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

This transcript must be read in conjunction with the corresponding webcast slides, posted on fpa.com.

You should consider the FPA Crescent Fund’s ("Fund") 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.

(00:00:00)

Moderator: Hello and welcome to today’s webcast. My name is Christina, 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’ll have a question and answer session. You may ask text questions at any time by clicking the green Q&A icon on the lower left-hand corner of your screen. Type your question in the open area and click Ask to submit. If you would like to view the presentation in a full-screen view, click the Fullscreen button on the lower-right hand corner of your screen. Press the Escape key on your keyboard to return to your original view. For optimal viewing and participation, please disable your popup blocker.

And finally, should you need technical assistance, as a best practice we suggest you first refresh your browser. If that does not resolve the issue
please click on the Support option in the upper right-hand corner of your screen for online troubleshooting.

It is now my pleasure to turn today’s program over to Mark Hancock. Mark, the floor is yours.

Mark H: Good afternoon and thank you, and thank you to all participants for joining us today. We’d like to welcome you to the FPA Crescent Fund’s First Quarter 2019 Webcast. My name is Mark Hancock and I’m a partner here at FPA.

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

Momentarily, we’ll 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 Fund since its inception in 1993, with Brian and Mark joining Steven as portfolio managers in mid-2013.

(00:01:58)

Before we get started, I do want to note that we as FPA will be attending as an exhibitor at the Morningstar Conference in Chicago May 8-10, so in a few weeks. Abhi Patwardhan, one of the portfolio managers of our FPA New Income Fund and FPA Flexible Fixed Income Fund, will be at
the conference, and he will be at the booth in the afternoon of Wednesday May 8. If you are attending the conference, please feel free to reach out or come visit us at the booth, and if you would like some specific time with us, please reach out to your relationship representative at FPA or email us at crm@fpa.com, and we hope to see you then.

It is now my pleasure to introduce Steven Romick. Steve.

Steven: Thank you, Mark, and thank you for joining us today. FPA Crescent has continued to deliver on its charter of equity [like] rates of return while assuming less risk than the market.

[Please reference slide 2] Looking at the Fund’s returns since inception a little bit more granularly, you can see that Crescent has achieved its goals in that time. The left bar chart shows the Fund’s historic weighted return, where Crescent has returned almost 10%, achieving our goal of an equity-like rate of return. It’s important to clarify that beating the equity market is not the objective. We’re just looking to do as well as the market over time.

[Please reference slide 3] Since 1993, Crescent has captured 68% of the market’s upside and just 48% of its downside—the center bar chart. We don’t manage it to be one way or the other, upside or downside capture. Like volatility, it’s simply a by-product of being a value investor, particularly...
one that invests in stocks of different market caps around the world, while periodically maintaining significant periodic exposure to high yield and distressed debt. Given our predilection to manage a portfolio that looks nothing like a benchmark, with significant industry overweights and underweights, the upside and downside capture can look very different over shorter timeframes.

(00:04:01)

[Please reference slide 4] In this current market cycle, while the Fund has lagged the returns of the US market, it has exceeded that of the global market. While we are showing the current market cycle return for context, it is important to note that the MSCI ACWI Index really became more relevant to our portfolio beginning in 2011. The Fund has continued to provide reasonable downside protection and upside capture—the center chart—again, and even lower volatility relative to benchmarks as compared to prior cycles—the chart on the right.

The performance of this current cycle has not only met the Fund’s broad charter but it has done so despite three significant headwinds to the Fund’s strategy.

One, value has been significantly out of favor; we’re value investors. The S&P 500 Value Index has underperformed the S&P 500 by 2.25%
annualized since the 2007 market peak and, significantly, in 85% of the rolling five-year periods since then. Our broad mandate and depth of team resources have allowed us to partially sidestep this headwind by owning a host of growing companies that were purchased at very reasonable prices. This has allowed Crescent to outperform the S&P 500 Value Index in this cycle to date.

Two, the second headwind, high yield—one of the tools in our tool chest, as an asset class in which Crescent has historically had a significant allocation—has delivered mediocre yield for most of the last decade. Since the 2007 peak, high yield has yielded greater than 8% just a third of the time, versus two-thirds of the time in the prior market cycle of 2000-2007. Since 2007’s peak, the High Yield ETF, the HYT, has delivered an annualized return of just a bit more than 5%. We have not and will not sacrifice our absolute value mandate in the pursuit of keeping up, or in the prayer that there are neither higher interest rates nor a weak economy that could cause prices of corporate credit to weaken in our future.

(00:06:02)

The third input has been the fact that our cash balances have not delivered a return consistent with the past. Short rates have been repressed since the last financial crisis. From 2000-2007, one-year treasuries yielded
better than 2% for most of that time. Since then, they have been, for the most part, lower.

