Longleaf Partners Funds | *Advised by Southeastern Asset Management, Inc.®*

# Partners Fund Management Discussion

*Longleaf Partners Fund gained 0.3% in the first quarter versus the S&P 500 Index's return of 1.8%. The lack of new qualifiers and resulting higher cash position over the last twelve months dampened shorter-term relative performance.*

## *Cumulative Returns at March 31, 2014*

| | Since Inception | 20 Year | 15 Year | Ten Year | Five Year | One Year | 1Q |
|---|---|---|---|---|---|---|---|
| **Partners Fund (Inception 4/8/87)** | **1756.23%** | **620.47%** | **185.23%** | **78.21%** | **177.40%** | **18.66%** | **0.27%** |
| S&P 500 Index | 1084.89 | 517.49 | 92.53 | 104.52 | 161.07 | 21.86 | 1.81 |

## *Average Annual Returns at March 31, 2014*

| | Since Inception | 20 Year | 15 Year | Ten Year | Five Year | One Year |
|---|---|---|---|---|---|---|
| **Partners Fund (Inception 4/8/87)** | **11.43%** | **10.38%** | **7.24%** | **5.95%** | **22.64%** | **18.66%** |
| S&P 500 Index | 9.59 | 9.53 | 4.46 | 7.42 | 21.16 | 21.86 |

*Returns reflect reinvested capital gains and dividends but not the deduction of taxes an investor would pay on distributions or share redemptions. Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by visiting longleafpartners.com.*

**The total expense ratio for the Longleaf Partners Fund is 0.91%. The expense ratio is subject to a fee waiver to the extent the Fund's normal annual operating expenses exceed 1.5% of average annual net assets.**

Level 3 Communications gained 18% in the quarter, making it the Fund's largest contributor. This fiber and networking company's strong results exceeded expectations largely due to growth in the Enterprise business, and management issued higher 2014 guidance. Over the last year since Jeff Storey became CEO, the stock has risen 93% reflecting the expansion of operating margins and improved balance sheet. Level 3 is now cash flow positive with value increasing. The stock remains one of the most discounted in the portfolio even after the significant run up since Storey's appointment.

DIRECTV (DTV) added 9% with strong U.S. subscriber and ARPU (average revenue per user) growth. U.S. churn was the lowest in five years. We sold the stock as price responded strongly to the company's results and reached our appraisal value. As discussed in our letter to shareholders, we are especially grateful to CEO Mike White and his predecessor Chase Carey for driving the strong value growth that helped us earn over 385% in this investment since it began as GMH in 2001.

Cheung Kong and CONSOL Energy also contributed nicely in the quarter, each gaining 5%. Cheung Kong, the Asian based global conglomerate, appreciated as the company made value-enhancing asset sales and 50% owned affiliate Hutchison Whampoa (HWL) reported a 20% earnings increase. After almost a decade of investments outpacing disposals, Chairman and primary owner Li Ka-shing quickened the pace of asset sales during the quarter. China contracted land sales rose 27% year-over-year. EBIT (earnings before interest and taxes) margins on property sales in both China and Hong Kong were near 40%. Power Assets, majority owned by Cheung Kong Infrastructure, spun off and listed Hong Kong Electric to maximize cash distributions to shareholders and cater to yield-hungry investors. HWL announced the sale of 25% of A.S. Watson Group, the world's largest health and beauty retailer, to Singapore fund Temasek Holdings at a price in line with our appraisal. Shareholders will receive a special dividend from the sale proceeds.

CONSOL's long-term strategy to focus on natural gas exploration and production is well underway after the sale of five large thermal coal mines in West Virginia to Murray Energy. The company expects to grow gas production by 30% in 2015 as well as 2016. Management continues work on monetizing the company's infrastructure assets. Insider purchases during the quarter signaled confidence in the company's future. As expected, CONSOL announced that long-time executive Nick Deluliis joined the board and will be promoted to CEO and President replacing Brett Harvey, who will become Executive Chairman.

Loews, the diversified holding company owned and managed by the Tisch family, detracted from the Fund's return in the quarter, declining 9%. Loews' largest holdings are three publicly traded subsidiaries: property and casualty insurer

CNA Financial Corp. (CNA) (90% owned), offshore contract driller Diamond Offshore (DO) (50.4% owned), and natural gas pipeline Boardwalk Pipeline (BWP) (53% owned). During the quarter, CNA reported solid earnings and combined ratios, but DO and BWP disappointed. As large exploration and production companies reined in spending, demand for offshore drilling fell, reducing day rates and rig utilization at DO. Higher gas production in the Northeastern U.S. has reduced demand for pipelines serving that region while the cold winter lowered gas storage. BWP cut its dividend to invest in expanding pipeline reach for higher long-term EBITDA (earnings before interest, taxes, and amortization).

FedEx lost 8% after this shipping and logistics company reported a weak quarter due to weather-related challenges. The company took advantage of the short-term hit and bought back almost $3 billion in stock. As the aggressive cost improvements in the Express segment begin to materialize in the next year and management remains focused on disciplined capital allocation, the company is poised to see free cash flow growth.

Energy company Chesapeake retreated 5% in the quarter following a strong 2013. Short-term questions about production levels, the mix between gas and liquids, and additional asset sales pressured the stock. Our appraisal, however, grew slightly due to successful cost reductions. CEO Doug Lawler has made substantial progress since taking the helm last year, and we believe his capital discipline and operational effectiveness will reward shareholders.

Following the market's appreciation over the last few years and with little volatility in the quarter, no new names met our investment criteria. In addition to selling DTV, we exited Vulcan, the aggregates company, as it reached our appraisal. We bought Vulcan in 3Q of 2010 during the U.S. construction depression. Our appraisal modeled volume improvement over time but never to the peak levels of 2006. Rock quarries have substantial barriers to entry that enable long-term pricing power, and the company sold far below prices paid for similar assets. As construction and confidence started to return, the stock rebounded. We made over 63% in our three-and-a-half year holding period.

At the end of the quarter, the P/V (price-to-value ratio) stood in the high-70s% and net cash was higher-than-normal at a reported 27% but an effective 23% given our AON options. We prefer to own investments that offer significant compounding opportunity rather than cash with meager returns. With our capital invested in the Fund, we will maintain our long-term perspective as we have in the past, and patiently wait to buy names that qualify rather than force the cash into less discounted or lower quality companies that would increase the risk of permanent loss.

**Before investing in any Longleaf Partners fund, you should carefully consider the Fund's investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.**

*RISKS*

*The Longleaf Partners Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Mid-cap stocks held by the Fund may be more volatile than those of larger companies.*

*The S&P 500 Index is an index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. An index cannot be invested in directly.*

*P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.*

*As of 3/31/14, the top 10 holdings in Longleaf Partners Fund – Loews (7.4%), Chesapeake Energy (7.2%), Level 3 (7.1%), FedEx (6.7%), Cheung Kong (6.7%), CONSOL (5.7%), Mondelez (4.9%), Philips (4.9%), Bank of New York Mellon (4.9%) Abbott (4.5%). Holdings are subject to change and are not recommendations to buy or sell any security.* **Current and future holdings are subject to risk.**

*Funds distributed by Rafferty Capital Markets, LLC. As of May 1, 2014, Funds distributed by ALPS Distributors, Inc.*

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