FPA CAPITAL

FPA CAPITAL FUND PORTFOLIO

Portfolio Date: 2018-12-31
Updated on 2019-01-11

Portfolio Overview

Portfolio:	FPA Capital
Fund Type:	Mutual Fund
Portfolio Date:	2018-12-31
Number of Stocks:	22
Equity Value:	$170.00 Million
Number of New Buys:	4
Q/Q Turnover:	18%

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I. Portfolio Overview, Profile

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Profile

FPA Capital Fund, Inc. (FPPTX) seeks long-term growth through investing primarily in carefully selected common stocks and select fixed income securities. -Fundamental bottom-up, deep value stock picking with economic and industry point of view -Capitalize on best ideas with concentrated portfolios -Focus on long term, turnover averaging less than 20% over 20 years

Investing Philosophy

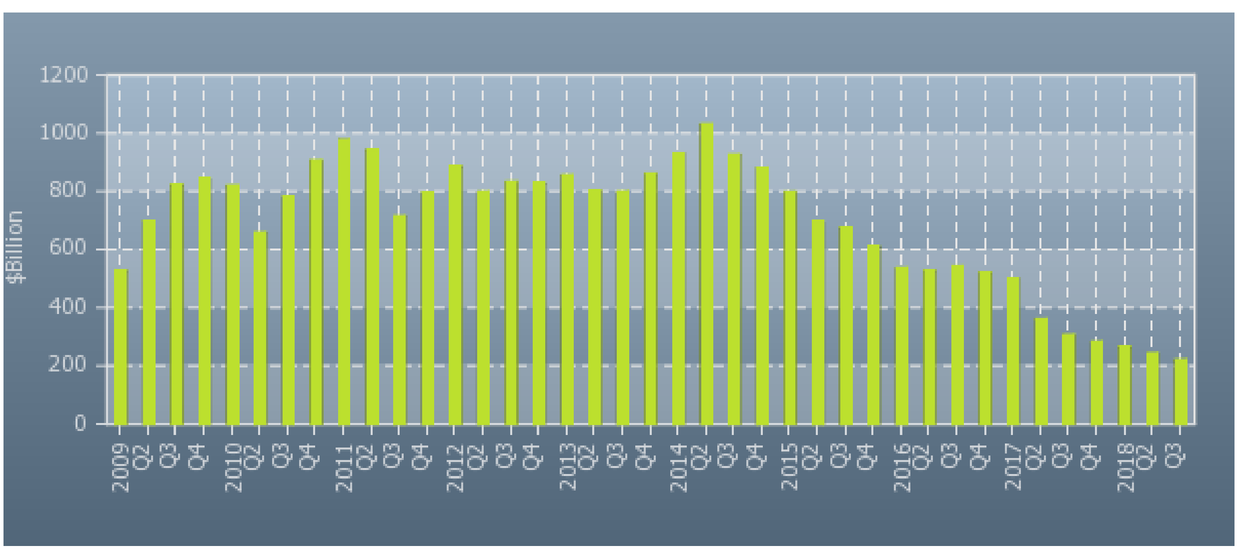
FPA Capital Fund primarily invests in the stocks of smaller companies. It selects stocks based on specific fundamental criteria: strong balance sheets, free cash flow, an understandable and successful business strategy under capable management, and unique business characteristics. The fund's purchases are concentrated in companies with relatively low Price/Normalized Earnings, low Price/Pretax Cash flow, low Price/Book Value, low Price/Replacement Value and low Market Cap/Total Revenues. The fund looks for companies with a track record of high returns on equity, and a long history. It sells stocks when the basis for investment has been revised, the stock is selling at a significant premium P/E to the market, profitability recovery has been attained, a management disappointment without expectation of recovery has occurred, or a superior alternative value has presented itself. The fund's portfolio generally holds 25-45 equities and its investment outlook is typically 3-5 years.