We have not historically had to manage the Fund with more than one of these three factors providing headwind, and we feel it unlikely that all three of these headwinds will exist permanently.

[Please reference slide 5] Crescent’s mark-to-market losses of Q4 2018, along with the broader market, have been largely erased in Q1 2019, benefited by both a robust stock market as well as the purchases we made during Q4’s market weakness. While our conservative posture led to less downside versus the stock market in Q4, it has similarly led to less upside thus far in 2019.

Crescent has historically outperformed in downmarkets, 100% of the time in fact over rolling five-year periods—the far left of the table at the bottom of this page. The Fund has also outperformed the majority of time the more average-returning markets, 96% of the time, and since 2009, we have been living through the longest post-World War II bull market.

[Please reference slide 6] In addition to recent market returns being unusually robust in the last decade, our value style of investing has been out of favor, decidedly. This won’t last forever. At the very least, there will eventually be a market crash and/or a bear market.
We’ve added this new chart that’s in front of you for additional context. The chart shows how Crescent has performed depending on whether value is outperforming or underperforming growth. Since Crescent’s inception, value has outperformed growth in only 35% of the rolling five-year periods, down from 60% prior to 2007. In those periods where value does outperform, whether the market is up or down, a little or a lot, or just flattish, we have just kept up or we’ve outperformed 90% of the time, adding more than 800 basis points of annualized performance—the right column of the table below the chart. This compared with the much less 260 basis points of underperformance versus the S&P 500 where growth is outperforming—the left column.

(00:08:21)

[Please reference slide 7] This chart and the previous one show how we can make up quarters and even years of underperformance in relatively short order when markets correct and we were able to put capital to work, and when what we do and have done for more than a quarter century is more in favor, just as we did in the last quarter of 2018.

[Please reference slide 8] Despite the aforementioned headwind and value underperforming growth, the return of the Fund’s underlying equities has outperformed the broad market averages, besting the S&P 500
by 1.82% and the MSCI ACWI by 5% since 2007. In part thanks to the
recent greater divergence of growth and value, our stocks underperformed
the broader markets in 2017 and ’18, although that is reversed thus far in
2019.

[Please reference slide 9] Individual security performance for the
first quarter was generally quite strong. The top five securities among the
Fund’s equity holdings provided fairly similar contributions to the overall
quarterly return, although Broadcom declined in value in the fourth quarter of
last year, on little news, following a rebound similarly without any discernible
newsworthy events in this most recent quarter.

Our investment in PG&E was the only detractor of any note. The
process surrounding the resolution of its fire liabilities and bankruptcy grinds
on.

[Please reference slide 10] As to where we are today, growth
continues to trounce value and the US markets continue to be more robust
than those foreign. In Q1, the S&P 500 growth index was ahead of the MSCI
ACWI Value and MSCI Emerging Market indices by about 500 basis points.
Crescent equities have returned 15.4%, ahead of all the major indices that
we show here.

(00:10:08)
Meanwhile, equity volatility, that gave us the opportunity to put capital to work last year, has declined significantly.

Through the first quarter, the S&P 500 and the MSCI ACWI had just three days when their value declined by more than 1%, shades of 2017. It’s not just equity volatility that’s low. Interest rate, commodity, currency vol are about as low as we’ve ever witnessed. Volatility in recent years is shown in each of the four charts displayed on this slide. You can see vol not only well below average but at or near lows.

Crescent’s risk exposure is higher than average, although that’s recently been declining due to price appreciation. In order to achieve our long-term market return goals, risk exposure needs to be somewhat higher over time. Although this could add some volatility to the Fund, that should be justified by the prospective long-term return benefits.

You should generally expect to see us sell into strength, buy into weakness. Our recent actions are certainly consistent with that. Crescent’s exposure to risk assets was 67% at the end of Q3 2018 but increased in Q4 as we bought into market weakness.

As mentioned earlier, the Fund’s equity book returned 15.4% during the most recent quarter, Q1. Such unusually strong performance certainly reduced upside potential across the portfolio, and so we decided to
selectively reduce equity exposure during the first quarter, which caused risk assets to marginally decline versus year end.

(00:11:47)

[Please reference slide 15] We added about 10 percentage points of risk exposure in 2018. Of that, the majority was allocated to companies domiciled outside the United States. As a result, the Fund’s foreign exposure increased from 20% to 30% of the total invested portfolio. [Please reference slide 16] The increase in foreign exposure was the result of more attractive opportunities overseas. These better risk/rewards are due in part to international stocks having underperformed their US counterparts by 27% in the last couple of years.

