Brande: Good afternoon and thank you for joining us today. We would like to welcome you to the fourth quarter 2013 webcast for the FPA Perennial Fund. My name is Brande Winget and I'm Senior Vice President here at FPA.

The audio and visual replay of today's webcast will be made available on our website, fpafunds.com.

It is my pleasure to introduce the portfolio management team Eric Ende, Steven Geist and Greg Herr, of our Small Mid Cap Quality strategy which includes our FPA Perennial Fund, as they review the funds performance, discuss portfolio related events and current positioning.

Now, I would like to hand the presentation over to Steven Geist.

Steven: Thank you, Brande. As usual, we'll start off with performance for both the fourth quarter and the year. You can see that for the fourth quarter and the year, Perennial had some really strong returns—close to 7.5% for the quarter, over 30% for the year, which are on a standalone basis very good returns. Unfortunately the Russell 2500 had even a better year, so we're a little bit below the index for 2013. If you look at results for longer periods of time—say, 5, 10, 15 years—you can see that Perennial still matches up fairly well with the index, and certainly well above the S&P 500.

For the fourth quarter, I've listed the five best and worst performers for Perennial. These are in order of positive dollar impact or negative dollar impact. The largest positive dollar impact for the portfolio in the fourth quarter was Heartland Express, which is a short to medium haul trucker. During the quarter they announced an acquisition of Gordon Trucking, which the market was very happy with. And in a few moments, Eric Ende will be discussing that acquisition in a little bit more detail.

The second largest positive dollar contributor was ScanSource, which is a distributor of specialty technology products—automatic identification equipment, etc. They reported an excellent first quarter, and the market warmly greeted those results. And right after this call, they'll be reporting their second quarter, so hopefully we'll have some good news there as well.

On the negative side, CarMax had the most significant negative dollar impact on the portfolio. The stock itself is only down 3%, but it is a rather significant weighting within the portfolio. When they reported last quarter's earnings, they indicated that at least one of their subprime lenders was starting to engage stricter lending practices. So the Street became a little bit worried about what that would do to the CarMax auto finance contributions to operating income. However, CarMax also announced that they would be internally generating more subprime loans. So it'll take some time to see how that works out in the long run. However, again the actual hit to the share price was really not that hard.

Going to the year-to-date performance, you can see that on the positive side we had some very significant returns for all five of the top performers, and they were also some of the larger weightings within the portfolio. At the top of the list, O'Reilly and Signet, both retailers, posted very strong returns, followed by three industrial companies that again posted solid returns and again were fairly significant positions within the portfolio.

On the negative side in terms of negative dollar contribution, L'Occitane, the health and beauty products company had the largest negative return even though it's a fairly small weight within the portfolio. Unfortunately they had some same-store sales declines in Japan, and growth slowed down significantly in China. The two countries represent mid-teens of the total revenue of the company, and China had been one of the fastest growing economies for L'Occitane. So the market was not pleased with those results.

At this point, I'd like to turn it over to Eric where he'll be discussing a couple of the truckload companies.

Eric: Last quarter we discussed a possible deal by one of the truckload carriers in our portfolio and the favorable consequences that might follow for us. We would like to bring the Perennial shareholders up to date on this and other similar activities.

The industry displays dynamic change. There are deals proposed and deals rejected. Government regulation gets tighter, and there are signs of a revival of industry demand. Looking specifically at the proposed unfriendly Knight acquisition of USA Trucks, the deal is neither on nor off. Progress, if any, is well concealed. Since we believe that the deal as proposed by Knight would have the potential to be highly beneficial, we find this absence of progress discouraging. The fact that the Knight offer has been $9 per USA Truck share and its recent price is about $14 is also disheartening.

However, there is a more positive outcome. Knight still expresses a willingness to negotiate, and increased offer price is a possibility. If the proposal ultimately goes nowhere, the result would be that USA Truck is replaced by a different target. Knight's high operating margins, powerful balance sheet, and well regarded management are strategic assets which might be directed towards a different merger target with this similar ultimate effect.

As a consolation for our Knight problems, in mid-fourth quarter, Heartland Express announced a $300-million friendly purchase of Gordon Trucking, a deal which looks a lot like USA Trucks. The combined fleet will be the fifth largest in the industry, just ahead of Knight, with an operating ratio that is much in need of improvement and the promise of a geographic and cultural fit, which could help to make that improvement happen.

We continue to hold a substantial position in the truckload industry, currently about 7.5% of the portfolio. We see three ways to win here. First, strong managers with tracks records and capital structures to match can be expected to deploy and manage such assets to the ultimate benefit of shareholders. Second, it should be noted that there is a strong macroeconomic influence on truck transportation. The economy gets stronger; more trucks drive around. Continued economic recovery should continue to be a positive support to our portfolio position. And finally, just as increased demand benefits the industry, reduced supply also should be helpful.