II. Performance of FPA Capital Fund

Year	Return (%)	S&P 500 (%)	Excess Gain (%)
2017	-5.11	21.71	-26.8
2016	22.86	11.99	10.9
2015	-17.16	1.24	-18.4
2014	-1.31	13.47	-14.8
2013	22.85	32.3	-9.4
5-Year Cumulative (Average)	**17.1 (3.2%/year)**	**107.2 (15.7%/year)**	**-90.1 (-12.5%/year)**
2012	9.69	15.99	-6.3
2011	0.9	1.9	-1.0
2010	24.25	15.05	9.2
2009	53.78	26.35	27.4
2008	-34.79	-36.79	2.0
10-Year Cumulative (Average)	**61.5 (4.9%/year)**	**125 (8.4%/year)**	**-63.5 (-3.5%/year)**
2007	-0.39	5.14	-5.5
2006	5.42	15.85	-10.4

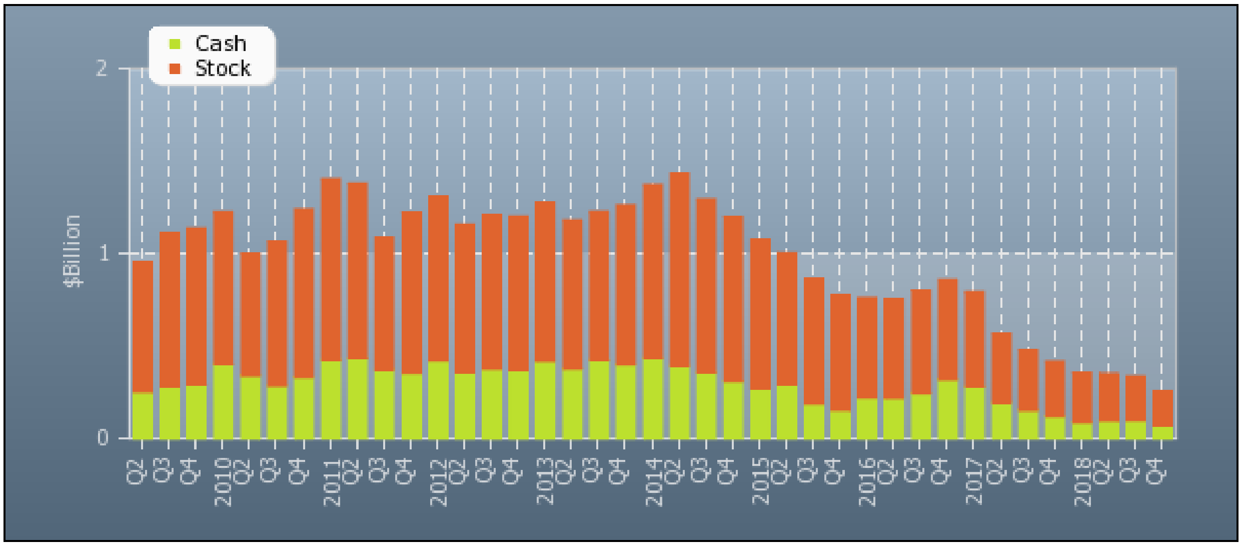
2005	16.53	4.83	11.7
2004	12.62	10.7	1.9
2003	38.54	28.19	10.4
15-Year Cumulative (Average)	**208.3 (7.8%/year)**	**307.7 (9.8%/year)**	**-99.4 (-2%/year)**
2002	-3.86	-21.58	17.7
2001	38.13	-11.76	49.9
2000	-3.08	-9.75	6.7
1999	14.24	20.4	-6.2
1998	-0.42	28.7	-29.1
20-Year Cumulative (Average)	**351.4 (7.8%/year)**	**294.5 (7.1%/year)**	**56.9 (0.7%/year)**
1997	17.7	33.47	-15.8
1996	37.76	22.49	15.3
1995	38.39	38.04	0.3
1994	10.37	0.4	10.0
1993	16.74	10.08	6.7
25-Year Cumulative (Average)	**1205 (10.8%/year)**	**883.9 (9.6%/year)**	**321.1 (1.2%/year)**
1992	21.57	7.62	13.9
1991	64.51	30.47	34.0
1990	-13.8	-3.1	-10.7
1989	24.3	31.69	-7.4
1988	18.11	16.61	1.5
30-Year Cumulative (Average)	**3202.9 (12.4%/year)**	**1955.8 (10.6%/year)**	**1247.1 (1.8%/year)**
1987	10.75	5.1	5.7
1986	12.57	18.6	-6.0
1985	28.95	31.6	-2.6
1984	7	6.1	0.9