[Please reference slide 17] Let me now share a few bigger-picture observations. This has been an extended economic expansion and it’s now just one short quarter away from being the longest on record, although, as far as economic recoveries, this has been one of the most anemic, with the least amount of GDP growth relative to the magnitude of the decline in the last recession.

[Please reference slide 18] Investors that have been willing to look past that, guided by the unprecedented low interest rates, which make risk assets more valuable, all else equal, and the resulting scarce low risk
alternatives for return, investors have fomented the longest bull market since World War II, [Please reference slide 19] which has naturally left stock markets around the world at or near their all-time high valuations relative to the size of their respective economies.

[Please reference slide 20] It's not just stocks that are priced as if economies remain strong and interest rates low. The same can be said of junk bonds. These higher-yielding, lower credit quality bonds trade at or near their all-time highs. In this chart, we have inverted a graph that depicts historic yield-to-maturity. The representation shows the effect of high price being paid for junk, with gross yields in the low to mid-single digits in the US and Europe. The net effective yield after some certain level of defaults will be lower still.

[Please reference slide 21] If we just use net default history as a guide, then the prospective net yield for the US high yield bonds would be just 4.6%, while the EU high yield bonds would yield worse, just 1.2%.

[Please reference slide 22] This is particularly interesting when one recognizes the average life—I'm sorry, recognizes the average leverage of US public companies is far higher than normal. The net leverage, as shown here, is the ratio of net debt to EBITDA, is at its all-time high for the Russell
3000. Sure, it can go higher, but it’s already almost two times average leverage.

(00:14:26)

We’ll leave it to you to form your own view as to whether or not the future level of defaults will be above or below average. [Please reference slide 23] It would be a mistake, however, to conclude that such low corporate credit yields are unattractive when the stock market is still cheap. This chart reveals that stock and high yield bonds move up and down together, albeit with the stocks having more volatile moves to the upside and downside.

It’s generally easier to opine on the relative attractiveness of bond valuations. A corporate bond investor need only worry about a company’s ability to repay its debt at maturity, and a view to the appropriate risk premium. Equity investor—equity investors—must contend with far more moving parts, including a view to cash flow or earnings, and contend with what is effectively an infinite duration, as they decide what price to pay.

The seemingly effortless outperformance of the S&P 500 over the last decade compared to foreign stocks of any kind, any kind of bond as well, and almost all other asset classes, has created a great deal of complacency. We caution, however, that the more people who do the same thing because
it seems the right thing to do, the more likely it is that one day it will become
the wrong thing.

[Please reference slide 24] There's been some talk of the recent
inversion of the US Treasury yield curve foreshadowing an economic
contraction. [Please reference slide 25] That has been true more often than
not over the last 50+ years, but with central banks acting in ways that have
never been the case heretofore, however, we just don’t have a view that the
yield curve says what it used to. There will be a recession at some point, of
this we have no doubt. Economic law may have been amended but it has
not been repealed. When that occurs, we suspect that additional opportunity
will present itself.

It’s also probably worth pointing out that the yield curve is inverted at
the 10-year mark today.

(00:16:21)

That ends our prepared remarks. We have questions that have come
over the transom, are coming over the transom now, so please submit your
questions. We have some that came in previous. Now, if we don’t answer a
question, it may be for reasons of maybe being involved in a certain security
and transaction, buying or selling it, and we don’t wish to speak about that;
or a position that we’re not at liberty to speak of. If there is something that
we do not answer, however, or something you’d like to be answered in more completeness, please reach out to Mark Landecker or Ryan Leggio or another member of our business development or client relation team so that…

Mark L: Preferably Mark Hancock, by the way.

Steven: Oh, thank you, Mark Landecker. Sorry, Mark Hancock. Preferably Mark Hancock.

Let’s start with our first question. Your outlook for bank loans and high yield bonds—any credit concerns?

We offered a few slides today that touched on this subject, but we also published a piece in early January called “Risk is where you’re not looking”. It’s available on our website FPAFunds.com. I’d like to direct you to it as it answers this question in far more detail than we could otherwise do justice to on today’s call.

With foreign valuations overall less expensive, are you finding more interesting names abroad?

And hopefully our prepared remarks sufficiently answered this as well.

What magnitude equity risk do you assess in today’s US stock market? The market isn’t offering great bargains. How does that translate into market downside or when we might see a dip or even worse?
It’s truly beyond us. We wish we had such a crystal ball.

(00:18:01)

Please share your global macro view of valuations and expected return in the next three to five years.

We do a reasonably good job of responding to price, buying into price weakness and selling into its strength. We do not have any skill at predicting returns over any future timeframe. We did share some slides that reflect that stock and corporate bond valuations are higher than average. One can then reasonably hold a view that the future might not be as good as the recent past, and that’s about as far as we’re really able to go.

