

July 2021

Longleaf Partners Fund Commentary 2Q21

Longleaf / Partners
Funds

Longleaf Partners Fund added 4.40% in the second quarter, taking year-to-date returns to 23.42%, while the S&P 500 returned 8.55% and 15.25% over the same periods. Almost every company was positive in the quarter. The portfolio's cash position and lack of information technology holdings together drove the majority of the relative performance drag in a period where growth stocks saw a (we believe temporary) rebound. Despite relative underperformance, it was a solid period for value per share growth at our holdings.

We highlighted several high-conviction companies in last quarter's letter, and all saw positive progress. For example, Mattel reported another good quarter and is well on track to generating more free cash flow (FCF) this year than we initially expected. The company also continues to announce new media projects - including tangible progress for Polly Pocket and Masters of the Universe in the quarter - to monetize the value of its intellectual property. Lumen management spoke publicly of its efforts to realize value from its distinct parts, in line with the 13D that we filed at the end of last year. CNX Resources is taking advantage of gas price strength to lock in more FCF with

Average Annual Total Returns for the Longleaf Partners Fund (06/30/2021): Since Inception (4/8/87): 10.25%, Ten Year: 7.55%, Five Year: 10.96%, One Year: 62.43%.

Average Annual Total Returns for the S&P 500 (06/30/2021): Since Inception (4/8/87): 10.59%, Ten Year: 14.84%, Five Year: 17.65%, One Year: 40.79%. Average Annual Total Returns for the Russell 1000 Value (06/30/2021): Since Inception (4/8/87): 10.04%, Ten Year: 11.61%, Five Year: 11.88%, One Year: 43.68%.

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 southeasternasset.com. The prospectus expense ratio before waivers is 1.03%. The Partners Fund's expense ratio is subject to a fee waiver to the extent the Fund's normal operating expenses (excluding interest, taxes, brokerage commissions and extraordinary expenses) exceed 0.79% of average net assets per year.

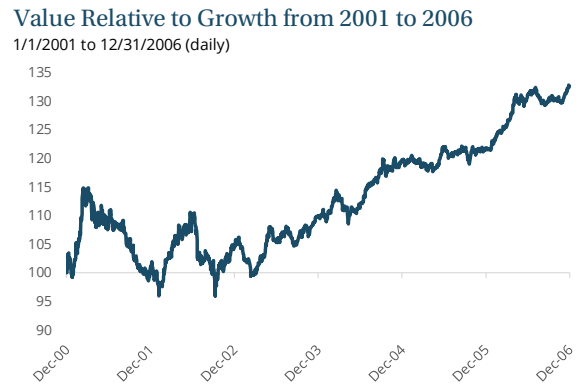
accretive hedges. CK Hutchison began buying in stock in a material way, with more than \$460 million in shares repurchased YTD.

The investments in the preceding paragraph have been long-term holdings, but what about our newer purchases? We have heard from long-time Southeastern/Longleaf observers who look at these stock charts and ask, “How can that still be cheap?” We continue to focus on the importance of value growth and dynamically updating our appraisals. MGM for example has seen very strong value growth since our purchase last year as the company’s properties in the US have rebounded much stronger than even the biggest optimists predicted. Management and the board have reduced risk by monetizing more of MGM’s holdings in MGM Growth Properties, its real estate subsidiary. There is still plenty of value to be added in the online division as well. All this leads to a value per share that was in the \$30s last year now approaching \$50. The company remains attractively discounted, even after price appreciated 109% since we first bought the stock 10 months ago.

But price will always be important to us, no matter how great qualitatively a business or people are or how nice it feels to have price and value momentum. We will gladly sell fully priced winners like Biogen, where positive news sent the company’s stock price to our appraisal in only a few short months, as detailed later in this letter.

More broadly, “value” had a pullback vs. “growth” in the second quarter on the back of lower interest rates and various other factors. Over the last year, we have seen interest rate consensus go from “low rates forever” for most of 2020 to “rates are definitely going up” in February/March of 2021 to now what feels like magical goldilocks thinking for growth stocks in the 1-2% US 10-year range. While we cannot predict precisely what rates will do in the near term, we welcome increased volatility on this all-important valuation input, especially after decades of gradual moves down have made things relatively harder for value-focused public equity investors.

It is also important to remember that, while what matters most will always be our individual holdings, we do not expect value to ever go up in a straight line. The chart below illustrates that point well. It can be easy to forget that, even in the greatest value bull market of our lifetime that started in 2000, there was a several month period after the initial turn in March/April in which growth fought back from similarly absurd relative valuations.

