

## **Q4 2024 FPA Queens Road Small Cap Value Fund (QRSIX) Webcast February 11, 2025**

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*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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**The prospectus for the Fund dated September 30, 2024 and corresponding supplements, can be accessed at: <https://fpa.com/request-funds-literature>. The most current prospectus can always be obtained by visiting the website at fpa.com, by calling toll-free, 1-800-982-4372, or by contacting the Fund in writing.**

(00:00:00)

Moderator: 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 question in the questions and answers panel and click New Question to submit.

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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 Jon Cusa.

Jon, the floor is yours.

Jon: Thank you so much and good afternoon, everybody. Welcome to the FPA Queens Road Small Cap Value Fourth Quarter Webcast. We appreciate you taking the time out of your day to join us. My name is Jon Cusa. I'm the product specialist and sales support for the strategy that has been managed by Steve Scruggs since its inception in 2002.

In just a moment, you will be hearing from Steve, who will take you through recent performance and offer some general comments on the year. Our senior analyst Ben Mellman will touch on some of the criteria the team uses to sort through the universe and help identify names they want to invest in.

[Please see slide 2] 2024 marked another period of excess returns over the benchmark for the strategy, lifting both 3- and 5-year returns to figures north of 300 basis points over the index on an annualized basis. Perhaps most impressive is that the team has been able to do this with less risk, which has become a hallmark for the strategy.

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Morningstar doesn't make it easy to compare funds with over 20 years of history but they do measure 15-year stats, and over the last 15 years, Steve's fund ranks number 5, having the best Sharpe ratio in the Small Cap Value category over the timeframe. Similarly, the Fund is number 1 on the 15-year ranking of Sortino ratio, which connects directly with the Fund having the lowest down-market capture over the same timeframe. We'll look at this a little bit more closely in a few moments.

The Fund is a 5-star fund by Morningstar, and total asset just surpassed \$850 million, which is a new high but still well away from any capacity constraints.<sup>1</sup>

At this time, I'd like to turn the call over to our portfolio manager Steven Scruggs to offer a few prepared remarks. Steve?

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<sup>1</sup> Source: Morningstar as of 12/31/2024 **Morningstar Small Value** portfolios invest in small U.S. companies with valuations and growth rates below other small-cap peers. Stocks in the bottom 10% of the capitalization of the U.S. equity market are defined as small cap. Value is defined based on low valuations (low price ratios and high dividend yields) and slow growth (low growth rates for earnings, sales, book value, and cash flow). As of December 31, 2024, there were 497 funds in the category.

**Morningstar Rating:** The Morningstar Rating™ for funds, or "star rating", is calculated for funds and separate accounts with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. For more information about the Morningstar Rating for funds, including its methodology, please go to [global.morningstar.com/managerdisclosures/](https://global.morningstar.com/managerdisclosures/). The FPA Queens Road Small Cap Value Fund was rated against the following numbers of the Small Value Category funds over the following time periods: 464 funds in the last three years (Category Rank 38%), 441 funds in the last five years (Category Rank 30%), and 349 funds in the last ten years (Category Rank 23%). Past performance is no guarantee of future results.

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Steve: [Please see slide 3] Thank you, Jon, and thank you all for joining us this afternoon as we go through a recap of 2024 performance for the FPA Queens Road Small Cap Value Fund.

I think we had a great year last year. The Fund, we outperformed our benchmark. We were up 10.76% versus a little over 8% for the Russell 2000 Value. We were pleased to see that.

If we look through the year, as most of you remember, it was a pretty choppy year for small caps. There were some strong runs and some strong selloffs throughout the year, and our relative performance in each of those different types of markets was very consistent with what we've historically experienced. And that is, during the selloffs we held up well, and during the strong runs we lagged a little bit, most notably the huge small cap rally in July. But through it all, we outperformed, I think, meaningfully and we did so with much less volatility.

(00:04:00)

[Please see slide 4] As we look through the portfolio management changes during the year, you can see on this slide, we added three new positions.<sup>2</sup>

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<sup>2</sup> The company data and statistics referenced are sourced from company earnings calls, transcripts, and press releases, investor presentations, and financial disclosures (e.g., 10Q, 10-K) unless otherwise noted. The information provided does not reflect all positions purchased, sold or recommended during the period..

