July 2021

Longleaf Partners Small-Cap Fund Commentary

2Q21

Longleaf Partners Small-Cap Fund added 1.91% in the second quarter, taking year-to-date returns to 13.88%, while the Russell 2000 returned 4.29% and 17.54% in the same periods. The majority of our holdings were positive in the quarter, but it was a much more muted absolute return period contrasted to the dramatic small-cap rally in the last several quarters. The portfolio's cash position was a primary driver of the relative performance drag in a period where growth stocks saw a (we believe temporary) rebound in the latter end of the quarter. 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 accretive hedges.

Average Annual Total Returns for the Longleaf Partners Small-Cap Fund (6/30/21): Since Inception (2/21/89): 10.74%, Ten Year: 10.21%, Five Year: 9.60%, One Year: 63.54%. Average Annual Total Returns for the Russell 2000 (6/30/21): Since Inception (2/21/89): 10.23%, Ten Year: 12.34%, Five Year: 16.47%, One Year: 62.03%. Average Annual Total Returns for the Russell 2000 Value (6/30/21): Since Inception (2/21/89): 10.79%, Ten Year: 10.85%, Five Year: 13.62%, One Year: 73.28%.

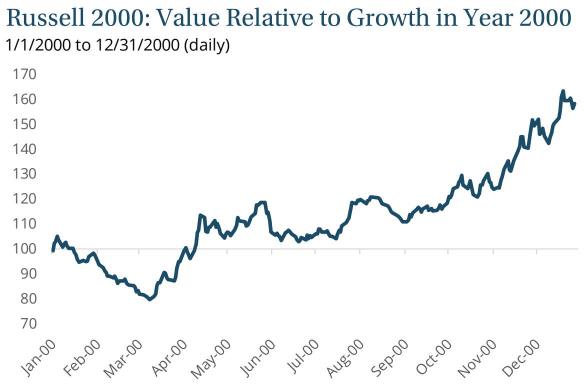
Returns reflect reinvested capital gains and dividends but not the deduction of taxes an investor would pay on distributions or share redemptions. Performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment 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. As reported in the May 1, 2021 prospectus, the total expense ratio for the Small-Cap Fund is 0.96%.

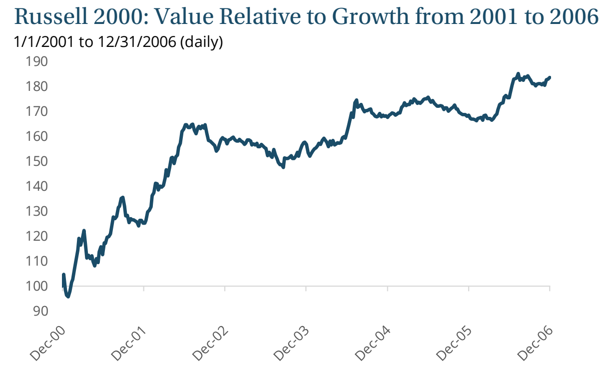
In addition to these long-term holdings we highlighted last quarter, we have seen price rallies at some holdings that have prompted long-time Southeastern/Longleaf observers to look at these stock charts and ask, "How can that still be cheap?" We continue to focus on the importance of value growth and dynamically updating our appraisals. Realogy, for example, has seen massive value growth over the last 12 months due to both significant FCF generation (~$3 per share) and an improvement in the baseline FCF level that we capitalize. CEO Ryan Schneider also has taken advantage of wide-open credit markets to refinance the company's debt, saving almost $100 million per year in the next 12 months vs. the 2020 run-rate, and therefore reducing risk while improving future value growth. Our appraisal has grown from the $10s this time last year well into the mid-$20s+ today. The company remains attractively discounted, even after price appreciated over 400% since its COVID-driven low last March.

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 winners like PotlatchDeltic and Formula One, both of which we sold in the first quarter after strong price performance. We have not regretted selling the businesses (and both ended the second quarter below our last sale prices), but we do hope to have the opportunity to own both again.

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 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.



