October 8, 2019

Longleaf Partners
Fund Commentary
3Q19

Longleaf Partners Fund declined -3.11% in the third quarter, taking year-to-date (YTD) returns to 5.29%. The S&P 500 Index added 1.70% in the third quarter and gained 20.55% YTD. As the largest shareholder group in the Fund, we are disappointed in these results but confident in the future. We saw a continuation of the headwinds we have written about over the past several years in the third quarter – fears of a trade war and Hong Kong unrest, US dollar strength, concerns over US interest rates, the continued dominance of Growth stocks over Value stocks and US markets outperforming Non-US markets, alongside temporary, unrelated stock-specific issues. However, the values of the companies we own have generally remained steady or grown, even as prices have declined, resulting in an attractively discounted portfolio with a price-to-value (P/V) ratio in the high-50s%.

We continue to see overvaluation in large segments of the S&P 500 and believe that sticking to our long-term, fundamental value investment discipline will ultimately pay off. We saw a glimpse of how quickly market forces can revert in the 11-day period

Average Annual Total Returns for the Longleaf Partners Fund (9/30/19): Since Inception (4/8/87): 9.49%, Ten Year: 6.61%, Five Year: -0.16%, One Year: -16.47%.

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. Effective August 12, 2019, Southeastern has contractually committed to limit operating expenses (excluding interest, taxes, brokerage commissions and extraordinary expenses) to 0.79% of average net assets per year. This agreement is in effect through at least April 30, 2021 and may not be terminated before that date without Board approval.
from August 27 through September 11, which saw one of the most dramatic value vs. momentum reversals in the last 25 years, comparable only to 1999-2000 when the tech bubble burst. Our portfolio added 10.87% in the period vs. the S&P 500’s 5.01% and the S&P 500 Value’s 7.18%. As long-term investors, we do not hang our hats on two weeks’ performance, just as we do not believe the last year plus has been representative of what our strategy can deliver for clients over the long term. However, we believe the portfolio is well positioned for outperformance based on shifting market dynamics, individual company fundamentals, and management teams that can take advantage of opportunities to create value.

Our absolute return focus dictates that we need to 1) own undervalued, high quality investments and 2) avoid expensive speculation. 126 months into a bull market, we believe the second part of the equation is both far more important than it has been and more widely overlooked. At the last relative peak for value investing in May 2007, 16% of the S&P 500’s market cap came from stocks with price-to-earnings (PE) ratios over 20x - the same level seen in mid-to-late 2014, when the Partners Fund’s performance began to meaningfully diverge from the S&P 500’s. These were both evenly distributed valuation markets relative to history and other indexes. At the end of August 2019, the percentage of >20x PE stocks was all the way up to 49%. While that is not quite the once-in-a-lifetime 69% level seen briefly in early March 2000, we are confident that the S&P 500 is far more tilted than it has been in recent history to overvalued market favorites that have driven the last decade’s returns.

We have limited or no exposure to the historically expensive low-volatility, “dividend aristocrat” stocks and/or growthier technology-related stocks. At this point in the cycle, we believe we have seen the majority of the pain for not holding these stocks and that we have the portfolio, the experienced team and the right approach in place to exploit what we expect will be “our kind of market” on a prospective basis.

Some might argue that low interest rates mean “this time is different”. Another form of “this time is different” is the argument that the level of bond yields justifies the current low level of earnings yields. As contrarians, we take comfort that most market participants have given up on interest rates ever moving higher. Even if interest rates stay low, our counter to this argument is that a discounted cash flow (DCF) model has
both interest rates \( (r) \) and growth \( (g) \) in the denominator of the simple net present value (NPV) calculation: \( DCF = \frac{\text{Free Cash Flow}}{r-g} \). The tradeoff between \( r \) and \( g \) within a DCF means that it is not as simple as a current snapshot of bond yields vs. earnings yields, any more than it makes sense to pay any low cap rate for a piece of real estate if you can secure a loan at an interest rate that low. The \( g \) looked a lot better in the past than it does today for the current market favorites. We have owned many low-volatility, dividend aristocrat stocks in the past, but today these companies are facing slower growth and more competition from retailer concentration/competition, the internet making it easier to start new brands direct to consumer and a much worse outlook for global expansion than existed 10-20 years ago. For the healthcare stocks that seem like steady dividend payers, we see trouble on the horizon ahead of an election year as the challenged US healthcare system spends significantly more yet does not make the US significantly healthier than other countries with similar gross domestic product (GDP) per capita levels. For the historically faster growers, we agree that favorites like Visa, Mastercard, Amazon, Microsoft, etc. are good — even great — businesses. However, we would argue that it is mathematically and regulatorily much harder to double or triple a mega-cap over the next five years, when it just spent the last five years tripling (Visa, Mastercard, Microsoft) or quintupling (Amazon). We compare these extreme market valuations to our portfolio, which trades at an adjusted price to free cash flow power of less than 9x.

Even more importantly, we believe that our portfolio is comprised of high-quality businesses with management teams that are taking action to close the gap between price and value and can deliver strong results. In last quarter’s letter, we discussed the potential catalysts that we expect to drive positive results across many of our holdings over the next few quarters. We saw initial positive progress at CNH Industrial, which announced plans to improve profits dramatically and split into two businesses: a pure-play Ag/Construction company and a commercial vehicle/powertrain company. Additionally, CNX reported a strong quarter that led to a 25% increase on the day and strong growth in our appraisal. Please check out our recent podcast with CNX Chairman Will Thorndike if you would like to hear more on the company’s transformation during our ownership at \url{https://southeasternasset.com/podcasts/will-thorndike-on-cnx-outsiders-and-private-equity/}. CenturyLink was the top portfolio performer in the quarter based on steady FCF/share guidance, but we expect
significant additional upside potential from multiple strategic levers that management can pull. We have a 13D filed and have made progress behind the scenes in discussions on strategic options for the business. The other businesses we outlined last quarter remain some of the most fertile ground for our corporate leaders to generate rewarding performance payoffs. While we have been too early in our most discounted businesses, they remain among our highest conviction holdings today. We expect to see continued progress over the next several months.

**Contributors/Detractors**
(Q3 Investment return; Q3 Fund contribution)

CenturyLink (9%, 0.73%), the fiber and telecom company, was a strong contributor after reporting a relatively flat quarter in line with expectations and maintaining free cash flow guidance. We expect the sales force now being fully integrated after the Level 3 acquisition and faster pace of new installations to drive accelerated growth in the key Enterprise business in the coming quarters. CEO Jeff Storey and CFO Neel Dev continue to make progress in improving the cost structure, with a further $200-300 million per year of additional cost savings identified and a focus on increasing cash flow. CenturyLink’s management has intentionally run off non-core, unprofitable businesses, like low-speed consumer internet and voice, while intelligently investing to expand the network’s Enterprise fiber coverage and growing high-margin revenues over the long term. As CenturyLink’s Enterprise growth inflects to outweigh the legacy declines later this year and next, we expect both the company’s top line and consolidated EBITDA per share to grow. The company trades at a roughly 65% discount to our appraisal today and a multiple of 4-4.5x free-cash flow. We are engaged with management to explore additional options to close the price-value gap, as there continues to be a healthy amount of M&A in the industry at multiples above where we appraise CenturyLink’s parts.

Alphabet (13%, 0.44%), the diversified internet company with strong positions worldwide in search (Google), video (YouTube), mobile (Android), and more, contributed positively after reporting accelerating revenue growth in the US (20% year-over-year) and even better results internationally. The pace of margin decline seen in prior quarters improved. Google Cloud has roughly doubled revenues over the last 18
months to become a solid number three in the industry. The company bought back $3.7 billion worth of stock, a significant year-over-year uptick and a welcome sign that the company saw value in the stock at discounted prices in the second quarter. We trimmed our position towards the end of the quarter, as price appreciated.

Comcast (7%, 0.40%), the leading US cable company, was another top contributor. The company reported 9-10% revenue growth from its cable internet and business segments. A decline in video subscribers was largely immaterial to Comcast cable’s cash flow, and the segment’s margins again improved. NBC Universal’s (NBCU) network and broadcast revenues increased moderately, and NBCU announced its streaming service, Peacock, would take back NBC’s best video content, including The Office, from Netflix. Sky, Comcast’s recently acquired European subsidiary, also grew moderately, while developing more of the proprietary content that has maintained its relevance with subscribers.

