FPA investors first

FPA International Value Fund

Quarterly Commentary

1st Quarter
March 31, 2013

Dear fellow shareholders,

During the first quarter of 2013, the Fund rose 4.32%[1] which compared positively to the MSCI All Country World Index's (ex-U.S.) (Net) (the "Index") gain of 3.17%. Since inception on December 1, 2011, it has returned a positive total return of 22.32% versus 14.07% for the Index. At the end of the quarter, we were about 60% invested (down from 66%[2] at December 31, 2012). Over the quarter our cash stake averaged around 40%.

New Additions to the Team

We added two key members to the International Value Team during this quarter. As highlighted in our last quarterly commentary, Victor Liu joined the Firm from Causeway Capital Management on January 30, 2013. Jason Dempsey joined FPA as Senior Vice President on March 18, 2013. Jason was previously Research Analyst at Artisan Partners and prior to that, he was Analyst at Deccan Value Advisors. Similar to Victor, Jason is a seasoned long-term value investor with a strong bias towards business quality, and a high caliber individual with a unique background. We expect him to play an important role in the management of the Fund going forward.

Artistic Block

While we deployed some capital over the course of the quarter in a manner that is consistent with our investment philosophy, we found ourselves unable to move forward with many of the new ideas that we had identified in the past few months. Within the top ten research priorities from our mid-January trip to the Nordics, only one company traded down over the remainder of the quarter. The other nine were up on average 15%, with five of them up between 15% and 33%. The continued rise in prices we have experienced is making it increasingly difficult for us to find new compelling investment opportunities.

The curse of absolute investors is to be confronted daily with their failure to find ideas in an increasingly expensive market. As we cannot rest on a fully invested approach, we feel challenged to look further and dig deeper to unearth elusive new bargains. In times like these, we are like artists confronted with creative block. Unlike them however, what we don't put on the canvas says much about our art. Our paralysis is a testament to our discipline and a reflection of how strong we feel about not investing at any cost. If we don't invest, it means all potential candidates we have encountered simply fail to meet our full set of investment criteria.

Given the buoyant markets and scarcity of genuine bargains, we urge investors to not give too much weight to the out-performance that the Fund has delivered relative to the Index. Continued run-up in market prices typically translates, for us, into increased cash exposure and reduced margins of safety[4], as reflected in the

[1] The large inflow the Fund received on the first day of the year significantly impacted relative performance because the Index appreciated 1.84% during the first trading day of the year.
[2] The percentages shown exclude a subscription receivable of $20.8 million received by the Fund as of 12/31/12 in order to more accurately characterize the portfolio manager's investment allocations.
[4] Buying with a "margin of safety," a phrase popularized by Benjamin Graham and Warren Buffet, is when a security is purchased for less than its estimated value. This helps protect against permanent capital loss in the case of an unexpected event or analytical mistake. A purchase made with a margin of safety does not guarantee the security will not decline in price.

continued decline of the portfolio's price to value ratio[5]. At the end of the quarter, our holdings offered a weighted average discount to our estimated intrinsic value[6] of about 27% (versus 30% at December 31, 2012). In the short-term, this may be detrimental to relative returns. On the other hand, eschewing expensive stocks, levered businesses, and companies or management teams of lesser quality helps reduce the risk of capital destruction and positions us to take advantage of market corrections. We believe this will allow us to achieve our stated goals and encourage shareholders to consider the Fund's performance over the long term.

For now, we continue to scour the globe for new ideas. This includes a recent trip to Latin America, researching companies that we consider potential investment candidates while patiently waiting for their stocks to trade at a significant discount to our estimates of their intrinsic values. Market opportunities, like a muse, cannot be summoned, but when they finally present themselves we will not be lacking inspiration.

Key Performers

Our best performing holding in the quarter was **Travis Perkins** (up 24.82% in US currency). Based in the UK, Travis is the country's leading builders' merchant with a strong plumbing and heating distribution business, and the third largest player in retail "Do It Yourself". Builders' merchanting is a necessary channel as there are too many small contractors for manufacturers to sell direct. While the industry is fragmented, relative market share is key to delivering good customer service. As the dominant player, Travis possesses significant scale advantages. This should allow them to widen their competitive moat during difficult times, and ultimately drives profitability. Given its superiority in size, deep knowledge of the market, and entrenched positions in lucrative regions, the group has consistently outgrown its peers and delivered industry leading margins. This is also a testament to the team of industry veterans that has run the business with consistent operational excellence and a focus on returns. Operating returns on capital employed[7] are close to 30%. Free cash flow[8] generation is strong, while the balance sheet is robust with leverage at less than 1x net debt to EBITDA[9]. Assuming little support from Travis' challenging underlying markets, we bought into this name at 9x earnings and a free cash flow yield of 10% back in the second quarter of 2012. Our interest in the company remains as long as we can hold the stock at a significant discount to intrinsic value.

