

Performance

For the first quarter Paramount was up 11.76%, 1.09% behind the benchmark Russell 2500.

Fund/Index	MTD	YTD	1 Year	3 Years**	5 Years**	10 Years**
FPA Paramount	3.32%	11.76%	16.14%	13.07%	8.86%	12.10%
Russell 2500	4.43%	12.85%	17.73%	14.59%	9.02%	12.30%
MSCI World	2.34%	7.73%	11.85%	8.46%	2.23%	8.88%

** Annualized.

A redemption fee of 2.00% will be imposed on redemptions within 90 days.

Expense ratio calculated as of most recent prospectus is 0.94%.

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. Current month-end performance data may be obtained by calling toll-free, 1-800-982-4372.

Let us now address from where this performance was attributed and discuss some of the best and worst performing stocks in the Paramount Fund during the first quarter. Manpower Group (+34%) rose after unveiling a restructuring program that is expected to boost margins. Life Technologies (+32%) advanced on speculation that the company would be acquired. Life’s Board of Directors has undertaken a strategic review of the business, and hired bankers to solicit potential bids. At this time the outlook of the process is unknown. FMC Technologies (+27%) won several oil/gas subsea equipment awards in the quarter.

Underperformers were led by ScanSource (-11%) which reported weak results during the quarter. One of the company’s largest suppliers, Avaya, has struggled, and the rest of ScanSource’s business has been unable to fully offset that weakness. L’Occitane International (-4%) lagged after gaining 57% in 2012. Finally, Heartland Express (+2%) trailed the market as freight volumes saw limited increases during the quarter compared to the second half of 2012.

Commentary

“Shopping, But Nothing on Sale”

Along with keeping a watchful eye on the Fund’s current holdings, we spend much of our day-to-day time searching for new investment ideas. Successful entrants into the portfolio possess two elements: the quality criteria we demand, and attractive valuations. Since the start of the year, we note that it is increasingly difficult to find companies satisfying both. When quality is present, few new potential investments meet our valuation threshold. This situation is not surprising given recent market performance. From June 1, 2012 through the end of the first quarter 2013, the S&P 500 and the Russell 2500 indexes appreciated 22% and 27% respectively.

In an environment with scarce opportunities, we are patient. There are several ways that some of our high-quality targets might become attractively valued. First, market dislocations are possible as politicians in Europe and the U.S. grapple with structural issues. Second, individual companies periodically miss earnings expectations, or have other events that can cause short-term declines in their share prices. Finally, as we

describe below, companies also undergo transformations that may create hidden investment opportunities. We also remind our investors that one of the benefits of our portfolio concentration is that we only need to find a few good, attractively-priced ideas each year.

Turning to the Fund's current holdings, the quality of the companies remains high, but valuations are a mixed bag. Some of them continue to appear attractively valued while others have also risen along with the market to reach more fully-valued levels. In the months ahead, we would expect to add to the undervalued positions and reduce those where additional upside potential appears limited.

Company Discussion

Several years ago we embarked on a lengthy discussion of one of the Fund's stocks, **Franklin Electric**, as an example of a company that had successfully anticipated and adapted to significant changes in its underlying business.

We are pleased to report that Franklin's transformation continues to go well, as it broadens its product line, extends its geographic reach, and reduces its cost structure.

Now we would like to examine several other portfolio companies which are in various stages of transforming, or at least altering, their core businesses.

First is **HNI**, best known for its metal filing cabinets sold under the Hon Industries brand, has gradually added another strong business to its office furniture core.

It has transformed itself into a supplier of pre-fab hearths, used for both new-home construction and remodeling projects. HNI has used a combination of key acquisitions and internal growth to strengthen its position in hearth manufacturing and distribution. It is now the leading supplier to national home builders, as well as the retailers and distributors of hearth products, with brands like Heatilator, Heat & Glo, and Harman.

Given its strong competitive position, we believe HNI is especially well suited to participate in the revival of new-home construction which is now in its early stages.