With so many indexing, are the advantages of stock-picking mitigated as all ships decline with the tide?

Passive investing is an excellent tool, wielded appropriately. There are many ETFs that invest in the less liquid though, and the illiquid, like high yield and small caps. I suspect when the tide does go out that many good companies, as you allude, will follow. We can only hope that happens, as we have approximately 30% of available capital that we’d like to put to work.

Somebody’s looking for the lay of the land and where opportunities are and historical performance.
We talked about historical performance in our prepared remarks and as to future opportunities, it’s not easy to find compelling risk/rewards today. There’s not a lot of stressed or distressed in the world, and we traffic in that.

Our team has mobilized in a number of areas but as to where we end up, price will be the deciding factor.

What percentage of cash was invested during the market retreat in December?

This was answered during the call but I think it’s good to reiterate that we put about 10 points to work last year, much of that’s happened in Q4. We are opportunistic investors, always looking for a natural seller, of which thankfully there were many in Q4.

I’m going to turn this one to Brian Selmo. Are you deliberately addressing the biases regarding possible currency or debt valuations via CB rates, QE, MMP?

Yes, the short answer is no. The things we have done that are possibly related or created by those phenomena is doing some volatility, forward volatility positions on long bonds and then we’ve also done some options on the 2/10 and 2/30-year curve. So essentially the flatness of that curve, we’re
betting against it. Other than that though, there’s not anything particularly to note.

Steven: There’s how does our definition of value differ from that of traditional value indices?

We define value quite simply. It’s just investing with a margin of safety. A lot of the strict practitioners on value, in a very Graham-and-Doddian kind of way, look at value as being protected by the balance sheet, and many years ago we viewed—thanks to the guidance of Mr. Warren Buffett, Mr. Charlie Munger—that the importance of understanding protection and the margin of safety is also to understand not just the balance sheet but to understand the business itself. So a lot of that margin of safety has shifted from balance sheet to business.

There’s a question on how did foreign stocks underperform because of the FANG factor? Tech is so low overseas.

I don’t think any of us here can give you the exact numbers as to what that contribution might be from FANG relative to other parts of the world. Clearly, Europe does not offer a lot on the tech side. They don’t have any of the cutting-edge technology companies to speak of, as a generalization, the Googles, Facebooks and the big, the Netflix of the world are in the Europe, and Spotify. There’s a lot in China. You’ve got Alibaba, Tencent and Baidu,
and JD.com and others. Other parts of the world where there is a significant technological input, there's others factors that are driving it to, not just that. If you look in the US, look at our banking system, our banking system is in a far better financial position today than it was a decade ago, and both in terms of having more equity support its assets, and having fewer bad loans on the books. Now if you look in Europe, for example, and the financials have a larger rate in Europe than they have in the US, the banks actually have more bad loans today, nonperforming loans, than they had a decade ago, and they only have marginally better equity, more equity, to support their assets, and we actually would argue that that equity is not probably accurately stated because there's probably a lot of write-offs that haven't yet been taken, otherwise you wouldn't see companies like Deutsche Bank trading at such large discounts to their tangible book value.

(00:22:37) So when does value outperform again, in what sort of environment do you foresee this occurring?

Again, I think, and addressing that earlier question of the value and what value is, it's literally a somewhat fuzzy topic. We just don't have any idea as to what's going to cause it to outperform at any given point in time now.
Okay, do you want to turn to some of these questions?

Brian: Sure. There's a question about Jefferies, do we envision a catalyst.

I don't necessarily envision a catalyst. We've been happy with their performance over the last year. They had a couple of meaningful realizations and they've used excess capital to buy back shares, and meaningfully buy back shares, I think approaching 20% of the shares outstanding, at what we think is a significant discount to readily ascertainable net asset value. So I would expect Jefferies would continue to behave in a financially rational manner and over time, the value of the shares will go up if they continue to do that.

There is another question, can you talk about AIG, Arconic and Baidu in your top ten holdings?

You know, AIG is a company that we discussed last year at our Investor Day. I think there are some slides available on the website. I'll go over it just briefly considering that history. So it's an insurance company that’s undergoing a turnaround. There's a new management team that we think has a lot of credibility, we think they’ve made a lot of progress. The stock continues to trade at a very meaningful discount to tangible book and at a meaningful discount to peers that perform more appropriately. Turning around an insurance company is a long-term game. It doesn't happen in one
quarter, but we would expect and hope that over the next couple of years, the performance of the commercial business at AIG looks more like industry peers and if that’s the case, hopefully the stock performs as well.