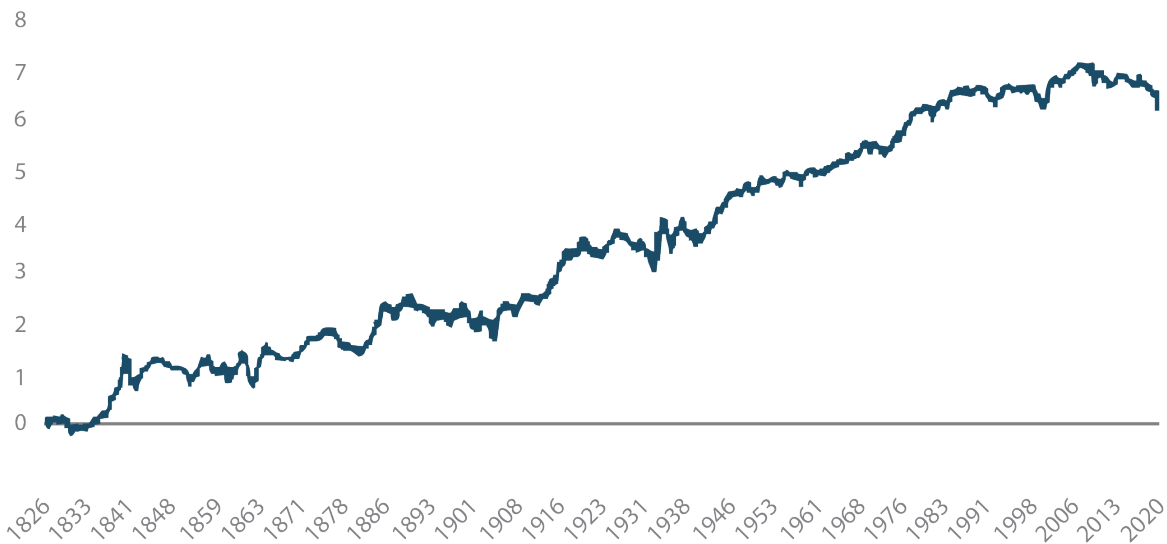


Source: Factset

However, value ultimately prevailed (with even more ups and downs in 2001-02), and the next several years looked like the previous 200 years for value. (Note the chart below is a reprint from our [“Why We Believe Value Will Work Again”](#) white paper published in December 2020.)

The Value Factor

Cumulative Excess Return of Value vs Growth



Source: TwoCenturies

Joining the macro with the stock specific, we continue to like our portfolios on both an earnings multiple and earnings growth basis vs. the growth and value parts of the index.

Implied Returns Based on Various P/E Assumptions

	2022 P/E		P/E Change	Performance from P/E Change
	Current	Assumption		
S&P 500	20.7	16.7	-4.0	-19%
S&P 500 Growth	27.3	20.0	-7.3	-27%
S&P 500 Value	16.2	14.3	-2.0	-12%
Longleaf Partners Fund	11.5	14.3	+2.8	+24%

Source: FactSet. Actual investment results and performance are not guaranteed

Contributors and Detractors

(Q2 Investment return; Q2 Fund contribution)

Biogen (51%, 1.78%), a biotechnology company specializing in therapies for the treatment of neurological diseases, contributed in a way that warrants a longer than usual writeup. When we first began buying the company in early January, the stock scored well on all three Business, People and Price criteria, but the range of outcomes was wider than most investments for us. On the business, while the company has had a leading position in neuroscience for decades, it had become a collection of assets that was hard for the stock market to value. This led to most short-term investors focusing on year-over-year (YOY) earnings declines in 2021 and pipeline uncertainty. We focused most on strong cash flows from Biogen's Multiple Sclerosis franchise, a growing yet hidden biosimilars business, and a pipeline that we believed was actually quite interesting and diversified beyond the manic market focus on Aducanumab, a proposed treatment for Alzheimer's. On the people front, we also liked what the board and management had been doing (large, discounted repurchases and prudent internal and external investments) and not doing (no big, dumb M&A or unsustainable dividends). Our single point appraisal was around \$375/share, but we saw a range at the low end of slightly above \$250 if the pipeline totally failed or approaching \$500 if the company saw a reasonable amount of pipeline success. We also thought that we were effectively paying a very low double-digit multiple of FCF/share. It is important to note that we were not betting on our science expertise or any other predictions that fall outside our circle of competence. Rather, we used our bottom-up appraisal skills to find a security that was mispriced at that given moment - we had followed the company for over 10 years before our purchase - and that shorter-term investors were

afraid to own due to the potential for near-term stock price volatility. We started with a partial position, as we felt the wider-than-usual range of outcomes and uncertainty around the stock could lead to the chance to fill it out at a better price later.