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Advance Auto Parts—which we spoke about at length in our last call.<sup>3</sup> Advance, they're an auto parts distribution business. It really struggled after an acquisition seven years ago, brought in new management, getting back to basics, rationalizing their distribution. I think it's a great industry to be in, and I think they've brought in a great management team that's going to be able to fix the very identifiable problems that they've had. So this is a holding that we have a really good—a lot of, very confident in.

Another holding we added was John Bean Technology, which is now called JBT Marel. It's food service equipment; they have a very broad portfolio, dominating a lot of the positions they're in. For instance, 75% of the citrus juices in the world are produced with their technology, and they dominated other industries similarly. It's a very well-managed company. It sold off during the second half of 2023 and we started buying early last year. It's another one that we feel really good about.

And then AGCO, the agricultural products manufacturer. Primary lines are in their Fendt and Massey Ferguson tractors. It's a really innovative company. They spend over \$500 million a year in R&D. They've made some changes. They've consolidated some lines, their two

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<sup>3</sup> [https://fpa.com/docs/default-source/funds/fpa-queens-road-small-cap-value-fund/quarterly-webcasts/fpa-qr-small-cap-value-fund-webcast-presentation-2024-06\\_watermark.pdf?sfvrsn=2a729e9d\\_3](https://fpa.com/docs/default-source/funds/fpa-queens-road-small-cap-value-fund/quarterly-webcasts/fpa-qr-small-cap-value-fund-webcast-presentation-2024-06_watermark.pdf?sfvrsn=2a729e9d_3)

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main line—two of their big lines into the Fendt line, and they're really giving John Deere a run on the high-end tractor market. They've done some good work realigning their dealer network and are doing some great things in precision agriculture. And if we look at the ag market, it's been, spending's been really soft for the last several years, and we think how the company's positioned and the valuation it's trading at, I think when this market comes back, they're going to do really well.

(00:06:22)

As far as significant additions to the portfolio throughout the year, Enstar, which is a specialty insurer that we started buying just a couple of years ago, we added to that pretty significantly, and only to see management made what we think was a low-ball buyout offer to take the company private, which shareholders approved. And while we did do well on that, we would have much preferred to have—let that company compound over time. It's a very unique business model that we really liked.<sup>4</sup>

Another significant addition, Science Applications. They are a federal contractor focused primarily on enterprise IT. About 70% of their business is through Department of Defense, and they have a—they specialize in areas that require high-level security clearances, which many

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of their programmers and engineers have. It gives them a bit of a competitive advantage. Recently, the stock has been beat up on a lot of the DOGE fears, and management has addressed this directly. They are concerned and monitoring it, but they're confident that they are going to be okay. Because they are, they're a critical contractor and if you look at the services they provide, they generate reasonable but competitive margins. So trading pretty cheap, there are some worries there, but we—another one that we feel good about.

(00:08:04)

Throughout the year, we had a few takeouts. American Equity Life; Livent, the lithium producer; Aaron's, the rent-to-own company which we had just started buying not too terribly long before it was announced that they were going to be taken private as well.

And then if you look at the reductions, so you've had some of our biggest and longest-term holdings you can see we have been selling off, and to a certain degree continued to. These—each of these companies, we would consider very high-quality compounders. They've all performed really well for us. But as their valuations have increased, they are moving up towards the upper end of what we call our range of reasonableness. And for risk management reasons, we have begun to trim, and some of these we'll continue to trim.

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So for the year, turnover 19%, which is in line with our history, and from this you can see that most of the turnover was portfolio management trades; it wasn't jumping in and out of new companies.

[Please see slide 5] So when we talk about long-term focus and quality compounders and how we like to have our—our preferred holding period is forever, it's not just as though we buy companies and forget about them. We do like to have the long-term holding periods. We think it's best for return. It's also more tax-efficient.