(00:24:37)

Arconic is also a situation we’ve been in for a while. It’s fairly frustrating situation of, I think, four CEOs in four years, a highly dysfunctional board, continues to be dysfunctional, and underlying it is a really great business that hasn’t gotten a lot of attention. That’s caused the underlying business to underperform its potential. Where we’ve been fortunate in that investment is that the end market has done very, very well over that time and so the earnings of Arconic have actually gone up even though there’s, sort of, through no fault of the management team. We continue to own it. We think it’s cheap at current levels for its existing performance, and there is a large potential for the underlying businesses to perform better or more like peers in the future, and so hopefully in time, we’ll get a double whammy of improved performance and improved valuation.

Steven: And we have a more actively engaged board in that company today than we had in the past.

Brian: That’s true.
Mark L: Let me take Baidu. Baidu was covered in that same Investor Day where you would see slides on AIG, if I’m not mistaken, Baidu would have been covered. Baidu is the leading search player in China, and they also hold stakes that are significant in Ctrip, which is the leading OTA—online travel agency—in China, as well as iQiyi, that is commonly referred to as the Netflix of China. Each of Ctrip, by the way, and iQiyi are independently listed, and if you were to back the value of each of those out of Baidu, you’d end up with the core Baidu trading at something less than a market multiple, and that would include investments that are being made in each of autonomous vehicles as well as artificial intelligence. And so when we went through it at the Investor Day, we talked about being able to purchase Baidu, effectively, at a fair multiple for the search business and getting a lot of optionality for free, not to mention you do have an owner-operator in Robin Li, who is the CEO and largest shareholder.

(00:26:49)

Steven: There’s a question that’s: vol is low, have you considered buying splits or a debit put spread to reduce equity exposure?

I mean, well, first I would argue that just because vol is low doesn’t mean the market is expensive. So we don’t react to where vol is in that way. What we tend to do when we find our companies to be expensive in our
portfolio, we tend to reduce exposure. Again, as I mentioned earlier, our job is to—we do a reasonably good job of responding to price. Prices go up, we reduce exposure. Prices go down, we increase exposure. There is, there are some positions we have in the portfolio at points in time where we’ll take advantage of certain derivative opportunities and then vol will play a role in that, and Brian, do you want to talk about one?

Brian: Well, as I said, I think Steve does a pretty broad overview of the market backdrop to begin these calls, and I think he does that to help set the table for everyone. But I would encourage you to understand that we really do not take a top-down macro or market-level when investing. And so our portfolio, despite what the market might look like, we pick on a name-by-name basis and try to find compelling opportunities. When something becomes less compelling, whether it’s a diminished margin of safety, whether it’s erosion of the business’s competitive position, whether it just gets too expensive, we sell or exit the position. We might occasionally hedge certain exposures, and in that case, lower volatility may provide us some instruments to use as hedges, and that might be where something like low vol would come into play.

Mark L: There is the occasional—and it is not down the plate where we’re looking to swing very often, but occasionally we see something where valuations seem
to be almost a bit of an anomaly, or we think that there is significant
optionality in an investment. So if you look last year, we did have short
positions in the Russell 2000 when we thought that the valuations at large
for small caps were rather stretched. We also had a modest short position in
the JPMorgan Emerging Bond Index, and in each of those cases, we simply
felt that valuations were out of kilter with reality. In terms of the Emerging
Market Bond Index, you had the worst countries in the world being
countries—and I don’t mean the worst people or the worst places to live, I
mean credit—such as Kazakhstan, Ukraine, Uzbekistan, and those are just
the highlights of the best ones, and effectively they were trading at a 4%
yield with quite a bit of duration, and we simply said that probably doesn’t
make sense, and worse, maybe yields go down a bit and we take a bit of a
loss. But we thought that yields were pretty much as low as they should be
for that part of the world. And we took that off in Q4 of last year. So there is
the occasional dabbling in macro, but it has to be at the extreme to really
catch our attention. We’re not looking to do 50/50 coin flips.

(00:30:02)

Steven: There’s a question about the healthcare space and HMOs.
I think generally, in the context of the rhetoric out of D.C., we don’t have any investments in that space. I think we find it a little bit too hard for us, and so I don’t know that we have anything to say.

Mark L: Speaking of too hard, there’s a question: discuss some of the positions you closed out—Expedia, Oracle, WPP—and the reasons for closing out positions.

Expedia is a name where, picking up on what Brian just mentioned, we feel it’s a difficult space to handicap longer term. It’s quite dynamic. Interestingly, the players in OTAs, the largest players, being Expedia and Bookings, are huge customers of Google, and Google is also competing directly with their customers as well. And so it’s a very dynamic space. We’re interested at a price for each of Expedia and Bookings, which we haven’t owned but which we closely monitor and track. But when the valuations get a little bit more expensive, there’s less of a margin of safety, not to mention we do feel like the ground is somewhat shifting beneath us, hence the more work we did and the more time we spent on this space, we decided to exit Expedia on a bit of strength previously.