General Electric (-15%, -1.24%), the aviation, healthcare and power company, was the largest detractor. In August, fraud investigator Harry Markopolos, working with a short seller, released a report alleging the company was concealing financial problems. The report focused mostly on the company’s long-term care insurance reserving and the accounting of the Baker Hughes GE (BHGE) stake. GE management responded firmly, pointing out that the work in the report was flawed in that it incorrectly compared insurance policies across the industry, and the BHGE accounting had already been properly footnoted. Our appraisal was not impacted, as there was no new information. We already factored in additional contributions to bolster GE Capital reserves due to lower interest rates as the year has gone on, and our sum of the parts appraisal already incorporated the loss on the BHGE investment. CEO Larry Culp and numerous other executives and directors bought several million dollars’ worth of shares as the stock dropped on the back of these headlines. Later in the quarter, the company raised another $2.7 billion of cash by selling down the next portion of its Baker Hughes stake. Operationally, GE reported moderate revenue growth in aerospace, though the ongoing Boeing 737 problems will temporarily delay some of the segment’s cash inflows over the coming months. GE Power revenues shrunk 5%, but much more importantly Culp cut the unit’s cash burn as it approaches profitability. The share price has since rebounded 17% after the initial 15% decline in the aftermath of the report,
but it remains overly discounted today. We highlighted GE and Larry Culp last quarter as an example of a management team that had already taken steps to turn around the business, and we expect to see additional value-accrative transactions in the future, as Culp remains focused on opportunities to monetize assets at fair prices.

FedEx (-11%, -0.69%), the transportation and logistics company, fell after non-US Express revenues missed expectations with lowered revenues and earnings guidance. FedEx Ground grew, but the segment’s margins contracted. Tariffs and trade uncertainties have thus far hurt Express more than any of the Fund’s other portfolio companies, as increased integration costs at TNT have combined with a worse revenue outlook to produce current results well below the segment’s long-term earnings power. None of these disappointments have changed the business’s competitive position or five-year outlook, but we lowered our appraisal in the quarter to reflect the lower-than-expected year-to-date results. Amazon’s increasing competition has received much media attention, but FedEx has (unlike UPS) already taken the pain of dropping direct revenue from Amazon. Plus, there are many companies that compete with Amazon and will therefore choose to partner with FedEx instead. Despite a poor outlook through 2020, FedEx stock is trading at a low-double-digit multiple of forward earnings and priced at a substantial discount to our appraisal, its free cash flow power and its historical valuation range.

Fairfax Financial (-10%, -0.55%), the insurance and investment conglomerate, declined despite solid underwriting results. The market focuses at times on Fairfax’s emerging market exposure, which has been achieved very profitably and is a competitive advantage going forward, but has been viewed this year as a negative when countries like India struggle. In developed markets where Fairfax has more of its value, property and casualty and reinsurance markets have been turning around with better pricing after years of overcapitalization in the market. Fairfax remained disciplined and avoided growing its policies unprofitably throughout the soft pricing market, and the company is now intelligently increasing business across its subsidiaries, while maintaining a strong combined ratio. The Fairfax balance sheet safely holds low-duration debt and plenty of cash, allowing the company to be a liquidity provider when superior equity investment opportunities arise.
Portfolio Activity
We sold our position in Allergan after the company announced late last quarter that it had agreed to be acquired by AbbVie. We also trimmed Fairfax early in the quarter and trimmed Comcast and Alphabet as each appreciated in the quarter. We added to Park Hotels but did not purchase any new businesses. The pipeline of prospective investments has steadily improved throughout the year after the market rebound in Q1. We have met with and pre-qualified several interesting investment prospects across a range of industries that could come into the portfolio if we get a market pullback.

Outlook
The portfolio ended the quarter with a strongly discounted P/V in the high-50s% and 15.2% cash, which we can put to work quickly as new opportunities qualify. We expect to see continued progress in our individual holdings, as our management partners pursue catalysts that could drive significant near-term payoffs. We believe that our largest macro headwinds over the last five-to-ten years could soon become tailwinds. While we cannot predict the timing, we believe that trailing trends are longer in the tooth than they've ever been. We were encouraged by some broader market moves in our favor in September.

We are grateful for our long-term clients, who have remained with us through a challenging period. In recognition of your patience and to ensure an increasing expense ratio does not disadvantage our loyal partners, the Longleaf Trustees approved a temporary expense cap for the Fund. As of August 12, 2019, the expense cap lowers the total cost of the Fund (total expense ratio) to 0.79%. We remain committed to treating your investment as if it were our own and will continue to communicate with you as candidly as possible. We recently redesigned our website to enable better access to portfolio information and communication from your portfolio managers. We would encourage you to visit the new site at www.southeasternasset.com.

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 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. 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.

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

Discounted cash flow (DCF) is a valuation method used to estimate the attractiveness of an investment opportunity. DCF analysis uses future free cash flow projections and discounts them to arrive at a present value estimate, which is used to evaluate the potential for investment.

Net present value (NPV) is the difference between the present value of cash inflows and the present value of cash outflows.

Dividend aristocrat stocks are a group of stocks in the S&P 500 that meet certain minimum size requirements and have 25 years of consecutive dividend increases.

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.
FCF Power is Southeastern’s estimate of the amount of free cash flow per share that the company can produce on an annual basis once the business has achieved what we consider to be a normalized level of operations of its ongoing businesses.

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.

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

As of September 30, 2019, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 9.8%; CK Hutchison, 7.3%; GE, 7.2%; Mattel, 6.3%; FedEx, 6.1%; CNH Industrial, 5.6%; Fairfax Financial, 4.8%; LafargeHolcim, 4.8%; CNX Resources, 4.6%; Affiliated Managers Group, 4.6%. 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.
LLP000949
Expires 1/31/2020
Longleaf Partners Fund declined -2.87% in the second quarter following the Fund’s strong absolute return in the first three months of 2019. The Fund’s 8.67% year-to-date (YTD) gain exceeded our absolute annual goal of inflation plus 10%. The S&P 500 Index added 4.30% in the second quarter and gained 18.54% YTD. As the largest shareholder group in the Fund, we are not pleased with results in the quarter or over the last year. We are heavily engaged with our corporate partners to pursue opportunities to build and gain recognition of value. We anticipate productive activity at the Fund’s holdings that could deliver solid results in the second half of 2019.

The Index’s performance in the quarter continued to be driven primarily by Information Technology, a sector where the Fund had no exposure. Additionally, the dominance of Growth stocks over Value stocks continued. Anticipated rate cuts by the Federal Reserve turned a May market decline into a June rally. Over half the companies in the portfolio rose. The Fund’s primary performance detractors fell for unrelated, company-specific reasons that we do not believe impact the long-term cases for owning these businesses. Our appraisals remained steady even as the Fund’s net asset value (NAV) declined, and the divergence between the two pushed the portfolio’s price


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to value (P/V) ratio back below 60% in May, a discount rarely reached and from which subsequent long-term outcomes have been strong historically.*

Given the deep discounts at numerous Fund holdings, our partners are pursuing catalysts for value recognition that we believe could be months, not years, away. One announcement can create a quick shift to positive price momentum. Several companies that were most hated in the last twelve months began to change direction following management-led activity to close the gap between price and value.

- **Allergan** had been among the recent quarter's notable detractors, but days before quarter-end, the company announced that it had agreed to be acquired by AbbVie. The stock quickly rose over 25%, illustrating how unexpectedly payoffs can occur. The deal was structured to reduce risk while allowing for upside at the new company. Allergan CEO Brent Saunders had previously demonstrated a commitment to value recognition in 2016 with the opportune sale of the generics business to Teva and a negotiated sale of the company to Pfizer, which subsequently was scrapped when the U.S. changed its tax inversion policies. The AbbVie agreement illustrates the importance of a good partner serving shareholders.

- **Comcast**, which we bought last year when the company made a bid for Sky, subsequently highlighted CEO Brian Roberts' value per share discipline by not outbidding Disney for all of Fox. The drama around the deal has died down, and Comcast has delivered solid results. More recently, Comcast boosted value through the deal negotiated with Disney to monetize its one-third stake in Hulu. Roberts' strong transaction record has created catalysts for value growth and price recognition.

- **General Electric**, the Fund's worst performer in 2018, reversed course after CEO Larry Culp, who had already shown his willingness to monetize assets at the right price, announced an attractive sale of GE's Biopharma segment to Danaher, completed the improved spinout of the transportation business (Wabtec) and reported two quarters of no surprises at GE Capital. While up from extreme lows, we believe the stock price remains deeply discounted. Additional
transactions could be forthcoming, as Culp remains focused on opportunities to monetize assets at fair prices.

