International Fund Management Discussion

Longleaf Partners International Fund produced strong relative and absolute performance in the first quarter, returning 7.2% vs. the EAFE Index's 5.1%. The Fund's cumulative returns since inception have almost tripled EAFE returns.

Cumulative Returns at March 31, 2013

	Since Inception 10/26/98	Ten Year	Five Year	One Year	1Q
International Fund	**227.88%**	**136.16%**	**-1.03%**	**16.53%**	**7.19%**
EAFE Index	82.05	152.23	-4.36	11.25	5.13

See page 18 for additional performance information.

Most holdings had positive performance in the first quarter, with many producing double-digit returns. Macau gaming company Melco International was the top contributor, adding 37% in the quarter. Subsidiary Melco Crown completed an IPO of its Philippine project, Belle Grande Manila Bay, with an implied value of US$1.5 billion – over twice our carrying value of US$700 million. We have partnered with a proven owner-operator in CEO Lawrence Ho, who owns 49% of Melco International.

Dell stock was up 42% as Michael Dell and private equity firm Silver Lake proposed to take the company private. To see more on the reasons we are fighting the buyout offer, please see the Partners Fund discussion on page 4.

Philips gained 13% as the company grew revenues and margins in its three core businesses of Healthcare, Lighting, and Consumer. Philips sold its consumer electronics business and is dropping "Electronics" from the corporate name to better reflect its lighting, healthcare, and well being focus.

Global cement company Cemex returned 13%, and we sold our converts which we exchanged for our equity stake last year. These convertible bonds benefitted from both tightening spreads and a rising equity price, which rose to over $12 in the quarter from its low of under $3 eighteen months prior. While our appraisal took a hit in the economic crisis, Lorenzo Zambrano and his team did admirable work in restructuring the company to manage its debt and reduce costs in response to demand levels at half of peak.

Hochtief, the construction and engineering company, rose 13% in the quarter. Management conservatively lowered guidance and stated that the focus for this year will be on asset disposals, with profitability improvements in the core businesses coming through in 2014. Leighton, in which Hochtief holds a 54% stake, announced the sale of the bulk of its telecommunications business at an attractive price.

Only a few names were detractors in the quarter, with most down only slightly. Our positions in Hong Kong and China real estate developer Henderson Land and Hong Kong-based conglomerate Cheung Kong both declined 4%. Broad fears over Chinese and Hong Kong real estate prices impacted each company. Both Henderson and Cheung Kong have minimal financial leverage, and despite heavy government crackdown on prices, including increased mortgage rates and stamp duties, each company has low cost inventory that will enable them to profit even at much lower real estate prices. Cheung Kong actually raised its sales targets, expecting to sell 30% more Hong Kong residential property than last year. Cheung Kong Chairman KS Li and Henderson Chairman Lee Shau Kee are personally buying shares at their respective companies.

Spanish construction and engineering firm ACS fell 7% in the quarter, as negative macro sentiment in Spain overshadowed company improvement, and the market waited for planned non-core asset sales, which will further deleverage the company. ACS sold its transmission lines. Core operations continued to generate free cash flow. HRT, the Brazilian oil and gas exploration and production company, declined 29% in the first quarter. We have actively worked to improve governance at HRT over the past year, but the stock price is unlikely to rebound significantly without successful drilling results or signing a major partner. After quarter-end, John Willott from Exxon was elected the new independent Chairman at the Annual General Meeting.

After a period of strong performance, we sold four positions and trimmed an additional four. We exited Irish drinks company C&C Group as its price reached our appraisal. Our management partners – first CEO John Dunsmore and later CEO Stephen Glancey and CFO Kenny Neisen – created and realized intrinsic value by successfully managing through a challenging economic environment in the core markets of the UK and Ireland and deftly pursuing key acquisitions. Our results at C&C highlight the benefits of partnering with shareholder-oriented management teams who think and act like owners.

We also sold Accor as its price neared appraisal value. As discussed above, we sold the Cemex converts, and we sold Willis as its price rose. We initiated a new position in European shipping logistics company, TNT Express. We also added to EXOR and Fairfax.

With a price-to-value ratio in the mid-60%s, the International Fund portfolio remains attractively discounted. Recent price appreciation has limited our ability to find new qualifiers and fill out some of our positions. Cash rose during the quarter, but the reported 26% level is higher than what we have to invest given our participation in the pending Orascom offering. General market volatility or individual company disappointments will eventually provide opportunities that meet our criteria. As we wait, values across our 20 existing holdings should grow given their strong market positions and financial strength, as well as management partners who are large insider owners.

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