China but not necessarily out of line with consumer-focused regulations in the developed world.

In other instances, the Chinese authorities are in the midst of creating new regulations regarding data and security that are unique to the country. From our conversations with local experts and our reading of the tealeaves, we understand that the largest internet platforms have actually participated in the discussion process to create these new rules, leaving them well-positioned to achieve compliance on a go-forward basis.

Nonetheless, it's impossible to opine and have *the* answer with any specificity how the various antitrust rules being introduced by the varied regulatory bodies may impact the economy at large, or our companies on a micro basis. But nonetheless, since I do see a handful of questions on each of our companies, why don't I go through one by one.

Starting with Baidu, the company has already been through the wringer of government regulation some years back, after a search user died from a substandard cancer treatment marketed on the company's advertising platform. Under the heavy hand of the government, Baidu effectively cleaned up their search listings by purging those that had the potential to catch the ire of the authorities, and the relationship between Baidu and the government has since been on the mend, at least from what we can tell.

(00:32:17)

We also think of all our holdings, Baidu is perhaps best positioned to help accomplish China's current five-year plan, particularly as it relates to digital innovation and ecological improvement. As an example, Baidu spends two times on R&D as a percentage of sales versus that of Baba and Tencent. Baidu is the leading filer of AI patents in the country, and Baidu has a leading position in the nascent development of technology to enable smart cities that, in theory, will improve transportation efficiency and reduce pollution.

As for valuation, we believe the core search business at Baidu generates approximately a 40% operating margin fully burdened for stock comp. That said, we think the overall EBIT margin over the next 12-24 months will probably be circa 20% on a reporting basis due to significant investments in the embryonic areas of artificial intelligence and autonomous driving.[8]

Nonetheless, on an enterprise value basis, after accounting for cash and securities, plus our estimate of the value of the cloud business, we believe Baidu is valued at a single-digit multiple of after-tax earnings using the aforementioned 20% margin.

We have an owner-operator in the form of Robin Lee at the helm and while we don't know exactly what the AI and autonomous driving businesses will look like in the

[8] While we believe we have a reasonable basis for our comments and we have confidence in our opinions, actual events or results may differ from materially those we anticipate, or the actual performance of any investments described herein may differ from those reflected or contemplated in such forward-looking statements, due to various risks and uncertainties. Statistical data or references thereto were taken from sources which we deem to be reliable, but their accuracy cannot be guaranteed. EBIT is earnings before interest and taxes. EBIT margin is a financial ratio that measures the profitability of a company calculated without taking into account the effect of interest and taxes.

future, the company is among the domestic leaders in each segment, suggesting these free options may yet have value. We think Robin Lee largely shares our view, as illustrated by the company spending over a billion dollars to repurchase stock during 2020.

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Moving on to Alibaba, after the country's largest ever fine—equal to 4% of revenue—was administered, we feel as though Baba is on the path to emerging from regulatory scrutiny, though further fines are still possible.

As for the core ecommerce business, we continue to be excited by our exposure to a company that is roughly 50-60% share of the domestic online retail market, and accounts for a mid-teens percentage of total retail sales.[9] The business is still very under-monetized versus global peers, with a take rate of only 4% as compared to double digits at comps such as Amazon and Etsy.

Going forward, we think the company can grow ecommerce earnings at circa 15% a year over the next five years, leaving the shares attractively valued [in our view] as compared to the prospective growth we envision.

Lastly, Tencent. It's widely regarded that the company has always acted with more humility and had a more conciliatory relationship with the government than Baba. Having undergone its own brush with regulatory authorities during the gaming crackdown a few years back, the company emerged relatively unscathed despite some temporary upheaval.

[9] Source: Yuanta Research: China E-commerce Industry – An Unreversed Uptrend, April 28, 2021. Statistics as of December 30, 2020.

As for the business itself, we actually view the company as somewhat akin to a modern-day digital Berkshire Hathaway. Firstly, like Berkshire, Tencent has 100% ownership of some fantastic businesses including the WeChat platform, WePay, and the largest domestic publishing business for online games. To top it off, Tencent owns stakes in other wonderful assets that we believe are worth more than a quarter of the company's market cap. On the private side, this includes Epic Games, the producer of Fortnite, Flipkart the Indian online retailer, and in the public realm the companies owns positions in many leading digital-focused companies including PDD, JD and Meituan in China; while outside, the group has seen significant gains from their ownership of Spotify in Europe, Sea Limited in Singapore, Afterpay in Australia, Activision and Snap here in the U.S., to name but a few.