III. Historical Total Value ($Billion) of Filings

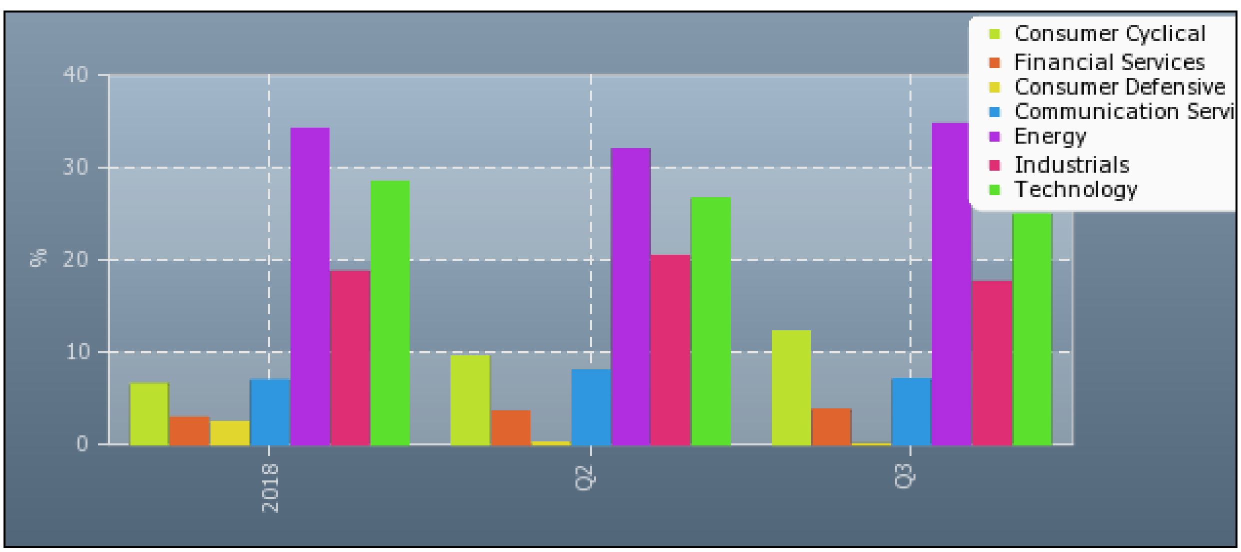


V. Equity, Cash, Bond Asset Allocations

VI. Historical Equity, Cash, Bond Asset Allocations



VII. Industry/Sector Shift in Past 12 Months



VIII. Comments by FPA Capital Fund on Stocks in the Portfolio

FPA Capital Comments on Cision Ltd.

As part of our effort to improve portfolio quality without sacrificing our conservative standards on valuation, we initiated a position in Cision Ltd. (NYSE:CISN) during the first quarter. At the time of underwriting, CISN was just six months removed from its IPO, poorly covered by the street, and was trading at a significant discount to other vertical software peers.

The company is the clear leader in an otherwise fragmented (point solution driven) market and provides the only comprehensive SaaS platform for public relations and marketing communication professionals at 91 of the top 100 worldwide brands and 96 of the top 100 PR companies in the U.S. Our research suggests that CISN can generate attractive long-term organic cash flow growth by converting customers away from a typical infrastructure of disparate point solutions, to its closed-loop SaaS platform, allowing it to grow well beyond its 20% share of the PR Software and Services market. Further, the company recently launched the first monitoring tools that truly quantify ROI on earned media campaigns (i.e. Nike can track spending online and at retail stores that stems from a marketing campaign coordinated with a widely followed Instagrammer). Our survey work covering current and potential customers clearly indicates that this could make CISN's software offering more of a necessity. It could also significantly increase the company's total addressable market by enabling it to enter the much larger Marketing Software market. It's important to understand that there's a clear consensus view that earned media generates significantly higher ROIs than the dominant paid media category (i.e. banner ads, etc.), yet earned media marketing budgets remain very small because reliable attribution tools were previously unavailable.