Second is **Knight Transportation**. We first purchased Knight during 2000, at the bottom of the tech stock collapse. At the time it operated as a traditional dry van truckload carrier, carrying full trailer-loads of cargo on irregular routes across the country. Although Knight was one of the leading companies in this business, based on return on capital and growth, its leader Kevin Knight felt that well-considered diversification would strengthen the company in the long run.

Knight entered the refrigerated business in 2005. As both a temperature-sensitive and time-sensitive cargo, refrigerated plays to Knight's operating strengths. It has been a successful business for them, currently utilizing about 15% of the total fleet.

In addition to refrigerated, Knight has entered several asset-light businesses, including Port Services, Intermodal, and Brokerage. These are less capital intensive than dry van, but give Knight the opportunity to meet many client needs for multiple, flexible services.

Knight says it added more capacity over the past five years than the ten largest truckload companies combined, demonstrating that there is growth in truckload, for the right business.

Third is **Heartland Express**. **Heartland** is another truckload carrier. The company has taken a more conservative approach to expansion of services for customers. It continues to operate as a dry van

carrier only, with a reputation for very high services levels and a specialty in time-specific deliveries for increasingly demanding shippers.

As a consequence of Heartland's conservative and tightly executed strategy, it has earned industry leading returns on capital and operating margins, but its management has not been able to reinvest capital while earning comparable returns. As a consequence, the fleet has hovered at around 3,000 tractors in recent years, as Heartland has instead returned capital to shareholders through several special dividends.

Fourth is **O'Reilly Automotive**. For the past few decades O'Reilly has followed the same simple, straight-forward business plan – use all cash flow to expand the store base incrementally from its Springfield, Missouri headquarters, supplemented by infrequent opportunistic acquisitions.

O'Reilly has successfully followed that strategy while growing from its original single store in southwest Missouri to the current 4,000 stores, covering most of the country.

As it starts to fill-in the parts of New England and Florida where it currently is unrepresented, O'Reilly is making some changes to how it allocates its cash flow to reflect its reduced internal reinvestment opportunities.

These changes include:

- Slowing store growth
- Negotiating changes in terms with suppliers to increase cash flow by slowing payments for goods
- Modestly increasing leverage
- Using free cash flow to repurchase shares

Interestingly, this strategy has been followed to great success by Auto Zone, the #1 auto parts retailer, over the past decade. The impetus was similar – running out of attractive new store locations.

Lastly, **Copart**, which we first purchased in 2006, is a business with an uncommonly low profile. Some people are aware that there are frequent used car auctions being held all over the country, selling perhaps 10-15 million cars annually. Since they are wholesale only, essentially car dealers rebalancing their used car stocks, they are little noticed by the general public.

An even lower profile is Copart's business, which is to run auctions for salvage vehicles, cars deemed to be economically unfixable after a traffic accident.

Copart sources the vehicles, which it does not own, from auto insurance companies and auctions them to a variety of buyers, including used parts wholesalers and car rebuilders, as well as for scrap. The cars are sold at online auctions, conducted using a proprietary technology developed by Copart. This business turns over about 3 million cars annually.

Copart is now working to make two major changes in its business model.

First, it is taking the business international. The first step, starting several years ago, was a number of acquisitions in the U.K. These have been effectively integrated, and Copart now has the leading share in that market.

More recently, Copart has acquired businesses in Germany, the United Arab Emirates, and Brazil. Though these each are supported by a good business case, it is currently too soon to assess how well they are doing.

The second change Copart is making is to widen its sourcing of vehicles for the auctions. This has been traditionally dominated by insurance companies and it has been a solid and stable business, amounting to about 80% of its vehicles sold. Some of the potential incremental sources are cars coming off lease, cars owned by finance companies, and cars held by auto dealers, as well as repos. It is not completely clear how

rapidly this business is building since Copart doesn't publish a lot of detail on its operations, but we are at this point optimistic that it will be a success.

We are pleased to receive reader feedback to shareholder letters at the email address, paramount@fpafunds.com.

Thank you for your continued support and trust.

Respectfully submitted,

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President & Portfolio Manager
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