- **LafargeHolcim** has sold several emerging market operations in the last six months, including Malaysia, Indonesia and the Philippines, as CEO Jan Jenisch has focused the company on maximizing profits in geographies where it has a long-term advantage. We expect to see more sales in non-core regions, such as the Middle East or Africa, that could be stock catalysts.

Many of our other corporate partners have a history of driving value recognition and currently are pursuing prospective near-term actions that could drive stock payoffs. We are engaged with management teams. Sometimes this means filing 13Ds to suggest board members and talk to interested parties. In other cases, we work privately to ask our management partners tough questions and improve outcomes. The following list illustrates some of the levers available to our partners.

- **Affiliated Managers Group** has acquired interests in investment managers at opportunistic points, leading to high return on investment (ROI) and value growth since the company’s inception, and management historically repurchased meaningful shares when prices were substantially discounted. A similar opportunity to meaningfully build value per share through buybacks exists today.

- **CenturyLink** (CTL) has grown value through improved operations and fiber acquisitions, including Qwest prior to CTL’s acquisition of Level 3 and Level 3’s previous purchases of Global Crossing and tw telecom. CEO Jeff Storey announced a strategic review of the Consumer business in May. Given recent fiber transaction multiples at 2-3X CTL’s current consolidated multiple, Storey’s options range from separating the Fiber and Consumer businesses to selling some or all of the company’s assets. We have a 13D filed to enable us to explore options with CTL and to suggest board members who would bring experienced perspectives on fiber’s value to different potential acquirers.

- **CK Asset** and **CK Hutchison**, led by Chairman Victor Li, previously consolidated Cheung Kong and Hutchison Whampoa and separated the real estate assets
into CK Asset. A similar opportunity exists to separate the infrastructure assets held across the two companies. Additionally, CK Asset can continue to sell its Hong Kong properties at premium prices, and several of CK Hutchison’s segments, including the A.S. Watson’s retail business, might receive higher multiples as pure-play entities.

- **CNH Industrial** was created in the Fiat Industrial and CNH merger conducted by John Elkann, who is Chairman of controlling owner EXOR. The opportunity remains to further simplify the company by separating its valuable Agriculture business from the non-core Commercial Vehicles and Construction segments.

- **CNX Resources** successfully separated its coal business from the natural gas company and has sold gas assets at good prices. CEO Nick Deluliis and the board, which includes three members suggested by Southeastern, can continue to sell some or all the company’s gas reserves, as well as monetize its pipeline assets. Insider buying has been significant.

- **FedEx**, which Chairman Fred Smith built from scratch and transformed through acquisitions including Flying Tigers and RPS, should benefit as the company integrates its TNT acquisition in Europe. Earnings are troughing as this integration nears its end and the company’s value and earnings shift more to its higher multiple Ground and Freight divisions.

- **Mattel** has decreased its cost structure and created joint ventures to produce media content for its Barbie and Hot Wheels brands since Ynon Kriez became CEO in April 2018. Mattel has significant opportunity to further extend its top brands into other revenue streams. Additionally, after various rumors of interested acquirers, the board, which includes a member introduced by Southeastern, could sell the company if offered full value.

Our confidence in the Fund’s future results has much to do with our belief in the ability of our corporate leaders to deliver self-help that generates rewarding payoffs. Any one or two catalysts mentioned above could have a 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)

Allergan (15%, 0.72%), the medical aesthetics and pharmaceutical company, was the most notable performer in the quarter. As described above, the stock, which had been under pressure after management failed to announce a breakup or other strategic actions in its second quarter reporting, quickly turned direction when the company announced it had agreed to be acquired by pharmaceutical firm AbbVie. This transaction creates a stronger and more balanced combined entity. The cash portion of the deal reduces risk, while the AbbVie shares Allergan holders will receive are undervalued themselves.

CNX (-32%, -1.77%), the Appalachian natural gas company, was the Fund's largest detractor 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 free cash flow (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.

Mattel (-14%, -0.80%), the toy company, declined during the quarter due to fears over litigation related to the Fisher Price Rock N’ Play sleeper recall. The stock bounced back briefly with the catalyst of a takeover offer by Isaac Larian, the CEO of MGA Entertainment, but retreated when the offer proved to be an insincere approach that was withdrawn. Mattel CEO Ynon Kriez made progress with the announcements of licensing agreements with Pixar, Warner Bros. Entertainment and Sanrio (Hello Kitty) during the quarter. Ongoing cost cutting initiatives are ahead of initial plans.
Portfolio Activity
The Fund's holdings remained well below our appraisal values, but we trimmed some of the stronger performers during the quarter to manage position sizes. We added to CNX but did not purchase any new businesses. As the market sold off in May, our on-deck list became more interesting, with a handful of stocks within 10% of buying range.

Outlook
Corporate fundamentals performed better than the Fund's price, and consensus earnings across the holdings grew. The P/V finished the quarter in the low-60s%, a discount well-below the long-term average. The portfolio has 14% cash to deploy in new qualifiers.

The Fund’s negative return came from a handful of companies that had unrelated, short-term disappointments or perceived issues. 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 Allergan recently demonstrated. One of Southeastern's competitive advantages is taking a multi-year perspective to stock ownership, as we know that prices should ultimately migrate to growing values. In the near-term, we are highly engaged with CEOs and boards who are exploring transactions 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.
*Quarter-ends since 1993 were identified where the Partners Fund’s “price-to-value ratio” (P/V) was less than 60%. From each quarter end identified, the 1, 3, and 5 year cumulative returns for the Fund and the S&P 500 were calculated. Those returns were then averaged and the 3 and 5 year returns were annualized. Current circumstances may not be comparable.

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
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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. 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.

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.

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.

Return on Investment (ROI) measures the gain or loss generated on an investment relative to the amount invested.
As of June 30, 2019, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 8.5%; GE, 7.8%; CK Hutchison, 7.4%; FedEx, 6.3%; Mattel, 5.7%; Fairfax Financial, 5.4%; CNH Industrial, 5.2%; LafargeHolcim, 5.0%; Comcast, 4.6%; Affiliated Managers Group, 4.6%. 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 10/31/2019
Longleaf Partners Fund Commentary

1Q19

Longleaf Partners Fund gained 11.88%, surpassing our annual goal of inflation plus 10% in the first quarter but underperforming the S&P 500 Index’s 13.65% return. The market’s rebound, following a double-digit fourth quarter decline in 2018, provided a tailwind. Almost all of the stocks in the portfolio made gains.

Even as the issues of global economic slowdown, tariff and trade disruptions, and geopolitical unrest remained unresolved, the investor concern that dominated late 2018 appeared to dissipate. We have little insight into how macro questions about trade, U.S. and China economic growth, and inverted yield curves and trillions in negative yielding debt will be answered, but we are confident these uncertainties will continue to provide opportunities to disciplined, long-term business owners like ourselves.

When stocks become as deeply discounted as we saw in December, it is not uncommon to have a big turnaround. The Fund’s two worst performers in 2018, GE and Mattel, were by far the largest contributors for the first quarter, followed by LafargeHolcim, which had been among the larger 2018 detractors. The businesses at each of these companies have very different drivers, but each has an aligned CEO who

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Average Annual Total Returns for the S&P 500 (3/31/19): Since Inception (4/8/87): 9.79%, Ten Year: 15.92%, Five Year: 10.91%, One Year: 9.50%

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, 2018, the total expense ratio for the Longleaf Partners Fund is 0.95%.
took the reins in the last eighteen months and is delivering demonstrable operating and capital allocation progress.

Information Technology (IT) stocks drove the Index more than twice as much as any other sector. While the Fund’s lack of exposure to IT contributed over 1% of underperformance, CenturyLink, the Fund’s largest holding and biggest decliner, was the primary culprit. As discussed below, the stock’s retreat, without any corresponding diminution in our appraisal, presented an opportunity to become more actively engaged to speed value growth and recognition.

We started the year actively assessing numerous new qualifiers, but the market’s rally shortened the on-deck list. We did not buy any new investments during the quarter, and we sold two positions. Even with the double-digit return, we believe substantial upside remains in the portfolio, with only a couple of holdings selling at over an 80% price to value (P/V).