But a company like Sprouts Farmers Markets is a great example of how a company can be extremely well-managed, we like everything about it, but it doesn't stay in the portfolio too terribly long. It's still in the portfolio, but we started buying about two years ago. They had brought in a new manager—or a few years ago—brought in a new manager. They've made some changes. And the changes, the strategic changes that they've made have been—have worked out really well. And over that time period, the stock's up about 400%, and earnings are up not quite double, are up 157% I guess. And accordingly, the P/E has gone from about a 14 to the low 30s.<sup>5</sup>

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<sup>5</sup> Source: Factset. References to 'time period' reflects the period January 1, 2023 through December 31, 2024 for the data related to Sprout Farmer's Market's ("SFM") share price and earnings, where earnings reflects the price to earnings using one year forward EPS estimates. This share price change may not equate with the performance of the holding in the Fund. As of December 31, 2024, SFM represented 4.0% of the Fund's assets. **Past results are no guarantee, nor are they indicative, of future results.**



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So this is an example of—we talk a lot about we focus on quality companies, we're willing to pay up for quality, but only to a certain extent. And this is an example where a company can move too much too quick, even though it's a great company, and we're going to trim, and oftentimes trim significantly. So that's the short story on Sprouts Farmers Market.

One other thing I would point out is last year we started using a process called ReFlow. What ReFlow is, they're a liquidity provider that allows for mutual funds to redeem redemptions in kind as opposed to having to pay cash or to sell appreciated equities to pay cash. This is a really powerful tool. We're excited about it. So we think this is a great new process that's going to benefit our shareholders.<sup>6</sup>

(00:12:05)

[Please see slide 6] If we look here, you can see the top 5 contributors to performance and the top 5, or bottom 5, detractors. Those 5 on the top you can see are among many that we have trimmed back on. They performed remarkably well through the year and we have reduced holding size on valuation.

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<sup>6</sup> Please refer to the Fund's current prospectus for more detailed Distribution and Tax information as it may relate to an investment in the Fund and for information relating to the ReFlow Liquidity Program ("Reflow"). **Note that Reflow can only be used when the Fund has net redemptions.** The primary purpose of Reflow is to manage a fund's liquidity when a fund has net redemptions. Reflow provides cash to meet redemptions by purchasing fund shares up to the value of the net shares redeemed which helps funds to avoid forced selling. Reflow will then periodically redeem their entire share position and request that the fund meet the redemption with an in-kind distribution of securities. **There is no guarantee that the use of Reflow will increase the tax efficiency of the Fund, and as noted, the Fund cannot use Reflow when it does not have net redemptions.** This is not intended to be, nor should it be construed as tax advice for investors. As always, you should consult your tax adviser about the potential tax consequences of an investment in the Fund under all applicable tax laws.

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As far as the detractors, some of you all will notice those as long-time holdings. We think that most of those were specific industry or company-specific situations through the year that caused some short-term underperformance, but we still remain very optimistic on their long-term prospects.

One thing I'd like to point out on this slide too is if you look at the sectors—and to remind everyone, everything we do is bottom-up. So we're not making sector calls or industry bets. We look bottom-up at individual companies, and where we're seeing value is what determines our sector weights. And if you look at the diversification, if you will, of our contributors and detractors across sectors, and if you looked closer you would see across industries, it really, I think, reinforces the point of our bottom-up view and that it's not like we made an industry bet on a particular industry that either did really well or did really poorly. So that diversification across the variance in our holdings is something that we like to point out.

[Please see slide 7] Top 5 holdings—I'm not going to go through each of these. Happy to talk to anybody if they'd like to get in-depth on any of these companies offline, but again, those are the top 5 holdings.

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They've been really good performers. Great companies. Some valuations are creeping up, so.<sup>7</sup>

(00:14:17)

[Please see slide 8] So this slide is a very, I think, a good summation of our overall portfolio characteristics, and we talk a lot about the disconnect between valuations in large cap companies and small cap companies, and we talk about small value versus small growth. And the way the broad portfolios look may look very cheap, but when you dig into them, they're not as cheap perhaps as they look. And so we're not buying an index—and we like to point that out. Bottom-up buying, searching for high-quality investments that are trading at a discount.

So if you look at our portfolio characteristics—this is a very simplified version—but we have 51 holdings, 96% active share, so as I say, we do deviate from the benchmark a great deal. But if you look at, for instance, the return on equity, 5-year return on equity, on average for our portfolio it's about 15.5% versus about 5% for our benchmark. So we have a--using this as a general rule, we have a higher-quality average portfolio.

But if you look at the next two lines, using just a simple P/E as a valuation metric, you can see that our average valuation is considerably lower than the index. So we're—I think this is good evidence that we're

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<sup>7</sup> Past performance is no guarantee, nor is it indicative, of future results.