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In fact, given Tencent's historical success at allocating capital, it could be argued the firm is one of the world's most successful venture capital investors and at minimum, probably the most successful domestically within China.

With respect to valuation, we think core Tencent, net of the stakes, is valued at an enterprise value of circa 20 times forward earnings. And of course, we have exposure at discounts of circa 35-45% through Naspers and Prosus respectively.

And looking at the questions, there was a question about the Fund's Chinese exposure, which I think we addressed a little earlier when I opened up that section.

Steven: You've answered that one.

Mark: So, there's a question about the VIE structure, which are variable interest entities, so I'll try and address that.

So, this was a structure established by publicly traded companies by which to list their assets and circumvent domestic laws limiting forward investment. Now, the government was obviously aware of the actions being taken by local champions by which to raise foreign capital, so the structure immediately operates in a somewhat gray area of never having received official approval, but also having been utilized literally hundreds of times without the government's formal objection.

Going forward, we can't tell you if things will change and companies will continue to be able to utilize the VIE structure for future listings, but our working thesis is that the government is not going to unwind the structure as it relates to our existing holdings. Quite simply, it would cause economic chaos if the government chose this path, effectively limiting the future flow of foreign capital that to date has funded billions of dollars of investment and created an untold number of domestic jobs. And despite operating in a legal gray area, we think it unlikely that the Chinese government would effectively foreclose on the public listing of those local champions that already have dual listings in Hong Kong, which happen to include Tencent, Baidu and Alibaba.

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Along those lines, we've already initiated the process of converting each of our Baidu and Baba holdings to HK-listed shares, and that should be completed probably by the end of this week.

There's another question related to the crackdown on the education stocks, which some of you may have read about.

Now, as for what's going on in the education sector, I'm going to reserve our right to limit our comments. We've never spent much time on this space but from afar, we can observe there is no mention of increased afterschool tutoring in the current five-year plan.[10] Additionally, common sense would suggest that afterschool education for those who can afford it works against the government's goal of common prosperity. Anyhow, given this is an unfolding situation, we will obviously monitor if there are any lessons to be learned that might impact our existing holdings in the future. We can only imagine the same can be said for the world's largest MNCs [multinational corporations], who also have sizeable businesses in China, including prominent tech members of the S&P 500, ranging from Apple to Tesla.

I think we've knocked off the China questions that came in so I'm going to take a break and toss it back to Steven.

Steven: Great, thank you, Mark. Going through past fund history, why has Crescent experienced more downside during corrections since 2018 in comparison to the large-cap index? I'm going to hand that off to our partner Ryan Leggio.

Ryan: Thanks, Steven. I believe the question is probably referring to the two major equity market drawdowns since the beginning of 2018, the one in late 2018 and of course the one in February and March of 2020.

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[10] Source: Xinhua, July 24, 2021. *China Focus: China issues guidelines to ease burden of young students* http://www.xinhuanet.com/english/2021-07/24/c_1310083396.htm

So, stepping back, Crescent's net exposure is not static over time like a more typical balanced fund, and usually moves inversely to the market. As the risk/reward of the underlying portfolio and opportunity set changes, so too does the cash, since it's always been a residual of the team's investment process. The team has never targeted specific performance during drawdowns, as the downside protection has always been a residual of the investment process as well.

Now that said, Crescent has experienced more downside since 2018 because of partly two main reasons. One, the Fund has been more invested on average, partly driven by taking advantage of opportunities early in both of the aforementioned market corrections, and the team putting significant capital to work during those market corrections. And two, value stocks, which make up part of the portfolio, have been a drag relative to growth stocks during those periods.

[Please reference slide 26] Now, specifically in late 2018, the investment team leaned into weakness as the market corrected almost 20%, and Crescent performed about in line with its net exposure over that period, and it was down less than 15%.

In early 2020, as the pandemic unfolded and markets corrected again, again the investment team leaned into weakness. The Fund's drawdown, while again better than the S&P 500 and MSCI ACWI, was still higher than we might have expected prior to the pandemic. This is because equity valuation spreads, which Steven has mentioned in past letters and webcasts over the past year, widened to levels not seen since the Great Financial Crisis in 2008 and 2009, which temporarily and disproportionately impacted some of our financial and industrial, including travel-related industrial, companies' share prices. We wrote about this at length in the Q1 2020 letter which can be found on our website.[11]

And as Steven has mentioned, while this brief period was unsettling, it set us up for the strong relative and absolute returns the Fund has experienced since, as markets have rebounded and equity valuation spreads have since contracted.