**Contributors/Detractors**
(Q1 Investment return; Q1 Fund contribution)

General Electric (37%, 2.51%), the aviation, healthcare and power company, was the largest contributor. CEO Larry Culp began fulfilling his promise to simplify operations and strengthen the balance sheet. Since becoming CEO in September, Culp and his team have funded GE Capital’s mortgage liabilities and long-term care reserves, improved accounting across the board and sold numerous non-core assets for good prices. Deals for transportation, distributed power, lighting, Baker Hughes GE shares and biopharmaceuticals have closed or are scheduled to bring in cash by the end of the year. The biopharmaceuticals sale alone realized $21 billion plus a pension liability assumption at high multiples of revenues and earnings before interest, taxes, depreciation and amortization (EBITDA). GE Capital, historically the most difficult segment to appraise due to its complexity and leverage, is simpler and less leveraged than it has been for decades, and Culp still has assets to sell. Aviation announced strong quarterly results and increased annual guidance due to the success of the efficient LEAP engine. Beyond selling assets for full prices, Culp’s operational priority is turning around the underperforming power segment. Returning to profitability in this
segment will not happen this year, but the company will benefit over the long run from a healthy high-margin gas-turbine service business. After rallying almost 40% in three months, the stock still trades at a substantial discount to our value.

Mattel (30%, 1.93%), the toy and media company, was another large contributor. During the last quarter, Barbie and Hot Wheels grew nicely once again. Mattel’s new media division demonstrated some of the possibilities for monetizing the company’s brands, announcing Barbie and Hot Wheels movie joint ventures with Warner Brothers, an American Girl movie with MGM, and 22 television shows to distribute across multiple platforms. The company’s earnings power should grow with a targeted 15% operating income margin over the next few years, following additional cost cuts, international inventory rationalization and longer-term investments during 2019. Management is focused on maximizing the value of the Barbie and Hot Wheels brands, while returning Fisher-Price, American Girl and Thomas to growth. Not only is the stock well below our current appraisal, but we expect that appraisal to grow rapidly over the next few years. CEO Ynon Kreiz personally bought $1 million of shares in the last few months.

LafargeHolcim (20%, 1.12%), the world’s largest global cement, aggregates, and ready-mix concrete producer, was also a notable contributor to the Fund’s return. After eighteen months as CEO, Jan Jenisch is delivering both operating efficiencies and value-accretive asset sales. Recent results showed efficiency gains and pricing that offset cost inflation. Cost savings were ahead of target, with Aggregates and Ready-Mix EBITDA margins improving considerably. The company also eliminated CHF400 million in central corporate expenditures. These cost initiatives combined with more favorable markets should meaningfully grow LafargeHolcim’s earnings power. The company has pushed through pricing in its North American business. Latin America and Middle East and Africa are showing signs of stabilizing in 2019. Europe should experience modest growth this year. The company closed the sale of its Indonesian assets at an attractive price, and management plans to accelerate divestments in other regions over the next two years, providing meaningful cash proceeds to reinvest.

CK Asset (21%, 0.98%), the Hong Kong and China real estate company, reported solid results for 2018, with dividends increasing 12% year-over-year and book value per
share growing 11%. In 2018, CK Asset sold the Center at below a 2.5% cap rate. CK Asset's hotel portfolio increased profits 22% with improvements in room rates and occupancy. Two hotels will open in 2019 and add around 15,000 rooms and serviced suites. Given relatively high land prices in Hong Kong, we expect Managing Director Victor Li to continue to deploy cash flow into global projects that offer attractive returns.

Wynn Resorts (21%, 0.96%), the casino and hotel operator, grew revenues and EBITDA at the Wynn Palace in Macau 13% and 20% respectively in the fourth quarter. While Wynn's original property in Macau declined as expected with the ramp up of Wynn Palace, the combination of the two continued to grow, and Macau overall performed better than expectations as the first quarter went on. Domestically, Las Vegas revenues grew 3%, and the Boston Harbor resort is closer to its June opening after several years of construction and Massachusetts Gaming Commission hearings in April. New CEO Matt Maddox and the reshaped board demonstrated their shareholder alignment by repurchasing discounted shares at a 6% annualized pace.

CenturyLink (-19%, -1.72%), the fiber and telecom company, was the primary detractor to first quarter returns after a dividend cut. We were disappointed by that decision and filed a 13-D to enable us to become more active in the investment through seeking to improve the board, encouraging opportunistic asset sales and exploring creating tracking stocks for the company's two segments. Private-market transactions of assets comparable to some of CenturyLink's (CTL) fiber assets have been over 15X EBITDA, far above CTL's depressed 5X EBITDA stock price. In addition to monetizing some of this fiber, separating the enterprise and consumer segments into distinct tracking stocks could help highlight the values and different opportunity sets for both. We believe that adding board members with experience in fiber and financial transactions can bring additional capital allocation discipline to drive value recognition. We maintain our support for Jeff Storey and his team operationally even while disagreeing about some capital allocation items. Storey bought $1 million in shares personally in the quarter, and CFO Neel Dev, as well as multiple directors, also increased their ownership of the stock.
Portfolio Activity
We examined several prospective investments but did not purchase any new companies in the quarter. We sold two holdings following spin outs. GE completed the sale of its transportation business via the separation of Westinghouse Air Brake Technology, which traded at our appraisal upon the transaction. DowDuPont initiated the spin out of its Materials Science business, which will go by the Dow name. Dow’s “when issued” price implied a full valuation for the remaining Agriculture and Specialty Chemicals segments, and we sold the position, which we had purchased in the fourth quarter, for a small gain.

Team Update
We welcomed Taieun Moon as a junior analyst in our Singapore office in the quarter. Taieun interned for Southeastern last summer and joins us full time following his graduation from The University of Hong Kong. We also concluded our search for a junior analyst in London. Alicia Cardale will join Southeastern in May. She has interned at several investment firms and most recently worked at a U.K. real estate company. Alicia has a Master’s degree in Real Estate from the University of Reading. We look forward to the broad depth that Taieun and Alicia will add to our research team.

In March, we shut down the concentrated Europe Fund (“SCV”). Although SCV had a strong performance record over its four years, in the last fifteen months the Fund’s cash balance grew to more than three-quarters of net asset value. Over the same period, the International Fund’s cash declined from 22% to less than 3%, as we were finding opportunities, including several European qualifiers. SCV’s idea generation was no longer benefitting Southeastern’s broader client base, and our investment partners could own the most compelling European engagement opportunities via the more flexible and less costly International and Global Funds. Consequently, we returned the capital to our partners, much of which was internal to Southeastern and will be redeployed into the Longleaf Funds. Because Scott Cobb was solely focused on managing SCV, he will depart from Southeastern upon its closing. We thank Scott for his years of service to Southeastern and our clients.
Outlook

The Fund began the year at a rare discount, with the P/V below 60%. The double-digit rally is not surprising from such depressed prices. More encouraging is that rebounds from 50s% P/Vs historically continued over several years. With only 6% cash and the portfolio trading at a low-60s% P/V today, we believe there is substantial upside opportunity. Beyond the P/V math, we are seeing value growth at our companies, which should drive further opportunity. Additionally, our partners are taking proactive steps to drive value recognition at many of our holdings. We believe their actions can drive much stronger long-term results than we expect from the fully valued Index.

See following page for important disclosures.
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RISKS
The Longleaf 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. An index cannot be invested in directly.

The S&P 500 Growth Index represents the companies of the S&P 500 Index that are considered to have growth characteristics (e.g., using earnings per share growth rate and sales per share growth rate).

The S&P 500 Value Index represents the companies of the S&P 500 Index that are considered to have value characteristics (e.g., using book value to price and earnings to price).

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.

Book Value is the value of an asset as carried on a company’s balance sheet.

Cap rate (capitalization rate) is the rate of return on a real estate investment property based on expected income.

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.

Aggregates are materials such as sand or gravel that are ingredients in concrete.
As of March 31, 2019, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 8.1%; GE, 7.7%; CK Hutchinson, 7.4%; FedEx, 6.6%; Mattel, 6.3%; CNX Resources, 5.5%; Affiliated Managers Group, 5.0%; LafargeHolcim, 4.9%; Park Hotels, 4.9%; United Technologies, 4.8%.

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.