Finally, we believe that CISN has a great cash-flow profile. The company has predominantly recurring revenues, EBITDA margins gravitating to the high 30s, and the majority of that EBITDA is converted to free cash flow because of low capital investment requirements.

From FPA Capital's second quarter 2018 shareholder letter.

FPA Capital Comments on Tenneco

Tenneco (NYSE:TEN) is one of the cheapest auto parts supplier stocks in the market today, trading at about 4.0x next 12-month EBITDA. Peers trade at much higher multiples -- nearly 7x next 12-month EBITDA, reflecting investor fear that Tenneco's exposure to the internal combustion engine (ICE) will ultimately send its business into a long-term secular decline.

We believe investors are missing a few critical points:

- Many market participants worry about pure battery-based powertrains (where TEN has no content) taking market share. But even if those vehicles garner a 10% market share, Tenneco could still have content on 90% of vehicles sold.

- More stringent regulation (already in place) will continue to increase Tenneco's content per vehicle each year over the next decade.

- Tenneco's Ride Performance & Aftermarket businesses (nearly 40% of EBIT) are largely agnostic to powertrain choice.

Over the last three years, management expressed confidence in the business by buying back stock (nearly 20% of shares outstanding) and routinely reiterated the points we made above. But the market continued to focus on secular decline worries, ignored content/vehicle growth, and would not assign a higher multiple to the secularly growing and less cyclical Ride Performance & Aftermarket businesses. We were left with a situation where earnings were expanding, but the multiple was contracting.

Doing more of the same was not an option. In order for each business to be appropriately valued, Tenneco needed to be split up so the secularly growing and stickier Ride Performance & Aftermarket businesses would be valued separately from the Clean Air business. Furthermore, with a simpler story, the Clean Air business could focus on returning its very strong cash flows to shareholders, potentially attracting a more value-oriented investor base.

Unfortunately, each business was too small to independently support its own public company cost structure, so alternatives needed to be explored. The recently announced Federal Mogul transaction allowed the separate businesses to get enough scale to profitably operate independently. Tenneco paid 5.4x EBITDA (including synergies), which we view as a fair price. While the deal does add leverage above levels we like to see from an auto parts supplier, management is focused on reducing leverage rapidly and has established reasonable targets for each business. Furthermore, we take solace in the debt term structure, which avoids material maturities until 2022.

In our view, the Federal Mogul transaction provides an opportunity for a substantial multiple rerating of both businesses, as capital allocation decisions to maximize FCF and shareholder returns can be prioritized in one business, while reinvestment in growth can be prioritized in the other.

As with any deal, we would always like to see a cheaper purchase price and less advantage used, but we believe this deal is a stepping stone toward long-term value creation.

From FPA Capital's second quarter 2018 shareholder letter.

FPA Capital Comments on Cimarex Energy

XEC has historically been a price taker that favors flexibility in order to sustain corporate-level returns above its cost of capital, and as such, has minimal hedging on the books to offset wide price differentials over the next year. The stock has been under pressure for this reason and because management has opted to defer returning capital to shareholders in favor of investing in higher-return growth opportunities (which they stress test for 10%+ corporate level ROICs at $40 per barrel oil). This came at a time when E&P's were (rightfully) being chastised for destroying shareholder value with overinvestment (or poorly timed investments?) and asked to prioritize dividends and share repurchases over volume growth. Although we understand this rationale quite well, we do not believe in putting every E&P in the same bucket, especially one like XEC, which we believe is a top-tier capital allocator compared to its peers.

From FPA Capital's second quarter 2018 shareholder letter.

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