Q2 2024 FPA Crescent Fund (FPACX) Webcast
July 29, 2024

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Moderator: Hello and welcome to today's webcast. Please note that today's webcast is being recorded.

During the presentation, we'll have a question and answer session. You can ask text questions at any time. Submit your questions in the questions and answers panel and click New Question to submit. If you would like to view the presentation in a full-screen view, click the corner of the slides panel to drag and resize to best fit your view. To restore the panels to their original view, click the Restore icon from the icons on the right side of the screen. 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 submit your issue in our question and answer panel and someone will assist you.

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

Ryan: [Please refer to slide 2] (Audio break @ 00:01:00) *[Good afternoon and thank you for joining us today. We would like to welcome you to FPA Crescent's second quarter]* webcast. My name is Ryan Leggio and I'm a partner here at FPA and lead client relations.

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

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.

We include longer-term performance here for disclosure purposes.

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

Steven: Thanks, Ryan, and thank you all for joining us today, or if you're hearing this in a recording, joining us in the future.

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[Please refer to slide 3] The US stock market continued its upward trajectory in the second quarter, rallying to a new high. The risk-on theme carries over to corporate bonds, where credit spreads remain near all-time lows.

The Fund's net risk exposure decreased in the last year from 73% to 69.5%, a function of higher share prices delivering less favorable risk/reward prospects. While large cap US holdings look less attractive, we have found select opportunities in small and mid-cap names, both here and abroad. Considering its risk exposure, the Crescent Fund performed well on an absolute and relative basis year-to-date.

[Please refer to slide 4] Crescent gained [2.67]% in the second quarter and [16.37]% in the trailing 12 months, and captured almost 85% of the MSCI ACWI's return in the trailing 12 months, which has outperformed its own 71% average net risk exposure.[1]

The stock market, as most of you know, has been a tale of the have and have-nots, with returns lifted by just four contributors—Nvidia, Microsoft, Alphabet, and Amazon—that represented 43% of the MSCI ACWI's returns and 53% of the S&P 500's returns. These are year-to-date returns.

[Please refer to slide 5] Value managers have not had an easy time of it. In the past decade, value has underperformed growth by such a significant margin that it threatens the existence of value

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

as an investment philosophy. Though value outperformed growth in 2022's market rout, growth is again leading the charge. In the last year, the S&P 500 Growth battered Value by more than 17 percentage points, while the MSCI ACWI Growth beat the Value component by almost 11 percentage points.

Crescent has returned better than the value indices in the last 12 months, but slightly behind the ACWI and S&P. The long equity book has performed very well, soundly trumping the value benchmarks and beating the ACWI Growth but lagging the S&P 500 Growth.

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[Please refer to slide 6] Looking at the Fund's long equity book over the longer term, you can see that it has outperformed the MSCI ACWI [Index] by 3.2% since 2011.[2]

[Please refer to slide 7][3] In the previous 12 months, Crescent's top 5 performers contributed [7.18]% to its returns, whilst the bottom 5 detracted [1.38]%. I'm going to highlight five investments that have proven meaningful to the Fund's trailing 12-month return. Building materials company Holcim, largely concrete, cement, and aggregates, has performed well over the past year, guided by a strong operating performance and management's shareholder-friendly steps to return value to shareholders, including share repurchases and increased dividend, as well as certain corporate actions.

Citigroup's shares have appreciated along with other bank shares. It still trades at the modestly depressed level of 70% of tangible book value.

Charter Communications has faced challenging operating conditions that have led to its share price weakness, including competitors have been overbuilding fixed wire assets; customers

[2] Comparison to the S&P 500 and the MSCI ACWI indices 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.

[3] The company data and statistics referenced in this section, including competitor data, are sourced from company press releases, investor presentations, financial disclosures, SEC filings, or company websites, unless otherwise noted. You can find the Fund's other positions addressed previously in our archived commentaries.

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losing out on government subsidies; and a more aggressive near-term capital spending plan. Given its relatively high leverage when compared to most of our position, its stock price tends to react with more volatility to both good and bad news. We don't believe the thesis is broken and look forward to it proving out over time. In fact, its stock price responded favorably to its earnings report last Friday, jumping 20% in the last two trading days.

