

July 9, 2019

Longleaf Partners Small-Cap Fund Commentary 2Q19

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Funds

Longleaf Partners Small-Cap Fund declined -1.11% in the second quarter following the Fund's strong absolute return in the first three months of 2019. The 9.28% year-to-date (YTD) performance was well above our absolute annual goal of inflation plus 10%. The Russell 2000 Index added 2.10% in the second quarter and gained 16.99% YTD. Over shorter-term periods, relative returns can move dramatically, as we saw in 2018, when the Fund significantly trailed the Index in the first nine months but, by year-end, was well ahead. Rather than focus on price swings and single end points, the best indicator of investment success for owners of the Fund is performance consistency over longer periods. The rolling returns for all 5 and 10-year periods in Longleaf Small-Cap's 30-year history have averaged over 11% and outperformed the Index 76% and 92% of the time respectively.

Industrial, Financial and Information Technology companies, sectors where the Fund had much lower exposure than the Index, were by far the largest contributors to the Russell 2000 in the quarter. Most of the other sectors in the Index were flat or declined. The large majority of the Small-Cap Fund's holdings were positive performers. The two primary detractors – Realogy and CNX – fell for unrelated reasons that did not impact our long-term cases. Their peers' stocks suffered from the same industry-related pressures that hurt these two holdings.

Average Annual Total Returns for the Longleaf Partners Small-Cap Fund (6/30/19): Since Inception (2/21/89): 10.53%, Ten Year: 14.19%, Five Year: 5.35%, One Year: -5.17%. Average Annual Total Returns for the Russell 2000 (6/30/19): Since Inception (2/21/89): 9.44%, Ten Year: 13.45%, Five Year: 7.06%, One Year: -3.31%.

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. As reported in the Prospectus dated May 1, 2019, the total expense ratios for the Longleaf Partners Small-Cap Fund is 0.92%.

Over Longleaf Small-Cap's strong history, numerous stocks have moved up sharply with some type of management-led transaction serving as a catalyst. When stocks are at extreme discounts, shareholder-oriented corporate partners go on offense. In 2018, two holdings were acquired at fair prices, creating rapid payoffs, and one company announced it was going private. In the second quarter of 2019, activity was also notable. **Kodak** sold its Packaging segment and restructured its debt; **Lazard** issued 10-year debt to aggressively buy its severely discounted stock at a meaningful double-digit pace; **Neiman Marcus** restructured its debt; and, **OCI** announced the separation of its Middle Eastern assets into a joint venture. More recently, we filed a 13D to speak more directly with **Summit's** leaders after rumored third-party interest in the company.

Given the deep discounts at many of the Fund's holdings, our partners are pursuing value recognition with prospective payoffs that we believe could be months, not years, away. CEO Randy Baker at **Actuant**, which has several board members suggested by Southeastern, previously sold non-core segments and has indicated a plan to sell additional assets to focus on the company's best industrial tool businesses. In the past, **CenturyLink** and its predecessor Level 3, have consolidated fiber networks including Global Crossing, tw telecom and Qwest, and in the recent quarter, management announced a strategic review of the Consumer businesses following our 13D filing, which encouraged a separation of the Fiber and Consumer segments. **CNX**, where management previously separated the coal business and sold gas assets, could pursue a deal for its pipeline business and sell some or all its gas reserves. **Mattel** is working to capture some of the enormous value in its Barbie and Hot Wheels brands through JVs to produce movies and television content, and we expect more brand expansion along with continued interest in the whole company by prospective suitors. The leaders at **Formula One**, **GCI Liberty**, **Graham Holdings** and **PotlatchDeltic** have demonstrated their willingness to negotiate deals that benefit shareholders in the past, and it is not farfetched they are likely considering how to drive value recognition again.

Our confidence in future results has much to do with the ability of our corporate leaders to deliver self-help that grows value per share and ultimately generates rewarding payoffs. Any one or two potential catalysts mentioned could have meaningful impact on the Fund's return, as could announcements from other Fund investments that we did not highlight.

