

LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

This Semi-Annual Report covers the six months ended September 30, 2000. Your Fund's net asset value (NAV) per share closed at \$26.73. The NAV reflects a distribution of \$5.83 on July 10, 2000, to shareholders of record on June 30, 2000. This distribution included a \$0.09 income dividend and a \$5.74 capital gains distribution, \$4.13 of which was long-term.

The following table shows the average annual total return for several different periods ended on that date for the Fund and several comparative indices. The data quoted represents past performance, and an investment in the Fund may fluctuate so that an investor's shares when redeemed may be worth more or less than their original cost.

Average Annual Total Return
Periods Ended September 30, 2000

	<u>1 Year</u>	<u>5 Years</u>	<u>10 Years</u>
FPA Capital Fund, Inc. (NAV)	12.95%*	13.46%*	23.11%*
FPA Capital Fund, Inc. (Net of Sales Charge)	5.61%‡	11.95%‡	22.28%‡
Lipper Mid-Cap Value Fund Average	24.24%	14.25%	15.88%
Russell 2000 Index	23.39%	12.38%	16.93%
Standard & Poor's 500 Stock Index	13.28%	21.69%	19.44%

The Fund's six-month return, which includes both the changes in NAV and the reinvestment of distributions paid, was -1.45%*. This compares with total returns of 4.91% for the Lipper Average, -2.71% for the Russell 2000, and -3.60% for the S&P 500. On a calendar year-to-date basis, these same comparisons are: 5.73%* for FPA Capital Fund; 11.70% for the Lipper Average; 4.18% for the Russell 2000; and -1.39% for the S&P 500.

Reopening of FPA Capital Fund, Inc.

We will reopen your Fund to new investors on January 1, 2001. The maximum sales charge is also being lowered from 6.50% to 5.25%, with adjustments to the break points. We decided to

reopen since we are of the opinion that there are a growing number of attractive investment opportunities. Since your Fund closed on May 23, 1995, we have witnessed a herd mentality, in which the majority of new investment dollars have been directed towards high-growth/high-expectation stocks. These massive dollar flows, toward a limited set of stocks and sectors, have left many other areas languishing. While the major market averages exhibit P/E ratios in high 20s, a large portion of the stock market is closer to a 12x P/E. This is among the widest valuation spreads in years. With the majority of investment dollars being directed toward growth and technology stocks, a wide variety of value stocks are being neglected. This is creating an investment opportunity we wish to share with additional investors.

When we closed your Fund, it was never our intention to close it permanently. We wanted to control the Fund's growth so that we could deploy your capital prudently. At the time, we were concerned that the Fund was on the verge of growing too rapidly to achieve this goal. In several interviews after the Fund's closing, I was asked what it would take to reopen your Fund. My answers have always been the same. First, there would have to be a plethora of investment opportunities. Second, it would be at a time when there was very little interest in the value style of investment management. I believe both of these criteria have now been met. While your Fund was closed to new investors, the Fund's Adviser has added additional investment professionals. Dennis Bryan, Rikard Ekstrand and Steven Romick now assist in the management of your assets. Each has extensive corporate and investment experience ranging between seven and fifteen years. I am excited because we work as a team toward a common goal of superior investment performance. We are all convinced that this is an excellent time to take advantage of the numerous undervalued investment opportunities we see.

* Does not reflect deduction of the sales charge which, if reflected, would reduce the performance shown

‡ Reflects deduction of the maximum sales charge of 6.5% of the offering price

To remind our existing shareholders and acquaint our new shareholders to our investment philosophy, I thought it would be helpful to briefly review how we invest. We are value investors, which means that our style of investing requires discipline, patience and a long-term outlook. We are not exceedingly preoccupied with short-term performance numbers since our investment time horizon is typically three to five years. Our portfolio turnover rate generally averages 20%, which implies a five-year holding period. Our focus is on individual companies that possess a position of business leadership or a market niche. They are financially strong with generally improving cash flows in industries or market sectors that are "out of favor," and have low normalized P/E ratios and low P/BV (price/book value) ratios. We do not depend upon a "top-down" strategy of economic or stock market forecasting, since it is difficult to consistently foresee these trends. We are also contrarian style investors. You will see us investing in companies that are generally "out of favor" and "unloved."