CarMax is the largest and most profitable independent used vehicle dealer in the US, but with a long runway to expand its just 4% market share. CarMax uses the data from its millions of vehicles purchased and sold to understand the right price to buy, recondition, and sell used vehicles and, as a result, has consistently generated an industry-leading gross profit per unit for decades. The recent downturn in used vehicle sales due to higher inflation and interest rates has hurt volumes, but the company continues to redeploy its free cash flow into improving the customer experience and expanding as well.

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[Please refer to slide 8] With market valuations higher, Crescent's net risk exposure has understandably declined to the 69.5% as stated earlier, but your portfolio managers have not sat idle. In addition to staying updated, looking at so many different new companies, we exited one position and added two others.

[Please refer to slide 9] Reflecting the geographic breadth of the Fund, companies based outside the United States represent 36% of the Fund's equity exposure. We view the fact that these companies have about 53% of their revenues derived from foreign markets as more relevant.

[Please refer to slide 10] It would be difficult to argue that the market has stocks on sale. While the stock market continues to migrate higher, earnings haven't kept pace at the same rate, thus making the market more expensive. In the last year and a half, the MSCI ACWI increased [32.48]%, the S&P increased a more robust [42.22]%, but neither grew earnings even 2%.[4]

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

[Please refer to slide 11] We remain mindful of seeking to deliver a good return while assuming reasonable risk, in the hopes of avoiding permanent impairment of capital. When looking at publicly traded equities, you can always find risk, you know, in some corner of the market. In assembling the Crescent portfolio, we incorporate various risk mitigants, including the consideration of company valuation, net risk exposure, business quality, and diversification. Overpaying for a business will hurt returns. Price matters.

It should therefore be of little surprise that Crescent's net risk exposure moves inversely with the stock market. We act reflexively, leaning into the lower valuations and pulling back when valuations make risk/reward less attractive, using price-to-earning as an imperfect proxy for market valuations, and while there are often exceptions, the chart on this screen reflects that general causation. P/Es, the green line, go up and the Fund's net risk exposure, the blue line, goes down. With P/Es higher today, the Fund's net risk exposure has declined.

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[Please refer to slide 12] Risk exposure is also a function of many squishy considerations that define business quality. Investing in higher-quality businesses should serve investors well over time, like those with a protective moat, good returns on capital, opportunities to attractively reinvest that capital, and helmed by an exemplary management team, skilled and shareholder-friendly. While there was a period when it was—or a long period—when it was easier to make money from lower-quality businesses, that is less the case today, thanks to the many disruptive businesses and new technologies that challenge them.

Crescent has therefore migrated over time to businesses of higher quality, which shows up in the Fund's higher average return on equity of its portfolio companies. What used to be price first and quality second has since reversed, with a business's quality being the first line of defense. Crescent often purchases shares in companies with depressed earnings, which temporarily lowers its ROE. As a result, this chart should be viewed more directionally, rather than with any exactness.

We manage a diverse portfolio, primarily comprised of stocks, higher-yielding bonds, and a smattering of other risk assets. While owning too many stocks will likely ensure poor to middling performance, having too many eggs in one basket can lead to debilitating when all doesn't go as planned. The Fund generally owns 40 to 60 stocks in different industries, far less than our peer group average.

About 30% of the Fund is invested in its top 10 holdings. Investors can expect Crescent to look very different from any index. With its large active share, as it's known, Crescent will frequently have more or less exposure to an industry group than the stock market, as a function of its benchmark-agnostic, absolute value investment philosophy.

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[Please refer to slide 13] The equities held in Crescent have largely risen in price in concert with the stock market, as measured by both price-to-earnings and price-to-book as exhibited here. While look-through valuations are higher when compared to the same time last year, the Fund's holdings continue to trade less expensively and, according to consensus estimates, have better expected growth than either the MSCI ACWI of the S&P 500.[5]

That's the end of our prepared remarks. We're going to turn to Q&A, and a number of questions have come over the transom, but first a little disclaimer.