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Expires 7/31/2019
January 21, 2019

Longleaf Partners
Fund Commentary
4Q18

Longleaf Partners Fund declined -20.67% in the fourth quarter, taking its 2018 return to -17.98%. The S&P 500 Index fell -13.52% in the final three months and ended the year down -4.38%. Four primary challenges impacted the Fund’s absolute and relative returns in 2018. First, our investment in companies based outside of the U.S. hurt performance, even though many of them have significant U.S. segments. The strong dollar was a headwind, and U.S. stocks outperformed those based elsewhere, despite the large fourth quarter U.S. decline. Second, we were too early investing in several of the Fund’s more recent purchases. While we averaged into General Electric (GE), Mattel and Affiliated Managers Group (AMG), these stocks are currently trading well below our average costs. Third, we owned five companies externally categorized in the Industrials sector. These are diverse businesses with very different factors driving results, but they collectively impacted the Fund’s return as the Industrials sector was among the worst performing areas of the market. Fourth, the strong investor preference for momentum-driven growth stocks, where we have limited exposure, continued to negatively impact undervalued businesses’ prices.

We periodically experience a year where either our geographic or sector exposure penalizes returns, our newer investments hit bottom after initial purchase or our

Average Annual Total Returns for the Longleaf Partners Fund (12/31/18): Since Inception (4/8/87): 9.54%, Ten Year: 10.19%, Five Year: -0.52%, One Year: -17.98%.


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approach is out of favor. In 2018, the Fund suffered from all of these. Companies that missed short-term expectations generated the largest declines, with the market severely punishing those that disappointed in the fourth quarter. On the other hand, stock prices largely ignored the progress that our companies and management partners made. CEOs whom we view as stronger were secured at CenturyLink, GE, CNHI and Mattel. Businesses sold assets for attractive prices, including Allergan, Fairfax, CK Asset, LafargeHolcim, United Technologies and GE. United Technologies and GE announced company breakup/simplification plans. Importantly, the primary business segments at most of our core holdings grew – Enterprise at Centuryink, Cable at Comcast, Search and YouTube at Alphabet, Aesthetics (Botox) at Allergan, Ground at FedEx, Agriculture at CNHI, North American Cement at LafargeHolcim, Aviation and Healthcare at GE, and Barbie and Hot Wheels at Mattel.

During the year, we sold three investments, added five new qualifiers and increased the Fund’s stake in three others. Cash started the year at 23% but was below 5% by the end of December. Portfolio repositioning and value growth amid stock price declines helped the price-to-value (P/V) ratio move into the mid-50s%, a somewhat rare level that has historically preceded strong absolute and relative returns*.

Taking a longer term view, 2018 marked the end point of a ten-year period when the Fund earned over 10% annual returns but did not meet inflation plus 10% or outperform the Index. The Fund was challenged as momentum stocks dominated and were pushed to greater heights with massive inflows into cap-weighted passive indices at the expense of active managers. In the last few years, larger technology-related stocks were the driving force. The Value/Growth disparity, tech-driven market and Index outperformance in the five years ended December 1999 were similar. Importantly, following 1999, the Fund delivered four years of outperformance – a cumulative 8000 basis points – that far exceeded the previous five years’ shortfall.

We are highly confident that the Fund may outperform the Index and deliver even better absolute results than the last decade for four main reasons:

1. As holdings reached full value in the extended bull market of the last decade, qualifying replacements for those sales were elusive. The consequential high cash levels over extended periods created the single largest driver of the Fund’s underperformance. Today, however, the Fund is fully invested after increased price volatility in 2018 created new, compelling investment opportunities.
2. The second largest performance challenge over the last decade, including in 2018, was the Fund’s collective investment in companies based outside of the U.S., which averaged approximately 20% of the portfolio. U.S. stocks in the Partners Fund actually outperformed the S&P for the ten years. But, the S&P 500’s cumulative return (+243%) dominated the international MSCI EAFE Index’s (+85%), making international companies more compelling investments today but also a relative headwind looking backward. Today, 28% of the portfolio is in stocks domiciled outside of the U.S. Not only does each company have compelling prospects, but international stocks are much more attractive overall with the price/earnings (P/E) multiple for EAFE at 12.5X versus 15.6X for the S&P. While U.S. and international stocks have performed at a similar annual rate of 8.4% (EAFE) to 9.3% (S&P) over almost sixty years, we believe the recent ten-year huge disparity (EAFE at 6.3% v. S&P at 13.1%) and large divergence from each index’s own average bode well for the Fund’s stocks based outside of the U.S.

3. Individual investments where our assessments of the people or the companies were wrong also hurt the Fund’s ten-year relative results. Each case was unique, but our analysis showed that holding mistakes for too long and increasing their weighting at the wrong time turned normal errors into performance killers. We have made adjustments accordingly. We build positions in new companies more slowly while getting to know the company and management more deeply. We limit exposure to businesses with less control of their own outcomes, either because they are closely tied to a commodity price or they have financial obligations that restrict flexibility. We also limit ownership of businesses closely linked in the same industry to less than 15% of the portfolio. We overweight few positions and only where the qualitative and quantitative characteristics are equally compelling, with the maximum investment at purchase generally being 10%. We also sell and move on more quickly if the qualitative case changes meaningfully, even if the stock remains statistically cheap. We focus more on declines in intrinsic value as a sign that we mis-assessed the company and take a deeper dive before adding to the holding. We systematically conduct an 18-month review of any new investment that is underperforming, as our data shows this to be a key time to decide whether to maintain an investment. Understanding our errors and making related adjustments in our execution will
not eliminate company-specific mistakes, but we believe they are less likely to compound as they should be shorter-lived and lower impact going forward.

4. Although the Fund posted double-digit annualized gains, the last 10 years were an abnormally long period of relative underperformance for our investment approach. Momentum, rather than fundamentals, fed the long-running bull market where many stocks sold for multiples far higher than we could justify, particularly biotech and technology-related areas whose long-term competitive advantages we find difficult to assess with confidence. More discounted stocks that did meet our criteria remained out-of-favor with their payoffs delayed. The S&P 500 Growth Index outperformed the S&P 500 Value by approximately 3.5% per year over the last ten years. We believe this disparity awaits a meaningful reversal, given the 30+ years prior, where Value outperformed Growth by approximately 2% annually. We were encouraged by early signs of Value making up ground in late 2018/early 2019.

The current positioning of the Partners Fund, along with improvements in our execution, make us confident in future return potential. The Fund is fully invested in businesses that meet our qualitative criteria and are selling at a rarely seen deep discount that can yield far greater-than-average upside. The chart shows that following other periods when the P/V was below 60%, the Fund averaged substantially higher returns than the Index at real rates in excess of 10%.*

<table>
<thead>
<tr>
<th>+/- Index</th>
<th>1 Year</th>
<th>3 Year</th>
<th>5 Year</th>
</tr>
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<tr>
<td>11.07%</td>
<td>5.14%</td>
<td>2.14%</td>
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# of Quarterly Observations | 19 | 19 | 19
**Contributors/Detractors**

(2018 Investment return; 2018 Fund contribution; Q4 Investment return; Q4 Fund contribution)

Park Hotels (10%, 0.43%, -18%, -0.78%), the owner of Hawaiian Village and other Hilton properties, was the primary positive contributor in 2018 after our first quarter purchase of the stock. The business delivered mid-single-digit comparable revenue per available room (RevPAR) growth despite hurricanes near its Florida and Hawaiian hotels. Early in the year, CEO Tom Baltimore sold multiple properties above our appraisal, and the company has additional opportunity to realize more value out of the portfolio’s assets. Recent transactions for top-tier luxury properties support significantly larger multiples than the stock price implies for Park’s trophy properties like the Hawaiian Village. Despite good results in its second year as a stand-alone company, Park still trades at a meaningful discount to peers with what we view as inferior properties.

General Electric (-54%, -3.14%, -32%, -1.93%), the aviation, healthcare and power company, fell throughout the year, making it the Fund’s largest detractor. GE’s former leadership and business model are dramatically different from what is in place today. The management team is new, plus the board has been reduced in size and upgraded in quality. The “business” and “price” parts of our investment case boil down to three main assumptions:

1) The best-in-class Aviation and Healthcare businesses continue to deliver strong profit growth, could be severed from the rest of GE and, we believe, are worth a combined $16+/share.

2) GE's holdings in transportation and industrial services businesses Wabtec and Baker Hughes GE are solid, liquid and have self-help ability to grow earnings. Other smaller businesses like Renewables have demonstrably positive value. This group of assets is worth more than the net industrial debt/share of GE.