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doing what we set out to do, and that is to buy higher-quality companies at cheaper prices.

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And you can see under that, our 5-year performance and what that leads to, these high-quality, inexpensive companies—reasonably inexpensive companies. You see our upside market capture there, [approximately] 76%. We talk a lot about giving up some of the upside in an advancing market. That demonstrates that. But below there, you can see a downside market capture of only [approximately] 63%. So, participating enough in the upside and holding up much better in the downturns, that's what's generated that 3.5% alpha over the last 5 years, doing so with very low turnover.

[Please see slide 9] Continuing on with performance, we use this slide a lot. I think it's a really good representation, really, both of our historical performance as well as what market performance expectations are.

If you look, each of these squares on the chart is a rolling 5-year return since inception of the Fund, and on the right side those are the rolling 5-year returns where the Russell 2000 Value was up greater than 10%. And about 90% of the time, we underperformed. I like to point out, we underperformed—our average return was about 12% versus about

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14% for the index. So while we did trail, we had very meaningful participation.

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If you look at the center part of that graph, that chart, you'll see what we call a normal market—0% to 10% on a rolling 5-year basis. There's [what we believe is] a reasonable amount of risk priced into market. In those markets, we outperformed almost 80% of the time, by just under 2%.

And then on the left side, you'll see down-markets, when the rolling 5-year was negative. Since inception, we have outperformed 100% of the time and also, while the index's average return was a negative 1.75%, we had an actual, an average positive return of just over 2%. So we like to say we make our money in down-markets.

[Please see slide 10] This, since inception, the Fund's experienced—there's been 20—there have been five times where the Russell 2000 Value has fallen 20% or more, since [the Fund's] inception. Each of those times, we have outperformed, and anywhere from outperformance of just over 11% [1102 basis points] to just over 19% [1930 basis points].

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So the downside protection<sup>8</sup>, as we talk about a lot, is very important to the process and return profile, but we often say quite simply that downside protection is great but at the end of the day, our ultimate goal is for our investors—of which we are significant investors in the strategy—is to end up with the most money over the long term.

(00:20:07)

[Please see slide 11] And I think this very simple chart does a wonderful job of illustrating that. The green line is the index. The blue line is our strategy and you can see that, steadily and consistently over time, we have widened our margin over the index. And we've, again, we have done so while taking less risk, measured by either volatility or downside capture.<sup>9</sup>

[Please see slide 12] So next, I'm going to let Ben talk a little bit about what we've been looking at, what we've been seeing, and how we've been going about looking at those.

Ben: We've been writing about quality in our letters for the past two years. At Queens Road, we are value investors but we sit firmly on the quality side of the aisle.

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<sup>8</sup> **Downside protection** refers strictly to a strategic investment goal and is not meant to imply any guarantee against loss, including the loss of the entire principal amount invested.

<sup>9</sup> Value investing does not protect against loss of principal and there is no assurance that the FPA Queens Road Small Cap Value Fund ("Fund") will meet its investment objective. Portfolio composition will change due to ongoing management of the Fund. Past performance is no guarantee, nor is it indicative, of future results.

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[Please see slide 13] Most of our listeners have seen this chart showing that small caps trade at a historic discount to large caps. Yet we have shown that, looked at in multiple different ways, the small cap indices are junkier than the large cap indices. This means that there are fewer quality small companies than large companies.

[Please see slide 14] On screen is a chart published by GMO in their September letter that shows that returns on capital for small caps have been declining for 20 years. We think this makes a compelling case for active management in small caps.

(00:21:55)

At Queens Road, we own a collection of [what we believe are] quality small companies trading at reasonable valuations, and we ignore the junk. At a time when large cap indices are expensive and index breadth is narrowing, we think that quality small companies look relatively attractive and that our portfolio provides investors with prudent diversification and peace of mind.

[Please see slide 15] Relatedly, we get questions about our top-of-the-funnel process and how we use quantitative screens as a starting point for our company analysis. The truth is that we don't do anything fancy, but large portions of the Russell 2000 Value Index are uninteresting

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if you are looking for quality compounders trading at reasonable valuations that you hope to own forever.