To sum it up, as the portfolio managers wrote in our most recent letter, which can also be found on our website, quote, "We are virtually certain at some point another drawdown will occur. We just can't tell you when. Though the portfolio will not be immune to the next selloff, whenever it may arrive, the investment team is committed to seeking equity-like rates of return over the long term while avoiding permanent impairment of capital." Steven, back to you.

Steven: Thank you, Ryan. The absolute value manager at another major fund says the market is so overvalued that only commodities and metals are reasonably priced. Do we agree? I'm going to hand this off to Brian Selmo who we haven't heard from today.

Brian: Hi, thank you, Steven. I think I would observe two things. We don't generally make broad comments about the market or the markets. As Mark went over earlier, our portfolio is a selection of individual names, both in the U.S. and internationally, and I think Mark made a very compelling case that there are a number of holding companies in Asia that one would describe as absolutely cheap, whether as a percentage of NAV or as a lookthrough basis of earnings. And that would be sort of multiple cheap.

[11] https://fpa.com/docs/default-source/funds/fpa-crescent-fund/literature/quarterly-commentaries/fpa-crescent-fund-commentary-2020-03.pdf?sfvrsn=fc72929d_14

I think the other thing that I would observe is that the forward look for commodities is always uncertain, as it is for many other economic variables, and the degree to which those businesses or those commodities prove to be cheap will depend on supplier reactions to current high prices for commodities.

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Now, that is not to say that we don't find any value in commodity-oriented businesses. I think Mark alluded to our cement holdings which, while maybe not—and I'm not familiar with that manager specifically said, but those would certainly be a commodity-type asset or a heavy material that we think has businesses that trade at attractive underlying valuations, low absolute multiples, in an industry that is fairly well-structured and for which we have reasonably optimistic outlook over time.

In addition, while not owning commodities for—in terms of hard commodities or mined commodities—for a number of years, we have had a position in Glencore over the last couple of years which, in our opinion, has an attractive position in underlying mining operations, is run by an owner-operator type businessman, recently transitioned, and also, and importantly, has an important competitive advantage in a trading or logistics business that has produced incredibly attractive returns on tangible capital generally north of 30% over the long term, which we think sets them up well to take advantage of commodity cycles over time.

Thanks, Steve, I'll turn it back to you.

Steven: And Brian, maybe you want to take this, or Mark, but there's a question on…

Brian: On Comcast?

Steven: Yes, exactly.

Brian: Sure. So, there's a question: the top ten holdings, Comcast and Charter seem to be competing in a very competitive industry. What separates them from others?

And so, I'd like to first separate their businesses slightly and I'll address where they overlap and then Comcast separately because it has some that doesn't overlap with Charter.

So, where Comcast and Charter overlap is in the cable TV distribution business and then also in broadband. And so that's really the core earnings generator for both companies. Our attraction to both businesses and the industry is around their broadband position.

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I think the reason for that is, one, we do think they have some advantages there in terms of footprint where they're competing against some legacy technology in the form of DSL, or competing against maybe some inefficient competitors on the fiber side in terms of how the businesses are operated. And then lastly, their existing footprint in the coaxial cable gives them a very cost-effective means to increase capacity for digital throughput and that is, in our view, a strong position to be in for what amounts to a necessary sort of infrastructure service that we think will have favorable pricing dynamics over time. And so, we do think they have some advantages in the provision of broadband in the US given their footprint.

On the television side, we would agree. It is very competitive. We'd also agree, or notice that from our perspective, there's not a lot of profitability in that side of the house, so we don't think it is a major driver of the firm's free cash flow or economic value.

If we then move over to Comcast, the cable business coupled with broadband which we just described accounts for something like two-thirds of the firm’s cash earnings power or owner’s earnings. The last roughly 30% is from a collection of media properties ranging from television studios, television stations, to Universal theme parks and Sky in Europe. I think—and recently launched Peacock, which hopefully all of you are signing up for on the back of the Olympics this summer.