Contributors/Detractors

(Q2 Investment return; Q2 Fund contribution)

Summit Materials (21%, 1.20%), the cement and aggregates company, became the largest contributor in the quarter after rumors of acquisition discussions hit headlines. Southeastern filed a 13D to allow us to have direct conversations with management and third parties about Summit's strategic options. Despite the recent appreciation, the stock still trades at a significant discount to our appraisal of its value as both an independent going concern and a target. Though extraordinary Mississippi river flooding has obscured Summit's earning power this year, the business has shown pricing power and maintained its strong local market positions. CEO Tom Hill owns a significant stake personally.

Realty (-36%, -1.59%), the residential real estate brokerage franchisor, was the Fund's largest detractor after reporting poor sales in one of the company's largest states, California. Not only was the California market weak in general, but Compass, the start-up real estate firm backed by SoftBank, has been aggressively recruiting realtors. The Compass model's long-term sustainability and economics are uncertain, but ironically this highlights that human brokers still have important value in the residential real estate transaction process versus the view that on-line real estate sites would make brokers obsolete. We continue to believe that Realty CEO Ryan Schneider will emphasize the highly profitable and #1 market share franchise model of its realtor brands, while bringing his expertise in big data from running Capital One's credit card business to an area with massive valuable data but very little monetization of it. The stock trades at a mid-single-digit free cash flow (FCF) multiple, well below its peers.

CNX (-32%, -1.37%), the Appalachian natural gas company, declined after reporting an increase in capital expenditures and missing sell-side quarterly earnings before interest, taxes, depreciation, and amortization (EBITDA) expectations by 10%. Lower natural gas prices and a few one-off factors were the primary reasons for the EBITDA miss. The capital expenditure change reflected a timing shift rather than a cost increase - CNX will invest more this year to begin production at three new wells but spend less in 2020 than previously planned. The business is on track to generate \$500 million of FCF in 2020, while the market value of the company is below \$1.5 billion. Our appraisal of CNX moderately increased on solid results from CNX Midstream and the decision of the board and CEO Nick Deluliis to repurchase the extremely discounted shares at an 8% annualized pace. Multiple directors also bought the stock personally.

Portfolio Activity

The Fund's holdings remained below our appraisal values, but we trimmed several stronger performers during the quarter to manage position sizes. Likewise, we added to five of the Fund's most discounted investments. We exited the preferred equity stake in Mytheresa that we received in the Neiman Marcus recapitalization. We also bought one new qualifier, which remains undisclosed. We successfully owned this company in the past, and management proved to be great partners.

Outlook

The price to value ratio (P/V) finished the quarter in the low-60s%, a discount well-below the long-term average. The portfolio has 15% cash to deploy in new qualifiers. As the market sold off in May, our on-deck list became more interesting, with a handful of stocks within 10% of buying range.

The Fund's negative return came from a few companies that had unrelated, short-term disappointments. We believe a return to outperformance will also likely come from occurrences at individual holdings rather than overall economic and stock market trends. The patterns for how stocks reach intrinsic worth are unpredictable, but appreciation can happen quickly, as Summit recently demonstrated. One of Southeastern's competitive advantages is taking a multi-year perspective to stock ownership, as prices should ultimately migrate to growing values. In the near-term, we are highly engaged with CEOs and boards who are taking actions that could be catalysts for their stocks to more fully reflect intrinsic worth. Given the portfolio's discount, positive business fundamentals and corporate partners pursuing catalysts, we believe significant payoffs could occur in 2019 and beyond.

See following page for important disclosures.

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 Small-Cap 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. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. 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.

Free Cash Flow (FCF) is a measure of a company's ability to generate the cash flow necessary to maintain operations. Generally, it is calculated as operating cash flow minus capital expenditures.

Aggregates are materials such as sand or gravel that are ingredients in concrete.

A 13D filing is generally required for any beneficial owner of more than 5% of any class of registered equity securities, and who are not able to claim an exemption for more limited filings due to an intent to change or influence control of the issuer.

As of June 30, 2019, the top ten holdings for the Longleaf Partners Small-Cap Fund: CenturyLink, 8.1%; Kodak, 7.4%; Summit, 7.2%; Graham Holdings, 6.8%; GCI Liberty, 5.9%; Neiman Marcus, 5.2%; PotlatchDeltic, 5.2%; Mattel, 4.9%; Liberty Media, 4.8%; OCI, 4.7%. Fund holdings are subject to change and holding discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

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