3) We believe the currently struggling Power business should recover over several years as the company and the industry rightsizing capacity and headwinds abate. GE Capital’s issues will continue to be addressed aggressively and will be smaller in the years to come. Even a negative value for GE Capital gets to an appraisal for the company that is over 2X the current stock price.
We slowly initiated our position in GE in late 2017 and bought most shares in the first seven months of 2018, after the unexpected increase in reserves for long-term care insurance at GE Capital. Nonetheless, we were too early, with an average cost basis in the low teens. Our adjusted appraisal approaches three times the current stock price, leaving ample margin of safety for a solid return even if some of our investment case assumptions above are wrong. Larry Culp, a legend given his record at Danaher, took the GE CEO job in September after doing deep diligence into the company’s challenges and prospects as a new board member earlier in 2018. GE stock must return to the high teens within four years for half of Culp's long-term incentive shares to vest and generate the kind of CEO-level pay he could have easily secured elsewhere, and he receives additional shares only if the stock reaches $31 in that period. This degree of out-of-the-money alignment is both extremely rare and highly encouraging.

Mattel (-35%, -2.32%, -36%, -2.42%), the classic toy company, fell in the fourth quarter, making it a detractor for the year after the company lowered full-year revenue guidance by 3%. The primary challenge was sorting through the retail disruption caused by the Toys “R” Us bankruptcy, combined with self-inflicted Chinese inventory problems. The weaker revenue number ignores CEO Ynon Kreiz’s solid progress towards cutting $650m in operating costs. For the first nine months of 2018, the company’s two most important brands, Barbie and Hot Wheels, grew gross sales 15% and 6%, respectively. Fisher-Price, Thomas and American Girl all declined, but each brand has strong, unique drivers for future growth. To invest in high-return growth projects, Kreiz is creating new businesses using Mattel’s deep well of brands and intellectual property. The stock ended the year trading at less than half the 2017 rumored acquisition offer and has already rebounded strongly in the first two weeks of 2019.

FedEx (-35%, -2.22%, -33%, -2.17%), the transportation and logistics company, fell in the fourth quarter and for the year. Express revenues missed expectations after weakness in all the major Euro economies and what CEO Fred Smith called “bad political choices” weighed down international trade. These headwinds caused the company to lower earnings per share guidance by 8%. The stock’s sharp decline ignored that the Ground segment, the largest part of our appraisal, reported strong high-teens earnings growth. FedEx’s Freight segment also performed very well with
EBITDA (earnings before interest, taxes, depreciation, and amortization) up over 20% in 2018. If the weakness in international trade persists, Ground should still grow revenues and margins. Because Amazon, another perceived risk to FedEx, constitutes less than 5% of company revenue, Amazon’s internal delivery development will have minimal effect on results. The company has a solid balance sheet and the potential to go on offense with share repurchase at these prices.

CK Hutchison (-21%, -1.53%, -17, -1.16%), a Hong Kong based conglomerate of telecommunications, health & beauty, infrastructure, global ports and energy, fell during the final quarter and the year. While a trade war between China and the U.S. will pressure less than 5% of its Ports business, concerns of this trade tension generated broad negative sentiment around Asian stocks. In Italy, the company’s Telecommunications business struggled as a tough macro environment and increased competition from a new entrant pressured prices. In the second half of the year, declining oil prices impacted Husky Energy, the Canadian energy associate of CK Hutchison. These short-term headwinds negatively impacted sentiment, but the overall company’s cash flow, as well as management’s capital allocation decisions, helped our appraisal grow in the mid-single digits for the year. Chairman Victor Li sold CK Hutchison’s interests in several infrastructure projects at 12X EBITDA and redeployed the proceeds to acquire the Italian telecom joint venture at 5x EBITDA. The company also repurchased its discounted shares for the first time in almost two years.

LafargeHolcim (-25%, -1.49%, -17%, -0.95), the largest global cement, aggregates and ready-mix concrete producer, was a 2018 detractor after a notable decline in the fourth quarter. Weaker cement demand in Latin America, the Middle East and Africa, as well as higher energy and transportation costs, globally impacted profits. With two thirds of consolidated revenues (but a smaller % of the net value) tied to emerging markets, broader EM concerns heavily contributed to the stock price weakness. CEO Jan Jenisch believes efficiency gains and pricing will offset cost inflation. The cost savings program is ahead of target, and Aggregates and Ready-Mix margins are improving. The company’s North American business, which represents over one quarter of our appraisal, grew profits during the year. The company announced the sale of its Indonesian assets at an attractive price, and management plans for additional divestments over the next two years, providing meaningful cash proceeds to reinvest.

Affiliated Managers Group (-32%, -1.37%, -28%, -1.16%), the owner of diverse investment firms, declined following our third quarter purchase and was among the
Fund's notable 2018 detractors. We purchased AMG, which we previously owned, in the third quarter. Asset-manager stocks fell as indices went down in the fourth quarter. AMG's intrinsic value is not tied to index performance, but instead to the differentiated outcomes at concentrated value managers (like ValueAct and Yacktman), quantitative strategies (AQR and Winton), international stock pickers (Tweedy Browne and Harding Loevner) and several other strong funds not directly correlated with public equities or fixed income. The various managers within AMG have long-term records of outperforming the S&P 500 that should drive asset growth, as should expanded international distribution. We have solid partners in CEO Nate Dalton and CFO Jay Horgen, a business that can grow with minimal capital and a deeply discounted stock.

CNX (-22%, -1.35%, -20%, -1.30%), the Appalachian natural gas company, detracted for the year. The stock declined after reporting an 8.5% increase in capital expenditure guidance during the second quarter. Additionally, nearly all energy stocks had a sharp selloff following the fourth quarter's commodity price volatility. CEO Nick DeIuliis took advantage of the dislocation by repurchasing over 16% of CNX's outstanding shares in the 12 months ended in October. Our appraisal increased with the company's growth in cash flow. In June, CNX sold its Ohio Utica acreage for a good price. The company has other non-core assets to monetize in coming years. Most production is hedged several years out, helping to insulate the business's value from declines in the gas strip. The stock trades at below half of our appraisal.

CNHI (-31%, -1.32%, -25%, -1.12%), the maker of Case and New Holland agriculture equipment (AG) and Iveco trucks (CV), was a detractor in the quarter and for the year. The U.S.-China trade tension threatened tariffs that would impact AG purchases by U.S. farmers. Tariffs remain uncertain and if imposed, may have less impact than anticipated because of offsetting subsidies and current equipment demand from less discretionary replacement needs after a several year downturn. CNHI is in a solid position to withstand the potential challenge with an investment grade balance sheet, balanced channel inventory and positive pricing and product mix trends. New CEO Hubertus M. Mühlhäuser sees opportunities to improve margins. The company returned excess capital to shareholders in the form of dividends and buybacks. The company also has upside from streamlining its disparate non-AG assets via either sales or spin-offs.

CenturyLink (2%, -0.65%, -26%, -3.25%), the telecommunications company, was a fourth quarter detractor, but ended slightly up for the year after substantial gains
earlier in 2018. The stock declined after third-quarter revenues came in below expectations, but our appraisal rose with 7% yearly EBITDA growth as higher margin revenue within the Enterprise segment increased and consolidated free cash flow (FCF) nearly doubled year-over-year. CenturyLink’s FCF is more than $3.00 per share and growing, yet the stock trades around $15. Revenues declined in part because the company wisely exited unprofitable business lines, prioritizing capital efficiency and deleveraging over top line growth. The dividend moved back up to a mid-teens yield with minimal chance of any cut. (Update at 19 Feb 2019: CTL did cut the dividend to use the cash instead to strengthen the balance sheet. We believe a better way to address the balance sheet is to explore asset sales given the multiples being paid in fiber transactions, and/or to issue tracking stocks for the separate Fiber and Consumer segments to highlight their values and offer the potential to raise capital. Southeastern filed a 13-D to talk to interested buyers and nominate appropriately experienced directors to the board. The dividend cut did not alter our appraisal of the company or its earnings power.) We expect consolidated EBITDA to grow by a low-single digits percentage next year, but within that number we believe high-value Enterprise fiber revenues and cash flows will grow above that, making up for the low-quality legacy landline run off. CenturyLink remains an overweight position given its deep discount and the quality of both its management team, led by CEO Jeff Storey, and its fiber assets, which we believe are of high strategic value to numerous infrastructure investors.