Our worst performing holding in the quarter was **Vesuvius** (down 4.80% in US currency). The company is an offspring of Cookson which we added to the portfolio last quarter. Based in the UK, it is the world's leading manufacturer of metal casting production equipment (such as filters, feeding systems, and coating products) and steel flow control products (such as pipes and valves). These products are typically short-lived consumables tailored to customer needs and account for a small portion of the end product cost, yet reduce defects and improve yields. Vesuvius is a clear leader with a market share in excess of 50% in both products. It generates good margins and operating returns on capital employed in excess of 20%. The current CEO, the former division head, is an industry veteran. He's shown a strong focus on operating efficiency and sound financial discipline, and has been refocusing the group on its core businesses. The balance sheet is healthy with leverage at around 1x net debt to EBITDA, and the business averages high free cash generation over time. With that, Vesuvius trades at less than 8x earnings and a free cash flow yield of about 9%. Cookson had

[5] Price to Value (Price to Intrinsic Value) is a term to describe the market price of a security compared to our estimate of intrinsic value.
[6] The actual value of a company or an asset based on an underlying perception of its true value including all aspects of the business, in terms of both tangible and intangible factors.
[7] A return from an investment that is not considered income.
[8] Free cash flow (FCF) represents the cash that a company is able to generate after laying out the money required to maintain or expand its asset base.
[9] Earnings before Interest Tax Depreciation and Amortization. EBITDA is essentially net income with interest, taxes, depreciation, and amortization added back to it, and can be used to analyze and compare profitability between companies and industries because it eliminates the effects of financing and accounting decisions.

been a strong contributor to performance last quarter following the spin-off of Alent and we had reduced our exposure according to the lower margin of safety[10]. We have added to the position on weakness and Vesuvius is now one of the largest holdings in the Fund.

All Stars Aligned

While the quarter was rich in frustrations with two investment candidates taken private and several others, in particular from our recent trips to Asia and the Nordics rallying beyond what we would consider appropriate discounts, we found a couple of reasons not to despair. With potential new ideas we never rush to a decision, no matter how enticing the prospective returns. We take the time to get to know the business, build our understanding of the fundamentals through proprietary research, gain comfort with management, and assess the intrinsic value of the company with confidence. We want all the stars to be aligned before investing and are happy to wait patiently, sometimes multiple years, for this to happen.

We experienced a couple of these rare occurrences in the past three months and seized the opportunities to make some additions to the portfolio. We initiated two new positions, one in France-based Danone and another one in Italy-based Interpump. **Danone** is a company that we have followed for a long time. It is the world's leading producer of fresh dairy products and we believe a superb franchise with substantial room for value creation. While management has shown great strategic foresight in repositioning the firm's old food portfolio towards attractive categories such as fresh dairies, baby formula, and medical nutrition, they had somewhat disappointed operationally over the last couple of years. They were able to recognize this and have recently placed greater emphasis on operating efficiency, notably through cost saving initiatives. With that, we think Danone now has all the ingredients - that is the right combination of price and quality - for us to be invested.

Interpump is the world's largest manufacturer of high and very high pressure pumps. It is also the leading player in power take-offs for trucks. We have followed Interpump for many years and believe that it is a great company. At the third quarter results, Interpump's long-standing chairman Giovanni Cavallini announced that he was parting ways with the rest of the management team and life-long business partners. With Giovanni's departure and having been the face of the business to the market for years, the stock fell 15% in the weeks following his departure. It took some time for us to be able to perform the necessary diligence as to what led to his decision to leave. With no identifiable material change in the business, we proceeded to invest in the company and were able to take advantage of the residual weakness in the share price to become shareholders.