Commentary

We believe we are in a market that is moving to a much broader investment base. For most of the last three to four years, the primary focus of investment dollars has been toward high-growth and technology stocks with little attention to valuation. In our opinion, many investment managers have compromised their valuation standards so as to be "players" in this stock market. During the past year, we wrote about the valuation excesses we saw in the stock market. Because of our discipline, our one- and five-year performance numbers lag the S&P 500 Index and the Lipper Average. We now believe that this trend is in the process of reversing. For example, the Nasdaq Composite, which is dominated by high-growth and high-technology stocks, has declined 19.6% for the six-month period ended September 30. More and more of these high-expectation stocks are witnessing deflation in their stock prices. We believe this trend is still in its early stages since we have not witnessed a large net-redemption cycle on the part of aggressive-growth funds or technology funds. Aggressive-equity-fund net cash flows totaled \$75 billion for the nine months

ended September, or 36% of total equity-fund net inflows for the period. This amount represents 2.7 times 1999's total for the entire year, the former record for net cash inflows. Technology-sector funds gathered 21% of the total or \$45 billion. When we begin to see net redemptions occurring with greater frequency, we will be more inclined to invest in technology stocks.

An example of this trend might be helpful. In our March shareholder letter, we did a comparison between a recent purchase, Centex, and technology stocks. We argued that Centex could not be appropriately priced if tech stocks were properly valued; and if Centex was correctly valued, tech stocks could not be properly valued. Since we began discussing this idea back in March, Centex has risen approximately 70% while the Nasdaq has declined about 36%. With the stock market's recent expansion in breadth, there appears to be a growing belief that some of these "old economy" stocks deserve investment dollars. We are convinced that we recently witnessed one of the great speculative periods in the history of the stock market. Despite the sharp price declines in technology stocks, many have not fallen enough to correct their extreme overvaluations. We believe they have entered a "bear" market phase similar to the one that has been occurring in the broader stock market since February 1998.

In light of these trends, we added another "old economy" stock to the portfolio: **Celanese**. It is a leading international chemical company with dominant market shares and low cost leadership in its core chemical segments. The company was recently spun out of the German conglomerate Hoechst AG. We purchased it at 45% of book value, 2x depressed cash flow and 27% of sales. Senior management has invested one year of personal income into the stock. The company has also repurchased 10% of its outstanding shares. Its current profitability is being negatively impacted by the rapid rise in its raw-material energy cost. We believe that this is a temporary situation that will correct itself within the next year. In light of this, we eliminated our energy investment, **Enso International**, which was acquired in February of

1999, when oil prices were at the \$12 level versus \$36 currently. The stock has more than quadrupled. We are taking a portion of the proceeds and deploying them into companies that are being negatively affected by the rise in energy cost. This is an example of our style of selling into enthusiasm while purchasing pessimism. Investors typically overreact at both extremes. We generally try to take advantage of these trends.

During the past six months, two stocks have hurt your Fund's performance: **Ross Stores** and **Conseco**. Ross declined approximately 40%, from 11x earnings to 7x earnings. We find this amazing since the company is earning in excess of 30% on equity with no debt. There are no operational problems other than a slowing in its current business trends. We believed that this was a possibility; however, we thought that this risk was generally factored into Ross's share price by its low valuation. The company is currently in the process of repurchasing 25% of its outstanding shares with its free cash flow. We do not believe that this stock can remain at this depressed valuation level for an extended period of time. Conseco, in contrast to Ross, has experienced operational problems. When Stephen Hilbert, the chief executive officer, announced the sale of a key subsidiary, Green Tree, in response to an asset write-down, we thought this was a strategic blunder. After two months of extensive analysis, we communicated our thoughts to the senior management and the board of directors. The board decided to replace Mr. Hilbert with Gary Wendt, the former head of GE Credit. We were very pleased with the announcement. He has since rescinded the sale of Green Tree and has proceeded with a more rational restructuring program. During this process, the stock declined to a price level that, we believe, will prove to be very attractive and, therefore, we have increased the position significantly. During our analysis, we reexamined several credit criteria for every outstanding financing of Green Tree since 1985. Our conclusion is that the portfolio is stable and generally performing within the underwriting guidelines. We will keep you informed on this situation.