Portfolio Activity
Swings in stock prices generated portfolio activity in 2018, ultimately driving cash from 23% to 2%. We sold three investments – Wynn and Chesapeake in the first quarter and CONSOL Energy in the third – and trimmed seven other holdings that performed well during the first nine months. We bought Park and Comcast in the first quarter, AMG in the third, and two undisclosed companies in the fourth. All five new holdings are “recycles” that we successfully invested in previously. Recycles tend to have fewer surprises since we have closely followed the business as owners and have already deeply engaged with our management partners.
Outlook
As co-investors in the Fund, we are neither pleased nor complacent about the 2018 return, but we firmly believe that the portfolio is positioned well for future absolute and relative results. First, a P/V at this level is rare, and we think portends an exceptional next few years. Second, the Fund’s cash position is below 5%, and our on-deck list of prospective qualifiers has more than a dozen possible opportunities. Third, numerous companies in the portfolio either have corporate transactions in process or are good candidates for prospective activity over the next few years, with capable management partners who can control their own destiny in terms of value realization. We are working with boards and leaders at certain holdings to accelerate this realization.

The Partners Fund is a compelling opportunity, with more prospective investments than cash. Consequently, we re-opened the Fund to new investors effective January 30, 2019. We believe that partners who invest now could be greatly rewarded, as the best time to hire a manager with a good long-term record often is when their record looks the worst.

*See following page for important disclosures.*
*Quarter-ends since 1993 were identified where the Partners Fund’s “price-to-value ratio” (P/V) was less than 60%. From each quarter end identified, the 1, 3, and 5 year cumulative returns for the Fund and the S&P 500 were calculated. Those returns were then averaged and the 3 and 5 year returns were annualized. Current circumstances may not be comparable.

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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. An index cannot be invested in directly.

The S&P 500 Growth Index represents the companies of the S&P 500 Index that are considered to have growth characteristics (e.g., using earnings per share growth rate and sales per share growth rate).

The S&P 500 Value Index represents the companies of the S&P 500 Index that are considered to have value characteristics (e.g., using book value to price and earnings to price).

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.

"Margin of Safety" is a reference to the difference between a stock's market price and Southeastern's calculated appraisal value. It is not a guarantee of investment performance or returns.

Capital Expenditure (capex) is the amount spent to acquire or upgrade productive assets in order to increase the capacity or efficiency of a company for more than one accounting period.
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.

As of December 31, 2018, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 10.8%; CK Hutchinson, 7.6%; GE, 6.9%; CNX Resources, 6.1%; LafargeHolcim, 5.9%; FedEx, 5.7%; Mattel, 5.7%; Affiliated Managers Group, 4.8%; Alphabet, 4.8%; Fairfax, 4.8%. 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.
LLP000872
Expires 4/30/2019
Longleaf Partners Fund gained 2.70% in the third quarter, on pace to meet our absolute annual goal of inflation plus 10% but lagging the S&P 500 Index's 7.71%. Year-to-date (YTD) the Fund gained 3.39%, while the Index rose 10.56%. The Fund compounded at 7.13% over the last 12 months, below our absolute goal. By contrast, the Index delivered 17.91%, capping off a 9-year bull run with a gain almost 2X its average long-term return. The Fund's relative results in the third quarter, the last year and the last 3 years have been primarily about what has gone right for the Index, rather than poor results at the companies we own.

A concentrated set of companies drove much of the S&P 500's 1-year return. Minus companies in the Information Technology sector, Amazon (part of Consumer Discretionary) and Alphabet and Netflix (both part of Communication Services), the Index would have approximately returned a more modest 8%. While a limited number of stocks often drive most of Index returns, the big drivers over the recent past have been mega technology-related companies that have now grown to a combined size that makes it very unlikely mathematically that they can grow by similar multiples over the next 5 years. We find it difficult to assess with confidence the next 5 years' landscapes and competitive advantages of most technology related businesses and/or think their current multiples imply a growth rate that has no room for inevitable bumps in the road. As was the case in the late 1990's, our requisite margin of safety to hedge against capital loss makes us avoid companies priced for perfection, and, when those dominate, the Fund underperforms.

Average Annual Total Returns (9/30/18): Since Inception (4/8/87): 10.43%, Ten Year: 8.06%, Five Year: 6.15%, One Year: 7.13%.

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, 2018, the total expense ratio for the Longleaf Partners Fund is 0.95%. The expense ratio is subject to fee waiver to the extent a fund's normal annual operating expenses exceed 1.50% of average net assets.
Beyond the absence of the high-flyers, two other things have held back the Fund’s relative returns. First, just as in previous overvalued markets, cash from successful sales has built in the absence of qualifying new investments. The Fund’s 18% average cash position over the last year cost approximately 300 basis points versus the Index but obviously incurred no risk of capital loss. Second, five companies based outside of the U.S. comprised 28% of the portfolio and subtracted 112 basis points from performance over the last year. The rising dollar, tariffs and geopolitical uncertainties, such as Brexit, all contributed to Non-U.S. stocks rising just 2.7% (measured by the MSCI EAFE Index) in the last year, while the overpriced U.S. market appreciated over 6X that amount. The Fund’s foreign holdings - LafargeHolcim, CK Hutchison, CK Asset, CNH and Fairfax - each have growing, quality, global businesses led by capable management teams and we view them as superior or comparable to their U.S. peers, even though they trade at lower multiples.

Although we believe the Index will face a correction and revert to its long-term average return at some point, our ability to compound at a real double-digit rate does not depend on what happens to the Index. With around twenty holdings, performance in any given year usually comes from just a few stocks. Company-specific events and management-led outcomes drive the Fund’s investment results, which generally have little to do with what drives the broader index. Stock prices often move up in a short number of days as sentiment quickly changes. For example, CenturyLink was the Fund’s largest contributor for the quarter and YTD as management delivered results that many had doubted, and the stock gained 26% over just 3 days in 2018. CNH rose 18% in less than two weeks after raising guidance, having its debt upgraded, and appointing a new CEO. Park Hotels began a 3-month 34% rise with news of HNA’s plan to sell its 25% stake.

Living patiently with idiosyncratic payoff patterns can be difficult but is necessary. More often investors make decisions based on stock price performance without regard to the direction of a company’s underlying business value. Chasing performance puts capital at risk, with the danger usually realized too late. We usually do not know when payoffs among our portfolio companies will occur, but most values are appreciating, and many current holdings offer significant upside potential with our management partners pursuing restructuring, substantial repurchases at deep discounts and sales of assets or entire businesses.

**Contributors/Detractors**
(Q3 Investment return; Q3 Fund contribution)
CenturyLink (17%, 1.65%), the global fiber infrastructure company, was the Fund’s largest contributor. Quarterly EBITDA grew 5% year-over-year (YOY) on nearly 300 basis points of margin improvement. The company’s Business segment revenues showed a slight decline due to management’s appropriate decision to eliminate unprofitable customers. Looking ahead, the company is improving customer service while reducing network, billing and inventory expenses. With free cash flow (FCF) ($3+/share) easily covering the dividend ($2.16/share),
CenturyLink is reducing debt and expanding in select areas of enterprise and consumer broadband. Late in the quarter, CFO Sunit Patel announced his departure to oversee the merger integration at Sprint and T-Mobile. Patel has been a valued partner during our investment with Level 3 and CenturyLink. Although the stock pulled back upon the announcement, Patel’s departure does not impact our appraisal of the company. Interim CFO Neel Dev is a well prepared 14-year company veteran who has worked directly under Patel for the last 6 years and overseen much of the successful merger integration.

Allergan (15%, 0.69%), the pharmaceutical company, added to the Fund’s results in the quarter. Allergan’s Medical Aesthetics portfolio, consisting of Botox, Juvederm and Coolsculpting, grew revenues 12%. Despite the stock’s recent performance, the price ascribes little-to-no value for Allergan’s promising late-stage mental health, migraine and macular degeneration research and development pipeline projects. During the quarter, CEO Brent Saunders sold the company’s dermatology drug portfolio to Almirall for a good price and increased the share repurchase program by $2billion. The stock trades at a low-double-digit multiple of next year’s FCF, despite Botox’s growing consumer franchise, insulation from systemic healthcare cost pressures and large non-earning assets in the pipeline.