So let's look at some numbers. Here we are looking at the percentage of the index that we are very unlikely to own. Starting with profitability, 25% of the Russell 2000 Value Index by weight and 45% by count is unprofitable this year [2024] or has been unprofitable on average over the previous 5 years. Conversely, 8% by weight and count are trading above 40 times earnings—quite expensive.

We avoid sectors and industries with poor historical returns and poor historical returns on capital. 12% of the index by weight and 19% by count is in energy, biotech, pharma, other commodities, or shipping, where we are very unlikely to ever own anything.

And finally, at the bottom of this page, we are liquidity-sensitive and 7% by weight and 35% by count have a free float below \$500 million, meaning they are hard for us to accumulate in size.

(00:24:00)

[Please see slide 16] Next, let's look at some more interesting characteristics that we might screen for. Indebtedness and returns on capital are two of our most important quality indicators. For these, the way we actually look at companies is more detailed and nuanced than a simple



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screen, but the study below should provide some sense of how much of the universe is the low quality.

Putting aside financials and utilities for now so that we can apply the right metrics, 16% of the index by weight and 17% by count have a debt to EBITDA ratio above 3 times. Looking at returns on capital, 35% by weight and 48% by count have a return on invested capital below 5%, a number at which we would struggle to believe that a company is creating economic value.

Now, looking at financials and utilities, 12% of the index by weight and 9% by count have a return on equity below 5%, again raising questions about those companies' ability to create economic value.

Summing it up, our rough estimate is that a little less than half of our benchmark by weight and a little more than half of our benchmark by count would not pass these basic screens of interest for the Fund.

Following the funnel analogy, we spend most of our time doing qualitative work on the remaining companies. As Steve always says, we are in the judgment business. Getting towards the bottom of the funnel, over Steve's long history with small caps, we think that at any time, there are roughly 150 small companies that we would describe as high-quality. We are obviously selective within that set for the portfolio.

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To give our listeners a sense of a company that ticks the high-quality boxes but that we do not currently own, Steve is going to spend a little time talking about Lancaster Colony, ticker LANC. Steve?

Steve: Thanks, Ben. Yes, Lancaster Colony is a very interesting company. It's one we've owned, we owned in the past, a while back, and sold on valuation. And they are in the specialty food business, and it's primarily, it's salad dressing and frozen bread. It's a really high-quality company in spite of an industry that is a little bit challenged. Has a wonderful management, all the things that we like to see. There's net cash on the balance sheet, consistent margins, a management that works hard to take out costs every year, returns on invested capital, returns on equity—all of the things that we like to talk about. But when we look at the valuation of this company, in spite of all that, the company, as you might imagine, in those categories that they're in, they grow low to mid-single digits. They do it with organic growth, which is impressive. Again, this is not to take anything away from management. I think it's a wonderful management. But when we normalized free cash flow and look at the normalized free cash flow yield for this company, it's around 3%. And while it is a high-quality company that we really like and are very familiar with, we are not going to pay 3% free cash flow yield for a company that's growing 3% to 5% a year.

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So this, hopefully this gives you a little bit of insights on how we think about—we talk a lot about what's in the portfolio but the fact that we have a long list of watchlist companies such as this that we continue to follow. Perhaps if valuation were to come down or if the growth prospects were to change, we would make another investment in this company. But for now, we're willing to pay up for quality, as we always say, but I think this is an example of the quality premium is not—the risk/reward on the quality premium is not there, so.<sup>10</sup>

(00:28:34)

[Please see slide 17] That's it for our prepared remarks. We can move on now. I think there are a few questions. Jon, do you have some questions for us?

Jon: [Please see slide 18] That's right, Steve, and thank you for those remarks, Ben as well. Yes, let's move into the Q&A section here of the webcast, and please continue to submit any questions that you might have. We'll try to get to as many as we can.

There have been a few here that we got ahead of time. Let me read those off to you, Steve, and you can comment accordingly.

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<sup>10</sup> Discussions about individual companies or sectors should not be considered a recommendation to purchase or sell a particular security or sector,

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The first question is about market cap, and it reads, **“We see a number of companies in the portfolio with market caps in the \$1-\$2 billion range but we also see a number that have grown much larger.”** And here they're referring to market caps in excess of, say, \$5 or \$6 billion. And the question really comes down to this, Steve, which is, **“How do these larger-cap names still fit the mandate of a small cap portfolio?”**

Steve: That's a good question. Let's see. One thing I'd say, the market structure has changed over the last 15-20 years that we've been doing this, and I think a lot of that has to do with the rise in private equity, the limited number of initial public offerings for quality small caps, and then also the number of small, high-quality companies that get taken private by a lot of this private equity that seems to be sloshing around.