And I think that hodgepodge of assets ranging from the attractive, in our minds, on the theme park side, to the somewhat challenged and perhaps structurally challenged on the television station and legacy cable channel side. And we are cautiously optimistic that the company understands that situation and is actively transitioning to the streaming future, and that possibly, over time, will be able to have a viable streaming offering in the form of Peacock, which may replace a significant part of the economics that may erode in the legacy TV business.

(00:48:20)

Steven: Thanks, Brian. There's one last question we have and that is asking, to Mark directly, what catalyst do you see closing the value gap on the South Korean conglomerates? It seems like these international companies can stay cheap for years and years. So, Mark?

Mark: Sure. So, we didn’t make our purchases with any specific catalyst in mind. If you think about the analysis that we did, what we’re looking for is high-quality businesses run by good stewards of capital, with rock-solid balance sheets, participating in industries where we think there's an opportunity for earnings to grow over time. For both of LG and Samsung, they ticked all the boxes.

Now, at the time of our purchase over a year ago, the discounts to NAV were actually at historically high levels and trading even wider than historical averages, and the multiples on lookthrough earnings at lower share prices would have actually been even lower than what we quoted you today with the share prices obviously being higher.

And so, when you're buying securities at, call it 66 or higher discounts to NAV, and lookthrough earnings multiples that are mid or low single digits, we don't think you necessarily need a catalyst for the shares to work over time. You just need nothing bad to happen. So hopefully, touch wood, things will continue to play out. And we've actually been very impressed, in particular, with the moves made by LG since we've taken our position, where they've exited the mobile business that had been money-losing for decades within LG Electronics, and there's been another—excuse me—a number of other initiatives such as selling the Beijing headquarters for over $1 billion just before the pandemic struck. And so, the timing has been good and we're quite impressed with the actions that management has taken as of late.[12]

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I don't think there's any other questions. I'll turn it back to Ryan, I believe, to wrap up.

Ryan: Thanks, Steve, Mark and Brian. Much appreciated. To those listeners still on the call, if we missed your question or if you have any follow-up questions, please don't hesitate to reach out to your FPA relationship representative or email us at crm@fpa.com and we'll circle back with you within the next 24 hours.

[12] **Past performance is no guarantee, nor is it indicative, of future results.**

Thanks again for listening to FPA Crescent's Second Quarter 2021 Webcast, and I'd now like to turn it back over to the system moderator for closing comments and disclosures. Over to you.

Moderator: [Please reference Important Disclosure Section, slides 27-31]] Thank you for your participation in today's webcast. We invite you, your colleagues and shareholders to listen to the playback of this recording and view the presentation slides that will be available on our website within a few days at FPA.com. We urge you to visit the website for additional information about the Fund, such as complete portfolio holdings, historical returns, and after-tax returns.

Following today's webcast, you will have the opportunity to provide your feedback and submit any comments or suggestions. We encourage you to complete this portion of the webcast. We know your time is valuable, and we do appreciate and review all of your comments.

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Please visit FPA.com for future webcast information, including replays. We post the date and time of upcoming webcasts towards the end of each current quarter, and webcasts are typically held three to four weeks following each quarter end.

If you did not receive an invitation via email for today's webcast and would like to receive them, please email us at crm@fpa.com.

We hope that our quarterly commentaries, webcasts, and special commentaries will continue to keep you appropriately informed on the strategies discussed today. We do want to make sure you understand that the views expressed on this call are as of today, and are subject to change without notice based on market and other conditions.

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The prospectus may be obtained by visiting the website at FPA.com, by email at crm@fpa.com, tollfree by calling 1-800-982-4372, or by contacting the Fund in writing.

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This concludes today's call. Thank you and enjoy the rest of your day.

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[END FILE]

Definitions and Disclosures

A **drawdown** refers to how much an investment or trading account is down from the peak before it recovers back to the peak. Drawdowns are a measure of downside volatility.

Morningstar Broad Category Group is a term used to group funds with similar categories and investing styles; can be used for a more broad-based analysis. The broad category group is determined by the investment's Morningstar Category assignment.

Morningstar Broad Category Group "Allocation" Funds in balanced categories offer investors a mix of stocks and bonds to provide capital appreciation, income, diversification, or specific allocations based on planned retirement dates. This group also includes funds that invest in convertibles, which act a bit like stocks and a bit like bonds. As of June 30, 2020, there were 1,355 Allocation Funds.

Morningstar Broad Category Group "Equity" Funds are funds invested primarily in equities. As of June 30, 2020, there were 3,624 Equity Funds.