Oracle is a long-held name in the portfolio. The database is still a great business, as is the maintenance, but in terms of how the business is positioned looking 10-20 years out, we feel like the franchise will be a little bit
of a death by a thousand cuts. Now, the management team is looking to counteract that by share buybacks and M&A. however, at the end of the day, the valuation started to creep up and when that happens, the margin of safety starts to erode and because we have less enthusiastic prospects regarding the growth opportunities for Oracle, again, we exited the name.

And WPP is a name we bought coming out of the Great Financial Crisis, probably in 2010 if memory serves correct.

Brian: That is right.

Mark L: And so at that time, we thought it was trading at a rather depressed multiple and things were going to get better rather than worse. You roll forward a decade and the business has become more challenged structurally with respect to digital and the like. The balance sheet is not in fantastic shape, albeit they have a division called Kantar that they’re looking to sell, which would improve it. And you saw Martin Sorrell leave and the new CEO get appointed. At the end of the day, we thought that while WPP was not expensive and it would still screen very much to be a value name given the P/E and the dividend yield, the longer-term earnings prospects in combination with the balance sheet and the cyclicality that the business would be exposed to in a recession led us to part ways with the name.

Brian: There's a question: can you talk about Lafarge-Holcim investment thesis?
I think I would start out with in this case, we think we are on very solid footing, cement-like footing even. Just trying to get a laugh from Mark.

Steven: I noticed you didn’t get try get a laugh from me on that one.

Brian: So this is one where we think the business is going to look pretty similar in 10 or 20 years. I would say Lafarge-Holcim is somewhat complex in that it operates around the globe, and in many places, its operations are conducted through majority stakes in either publicly traded or private partnerships or businesses. That can really confuse the reported financials of the company, both exaggerating the amount of debt at the ultimate holding company, and understating the contribution to free cash flow from more mature regions such as the United States, North America and Europe.

(00:34:03)

So our view would be that Lafarge-Holcim earns the vast majority, probably north of 80%, of their free cash flow from markets that are either depressed, being Europe; somewhat below cyclical, call it, midpoint, North America; or markets where the company has incredibly strong positions in very favorable growth projects, which would be Latin America. I think a lot of the taint on the company comes from Asia and Africa, where their actual ultimate look-through share is somewhat less than you would see if you just looked at the gross figures.
On top of that, the company has a well-structured board in which major shareholders have a strong voice, and we believe they have focused the management team on maximizing the value of the firm, and we are very impressed with the new CEO there. And so overall, we expect it to be a compounding type company, albeit in a lower-growth, less dynamic industry. And we purchased it at something like 10 or 12 times what we think of as somewhat below mid-cycle free cash flow.

Steven: How do you feel about share buybacks? Would you not just as soon have them paid to you in dividends and allow you guys to reinvest if you still saw value?

I mean, I think that share buybacks, if a company has, is trading at an inexpensive valuation and has excess cash flow and can repurchase its shares, then that’s really a very tax-efficient use of that capital, whereas if they were to pay us the dividends, we’d have less to work with at the end of the day, have to pay taxes, and we’d have to go out there and even buy more of those same shares that we then can buy at an effectively larger discount. But on the other hand, there’s many companies, admittedly, would we rather have the dividends than a company that’s buying their stock back at too high a price? Yes, then sure, but at the same time, the question then
becomes should we really be owning that company at that high price, with a poor capital allocation decision?

(00:36:24)

Mark L: What type of names/sectors did you most heavily lean into after the Q4 selloff, or I’ll say in the midst of the Q4 selloff I presume. What are your views on cyclical names today?

There are a number, I think, of significant events. I don’t remember them all. Brian will jump in as well, Steven if need be. We had a hedge position with Naspers/Tencent for quite a number of years. We took off the vast majority of that Tencent hedge, which allowed us to gain exposure to Tencent, for the most part. You could say the same I think for Altaba and Alibaba, where for a long time, we had hedged out Alibaba. We took, I think it was in Q4, probably most of that hedge. Brian’s nodding. Took that hedge off. You know, others, we would have added to existing positions in financials, which that’s a quite depressed…

Brian: And Signature.

Mark L: Yes, depressed valuations. We had some new names that came into the portfolio—Signature Bank. We added, Brian just talked about Lafarge-Holcim. We also own Heidelberg, which is another European-based cement and aggregates company which we were adding to.
Brian: Glencore.

Mark L: Yes, Glencore. Royal Bank of Scotland would have been in there, which was a new position, I believe, in Q4, or at least would have been built up mostly in Q4.