As you may have noticed, we paid a large

capital gain distribution in July. Those gains were the result of the elimination of AVX, Comdisco, EnscO, and Keithley Instruments, and the reduction of Arrow Electronics, Avnet, Kemet, and Michaels Stores. The eliminated positions reflected price levels that we could no longer justify from a valuation standpoint. Except for Kemet, which we have almost completed selling, the primary reason for reducing the holdings was to diminish their sizable exposure in the Fund. Arrow Electronics and Avnet continue to be the largest positions. Given the reductions in our technology holdings, some may wonder why we continue to hold these positions. They are the two largest worldwide electronic distributors and have materially enhanced their competitive positions recently. Shortages continue in several key component areas, and this trend creates a positive environment for distributors. Arrow and Avnet are valued at approximately 8x earnings.

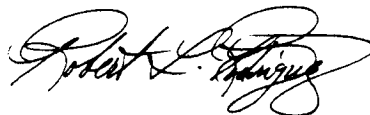
After the portfolio changes, your Fund continues to maintain a competitive valuation advantage over the market. At the end of September, the Fund's P/E and P/BV ratios were 15.6x and 1.5x, respectively. By comparison, the P/E ratios of the Russell 2000 and the S&P 500 were 25.5x and 28.5x, while the P/BV ratios were 2.5x and 5.2x, respectively. Our companies are financially strong, with a 31.8% average Total-Debt/Total-Capitalization ratio, which compares favorably to the 35.5% and 41.4% for the Russell 2000 and the S&P 500. The portfolio's median market capitalization was \$444 million, while its weighted-average market capitalization was \$1.5 billion. The Russell 2000's median and weighted-average market capitalizations were \$490 million and \$1.1 billion, while those of the S&P 500 were \$8.4 billion and \$134 billion, respectively.

We believe 2001 will prove to be a challenging investment year. In our opinion, expectations for the market's earnings growth rate are too optimistic. For example, estimates for growth in the S&P 500's earnings for next year range between 10% and 15%. We believe a 6% or less growth rate is more likely since revenue growth and corporate profit margins are likely to erode. During the first half of next year, we expect cost-

push inflation, from growing labor and raw material cost increases, to be more prevalent. Furthermore, we still think there is a possibility that the Federal Reserve will increase the Fed Funds rate one more time, in response to a more proactive fiscal policy. We believe the economy will remain reasonably strong for the first half of the year, with real GDP growing at better than 3%. During the second half of the year, the economy is likely to enter a more significant slowdown phase. Should these expectations prove to be reasonably accurate, the stock market will probably have difficulty making any material headway. This is an environment we look forward to since it is one that typically favors stock pickers. We believe and hope that the period of buying any technology or growth stock with a story, without any consideration of its valuation, has

come to a close. These past three years have been difficult for us because so much money has flowed toward many stocks where a rising price was predicated on the "greater fool" theory of investing. Only time will tell if this trend has essentially ended. We thank you for your continued investment and we hope to welcome many new shareholders.

Respectfully submitted,



Robert L. Rodriguez, C.F.A.
 President and Chief Investment Officer
 October 13, 2000

MAJOR PORTFOLIO CHANGES

Six Months Ended September 30, 2000

	<u>Shares or Principal Amount</u>
NET PURCHASES	
Common Stocks	
Celanese AG (1)	250,000 shs.
Conseco, Inc.	265,900 shs.
Oregon Steel Mills, Inc.	13,600 shs.
Storage Technology Corporation	445,600 shs.
Westcorp	78,120 shs.
 NET SALES	
Common Stocks	
Arrow Electronics, Inc.	19,500 shs.
Avnet, Inc.	23,870 shs.
ENSCO International Incorporated (2)	1,000,000 shs.
KEMET Corporation	100,000 shs.
Michaels Stores, Inc.	260,700 shs.
 Non-Convertible Bonds & Debentures	
Trump Atlantic City Associates —11¼% 2006 (2)	\$ 4,000,000
U.S. Treasury Inflation-Indexed Notes —3¾% 2007	3,308,460

(1) Indicates new commitment to portfolio

(2) Indicates elimination from portfolio