Partners Fund Management Discussion

Longleaf Partners Fund's 1.8% decline in the second quarter brought the year-to-date (YTD) return to 9.6%, well above our annual absolute goal of inflation plus 10%. The S&P 500 rose 2.9% in the quarter and has appreciated 13.8% for the YTD. The second quarter shortfall caused the Fund's one year return to dip below the Index, but at 19.4%, the Partners Fund far exceeded the 11.8% goal of inflation plus 10% for the last twelve months. For longer periods of 15+ years, performance has consistently beaten the benchmark.

Cumulative Returns at June 30, 2013

	Since Inception	25 Year	20 Year	15 Year	Ten Year	One Year	YTD	2Q
Partners Fund (Inception 4/8/87)	**1436.10%**	**1350.48%**	**591.29%**	**142.67%**	**74.24%**	**19.37%**	**9.62%**	**-1.80%**
S&P 500	900.65	923.41	426.59	86.46	102.25	20.60	13.82	2.91

See page 10 for additional performance information.

Three holdings have been among the largest positive contributors for both the quarter and the first half. DIRECTV (DTV) advanced 9% over the last three months and has risen 23% YTD. We have owned DTV for over eight years as its value has grown along with its price. CEO Mike White is one of our "all-star" partners. He and his team have grown ARPU (average revenue per user) for the company's 20 million U.S. satellite subscribers even as the industry has matured. Management has also made high-return investments in Latin America where subscribers have grown rapidly, making this geographic segment almost half of our DTV appraisal. Management consistently has returned capital to owners through repurchasing undervalued shares, including $1.4 billion in the second quarter.

Berkshire Hathaway (BRK), which we purchased for the second time in our history in 2012, rose 7% in the quarter and has advanced 25% YTD. The price rose earlier this year when BRK announced its joint acquisition of Heinz with 3G Capital. During the recent quarter, the company's various operating businesses reported solid results. In insurance, GEICO profitably grew at faster rates than its peers, and a lack of catastrophes benefitted reinsurance. In the rail segment, BNSF increased units and price with particularly strong transportation of petroleum and consumer products. The company's utilities had rate increases and higher natural gas volumes due to a colder winter. Additionally, BRK announced the acquisition of NV Energy, a Nevada utility.

Aon also performed well in the quarter and first half, adding 5% and 16% respectively. As the world's largest insurance broker, the Risk Solutions group grows with global economic recovery as insurance pricing and risk coverage increase. In addition, fiduciary income should rise as interest rates move up. CEO Greg Case and his team continue to improve the Human Resources segment, which has been hampered by various issues including European weakness. By repurchasing $300 million in shares at discounts to our appraisal, management built value per share over the period.

Over the last six months, our Dell position remained a top contributor with the underlying stock appreciating 33%. In the recent quarter, the stock was a detractor, declining 6% as uncertainty increased over the outcome of the proposed management buyout. We continued to work with Carl Icahn to propose a better alternative for shareholders. Given his structure, flexibility, and capital, Icahn was in the best position to lead the development of an outcome that provided an attractive payout but allowed shareholders to remain owners and benefit from the company's transformation. We sold approximately half of our Dell shares to Icahn to enable him to construct a compelling alternative. Subsequent to quarter-end, the Dell Board has extended the vote on the buyout offer three times as it became obvious that shareholders would not approve the deal. Prior to the third postponement, Michael Dell and Silver Lake increased their offer to $13.75 and included a special dividend of 13 cents plus the normal third quarter 8 cent dividend. Southeastern continues to oppose the offer and will work with Icahn Enterprises to ensure that Dell has the right leadership who will focus the company on its profitable and growing enterprise business while allowing long-term shareholders to participate in its long-term success.

Our participation in overhauling the Chesapeake (CHK) board last year is paying off. The stock has gained 23% YTD and is the Fund's largest holding. During the second quarter, Doug Lawler, who was formerly a Senior Vice President and on the Executive Committee at Anadarko Petroleum, became CEO of CHK. His compensation aligns his interests with shareholders. He is committed to increasing oil production, lowering operating costs, and reducing debt to extract value from CHK's strong set of assets.

The Fund's largest detractor in the quarter was Consol Energy (CNX), which fell 19% as lower coal prices and regulatory uncertainty punished all coal producers. The weak quarter also made CNX the largest performance detractor for the YTD with a 15% decline. Slowing Chinese demand has reverberated into worldwide price compression in met coal, which is used to make steel and is less than 15% of our CNX appraisal. Thermal coal used for power generation comprises much more of CNX's output and value. Less than 5% of the thermal coal CNX sold in 2012 went to power plants that are at risk of shutting down in the near term based on regulatory actions. Importantly, half of Consol's value is tied to its natural gas assets in the Utica and Marcellus shale plays, which arguably benefit if coal faces increased environmental regulation. The company also owns a port in Baltimore.

Our relative underperformance in the quarter and YTD was driven more by what we did not own than by holdings that declined. Financial stocks, specifically banks and life insurers, generated much of the S&P 500's return as rising interest rates improved their profit outlook. We do not typically own commercial and investment banks or life insurers. They rarely meet our "good business" requirement given their heavily leveraged balance sheets, inscrutable assets and derivatives, and commodity-like characteristics. We do own a number of businesses that should benefit from interest rates returning to more normal levels, but the impact on their profits will be less magnified because they do not have the same degree of underlying leverage.

During the quarter, we bought Cheung Kong, a multi-national conglomerate that we have owned in global and international portfolios. Chairman and CEO Li Ka-Shing owns 42% of the company and increased his stake during the quarter. He has been characterized as the Warren Buffett of Asia due to his successful history of acquiring disparate discounted businesses to build long-term value for shareholders. The stock declined and met our undervaluation criteria because of worries over Chinese and Hong Kong real estate prices, particularly with government efforts to cool property markets with new taxes and regulations. Cheung Kong has an extremely low cost basis in its real estate, and only a small portion of the value comes from its undeveloped land bank. Cheung Kong owns developed real estate, ports, health and beauty retailers, energy and infrastructure assets, and telecommunications businesses around the world. The company sells for an 8x P/E, trades well below book value, has a 3% dividend yield, and is priced at a significant discount to our appraisal of its various pieces.

Toward the end of the second quarter, we repurchased a small position in Cemex convertible bonds, which we sold earlier in the year after tightening spreads and a rising equity price pushed the price to our appraisal. More recently, the converts became attractive when investors broadly fled emerging markets, the peso weakened, and the Mexican government paused infrastructure spending. Longer term, we believe Mexico public improvements will increase, and Cemex also will benefit from recovery in the U.S.

We own proven franchises and industry leaders with growing values.

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During the period, we added to Murphy Oil. In addition to Dell, we trimmed other names that had appreciated to higher P/Vs including Vulcan, Travelers, Aon, and DIRECTV.

We believe the Partners Fund will deliver strong results over the next three years. The P/V is in the low-70s%, providing a comfortable margin of safety and attractive upside. We own proven franchises and industry leaders with growing values. Our management partners are capable operators and capital allocators. Our conservative appraisals have modest assumptions and use discount rates of 9-10% in a world of much lower interest rates. While few names currently meet our requisite discount for purchase, we have 11% in available cash to deploy as opportunities emerge either via market dislocations or company-specific disappointments. Our capital is on the line, and we believe we have a good foundation in place to both meet our absolute compounding goal and deliver strong long-term relative returns.