Brian: But also important to recognize that many of these companies that—Mark’s mentioned individual names, and while these were, the Asian internet platform companies, and we had a lot more that we invested overseas last year than we’ve had at any other point in time in one year in our history previously, such that as I said in the prepared remarks, 30% of our invested portfolio is now domiciled outside the US.

Mark L: We bought, speaking of that, we bought a Japanese-listed gaming company called Nexon in Q4. It’s under 100 basis points. We haven’t talked about it on the call. So I don’t think there was any one specific sector—Brian’s nodding—that we’d call that out that we leaned most heavily into. I think generally we’re buying names across the portfolio in existing positions, and then new positions were coming onto the books as well.

(00:38:44)

Steven: There’s a question: in your fundamental bottom-up analysis of companies, in or out of the portfolio, do you see signs of more prolonged slowdown or simply a short-term pause in the rate of growth?
Mark L: Much like when we talk to investors, we ask you to look at our returns over three to five years, we try and do the same when we’re evaluating companies for purchase, and so we do run low, base, high case scenarios, and you can think of those as our low case incorporates some sort of model slowdown or the like case, the base case things hum along, and the high case, things are going pretty well. We don’t try and underwrite that we think we have a crystal ball that tells us exactly how the future looks, so we’d rather try and think about how things may play out under a variety of alternatives and then see how the valuation looks taking each of those into account.

Steven: And if that question’s being asked as a drive to have a larger view as to what's happening in the economy domestically or globally, we wouldn’t know what to do with that, because a lot of companies, we do hear a scuttlebutt of things slowing down at a point, and then it reverses the next quarter. So it’s fluid, and so we want to, and as Mark has mentioned, as we evaluate our companies on a low/base/high case, we want to see what they’re going to be like in the next two to three years, and recognizing that there could be some hiccups along the way for growth as it relates to missteps for that company or industry weakness or just general economic malaise.

(00:40:11)
Mark L: I mean, anecdotally, I know someone who’s on the board of a company.
Brian: So Mark’s talking about me now.
Mark L: Who’s on the board of a company, and the company was, you know, I'll say wide-based exposure across the economy, and last year I’ll say...
Brian: Around the summer or...
Mark L: Yes, the economy was on fire. It was nothing but...
Brian: Full steam ahead.
Mark L: All cylinders.
Brian: Every end market.
Mark L: Roll forward three, four months later, full stop.
Brian: Can’t get an order.
Mark L: And so the world of...
Brian: The world can move around.
Mark L: So I think that goes back to when you try and invest, you don’t want to purchase when things are going well, saying that that’s going to last forever and it’s nothing but up and to the right like a hockey stick. And not only, you also don’t want to get too depressed when things are slowing and see we’re never going to get another order again, this thing’s worth scrap value. You want to have a more measured pace of thinking about how the world will look over three, five years, without frothing into any extreme. And I think if
you do that well and you’re looking at companies that are built to survive that have reasonable balance sheets and reasonable businesses that aren’t prone to disruption or being disintermediated by the internet or low-cost foreign companies and the like, you position yourself for success. And so that speaks to, I think, some of the portfolio additions that we’ve made in Q4.

Steven: And as we’re talking, there’s a question that came through about in our foreign-domiciled companies, do we hedge currency risk?

And generally, there is, occasionally we do hedge currency risk but we need to have a fairly strong view, not really understanding what currency will do for this and over time. But more importantly, or as importantly, I don’t know about more importantly, many of these companies have sales coming from all over the world. So if you have a company like the WPP Group for example is a company that’s not domiciled in the United States, did not have the majority of revenues in their home country, had revenues with a lot coming from the US, a lot from emerging markets, Continental Europe, etc. And you know, we just, we’re trying to going and hedge that because we didn’t know how this all—we didn’t know what we’d be hedging. And then you always have the question, is the company hedging? The last thing you want to do is hedge a hedger. If they’re hedging their own book and just
because they're doing it one quarter, it may not be they're doing it the next quarter.

(00:42:44)

So there's a great complexity in that. We believe most of that will shake out over time, but if we do have a strong view, which is rarely, we will occasionally hedge the currency, which we have done. And we do recognize that most of our clients are here in the United States and they're spending dollars at the supermarket, not euros or shekels.

Mark L: A question, why do you say it's hard to analyze healthcare? Is it the politics, or factors make it hard for you?

You know, in the past we have done, among that, quite a few years, HMOs and...

Brian: Healthcare broadly was the largest exposure in the portfolio seven or eight years ago, and it was primarily on the manufacturers of medical devices, drug companies and retailers. We had a small position in some HMOs. I think we've always been uncomfortable with the inherently political nature of the insurance and I'll call it distribution, call it... But yes, we did.