What will be the cause of this? Well, numerous new federal tracking regulations are in the process of implementation. The best known are hours of surface rigs. These reduce hours per driving shift, as well as total hours driven per week. Other regs being added or enforced more stringently, including electronic logging devices, sleep apnea testing, traffic tickets, speed limiters, and drug testing methodology… when combined, we expect these changes to have the same impact as directly reducing the driver population and truck fleet. This effective reduction in industry capacity will pose operating challenges throughout the industry. But we expect that large well managed companies like Heartland and Knight will be best equipped to handle them.

Now I'd like to ask Steve Geist to talk about one of our portfolio holdings, Clarcor.

Steven: Thank you, Eric. Clarcor is a worldwide manufacturer of air and liquid filtration products. Some of their products go into heavy duty engine market, which is… those engines are used by the two companies that Eric was just speaking about. Clarcor has annual sales of over a billion dollars, and a large portion of their sales is actually replacement filters, which is a very high margin business.

In December, Clarcor completed the acquisition of General Electric's air filtration business. The annual revenue of this business is around $230 million. Purchase price was about $265 million. The benefit to Clarcor of this business was it provides Clarcor with exposure to the gas turbine filter business, which Clarcor had previously lacked. The gas turbines are used in power generation where they GE engines to generate the power.

Clarcor at the time of the acquisition had about $200 million of cash on the balance sheet, with minimum debt. It's speculated that the acquisition could be funded about 50% cash and 50% debt. All those detailed haven't been released as of yet. Depending on the exact financing arrangements and whether the filter business meets the growth objectives, estimates are that acquisition could be $0.20 accretive to Clarcor this year.

The primary competitor in the gas turbine filter business is a company called Donaldson, which is a former portfolio holding of ours. So we're quite familiar with that company. Donaldson is a $2.5-billion revenue company, so it's larger than Clarcor. But they will dominate the gas turbine filter business. Between the two of them, they'll control roughly 40% of the market share.

Also as part of the acquisition agreement, Clarcor will continue to supply filters to GE's turbine manufacturing business under a multiyear supply agreement.

Now I'll turn it over to Greg to talk about Signet.

Greg: All right, thank you, Steve. The last company we want to talk about today is Signet Jewelers, and this is a business we've discussed many times before. But very briefly, the company operates jewelry chains in the U.S. and the U.K. A little more than 80% of the operating profit comes from the U.S. And you might recognize their two biggest chains in the U.S., Kay Jewelers and Jared.

So we wanted to talk about three things today with Signet. The first is how they go about sourcing the diamonds that they sell. The second topic is their holiday sales recap. And then third is an activist hedge fund has taken a stake in Signet, and that was a recent announcement. We wanted to talk about that for just a minute.

So starting with diamond sourcing, we went back and looked at, over the last 12 years, the industry's trends in supply and demand for diamond stones. And diamond jewelry sales grew faster than supply in nine of those 12 years. If you look ahead over the next few years, the industry is forecast to grow mid single digits in terms of the demand. At the same time, supply growth is likely to be flat over that time period. So we think the result is going to be upward price pressure on diamonds. And typically when that happens, retailers don't have many options. All they do is try to pass the price increases on to their customers. And this is in particular a significant problem when you get into larger stones. The bigger the diamond, the harder it is oftentimes to pass along the price increases.

So what we wanted to talk about today was the fact that Signet has enough scale to try to do something about this. And the first way they're doing it is an announcement in November that they purchased a polishing factory for polishing stones in Botswana, which is actually the largest supplier of diamonds in the world. The country produces about 25% of the supply every year. The second they thing they've done is open a buying office in India for rough diamonds.

And you can see from the table on this slide that what they're doing effectively is moving up the supply chain with the polishing factory, as well as buying the rough stones. They're doing this for two reasons. The first is each of those steps in the supply chain, there's some margin involved. And so hopefully Signet will be able to capture some of that and offset potential price increases. The second thing they're doing is trying to get access to larger diamonds and better quality diamonds that they'll need over the next few years in what potentially is more of a constrained supply environment.

So all that sounds great. Coming with it of course, they've purchased $35 million in rough stones already. That's about 2% of their outstanding inventories. And of course that's an increase in the working capital. Also there's investments being made to set up these facilities, and then of course they have to actually track this inventory, which is a lot harder to do and verify it in Botswana and India than it would be in Akron, Ohio where the company has their main inventory tracking facility in the U.S. So net-net we think this is something that could help offset some of the faulty goods pressure that might be resulting from higher diamond prices over the next couple years.