Faithful Volatility

We sold out of Alten in the quarter, for the second time since the inception of the Fund. Based in France, **Alten** is a European leading provider of engineering services and was among the Fund's original holdings. We had sold it in the first quarter of 2012 and bought it again in the following quarter on renewed weakness. Since then, the stock had returned 70% (in US currency) and no longer offered what we believed was a high margin of safety[8], so we exited the position. This is a good company that we will continue to monitor while waiting for another opportunity to invest. Our conviction is that we will be presented with such an

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opportunity at some point. We can always trust market dynamics to feed volatility thereby presenting us with hectic pricing and valuation anomalies[11].

The turnover in this case isn't what we would typically expect. Over the long run, we plan to stay invested about three to five years. This is neither a requirement nor a target. Market volatility is what ultimately dictates when we buy a stock and how long we hold on to it. As valuation driven investors, we buy companies that meet our investment criteria when their stocks trade at significant discounts to their intrinsic values. We weight these investments in the portfolio based on relative attractiveness. As the margin of safety[6] diminishes, we reduce exposure and eventually sell out of a position, no matter what the resulting holding period. When irrational markets offer us an opportunity to sell, and shortly after present us another chance to buy the same business we know well with little incremental work required, we are only too pleased to oblige.

"Self-Plagiarism"

What comes next is mostly a repeat of what we wrote last quarter and feels like "self-plagiarism". Given the limited activity, the general profile of the portfolio didn't change much over the last three months. The Fund is still geared towards companies domiciled in Europe. This is a reflection of where we continue to find the most compelling opportunities, as our approach is agnostic to geographic or sector exposure. In addition, many of our holdings operate globally and generate large portions of their future cash flows outside Europe. Where business value is created is what matters to us, rather than where a company is headquartered or incorporated.

While we appreciate the recent success of the long Japanese equities (preferably exporters), short yen trade, we see no reason to amend our assessments of individual businesses and management teams based on the underlying change in macro sentiment. Weak financial discipline is what often deters us from investing in otherwise sound businesses in the region. Another limiting factor has been insufficient discounts to our estimates of intrinsic value. We continue to review some intrinsic value estimates of local companies on our focus list assuming sustained change in the US dollar to Japanese yen exchange rate. When conducting a review, we take a neutral approach whereby we don't assume further currency devaluation. We consider how the business has dealt with years of strong yen through financial or natural hedging, and how it is impacted, both positively and negatively, by the weaker currency. At this stage, we haven't identified material net variations that would warrant investments. As a result, the Fund still has no exposure to companies domiciled in Japan.

While we are reluctant as bottom-up investors to comment on the macro environment, we see little change in the general status of the world's economy, despite unshuttering enthusiasm in capital markets. We are mindful of high levels of debt, in particular at sovereign levels, structurally weak financial institutions most notably in Europe, the likelihood of more tax pressure along with further austerity measures, and slower economic growth especially in mature markets. We worry that large injections of liquidity into the economy might lead to inflation, and are concerned with governments exceeding their mandates while failing to live-up to their missions, which typically translates into increased interference with the normal course of business.

Our approach is to focus on those businesses that are less likely to be impacted by state interferences, businesses that the world needs and thus, businesses that can not only withstand but also benefit from macro challenges. We are concerned about macro conditions only as far as they have an impact on a specific business and on our assessment of its intrinsic value.

[11] Disconnects that arise in the short-term between fluctuations in stock prices and business values.

Unaltered Conviction

Like we traditionally do in our quarterly commentaries, we conclude by reminding shareholders of our belief that discipline and consistency are key to achieving superior returns over the long run. As long-term absolute value investors, our focus is on competitively advantaged businesses with strong balance sheets run by capable management teams that we only invest in at significant discount to intrinsic values.

Given our absolute value philosophy, we may experience short-term relative underperformance in a prolonged market rally. This would leave our conviction unaltered. In any event, we will continue to measure the Fund's progress based on the value that our businesses build over time versus the limited risks of unfavorable outcomes we assumed. We will be content with our capital appreciating and sustainably so, even if at a lower rate than the market. Lastly, we will find comfort in owning financially robust, resilient businesses, and in having the liquidity to take advantage of future market dislocations. In the long run, we believe that our approach will result in our stated goals while carrying much less risk of permanent losses.

As always, we thank you for your confidence and look forward to continue serving your interests as fellow shareholders of the FPA International Value Fund.

Respectfully submitted,

The International Value Team

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