As a reminder, we won't be discussing companies where we are currently engaged in transacting—could be a buy, could be a sell—or, for that matter, really we won't be discussing positions that are so small as to not be terribly relevant to Crescent's performance. We also won't be speaking to companies that are not in the portfolio and of which we have no opinion, including macro-related questions.[6]

So, first question. **"In the past, when the Fund was smaller and there were opportunities in small cap stocks, Crescent was a buyer. With the acquisitions of the Queens**

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

[6] Portfolio composition will change due to ongoing management of the Fund. References to individual securities or sectors should not be construed as a recommendation by the Fund, the portfolio managers, the Adviser, or the distributor to purchase or sell such securities or invest in such sectors, and any information provided is not a sufficient basis upon which to make an investment decision.

Road's team, do you see Crescent both, because of its larger size than Queens Road, no longer looking at the small cap universe?"

For those unfamiliar with other FPA funds, this question relates to the FPA Queens Road Small Cap Value Fund managed by Bragg Financial, which manages the fund for FPA as a subadvisor. The portfolio manager, Steve Scruggs, is a talented manager with a stellar track record, and he and his colleagues at Bragg are wonderful people—smart, kind, and filled with integrity, our kind of people. How Steve and his team manage the Queens Road Small Cap Fund has never had, nor will ever have, any bearing on how Brian, Mark and I manage Crescent. Nor, for that matter, will we influence how they manage their fund. While most of Crescent will likely remain invested in mid- and large cap companies, small caps will have a presence. As of the recent quarter end, June 30, 2024, 18 companies with market caps of 10 billion and under represented 13.4% of Crescent's equity exposure.

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"In the late 1990s when…" This is another question. **"In the late 1990s, it was all about dotcom. You found great value in small cap and REITs. Now it is all about AI and only a handful of stocks lay in the market. How much of a connection do you see between now and then? Are you finding interesting ideas that go against the grain like you did in '99?"**

The difference between now and the late '90s and early '00s is that tech stocks used all of the oxygen in the room back then, leaving small cap and value stocks at incredibly low valuations. Today, it does not offer the same target-rich environment. While there is a bifurcation between growth and value, value is not close to the level of inexpensiveness seen at the turn of the century.

I'm going to turn over to—there's a number of other questions—I'm going to turn over to Brian and Mark, first to Brian.

Brian: Okay, first question. **"How do you anticipate or are you currently using AI tools in your investment process?"**

So I would say first, we are not currently using AI tools in our investment process. I probably, and I would guess most of us, cannot actually anticipate all the ways in which we will use AI in the future but in the nearer term, we are looking at a couple of projects or use cases that would allow us to better search or reference or contextualize existing research or sort of company folders and files that we have around various, you know, kind of natural topics that you might want to reference back to that you maybe did work on or had conversations about years ago that are deep in files somewhere. So maybe an easier way to find what you already have. But other than that, we do not have anything or projects live that would directly benefit from AI.

(00:13:56)

Next question. **"My belief in the value of diversification (and active management) has been tested by year after year of strong performance by IVV and VOO," which is basically S&P, "What can I say to clients to help them feel better about being diversified?"**

So I think there are a couple of things, and I think that first of all, I would assume, or the way we think about managing the portfolio is that we're managing it all of one wealthy family's assets, or perhaps a retired person who is pretty dependent—or determined not to go back to work. And I think if that's the profile of someone's clients, I think the goal that we have in mind and that I would hope people who are invested in the Fund have in mind is maximizing the probability of an acceptable return while minimizing the probability of a terrible return. And I think that the way to get to that outcome is through diversification, both in terms of strategies, asset classes, and probably types of managers. So there is probably a role in that goal for passive goals. There's probably also a role in that type of goal for actively managed funds and managers such as us with very broad mandates that allow us to take advantage of opportunities in real time as they come up. So I think that would be the first thing I would suggest.

And then the other would be—and this I'm going to credit our partner Ryan Leggio, who you probably are all familiar with—but maybe invert the question and ask why would one choose not to be diversified. And I think the only reason you would choose to not be diversified is if you had incredibly high confidence of material outperformance of whatever it was that you chose not to be diversified in.

And so I think the combination of those two ideas—one, what diversification does for you; and then, two, kind of the logic that would need to hold to choose to be undiversified—would be what I would suggest is what we are in part trying to offer to you and your clients.[7]

(00:16:09)

I'm going to move—Mark, I don't know if you would like to add anything to that.

Mark: Thanks, Brian. I think you covered it all.