The second thing we wanted to talk about was holiday sales, and the headline on this slide is that the company missed expectations, which is technically true. Consensus I think was 5.5% growth for the period. Signet did 5%, which given the overall weak retailing environment around the holidays we think is pretty good. It was weak in terms of people going into the stores, as well as fairly promotional. Signet actually had a 50 basis point impact to their gross margins from some discounting, and we think that's very much in line with what we saw in the industry. Just to put it in perspective, you can see here how Signet's results compared against some other retailers, and overall we would say we're quite pleased with the results and think that the management executed well given the environment.

The final topic for Signet is just the news that Corvex, which is an activist hedge fund, has acquired roughly an 8% stake in the company. They've been talking to management about optimizing the capital structure, which is another way of saying: go out and borrow some money, increase your balance sheet leverage, and either buy back shares, pay it out as a dividend, maybe do some M&A.

So we looked at this announcement, and we recognized that Signet does have balance sheet capacity. It would be possible for the company to borrow and do some of those things. We would point out, however, that it is a net cash balance sheet because of the business. I mentioned working capital a few minutes ago. Holding inventory, jewelry inventory, is expensive, and working capital's typically 40% of sales. Also the company has a credit portfolio where they extend credit to about half of the people that purchase jewelry from them, and so the ability to fund that credit portfolio is also a reason to maintain a very unlevered balance sheet.

So were they to borrow and do any of the things… the activities mentioned a minute ago, it's something that might be beneficial for the stock price in the short term. We're not convinced that adding leverage is something that really improves the business profile over the longer term. So this is something we'll be watching pretty closely as announcements unfold.

So with all that said on Signet, this is a business that we think has the potential to grow in the mid single digits over time. Normalized comp sales probably have the potential to be in the 2–3% range. The company also has the ability to grow square footage 2% or 3% a year. That, combined with some margin improvements and share repurchases, we think allows the company to potentially grow earnings per share in the high single digit to low double digit kind of range.

And this is a business that, despite the working capital needs that we mentioned, still can generate a 13%, 14% return on capital employed. That's what they've done historically, and we think that there's certainly potential to do that in the future as well. So we continue to be comfortable with our position in Signet. We think it's being run very well by the management team, and the business fundamentals continue to be quite solid.

So with that, we'd be happy to take any questions, and let me turn the call back over to Brande.

Brande: Sure, and thank you, gentlemen. And thank you to those of you who have submitted questions in advance. We've also received some questions during the call, and we'll now run through these in turn and answer each.

So the first question we have is: are there any indications of pickup in inflation?

Steve?: Yeah, Brande, that's a good question. Given what the Fed and the ECB and the Bank of Japan and all the other central banks around the world have been doing as far as increasing money supply and expanding their balance sheets… was something we're watching pretty closely. But the short answer to the question is we're not seeing much as it suggests a pickup in inflation. If you look at the… things are still fairly deflationary in the EU region. Commodity prices certainly are not going up, especially as the dollar's been strengthening, and labor cost inflation is still very subdued. So at this point, we don't see anything that's signaling a big pickup in inflation.

Brande: Right. Okay, thanks. The next question is: how do you go about looking for things of interest? Are you coming to ideas through brokers, through a 52-week low list, or what are some other sources?

Steven: Well, ideas are generated from many different sources. Certainly we attend broker-sponsored conferences where we might… each one of us might see 20–30 companies over a course of a few days. Our offices are located in Los Angeles, and we have quite a few company management teams coming into our office throughout the year, so we can meet and speak with them during these periods. When we speak with companies, in addition to talking about their specific company, we also talk to them about their vendors and customers so that we may gain additional insights on their companies. We do read broker analyst reports and industry pieces, trying to generate ideas as well. We do some limited computer screening to see if anything pops up there as well. And I also do look at some of the 52-week low lists—more than the 52-week gainers since I've already missed that opportunity. So the loser list is sometimes a source of ideas. And really the bottom line is anything we're reading or listening to that mentions a company, we'll do a quick screen to see if it meets our financial metrics. And if it does, we'll take it from there.

Brande: All right, thanks, Steve, for that. And next question is: with the volatility in the market, have you made any recent changes to the portfolio?

Greg: The answer, Brande, is that, as the market is sold off at the start of the year, we did have the opportunity to add one new position to the portfolio. That's Bed Bath & Beyond, which I'm sure most of you know is a retailer both of the stores with the same name, as well as a few other chains. And this is a business we've known for a long time. It generates significant amount of free cash flow, and it has a management team that we think really… they have a meaningful ownership stake in the business, and they do run it as if they were owners. It generates low teens operation margins. The balance has no debt. Returns on capital are in the high teens. And we were able to establish a position at what we think is a pretty attractive valuation. We're paying less than eight times EBIT and getting a 7% free cash flow yield. So with all those metrics, we decided it was a pretty good opportunity, and we started to buy some of the Bed Bath & Beyond.

Brande: All right, great. Thanks, Greg. Any implications with the emerging market trouble for any of your companies?

