Southeastern Asset Management, Inc.® | Advisor to Longleaf Partners Funds

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For Professional Investors Only

# Asia Pacific UCITS Fund Management Discussion

The Asia Pacific UCITS Fund delivered 37.94% in 2017, outperforming the MSCI AC Asia Pacific Index by over 6%. The Fund gained 7.60% in the fourth quarter, slightly behind the index's return, which benefited more from currency movements than the Fund. Our longer-term trailing returns for all periods have exceeded our absolute return objective, while also meaningfully outperforming the benchmark.

**Portfolio Returns at 31/12/17 – Net of Fees**

| | 4Q 17 | 1 Year | 2 Years Annualized | 3 Years Annualized | Since Inception 2/12/14 Annualized |
|---|---|---|---|---|---|
| APAC UCITS (Class I USD) | 7.60% | 37.94% | 24.50% | 14.64% | 13.75% |
| MSCI AC Asia Pacific Index | 8.15% | 31.67% | 17.55% | 10.63% | 9.85% |
| **Relative Returns** | **-0.55%** | **+6.27%** | **+6.95%** | **+4.01%** | **+3.90%** |
| | | | | | |
| **Selected Indices** | | | | | |
| Hang Seng Index* | 8.84% | 41.29% | 21.38% | 12.29% | |
| TOPIX Index (JPY)* | 8.67% | 21.84% | 10.36% | 10.82% | |
| TOPIX Index (USD)* | 8.71% | 26.23% | 14.23% | 13.03% | |
| MSCI Emerging Markets* | 7.44% | 37.28% | 23.53% | 9.10% | |

*Source: FactSet

The MSCI Asia Pacific Index continued its positive performance run for another quarter, resulting in the index's strongest annual performance since 2009. The Fund outperformed the index in a record year by a meaningful margin, even with limited exposure to the dominant, few top drivers of the index.

Our outperformance was particularly notable in a period where growth stocks outperformed value stocks by almost 16%. Information Technology (IT) was a large driver of growth's performance, and the sector was the largest contributor to the index in 2017. Primarily driven by the big four (Tencent, Alibaba, Samsung, and Taiwan Semiconductor Manufacturing Co.), IT accounted for approximately 31% of index returns in 2017, while Financials accounted for approximately 18% of returns. The Fund has no direct exposure to Financials, and our exposure to IT is less than half of the benchmark's weight, accounting for only 11% of the Fund's performance for the year. Superior stock selection and the ability to opportunistically invest across countries, sectors, and market caps allowed us to outperform the index while also adding meaningful value to the portfolio by investing in relatively "unloved" countries like Australia and Singapore, which together accounted for approximately 30% of our annual returns.

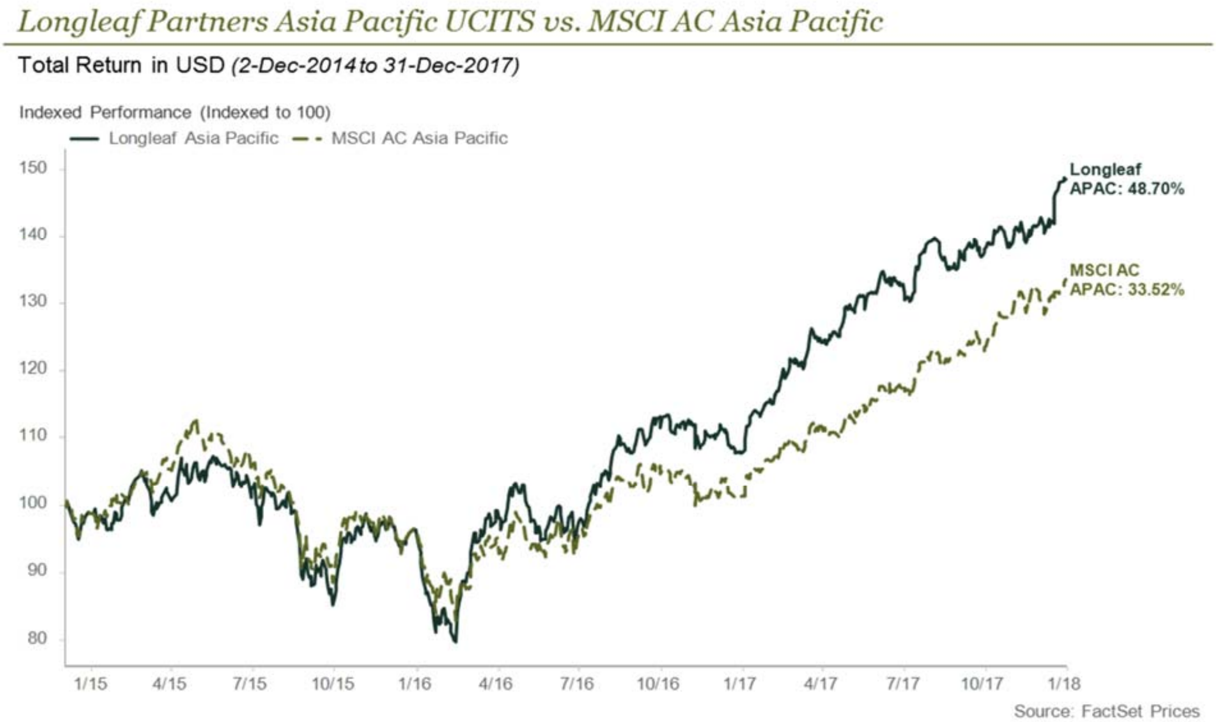
As a bottom-up, concentrated, value-oriented investor, we are benchmark agnostic and invest opportunistically based on long-term company fundamentals. As a result, our returns are driven by the businesses we own and often look very different than the drivers of the index. In fact, one component of the Fund's top contributor for the year, Melco International, is not in the MSCI AC Asia Pacific Index, while our top performer and second largest contributor, MinebeaMitsumi, represents only 0.07% of the index.

