Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund produced absolute returns far above our absolute annual return goal of inflation plus 10% in the first quarter and over the last year, rising 12.1% and 25.4% respectively. Over the long-term, the Fund has also outperformed the Russell 2000 Index, including more than doubling the cumulative returns of the benchmark over the 15 and 20 year periods. Since the financial crisis in 2008, and the Fund's low point in March of 2009, Small-Cap has gained 250.8% versus the Index's 193.3%.

Cumulative Returns at March 31, 2013

	Since Inception 2/21/89	20 Year	15 Year	Ten Year	Five Year	Since 3/9/09	One Year	1Q
Small-Cap Fund	**1164.43%**	**932.34%**	**294.83%**	**247.80%**	**62.61%**	**250.77%**	**25.40%**	**12.08%**
Russell 2000 Index	761.12	443.78	141.09	197.48	48.55	193.25	16.30	12.39

See page 12 for additional performance information.

Almost all of the names in the portfolio rose during the quarter, and a number of stocks gained over 20%. Texas Industries, the Fund's largest position, added 24%, and our appraisal also grew. Cement pricing has been strong in the company's primary market of Texas, and demand is beginning to grow with infrastructure spending as well as residential construction after several years of low capacity utilization. The company is working to bring its new cement plant to full capacity to help meet demand and has additional upside when a California recovery generates earnings from that plant. Madison Square Garden returned 30% over the last three months, and its strong momentum over the last year caused its price to approach our appraisal. We started selling the position late in the quarter and completed our exit in early April. As the major renovation of the arena nears completion on time and within budget, the company is raising ticket prices successfully. Meanwhile, television rights for the Knicks and Rangers have become increasingly valuable. Lamar, the billboard advertising company, gained 25% as results exceeded expectations, and guidance improved. The conversion to a REIT remains on track. Washington Post added 22% with encouraging margin development at its Kaplan Higher Education business and revenue growth at Kaplan International. The company has announced the sale of several smaller assets and reportedly is interested in selling its headquarters building. Legg Mason was up 26% following the appointment of new CEO Joe Sullivan, as well as strong share repurchase activity.

Three of the Fund's holdings declined in the quarter. Level(3) fell 12%. Although the company achieved its goal of 2% sequential sales growth, extra costs reduced operating income versus expectations. Management lowered EBITDA guidance accordingly. Given our disappointment over the last several years in Level(3)'s results, we worked cooperatively with the company to add Peter van Oppen to the board, and his appointment became effective during the quarter. Peter owns a private investment firm focused on technology and telecommunications and has specific knowledge of both long haul and enterprise businesses. Additionally, his financial background and experience on multiple boards will bring added discipline. In mid-March, Jim Crowe announced his plan to resign, and by mid-April, COO Jeff Storey was appointed the new CEO. The solid board, combined with Jeff's experience and operational focus, make us optimistic about the value of this company's assets being recognized over time. Our other fiber network holding, tw telecom, also invested in growth during the quarter, preventing margins from growing. The stock was down 1%. Our investment in Quicksilver, the oil and gas exploration and production company, declined 17%. Canada denied Transcanada's application to build a second pipeline connecting to the Horn River basin, leaving Quicksilver with only one route for its production but giving the company more flexibility with its capital allocation. The company lowered its reserve numbers based on the previous twelve month gas price average of less than $3/mcf. Given more recent higher gas prices, this accounting adjustment should correct itself in the future. On the last day of the quarter, the company announced that Tokyo Gas is buying 25% of its Barnett Shale assets at a price in line with our appraisal for this play.

... stock prices rose faster than our appraisals grew ...

During the quarter stock prices rose faster than our appraisals grew, resulting in a number of position trims, as well as two full sales in addition to Madison Square Garden mentioned above. Potlatch, the timber company, approached our appraisal as the housing recovery helped drive up lumber prices. Willis, the insurance broker, also moved toward our appraisal.

The overall strength in smaller cap stocks over the last year has left few names on-deck near our requisite discount. Consequently, cash rose to 27% of the portfolio, and the Fund's P/V reached the low-80%s. These levels are reminiscent of when we closed the Fund in 1997, and in the 15+ years since, the Fund has delivered solid cumulative returns over twice the Index. We remain confident that we will find additional qualifiers in time, whether through general market volatility or individual company disappointments. In the interim, we believe that the 18 companies we own will grow their values. Rising interest rates would offer further upside to a number of holdings, and several companies could have near-term catalysts for value recognition.