(00:30:09)

And so, again, when we look at companies from the bottom up to find the best investment opportunities, whereas 15 years ago I would say \$1-\$2 billion was the sweet spot, that sweet spot is probably \$3-\$4 billion now when we're making an initial investment. So we don't buy midcaps but you are correct that we do have companies within the portfolio that are of larger size. And we'd say that I think this is an exhibit of our process working. That's what we want. We want small companies that are going to

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compound over time and our shareholders are going to benefit. So while we will continue to hold small caps that grow up to become midcaps, we don't buy midcaps at the time of purchase. We do have a policy in place. The largest market cap size that we will hold is formulaic. It's 2.5 times the largest company in the Russell 2000. So that gives us a lot of runway to hold these great companies and to continue to allow our investors' money to compound.

And we've had a company that we have been selling, and we are almost sold out of it, due to that. We started buying it. It was about \$1.5 billion market cap. We've sold it the entire way up. Today it's about a \$24 billion market cap company. And so we would consider that a success. We're not going to invest in mid or large cap companies but we will hold small cap companies as they continue to grow up to a certain size.

(00:32:03)

Jon: Perfect. Thank you so much for that. Now the next question takes us actually a little bit further out on the lens and it's going to ask about sort of sectors and industries and again, to some extent, the market cap range. And the question really is this, Steve, which is, **"How do you view valuations right now across these different areas, and are you seeing value in any particular area, sector, industry, market cap that you'd tend to favor?"**

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Steve: Well, everything we do, as I always say, is bottom-up. So if you see that the Fund has what would be considered an over-allocation, if you will, or an overweight to a sector, you can interpret that as that's where we're seeing value. Technology is an area where we've had what would be considered an overweight for quite some time. It's not a bet on technology per se. It is when we go through our process, of our disciplined process—we talk about the four-pillar process a lot. We go through that and it leads us to a lot of these small cap technology companies. These are not disruptive, speculative type small cap companies. These are process companies, distributors, component manufacturers, companies that have a long-term history of consistent profitability, good management, and they do take advantage of a lot of the trends in information technology but they are generally very broadly diversified. So it's not your—doesn't have the risk of what a lot of people might think of when they think of tech stocks and particularly small cap tech stocks.

As far as market cap range, as I mentioned earlier, when we're looking, we—you know, we will go down, as long as the company has enough liquidity, we're going to look at it. But where we're seeing the value primarily in quality value, is a little bit higher market cap company, I'd say, the \$3-\$4 billion market cap is kind of our sweet spot right now.

(00:34:22)

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And then the last part of that question was the quality of the underlying businesses versus valuations. That gets kind of back to, you know, our job is to constantly weigh quality and valuation, and if you look at our portfolio, we have high-quality companies, we're paying up a little bit, I believe a reasonable amount for that quality, but we do see a lot of companies that are high-quality that we're not invested in. I gave you the Lancaster Colony example earlier. There's a list of those. The quality premium, broadly speaking, looks a little rich. So some of the new positions that we're spending a lot of time on now are companies that aren't of the highest quality—they're quality companies but not as high as some of the ones I've mentioned—that have something specific going on with the company that we feel really good about. I think Advance Auto Parts is a great example of that. It's not of the highest quality. I think the new management's going to need to make some changes. [We believe] they've already started moving in the right direction. But we think a company like that, with its prospects, versus the price we're getting it for, that's a good investment given the opportunity set that we have today.

(00:36:16)

Jon: Great. I'm going to continue along the line of questionings here, Steve. The next one is a little bit different but I'm going to ask it anyway, and the question reads like this—and I think it's getting at sort of how large

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caps have been sort of in the headlines more so than small caps. And the question really is, **“What is going to be the catalyst to light the small cap flame?”**

Steve: We've been asking that question for about a decade now. It's a great question, and I would say, the first thing I would say is that having the advantage from a valuation perspective is always a good starting point, and I think we've shown—and it's been widely communicated—that small caps are cheaper than large caps. Small cap value is cheaper than large value, and then we won't even talk about growth. So starting from that perspective, we think that's a good spot to be in.