On June 7, the FDA approved Aducanumab (now known as Aduhelm) after a contentious process that has yet to fully play out. The stock shot upward, and our single point value increased to \$425. With the stock trading at that level, we exercised our price discipline and sold our position. In this era of “multi-decade-compounders at any price” and given Southeastern’s history of being long term, it feels weird to be in and out of something so quickly. But it also feels OK to be able to use our appraisal skills to secure a payoff for our long-term clients. The company’s stock price has fallen since our sale, and we will continue to watch the price-to-value (P/V) gap going forward.

MGM (12%, 0.59%), the casino and online gaming company, was a top contributor as it reported a solid first quarter with Vegas EBITDAR (earnings before interest, taxes, depreciation, amortization and restructuring or rent costs) doubling sequentially and Regional EBITDAR actually growing strongly YOY due to exceptional cost control. The second quarter saw clear signs of even more growth with a strong rebound in travel to the company’s US properties. MGM also continued to de-risk its value and balance sheet by selling over \$1 billion of fully valued shares of its real estate subsidiary MGM Growth Properties in the quarter. On the first day of July, the company announced a transaction to consolidate and sell the real estate of its CityCenter project at a price that was accretive to our value per share.

Williams (14%, 0.51%), the natural gas pipeline operator, was also a positive contributor. The value grew slowly but steadily thanks to continued cash flow growth at Williams’s main Transco pipeline, as well as good volume trends (up 11% YOY) in its Northeast assets. The stock traded up with gas price strength as the quarter went on. We believe that management is open to more transactions to grow and simplify value per share, and as industry conditions improve, this becomes more likely.

Portfolio Activity

As discussed in detail above, we sold our position in Biogen in the quarter. We trimmed CNX early in the quarter on the back of positive performance and added to the heavily discounted position in CK Hutchison. It has been harder to find strong US large-cap on-deck qualifiers as the year has gone on, but we have a number of

companies in the portfolio where we hope to have the opportunity to fill out our positions. We have also added several businesses to the on-deck list in financial services, industrials, retail / consumer packaged goods, health care and media. We remain disciplined on the price we will pay and are watching and waiting for prices to cooperate so we can put our cash to work.

Outlook

Our outlook on the stock market and our portfolio is not dramatically different than it was the last time we wrote to you. Our confidence in the specific company opportunities in our portfolio has only grown, as our businesses made solid progress in the quarter, and we believe the Fund is more attractively positioned - qualitatively and quantitatively - than both the market and the average "value" strategy. We believe the recent pullback in value's performance of the last month or so is a temporary blip, and that the strong performance that began in the second half of 2020 marks a longer-term reversion to the mean for value vs. growth.

We wrote in our 4Q20 letter about the work we have done to formalize the way we incorporate environmental, social and governance (ESG) issues within our firm and our investment process in the last several years. We are excited to share our first Annual ESG Report, which highlights some of the progress we have made and the work we are doing to keep improving in this area. In addition to our [annual ESG report](#), we will be sharing a semi-annual portfolio carbon footprint report going forward and will continue to discuss our engagement efforts with our management partners on these important issues in our quarterly letters and the [Price-to-Value Podcast](#).

Speaking of podcasts, we thought it would be good to close with a recent interview that our Vice-Chairman Staley Cates did with Bob Huebscher of [Advisor Perspectives](#). It is a great summary of what we are all about at Southeastern and why we remain very excited about our future.

See following page for important disclosures.

Before investing in any Lingleaf 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 <https://southeasternasset.com/account-resources>. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS

The Lingleaf 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. S&P 500 Value Index constituents are drawn from the S&P 500 and are based on three factors: the ratios of book value, earnings, and sales to price. An index cannot be invested in directly.

PV ("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. PV does not guarantee future results, and we caution investors not to give this calculation undue weight.

Price / Earnings (P/E) is the ratio of a company's share price compared to its earnings per share.

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.

As of June 30, 2021, the top ten holdings for the Lingleaf Partners Fund: Lumen, 10.2%; Mattel, 6.1%; Affiliated Managers Group, 6.0%; CNH Industrial, 5.8%; Fairfax Financial, 5.2%; MGM Resorts, 5.2%; Douglas Emmett, 5.0%; CNX Resources, 4.9%; CK Hutchison, 4.8% and Holcim, 4.7%. Fund holdings are subject to change and holdings discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

Funds distributed by ALPS Distributors, Inc.

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Expires 10/31/2021