Most investments positively contributed to our strong returns in 2017, and the majority had double-digit performance. In 2017, the top five contributors drove 47% of fund performance. All five top contributors were deeply undervalued and unpopular in 2016, then recovered strongly in 2017, as market concerns over China (GLP), Macau gaming (Melco International and Melco Resorts), the iPhone cycle (MinebeaMitsumi), the energy sector (Speedcast), and Baidu's search business growth concerns dissipated. Each of these management teams created value in the market downturn that accelerated intrinsic value growth. GLP CEO Ming Mei privatized the company at a value above our appraisal, Melco CEO Lawrence Ho acquired Crown's stake in Melco Resorts at a large discount to appraisal, Minebea CEO Kainuma repurchased shares and achieved a remarkable turnaround of Mitsumi's loss making business that they had acquired cheaply, Speedcast CEO Beylier acquired providers of satellite communications to the energy sector cheaply, and Baidu CEO Robin Li repurchased shares, divested their food delivery business, and concentrated their capital and resources on their core search, artificial intelligence, and online video businesses. In the quarter, the top five contributors drove 80% of fund performance, with the top 3 contributors –small and mid-cap companies run by owner operators – driving almost 60% of performance.

2017 marked a year of higher than normal portfolio turnover, fueled by strong markets and high volatility in Asia. We took advantage of this volatility by purchasing ten new businesses and selling twelve companies in the year, as we re-allocated capital from top performers to more discounted opportunities with a higher margin of safety and more potential upside.

**Some Observations**

*Performance since Inception*




The Fund celebrated its third anniversary in December, and the journey has been exciting. Volatility has been our friend, and the results have exceeded our expectations. The market downturns in 2015 and 2016 allowed us to purchase world-class companies at extraordinary discounts to value. We have compounded returns at double digit rates – meaningfully outperforming both our absolute return goal and the benchmark – by investing in businesses that display sustainable competitive advantages, are run by managers who act like owners, trade at a substantial discount to intrinsic value, and are within our circle of competence. We seeded the strategy in 2014 because we saw a significant opportunity set that we wanted to take advantage of – Southeastern employees and related entities continue to represent the Fund's largest investor. Just as we take great comfort investing in companies where management teams have significant personal capital at risk, Fund investors can take comfort knowing that a significant amount of our personal net worth is in the Fund.

Over the last three years since inception, we have owned 53 companies, with all but six contributing positively to returns. Ten investments accounted for 64% of total performance and share some key characteristics:

- All are led by owner-managers with significant equity capital at risk. For example, our largest since inception contributor, MinebeaMitsumi, is run by 7% owner CEO Yoshihisa Kainuma. Kainuma-San is a Harvard Law school graduate who repurchased shares when cheap and acquired Mitsumi at a substantial discount to value, as evidenced by the company recording negative goodwill upon the acquisition of Mitsumi. AIN Holdings, our second largest contributor, is run by founder Kiichi Otani, who owns 9% of the company and has compounded book value per share at double-digit rates and achieved double digit ROEs with a net cash balance sheet by cheaply consolidating the highly fragmented Japanese drugstore industry. We strongly believe that companies that are led by owner managers will produce superior returns on capital versus those that are led by managements who have no equity at risk.