(00:37:43)

As far as the timing for when it's going to—when the catalyst is going to make itself known, that's impossible to predict. We think—we've heard a lot from our managements that the new administration, some of the things that they're saying with regard to regulatory relief, which is a very significant factor, especially for small cap—smaller companies. Companies are really excited about that and think that that can free up a lot of resources for more, I guess, productive goals. Lower interest rates would tend to help small cap vis-à-vis larger companies. So that could be something that could be a catalyst.



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But I'll also say, on the other side of that, the talk of tariffs, there's a headwind that we're facing. All companies are. When we look at the companies, our companies, the tariff scares, how much of that is positioning and how much is it really going to come to pass. But we have companies that tariffs would really help, and we have some that they would really hurt, and we can't—I don't think we're going to, nobody wants to make a prediction on trying to predict tariff policy by the administration with any detail. But we do think about it, and we think through what are the different outcomes that could happen, the probabilities, and how would it impact our companies, and we feel good about what we own. But I think regulatory relief, the potential of lower interest rates is a great thing, and then I think it's kind of offset perhaps by tariffs. And I think the Mag 7 selling off, we saw what happened a couple of weeks ago, some event like that could really, I think, ground everyone to look in other areas of the market where there might be better value. We clearly see better value in small value today than at the top end of say the Russell—I mean the S&P 500.

(00:40:03)

Jon: All right. Thank you so much for that. We've got a few questions that continue to come through and we're going to try to get to as many as we can. The next one here, Steve, is perhaps more of a business-related

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question. **It's asking about the ETF landscape and whether or not there's an ETF version of this strategy on the horizon. Any comments on that?**

Steve: Yes, we have talked about that a lot, and kind of active ETFs are a very hot spot right now. But there is, I think, a bigger issue and that is with an ETF, you cannot restrict capacity. So that would mean that we could not have a soft close or a close. And while right now we have about \$850 million, we have a lot of capacity left, but we could see, years down the road, getting to a point where it would be in our shareholders' interests to maybe soft close or even close, and we want to have that, the ability to be able to do that. Because, as most of you know who have invested in small caps over the years, the capacity constraints are a very real constraint.

Jon: Absolutely. We have a few more minutes here. I'm going to try to get to a couple more questions. This one is asking a little bit more about sort of the risk and worry in the system, and the question simply reads, **"What is your number one worry financially as you think about the market environment? Is it something like the national debt or the deficit? Anything in particular that has you in an area of concern?"**

(00:42:10)

Steve: Yeah. I think the national debt and the deficit are quite clearly very serious concerns. You know, the dollar's hegemony is the most important

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thing that, one of the most important things that the US economy has, and it is a requirement at this point. And so, evidently, the new administration is going to be very serious about tackling some of this wasteful spending. Again, I don't want to make any political comments one way or the other but you know, I think it's great that they're addressing it. It needs to be addressed. But how they go about doing it and what the ultimate results are, I mean they appear to be very committed and I think it's—I think, in the main, it's a good thing. But again, the disruption that could be caused by doing it in a way that is not very well-planned could cause some temporary setbacks. But so that's a big one, the deficit and what that—the effect that that's going to have long term on fiscal policy, tax policy, everything else.

Jon:                   Very good. And again, for those of you who are submitting questions, please know that if we don't have time to get to them today that we will follow up with you directly, but we do have still a few more minutes. Let's see if we can get to two more before we call it an afternoon here.

Steve, you've sort of addressed this already but just to reiterate, the question becomes, **“Is it becoming more challenging to find opportunities in that small cap space because there's so much activity taking place in private equity and a decrease in the IPO market? Are you finding more of your buys perhaps more in that**

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**SMID category by definition rather than pure small cap?”** And again, I know you’ve sort of offered some comments already but maybe you could summarize again.