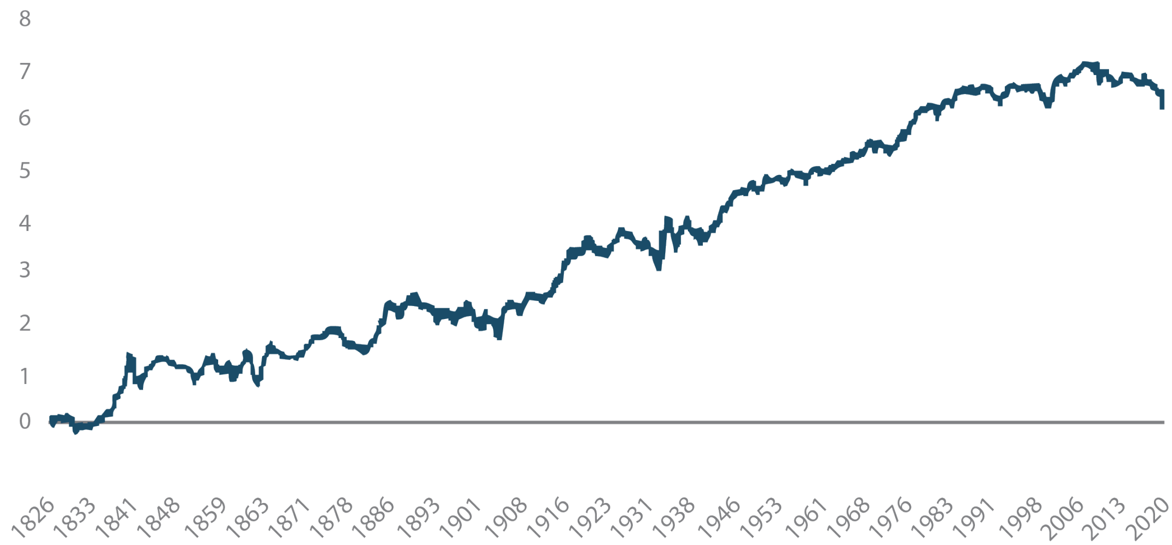


Source: Factset

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**		
Russell 2000	16.5	16.7	+0.2	+1%
Russell 2000 Growth	21.2	20.0	-1.2	-5%
Russell 2000 Value	13.8	14.3	+0.5	+3%
Longleaf Partners Small-Cap Fund	11.2	14.3	+3.1	+28%

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

Contributors and Detractors

(Q2 Investment Return; Q2 Fund contribution)

Realogy (20%, 1.35%), the residential real-estate brokerage franchisor, was the top contributor after another strong quarter of operating results, solid housing numbers and, most importantly, great management actions to continue to improve the company's financial strength. The key operating numbers came in the Franchising segment, where revenues and EBITDA (earnings before interest, taxes, depreciation and amortization) both grew over 40% year-over-year (YOY). Management made two very savvy, value-accretive moves in the quarter. Realogy completed its first refranchising transaction in some time. While small (and therefore largely ignored by the market), it was a great sign that this path is possible and getting more likely as the world returns to normal. Later in the quarter, Realogy issued very low-rate convertible debt with an effective strike price over $30 per share. This was unthinkable over a year ago, when it was feared that the company would need to issue straight equity in the single digits. CEO Ryan Schneider and team expertly navigated the company through a difficult period without needing to act out of desperation.

Graham Holdings (13%, 0.60%), the media, education and manufacturing conglomerate, was also a top contributor after its acquisition of Leaf Group in early April was well received by the market. Leaf Group is a smaller public company that is diversified across digital media and e-commerce. While we are generally wary of mergers and acquisitions, we think this deal can be a positive move that fits uniquely well with Graham's existing assets. Graham was able to take advantage of a limited buyer universe, given Leaf's size and disparate assets. Graham also reported a solid quarter that saw continued growth at the TV segment, with 8% YOY revenue growth without political advertising in either period.

Empire State Realty Trust (ESRT) (8%, 0.46%), the New York City property owner, contributed after reporting a positive quarter in April, a reinstated dividend in May and the world taking note of New York City returning to normal as the second quarter progressed. Office occupancy at the Empire State Building actually ticked up slightly quarter-over-quarter. Fears of massive vacancies and deeply depressed lease rates per square foot have not materialized. While this is good for ESRT's existing assets, it is disappointing for its hopes to buy its own stock cheaply and/or acquire distressed assets.

Portfolio Activity

While there were no exits or large position weight changes in the quarter, we did find another new investment to add to the two that we purchased last quarter. This newest company remains undisclosed as we continue to fill out the position, but it is a business that we know well from a previous successful holding.

We can now talk more about the two new investments we made in the first quarter. Gruma is a consumer packaged goods company that is headquartered in Mexico but derives over 70% of its value from a dominant position in US tortillas and corn flour – the Mission and Maseca brands in particular. Surging corn prices have led to near-term earnings uncertainty, but we believe Gruma remains positioned for strong long-term earnings growth, and the owner-operator management team has a strong history of growing value per share. Idorsia is a diversified pharmaceutical company that is headquartered in Switzerland but also has a strong majority of its value in the US. We are most attracted to the husband and wife founding team of Jean-Paul and Martine Clozel. Their incredible track record at previous company Actelion led to a sale at a great price to Johnson and Johnson, which then led to the creation and spinoff of Idorsia. Idorsia is not as focused as other "theme-y" small cap drug stocks that fit into US ETFs. The company is also in a news lull now until more pipeline news later in 2021-22, so the market views it as "dead money". We ultimately think the company will have several unique products in the market in the years to come, leading to significant FCF.

The portfolio ended the quarter with 19% cash. We have a number of companies in the portfolio where we hope to have the opportunity to fill out our positions and have also added two new businesses in the financial services industry to the on-deck list. 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 would also caution proponents of a broad trade into small-cap value that there are vast qualitative differences between some of the lower-quality highflyers driving the Russell 2000 this year (yes meme stocks, but also lower quality, capital intense businesses like banks, retailers and commodity producers) and our more carefully selected portfolio.

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 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 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 https://southeasternasset.com/account-resources. 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. The Russell 2000 Value index is drawn from the constituents of the Russell 2000 based on book-to-price (B/P) ratio. An index cannot be invested in directly.

EBITDA is a company's earnings before interest, taxes, depreciation and amortization.

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.

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

An ETF is an exchange traded fund.

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.

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, 2021, the top ten holdings for the Longleaf Partners Small-Cap Fund: Lumen, 13.0%; Realogy, 7.3%; Mattel, 6.3%; Empire State Realty 6.2%; CNX Resources, 5.5%; Graham Holdings, 5.3%; Lazard, 4.9%.; Eastman Kodak, 4.8% and Gruma, 4.6%. 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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