Greg: That's also a pretty timely question. I guess I would say that there are a number of companies in the portfolio. Eric mentioned Knight and Heartland, which are domestic truckload carriers. I was talking about Signet, which is a U.S. and U.K. business. So there are a number of companies that have zero exposure to emerging markets. I guess if we step back overall for the portfolio, we would probably say that overall sales for the portfolio on a weighted basis, probably 15–20% of those come from emerging market geographies.

What see from the company so far are people lowering expectations based on the changes in the foreign exchange rates. Nobody's really cut estimates or lowered guidance based on reduction in demand, but that's probably coming. And I guess I would say just overall the portfolio is not… it has some exposure, but it's certainly not heavily geared toward the results that are going to come out of emerging markets.

Brande: Okay, thanks, Greg. And can you give us an update on Life Technology?

Steven: Yes, Life Technologies is a long-term holding within the portfolio. And if you look at the back of the package with portfolio holdings, you'll see that it's no longer held in Perennial. For those of you who can remember, Life Technologies is a global life sciences company producing systems and reagents that are used in the research of genes, proteins, and cells.

We initially reported just about a year ago in the fourth quarter 2012 webcast that the company had hired two investment banks to assist in the strategic review of the company. Through various discussions with potential buyers, it was finally announced on April 14th of 2013 that Life Tech entered into a merger agreement with Thermo Fisher Scientific where Thermo would buy Life Tech at $76 per share in cash, making it roughly a $13-billion acquisition.

Perennial Fund sold its shares of Life in early December at well over $75 a share, so capturing pretty much all of the final price that Life will be sold for. Life had been in the portfolio since the third quarter of 2004, so it was a long-term holding, and as typical of the lifespan of a company within the portfolio. It's been recently announced that the last remaining regulatory holdout, the Federal Trade Commission, should finally be clearing the acquisition in a matter of days. And so that will put the final end to Life Technologies' independence.

Brande: Thanks, Steve. And given valuations, are you pushing for dividends rather than share buyback for the management teams you talk to?

Greg: So on the question of dividends versus share repurchases, it's kind of a long subject. But I guess what I would say just to answer the question is that we're always suggesting that the companies be sensitive to the price they pay when they buy back their shares. And what we see is in practice the management teams typically get it wrong, and—this is for the industry overall, the market overall—they're typically buying the most stock when the prices have gone up the most. If we go back and we look at 2007, that's when we had record share buybacks. Then of course in 2008, the amount of shares repurchased was down something like 70% for the S&P.

So we do try to make that point to our companies. Fortunately we have a number where the management teams either own a significant amount of stock or they are, we think, pretty shareholder-friendly and they do take price into consideration when they're buying the shares. But that's just the environment we're in where people are pressuring them typically at this point in the cycle to buy back shares.

Brande: All right. Thanks, Greg. And another final question: the Russell 2000 is getting expensive. Are you still able to find significant value in the U.S.?

Steven: Excellent question. Certainly the small and mid cap indexes are getting expensive—the Russell 2000, the Russell 2500. The portfolio, as has been the case for most of its existence, is selling at a discount to those indexes. So our portfolio is not quite as expensive as the 2000 or 2500. We still are finding companies to buy. In the most recent quarters, we added a company, and just recently Greg mentioned that we began purchasing Bed Bath & Beyond. So even though the indexes themselves are quite expensive, there are still values to be found, and we will continue to seek them out and purchase them when they meet all of the financial metrics, including valuation.

Greg: Yeah, and I guess, Steve, I would just add, too, that it's important to remember that with a relatively concentrated portfolio, we're currently managing a Fund with 33 positions out of 34 positions… that we're able to find one, two, three opportunities potentially in the market and have it still be somewhat meaningful for the Fund overall. So even though the Russell 2000, as the question implies, is visibly expensive, it doesn't require us to own the entire index, but just a handful of companies that can still be meaningful for the portfolio.

Brande: All right, thanks, Greg, and thank you all. Thank you for your participation in today's fourth quarter 2013 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 within the next week at fpafunds.com. WE urge you to visit the website for additional information on 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 fpafunds.com for future webcast information, including replays. We will post the date and time of the prospective calls at towards the end of each quarter and expect the calls to be 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@fpafunds.com.

We hope that our quarterly commentaries, webcasts, and special commentaries will continue to keep you appropriately informed on the Strategy. We do want to make sure you understand that the views expressed on this call are as of today, January 30th, 2014, and are subject to change based on market and other conditions. These views may differ from other portfolio managers and analysts of the firm as a whole, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice. Any mention of individual securities or sectors should not be construed as a recommendation to purchase or sell such securities, and any information provided is not a sufficient basis upon which to make an investment decision. The information provided does not constitute and should not be construed as an offer or solicitation with respect to any such securities, products, or services discussed.

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