- All have sustainable competitive advantages that have become stronger over time. Each of the top 10 contributors have dominant positions in their domestic industries – Baidu is the dominant online search business in China; JINS has the leading market share (by volume) of prescription glass sales in Japan; Global Logistic Properties is the dominant modern warehouse operator in China; and Genting Singapore is a duopoly casino operator in Singapore. Additionally, Iida Homes, JINS and AIN Holdings have consolidated their respective fragmented industries, such that their competitive advantage has increased through economies of scale.

- All were severely undervalued when we initiated the position, most of them due to misplaced macro fears and/or a narrow focus on short-term results. Our long-term time horizon allows us to look through short-term stock price volatility to invest in high quality businesses that are temporarily trading at a discount.

- Eight out of ten top contributors were small-to-mid cap when we invested in them, and only Baidu and Hyundai Mobis were over $12 billion market cap. When we began the Asia Pacific strategy, we identified smaller capitalization stocks in Asia as a significant potential return opportunity. These smaller businesses tend to be under-covered by the sell side, ignored by major indices, under-owned by most investors, and therefore – in many cases – undervalued. In the past few years, investment banks have downsized in Asia, and research coverage has dropped primarily among smaller cap stocks. This trend is expected to continue at an increasing pace with MiFID II implementation.

- Similarly, four of the top ten contributors have no representation in the MSCI Asia Pacific index, and an additional four had less than 0.07% representation.

- All of these investments were within our circle of competence, where we could underwrite the business quality, the value, and the people, with a large margin of safety.

**Our Approach—Why has it been successful?**

- Value investing in a growth market is difficult, and long-term, bottom up value-oriented investors are somewhat rare in Asia. However, our experience has proven that investing in a concentrated selection of businesses that qualify from a strong business, good people, and deeply discounted price perspective enable us to produce long-term returns that are superior to the index.

- The only way to beat the index is to look materially different. With an active share of 96%, the portfolio looks meaningfully different from the benchmark at any given time from a geographic, sector, and market cap perspective. As discussed above, a number of our holdings are not even represented in the index. Given our concentration and bottom-up, benchmark agnostic approach, we expect our returns and the drivers of our performance to be consistently materially different from that of the index. In the past three years, growth stocks within the MSCI AC Asia Pacific index have outperformed value by 56%, and in 2017, the outperformance of growth versus value was even stronger at 67%. In the same three year period, the IT sector – a large component of growth stocks – has grown from 14% to 21% of the index and drove 36% of MSCI AC Asia Pacific returns in the period. Our value investing discipline doesn't naturally lend itself to investing in the high growth technology or highly-leveraged financial sectors, and we were significantly underweight both areas. Despite having limited exposure to the top performing sectors, we meaningfully outperformed the market.

- We only invest within our comfort zone and within our "circle of competence". We agree with Seth Klarman's assertion in *Margin of Safety* that: "The hard part is discipline, patience, and judgment. Investors need discipline to avoid the many unattractive pitches that are thrown, patience to wait for the right pitch, and judgment to know when it is time to swing." We do not need to invest in every opportunity that comes along, and we concentrate only in our best ideas where we have an edge in understanding the business, the management, and what will drive future returns. We invest to maximize total risk-adjusted returns, regardless of benchmark, sector, size, or geography. After almost three decades of living and working in Asia, your portfolio managers – for better or worse – have developed simple heuristics that guide us in everyday life and in making investment decisions. We recognize that the region presents a fantastic investment opportunity. However, we often face increased foreign exchange risk, legal and political uncertainty, lack of transparency, and simmering regional conflicts that threaten market stability. Within this context, investing within our comfort zone and our "circle of competence" has been critical to our success. While this means we may miss some "multi-baggers", it also means we can sleep easy at night, knowing that we are comfortable with the risks we are taking, our management partners who allocate our capital, and our margin of safety.