(00:44:19)

Steve: Yes. No, I think, you know, I would say we have moved up the market cap. There's better quality in a higher market cap than what we used to see, generally speaking. I don't know where the small cap to the midcap line is blurred. We don't buy, generally speaking, we're not going to buy a company that would be considered a midcap. And again, as in general, market caps have risen, we would consider a \$5 billion market cap company as small cap. I think the largest company in the Russell 2000 market cap is maybe \$8 billion. So it is, it has changed. I think there's still a great number of wonderful companies. I think, we—I'm happy to go through the portfolio in great detail if anybody would like to, and we can talk about all the reasons we own what we own, and what great companies they are. But we're just seeing them at a little bit higher market cap entry point than we did 10 or 15 years ago.

Jon: Very good, Steve, thank you. Perhaps I'm going to invite Ben into the conversation here. **I'd say a very stock-specific question that's come in asking about VSH versus APH and whether or not they**

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**compete against one another. Ben, you want to offer a few  
comments on that?**

(00:46:00)

Ben: Sure, thanks, Jon. So we own VSH—it's Vishay Intertechnology. It's a sort of midweight portfolio holding for us. And Vishay is a component manufacturer. They make passive components, small electronic passive components like capacitors and resistors, as well as what we would consider less high-tech semiconductors. And APH is Amphenol, it's a much larger company that makes connectors, cables, and interconnect systems, and so they are not direct competitors although you can sort of think of them in the same way. Steve for Vishay uses the analogy as ball bearings for the old industrial economy, which is that these components are in everything. And I don't know Amphenol as well. They're too large for us. They are a midcap that has now probably graduated to a large cap. But it certainly has a reputation for being an incredibly well-run and successful company, and we would hope, and we are cautiously optimistic that some of the cultural changes that are going into Vishay, which we own, can hopefully produce some of the stellar results that investors in Amphenol have received over the years.

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So, short answer, not direct competitors but in a similar sort of corner of the market, and with Vishay, we are cautiously optimistic about the performance going forward.

Jon: Perfect, thank you, Ben. I am going to try to combine a couple of questions here and bring them into one. It's asking about more information on sort of the ReFlow process and the [redemption] in kind, if you will. And the question really is, **"If you could explain how that ReFlow process really works in greater detail, if capital gains should be eliminated or simply reduced, and why are you only able to use them or the ReFlow process when the Fund has daily net redemptions."** Ben, since you're on the phone already or have the microphone, do you want to go into a little bit of detail on that process itself? But I'd ask you to be brief because it does get pretty lengthy.

(00:48:35)

Ben: Sure. I'll go quickly and Steve, you can add on if you would like to. ReFlow, really the primary purpose is for liquidity management of mutual funds. And because it's a liquidity management tool, we only have the opportunity to make in-kind exchanges when we have net redemptions. And we've had some daily net redemptions but not many. The Fund is growing right now.

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So we'll use it to the best of our ability, but you should think of it as a tool in the toolbox like tax loss harvesting that [may] help take the total capital gains bill down. And we're certainly happy to talk through any additional details and mechanics. Just give us a call or reach out to Jon or any of the FPA folks outside of the call.<sup>11</sup>

Jon: That's perfect, Ben. And actually, with that, I think we're going to call it an afternoon here and conclude the session. On behalf of Steve and Ben, we thank you again for listening to our webcast. If we didn't have a chance to get to your question today directly on the cast, we're going to make sure that we reach out to you directly to make sure that you have the answers that you need. I will now turn it over to the system moderator for closing comments and disclosures. Have a great afternoon.

(00:50:02)

Moderator: [Please see slides 19-22] 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

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<sup>11</sup> Please refer to the Fund's current prospectus for more detailed Distribution and Tax information as it may relate to an investment in the Fund and for information relating to the ReFlow Liquidity Program ("Reflow"). **Note that Reflow can only be used when the Fund has net redemptions.** The primary purpose of Reflow is to manage a fund's liquidity when a fund has net redemptions. Reflow provides cash to meet redemptions by purchasing fund shares up to the value of the net shares redeemed which helps funds to avoid forced selling. Reflow will then periodically redeem their entire share position and request that the fund meet the redemption with an in-kind distribution of securities. **There is no guarantee that the use of Reflow will increase the tax efficiency of the Fund, and as noted, the Fund cannot use Reflow when it does not have net redemptions.** This is not intended to be, nor should it be construed as tax advice for investors. As always, you should consult your tax adviser about the potential tax consequences of an investment in the Fund under all applicable tax laws.

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

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