Steven: And some companies, like healthcare is such a broad, broad sector, as Brian is alluding to, right. You've got hospital companies, you've got your insurance companies, you've got medical equipment manufacturers, you've
got big pharma, you've got traditional pharma, you've got biotech. You've got generics, hospital companies, etc., etc. So there's lots of different businesses within that. And some of those industries, in the businesses we're more comfortable analyzing, we will own them on occasion. As Brian pointed out, we have in the past, and I think this first reaction to analyzing that question about healthcare is really as it related to some of the insurance companies which we're a little bit, which certainly we'd put in that more complex bucket.

(00:44:28)

Mark L: Yes, I think the question referred to managed care organizations. Yes, look, it's a space we've spent time on. We are not spending time on it at the moment, but if you go back once upon a time, we bought CVS and we were concerned about the PBMs, so we hedged our exposure, and then you roll forward a few years, we actually thought we got comfortable with the industry. We spent time on Express Scripts. We actually even briefly owned then Express Scripts in the portfolio. Then, the more time we spent on it, we became less comfortable and we ended up selling Express Scripts. And so it's not an area that we haven't spent time on historically or studied, but it is a challenging industry for us to ultimately develop a high sense of conviction, and that's what we've found over time. And so I don't think we're running to
look at HMOs at the moment. We realize they have come down in price, and probably for reasons that have always made…

Steven: It doesn’t make going in them wrong, by the way. It’s just, to Mark’s point, we need to develop a level of conviction so that we can have a decent-sized position in the portfolio. If we don’t have that conviction, we’re not going on—so we mentioned companies, not just industries, but other companies we mentioned about things that just come under the heading of “too hard”. Maybe it’s not too hard for somebody else but it’s too hard for us and so we, so the better part of valor is to buy what we understand and where we have some conviction as to what is going to happen over the future.

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A case in point, we’re seeing, yes, we lost conviction first early on the PBM, the pharmacy benefit management business, but also we’ve lost conviction over time as to how they are going to be competing against a new clutch of competitors led by the likes of Amazon online. And CVS has made a large acquisition in Aetna, in the insurance company, and maybe it’ll be great. But I think one can reasonably argue it was a defensive acquisition and those are always a little bit more suspect, and it’s very, very difficult for us to underwrite.
Mark L: Look, if you go back we did have, as Brian mentioned, very large healthcare exposure as a proportion of the Fund going back seven, eight years. Those names effectively have been long gone from the portfolio. We’re fortunate that some were bought out, like Covidien and…

Brian: CareFusion.

Mark L: CareFusion. And then there were others that we chose to exit because we lost confidence in how the business might look long term, like Walgreens or…

Brian: And they were just expensive.

Mark L: Yes. Yes.

Brian: And I think we sold CVS.

Steven: And again, some of these companies will be back in the portfolio as a function of price. We will respond to price. To some degree, if we can have a good hint at what that business looks like over time and the price is attractive enough to adequately compensate for the risk that we perceive, including our risk that we sometimes have a bigger discount required for risk that we don’t receive in certain businesses, we really, as I said, want to understand well. But there’s always an imperfect understanding in these businesses, even as Mark was referencing Brian’s board seat. Knowledge is not perfect.
Mark L: I think also—we’ll move on from healthcare in a moment but when we’ve bought a lot of these, I don’t remember all the valuations specifically but I remember Pfizer, Sanofi, Roche…

Brian: Single digits.

Mark L: Yes, we’re talking P/Es, the most expensive of the lot was probably going in like an 11 or 12, and some of them were single digit P/Es with mid-single digit yields. Just we’re in a different valuation now.

(00:48:04)

Steven: But more things have to go right. Anyway, those were all our questions. So we thank you all for joining the call and would turn it back to Mark Hancock for closing remarks, unless Mark Landecker wants to give them.

Mark H: I’m going to start talking about stocks. Mark, Steve, Brian, thank you, and thank you again to our listeners for participating in today’s First Quarter 2019 Crescent Fund Webcast. We will now turn it over to the system moderator for closing comments and disclosures. Thank you all.

Moderator: 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
on the Fund such as complete portfolio holdings, historical returns and after-tax returns.

Following today’s webcast, you will have the opportunity to provide feedback and to 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.

Please visit fpa.com for future webcast information, including replays. We will post the date and time of the prospective calls towards to end of each current quarter and expect the calls to be held 3-4 weeks following each quarter end.

If you did not receive an invitation via email for today’s webcast and you 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 strategy.

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We do want to make sure you understand that the views expressed on this call are as of today and are subject to change based on market and other conditions. These views may differ from other portfolio managers and analysts of the firm as a whole, and are not intended to be a forecast of future events, a guarantee of future results or investment advice. Any
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This concludes today’s call. Thank you and enjoy the rest of your day.

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