- The ability to access and engage with our global network of contacts built through over four decades of global investing and two decades of investing in Asia is a significant competitive advantage that cannot be easily replicated. Our network from 40+ years of global investing includes management teams, boards, clients, and industry, regional, and legal experts has helped us increase our "circle of competence" as we underwrite business valuations, evaluate competitive moats, and appraise company leaders. With billions of dollars invested in Asian companies and in global companies with major Asian businesses, we are often among the largest shareholders at businesses – leading to exceptional access to companies and people, giving us a tangible edge in this strategy.

- Investing alongside good management partners with "skin in the game" has been important to our success. Watching closely what insiders do with their own capital has often provided us with the confidence to act with more conviction. Knowing that management is closely aligned with shareholders and is highly incented to maximize value increases our margin of safety.

**Portfolio Update as of 31/12/17:**

| Q4 2017 | | | YTD 2017 | | |
|---|---|---|---|---|---|
| **Top Five** | **Contribution to Portfolio Return %** | **Total Return %** | **Top Five** | **Contribution to Portfolio Return %** | **Total Return %** |
| Speedcast International | +1.68 | +35 | Melco* | +5.04 | +103 |
| Vipshop | +1.66 | +33 | MinebeaMitsumi | +4.58 | +129 |
| MinebeaMitsumi | +1.53 | +35 | Speedcast International | +3.35 | +60 |
| Healthscope | +0.90 | +24 | Baidu | +2.80 | +45 |
| Melco* | +0.81 | +18 | Global Logistic Properties | +2.79 | +59 |
| **Bottom Five** | | | **Bottom Five** | | |
| L'Occitane | -0.41 | -13 | Adastria | -0.54 | -14 |
| Asaleo Care | -0.40 | -8 | Great Eagle | -0.22 | -8 |
| Baidu | -0.36 | -4 | Undisclosed | -0.18 | -4 |
| JINS | -0.34 | -15 | USHIO | -0.02 | 0 |
| Undisclosed | -0.12 | -4 | | | |

***Melco includes contributions from Melco Resorts and Entertainment Ltd. and Melco International Development Ltd.**

## Top Contributors

**Speedcast International** (+35%), a global satellite-based communication network service provider, was the largest contributor in the quarter and a top contributor in the year. We initiated the investment in the second quarter of 2017, when its price was significantly below our estimate of intrinsic value. Mr. Market disliked the acquisition of Harris Caprock in late 2016 and gave little credit for potential synergies. As long-term investors, we appreciated the transformative value of this acquisition from a forced seller. This was an opportunistic, yet contrarian purchase within the energy sector by Speedcast's owner-operator management. The company paid less than 6x trough EBITDA (post synergies), in an industry where businesses typically transact at over 10x EBITDA. We increased our investment in Speedcast after the company announced the Ultisat acquisition in July. Stock price was again impacted by concerns about increased leverage, which we believed was manageable given that over 90% of revenues are recurring and capex intensity is low in this business. Speedcast again paid less than 6x EBITDA post synergies for a business that reported over 75% year-over-year (YOY) growth in revenues in 1H FY17. Speedcast's market value has undergone a sharp re-rating in recent months, as the energy market reached an inflection point and maritime related revenues continue to post strong growth. Additionally, the company reconfirmed FY2017 guidance and upgraded its cost synergy target from the Harris Caprock acquisition.

**MinebeaMitsumi** (+35%), the Japanese manufacturer of high precision equipment and components, was a top contributor during the quarter and for the year. MinebeaMitsumi reported another strong quarterly result and revised upwards its full year results estimate for the second time this year. While operating profit expectations for the current financial year are 30% higher than initially forecasted, we believe that management has made conservative assumptions for exchange rates and both iPhone and Nintendo sales. Next year, the cash cow segment, precision ball bearings, is expected to remain strong with further benefits from efficiency gains and margin expansion. The LED backlight segment has an improved outlook and should have a longer life-cycle given the evolution in the iPhone. While the share price has risen with strong underlying results, we feel there is still additional upside. Given its meaningful intrinsic value growth and positive outlook for almost all segments of its business, we added to our position.