Brian: Okay. There is one other question which is, or two more**, "What is the team's current view on the oil and gas industry?"**

I would say that we don't generally have views on industries. There are probably occasionally times when things are deeply out of favor or deeply, you know, outrageously expensive. We might have general views. But I would say we don't have a particular perspective or take on the oil and gas industry today. Nothing new, I guess, to report.

The next question is, **"Does Comcast still offer attractive long-term growth prospects or is the stock just cheap?"**

And then I will kick the next part of this to Mark, but I think to answer that very directly, I think we've talked probably to many people on the phone and we've talked generally that we work on low base and high case scenarios for our investments. You know, we want to be okay in the event that the low case plays out. You know, it seems very likely that the low case is playing out at Comcast, and I would say that we are doing okay but not well in the investment. And I think that today, it probably represents just a cheap stock, although there is some probability that they can get some growth back into the business over time. But probably would not be the highest likelihood with the sort of probabilities of future outcomes.

And then Mark, the second part of that question?

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Mark: Sure. So going into questions about China and India, we've spoken in the past a few times how we've taken down our exposure to China quite meaningfully from a number of years ago.

And the punchline would be that when we originally had a larger exposure to China, our interpretation was that the economy was moving more towards free market tendencies, if you will. And over the last few years, it looks like it's turned more inwards towards essentially planned economy, with that in our minds becomes a more unpredictable situation and greater uncertainty, which makes it more challenging for us to underwrite investments with a long duration, and it's more suitable perhaps to more shorter-term trading-oriented decisions, which admittedly is not our strength. And with that, you've seen us pull back on our Chinese exposure quite significantly versus several years ago.

As for India, we've got no direct exposure. We obviously do have companies that have revenue that is generated from India, but we haven't yet built the muscle that would allow us to make direct investments within India. And we also do note that the valuations at which many of the larger companies trade at in India, at present, embed growth expectations that we might find challenging and difficult to underwrite, and that is commensurate with P/E multiples, if you will, or enterprise value or free cash flow multiples that are significantly north of where we currently—where we typically transact.

Brian, back to you.

Brian: Thanks. Thanks, Mark. We'll go to the questions coming in. There's one that I think is kind of mechanical about how we manage the portfolio, and it says, **"When you reduce equity exposure…" and I'll maybe say or we increase equity exposure or any other exposure, "…what do you do to fund those investments or what do you do with the cash that's generated when you sell something? Does it just go into treasuries or cash?"**

And the short answer is yes, we don't make, in general, a one-for-one buy/sell decision or reweight decision into the other names. Now we may in some environments, but as a general rule, when we buy something, we draw down cash and purchase it. And when we sell something, we just, it goes into whatever our mix of cash is, which has recently been commercial paper and treasuries.

Brian: Go ahead, Steve.

Steven: **There is a question, "How do you define a quality business beyond ROE?"**

And while that was answered in the prepared remarks, I'm going to repeat what I said earlier then maybe Brian and Mark want to add to it, but a quality business, we think of those with a very strong protective moat around its business; a business that generates returns on capital, not just the ROE but on an unlevered basis; the ability to—ideally, not that it's a necessity—but to reinvest that capital in its own business; or, you know, very, very—a management team that is very strong on capital allocation, that runs the business well, and is shareholder-friendly. Mark, Brian, do you want to add to this?

Brian: Mark?

Mark: I don't have anything to add.

Brian: Okay. I'll say something, to make it brief, but durability, growth, and management would be the things I would add to that, to put in a little punchline.

"I noticed in the Q2 commentary that the Fund shorted S&P, SPY. Can you please elaborate why?"

A couple of reasons. One, things seem a little bit expensive. We want to reduce exposure and we did not—we want to manage taxes over time as well. And so the combination of those two kind of drove that decision.

Steven: And that's the end of the prepared remarks questions as well, so Ryan, we'll turn it back to you for closing.

(00:22:00)

Ryan: Yes, thanks. There were one or two questions that we will respond to offline and get back to clients on. And if we missed your question, we apologize. Please feel free to email us at crm@fpa.com or feel free to reach out to your relationship rep.

Thank you, everyone, for listening to today's webcast, and we now turn it back to the system moderator for closing comments and disclosures.

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, typically within a few weeks, 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.

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 keep you appropriately informed on the strategies discussed today.

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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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