**Vipshop** (+33%), a leading online discount retailer for brands in China, was a top contributor for the quarter, after being a top detractor over the past two quarters. Third quarter topline growth of over 27% beat market expectations, and average revenue per active customer increased 11% YOY. Operating income margin, however, remained low as a result of accelerated spending on the logistics delivery team and a seasonally weak quarter. Vipshop's internet finance unit completed its second offering of asset-backed securities and is actively under discussion to spin-off the internet finance business. In December, Tencent and JD.com announced a joint cash investment in Vipshop of US$863 million at $13.08 per share. Upon closing of the transaction, Tencent and JD.com will own 12.5% of Vipshop and have signaled their intention to further increase the stake to 20% over the two year lock up period by acquiring more shares from the secondary market. The Tencent & JD.com investment at a 55% premium to the previous closing price triggered the share price recovery. We welcome the transaction because, not only does it validate our appraisal of the business quality and moat of Vipshop, it will bring significant additional internet traffic to Vipshop, from Tencent and JD.com, which we believe will accelerate its growth.

**Healthscope** (+24%), the second largest private hospital operator in Australia, was a top contributor in the quarter. We presented our investment case in our Q3 2017 letter. At the company's investor day in November, Healthscope's management reconfirmed FY18 guidance and indicated the key construction in progress project "Northern Beaches Hospital" in Sydney remains on schedule and on budget. Furthermore, the Australian Ministry of Health published its recommendations on Private Health Insurance reform, which are generally beneficial for the private hospital industry. In particular, plans to discount hospital insurance premiums for young people and changes to mental health coverage should benefit Healthscope. The share price has recovered from recent lows, but still offers an attractive margin of safety in an industry benefiting from the demographic tailwind of a rapidly aging population and associated higher medical expenses.

Macau casino operator **Melco Resorts** and holding company **Melco International** (+18% combined) were top contributors for the year and for the quarter, as industry gross gaming revenues (GGR) accelerated in the second half of 2017. Industry GGR growth of 19.1% in 2017 was substantially higher than the mid-to-high single digit full year GGR growth expectation at the beginning of the year. Former concerns over potential over-supply from significant capacity additions in Macau have turned into confidence that additional hotel and gaming supply will be well absorbed by the market. Melco Resorts is on schedule to open phase 3 (Morpheus) of City of Dreams (COD) in the first half of 2018, which will almost double the number of five star hotel rooms at COD. Upon the completion of Morpheus, we would expect free cash flow and distributions to shareholders to increase significantly with growth in industry GGR and the completion of significant growth capex. In addition, the opening of the Hong Kong-Zhuhai-Macau Bridge in 2018 could significantly boost visitation to Macau casinos.

**Top Detractors**

**L'Occitane** (-13%), the Hong Kong listed retailer of French organic cosmetics, was one of the top detractors for the quarter. L'Occitane reported soft first half results with marginally negative same store sales growth. While China and Brazil grew revenues at double-digit rates, this was more than offset by a slowdown in the US and Western Europe and foreign exchange headwinds. The recent euro strength relative to the US dollar and Japanese yen is a margin headwind, as L'Occitane is a euro based manufacturer. Additionally, the continued investment in marketing and emerging brands is negatively impacting operating margins and will continue to do so for the near-term. We believe these investments are necessary to drive a step change in the company's overall growth trajectory. The owner operator management executed opportunistic share buybacks as the stock price reached very attractive levels. We too opportunistically added to our position at a deep discount.

**Asaleo** (-8%): During the quarter, we exited our investment in Asaleo, the leading manufacturer of sanitary napkins and diapers in Australia and New Zealand. Despite strong brands and high market share, Asaleo downgraded its 2017 guidance due to aggressive price-led competitive behavior by key market participants. Asaleo management is responding to this by switching from "Everyday Pricing" to a "High-Low" pricing strategy, which gives the company flexibility to price competitively. In addition, pulp prices (an important raw material for Asaleo's products) have increased substantially in recent months as a result of Chinese import restrictions on recovered paper. Furthermore, electricity prices in Australia are expected to increase, adding to meaningful cost headwinds for Asaleo in coming quarters. While we appreciate the cash generative nature of this business and recognize that these cost headwinds could be temporary, we decided to exit this investment and allocate to more attractive opportunities discussed within this letter.

**JINS** (-15%), the Japanese optical retailer with a scale advantage, was a detractor in the quarter. The latest quarterly result fell below market expectation, and net store additions for the year was also below our forecast. The Japanese operation is performing well, despite reduced advertisement spending, but JINS faced some challenges overseas. Competition from new entrants has slowed China store expansions, and losses in the US widened in the year. Management took actions to address the issues and remains confident in the company's ability to deliver overall profits overseas. We are following the company closely and trimmed our investment in JINS ahead of the share price correction during the quarter.

**Baidu** (-4%), the dominant online search business in China, was a detractor in the quarter, but a positive contributor for the year. The third quarter results were in-line with company guidance and demonstrated further concrete evidence that the search business is recovering. The core online marketing services revenue growth bounced back to approximately 22% YOY, with the number of active customers growing steadily in the past few quarters. The newsfeed business, which started about a year ago, now produces approximately US$1bn in annualized revenue. Total consolidated operating profits grew 69% YOY, as a result of margin expansion from cutting online-to-offline (O2O) subsidies and disposing of the loss-making food delivery business. However, the share price retreated due to disappointment with the company's overall fourth quarter sales forecast. We took advantage of this short-term share price volatility and added to our position. The price recovered after management explained to the market that adjusted revenue on a like-for-like basis is still expected to grow 25% to 35%.

**Portfolio Changes**

Everything we do is guided by how we would invest our own money. With a significant portion of our net worth invested alongside client capital, we are laser focused on maximizing risk-adjusted returns for our families and clients. This alignment of interest ensures we treat your investment as if it were our own.

In a recently published Q&A in *Kellogg Insight,* Lou Simpson said, "One thing a lot of investors do is they cut their flowers and water their weeds. They sell their winners and keep their losers, hoping the losers will come back even. Generally, it's more effective to cut your weeds and water your flowers. Sell the things that didn't work out, and let the things that are working out run." We have not hesitated to cut our losses if our conviction fades or to add to investments where our conviction remains strong if share price had declined. However, it is psychologically difficult as value investors to add to the winners, whose discount to appraisal has shrunk, and to cut our weeds, as the discount to our appraisal has only increased, making it even more attractive on a price-to-value metric. We are getting better at this. This year, we watered some "flowers" (including Healthscope, New World Development, and MinebeaMitsumi), and they have blossomed. MinebeaMitsumi was a top contributor to returns since we initiated the position in 2016. Although price appreciated, we increased our investment in late 2017, after seeing better than expected earnings growth, more upside from extremely accretive acquisitions, share repurchases and intrinsic value growth. In 2017, MinebeaMitsumi returned 129% and 35% in the fourth quarter. One of the truly difficult skills as a value investor is to determine when a business whose stock price has behaved like a weed is an under-appreciated flower. We've watered a number of these "hidden" flowers in 2017, as we believe the market overly discounted them, yet our view of intrinsic value remained steady or grew. For example, we added to our investments in L'Occitane (discussed earlier) and in Hyundai Mobis, which was severely discounted due to geopolitical tensions between China and Korea. We also added to Vipshop, which was a detractor in 2016 and in the last few quarters.

We made ten new investments and sold twelve in 2017. We made four new investments in Australia, two in Japan, two in Europe with clear Asian growth drivers, one in Taiwan and one in China. In the fourth quarter, we bought three new businesses and exited four. We sold Asaleo and Adastria because we underestimated the intense competitive nature of the segments in which each company operates: the personal hygiene industry in Australia in the case of Asaleo, and the Japanese retail fashion industry for Adastria. We also exited our investment in Coca Cola Bottlers Japan as the market price reached our appraisal and K. Wah International, as our view of their capital allocation turned more negative, given their continued purchase of high priced land bank in Hong Kong. We redeployed the capital into three new businesses, which remain undisclosed as we build out our position in each.

**Portfolio Outlook**

Sticking to our investment discipline has allowed us to successfully navigate one of the most volatile periods in the Asian capital markets since the Global Financial Crisis in 2009, while demonstrating that active, value investing can be successful in Asia, despite the strong market preference for growth over value and persistent rise of the IT sector in the region.

Looking back on the strong performance of 2017, one might question the future relative opportunity set within the portfolio from here. As a result of our opportunistically exiting fully valued businesses throughout the year and redeploying capital into new, high-quality, discounted companies the portfolio remains attractively discounted, ending the year with a price-to-value ratio in the mid-70s%. The volatility and dispersion inherent in Asian capital markets have allowed us to find an adequate number of new investment opportunities and build a relatively large pipeline of potential "on deck" investment ideas, even in a bull market.

We do not expect the pipeline of potential investments to disappear as a result of the strong performance in the last 12 months. However, you can expect turnover of the fund to remain elevated, as we redeploy capital from winners to new opportunities. As always, our investments are driven by bottom up opportunity, resulting in a portfolio that is highly differentiated from the index with significantly different potential return drivers.

*See following page for important disclosures.*

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