CK Hutchison (10%, 0.64%), a conglomerate of telecommunications, health & beauty, infrastructure, global ports and energy, was a contributor in the quarter. CK Hutchison reported strong first half results, with YOY revenue and EBITDA up +16% and +19%, respectively. Interim dividend per share grew by 11.5%, the first double-digit increase in the past decade. The company highlighted the strength of its Retail segment, which is the largest health and beauty retailer in the world with over 14,000 stores, 12 brands and 130 million loyalty members that contribute over 62% of sales. Oil price recovery added to Husky results. In the first half, revenue increased by 37% YOY and EBITDA by 47%. In the quarter, CK Hutchison announced the sale of its interests in several infrastructure projects at a 12X earnings and redeployed the proceeds to acquire an Italian telecom joint venture at 5X earnings. Management also repurchased the company’s discounted shares in the quarter for the first time in almost 2 years.

CNH Industrial (CNHI) (13%, 0.64%), the maker of Case and New Holland agriculture equipment (AG) and Iveco trucks (CV), added to performance. CNHI reported strong Q2 results with sales growing 13% YOY at constant currency and EBITDA up 30%. Management upgraded its FY18 forecast. The AG segment continued to improve, with sales up 18% YOY. Increasing replacement demand for high horsepower NAFTA row crop equipment is driving AG margins higher. Cash generation was strong, and S&P Global raised CNHI’s credit rating by a notch within investment grade. The company continued to return excess capital to shareholders in the form of dividends and buybacks. New CEO Hubertus M. Mühlhäuser, who has both AG and breakup experience, joined in the quarter.
United Technologies (12%, 0.56%), the industrial conglomerate, contributed in the quarter. Aerospace revenues grew high single-digits, and the Rockwell Collins acquisition is scheduled to close soon. Climate, Controls and Security segment revenues increased steadily at 4%. Otis Elevators had smaller growth but a 10% increase in new equipment orders. Missed quarters, confusion around the company’s strategy and the temporary growing pains for Pratt & Whitney’s geared turbofan (GTF) engine allowed us to purchase the stock cheaply three years ago, but these worries are all fading. CEO Greg Hayes and the board are considering separating the company’s three businesses, which would likely result in further value recognition.

CNX Resources (-20%, -1.27%), the Appalachian natural gas exploration and production (E&P) company, detracted from performance in the quarter. The company disappointed the market on a few metrics – some that the company can do better on itself, some outside of its control – that did not impact our long-term appraisal. To the positive, the company closed the sale of a Utica joint venture for $400 million. Additionally, former partner Noble finally sold the last of its ownership of CNX’s midstream master limited partnership, removing an overhang and enabling CNX to operate the business more flexibly. CEO Nick Delulis and CFO Don Rush continued repurchasing discounted shares at an annualized double-digit pace, which is very rare in the E&P world.

General Electric (-16%, -0.95%), the reorganizing aviation, healthcare and power company, declined after announcing a technical problem with an H-series gas turbine blade. Based on management’s assessment, we view this as a temporary issue that should not impact the Power segment’s long-term value – much like United Technology’s GTF issues during our first 1-2 years of owning it. The extreme negative sentiment around the company, however, caused the stock price to overcompensate for any disappointing news. More importantly, GE Aviation and Healthcare, which constitute a large majority of our appraisal, grew on strong orders and revenues. Over the last year, GE sold nearly $18 billion of businesses for higher prices than we carried them. On October 1, the company announced that board member Larry Culp, former CEO of Danaher, would become CEO and Chairman, replacing John Flannery. We were excited when Culp joined the board in April, given his success at Danaher, and we believe he can accelerate GE’s turnaround that Flannery initiated. In the next year, it is possible that GE’s Healthcare segment could be spun off or sold to one of several suitors willing to pay a fair price. Energy (Baker Hughes) also is a candidate for monetizing. Transportation is slated to be a separate entity by this time next year. We believe that, as the company’s structure simplifies and divestitures further strengthen the balance sheet, the stock should more properly reflect the values of these strong assets, which we believe to be worth more than $20/share.
Portfolio Activity
During the quarter, we began purchasing one new business, which remains undisclosed while we work to build the position. The market’s big gains in the quarter reduced our on-deck list of prospects, as prices moved away. We sold CONSOL Energy, the coal business that spun off from gas company CNX Resources in November of 2017. Since separating, the stock gained 93%, after strong production led to increased earnings guidance.

Outlook
Because it is a challenging time for disciplined value investors to buy discounted, quality businesses, the Fund’s cash remained high, ending the quarter at 10.6%. Cash has been a performance headwind in this strong market, but we are disciplined buyers and will seek to avoid putting capital at risk of loss. We are confident that we will find additional qualifiers, as individual companies fall out of favor or the whole market pulls back.

The Fund's high-60% price-to-value ratio (P/V) is based on our discounted FCF appraisals, which are growing and potentially understated, especially to the extent that our management partners are successful in their pursuit of value recognition. Many companies we own are in whole or have parts that are more valuable to others, and acquisition multiples are notably higher than our long-hand appraisal math. We have CEOs with a history of monetizing assets and selling companies at fair prices, including Jeff Storey at CenturyLink, Victor Li at CK Hutchison and CK Asset, Ynon Kreiz at Mattel, Nick Delulii at CNX, Tom Baltimore at Park Hotels, Brent Saunders at Allergan, Prem Watsa at Fairfax and Greg Hayes at United Technologies. Transactions offer upside optionality not imbedded in the stock price or our appraisal.

As important, our appraisals should grow, as our management partners focus on the competitive strengths of their companies, drive higher margins and reinvest FCF prudently, including into discounted shares. Whether by internally-driven operations or externally-focused capital allocation, rising values ultimately pull stock prices higher. The timing is usually unpredictable, and big performance spikes occur regardless of the broader stock market’s direction. As the managers and largest collective investor in the Partners Fund, we are confident that our CEOs can create more of the idiosyncratic, large payoffs that have driven the Fund's successful long-term results.

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 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. 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.

“Margin of Safety” is a reference to the difference between a stock’s market price and Southeastern’s calculated appraisal value. It is not a guarantee of investment performance or returns.

Brexit (“British exit”) refers to the June 23, 2016 referendum by British voters to leave the European Union.

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.

As of September 30, 2018, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 11.8%; CK Hutchinson, 7.5%; LafargeHolcim, 6.5%; FedEx, 6.3%; Mattel, 6.1%; CNX Resources, 5.4%; GE, 5.3%; Park Hotels, 4.9%; Fairfax, 4.9%; Allergan, 4.8%. 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 1/31/2019
Longleaf Partners Fund Commentary 2Q18

Longleaf Partners Fund gained 3.37% in the second quarter, outpacing our annual absolute goal of inflation plus 10% and in line with the S&P 500 Index’s 3.43% return. Year-to-date (YTD) the Fund was up 0.67% versus the Index’s 2.65%. In the quarter, a combination of six holdings rising double-digits, including several more recent purchases in the last year, and an absence of any significant performance detractors drove returns. We delivered solid performance with less market risk given the Fund’s 14% average cash position.

Information Technology (26% of the S&P 500) remained the main driver of the Index, gaining over 7%. Consumer Discretionary (13% of the S&P 500), where Amazon and Netflix reside, was the other major Index contributor. “Growth” once again significantly outperformed “Value,” with a 4% difference in just the last three months. We manage the portfolio without regard to index weights or top-down style categories. Our investment criteria require both “growth” and “value” - quality businesses that will grow purchased at material discounts to what they are worth. The Fund’s long-term returns will depend on the outcomes of the limited number of companies we own, not on broader market trends.

Average Annual Total Returns (6/30/18): Since Inception (4/8/87): 10.43%, Ten Year: 5.72%, Five Year: 7.59%, One Year: 7.71%.

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, 2018, the total expense ratio for the Longleaf Partners Fund is 0.95%. The expense ratio is subject to fee waiver to the extent a fund’s normal annual operating expenses exceed 1.50% of average net assets.
Trade war fears were the largest collective pressure on those stocks that declined, including CK Hutchison, CNH Industrial, FedEx, and United Technologies. It is too early to know how tariffs will settle out, but in most cases, even where segments of our companies could be negatively impacted, other parts of the business seem largely immune or have catalysts that could help insulate them.

Stock price volatility and increasing return dispersion produced a growing on-deck list of prospective investments. We did not buy any new companies, nor did we exit any investments. Cash declined slightly to 14%, as we added to two of our newer investments, General Electric and Comcast.

**Contributors/Detractors**

(Q2 Investment return; Q2 Fund contribution)

CenturyLink (+17%, +1.45%), the global fiber telecommunications company that is the Fund’s largest position, was the largest contributor in the quarter and YTD, although the stock still sells for less than half of our appraisal. The merger integration with Level 3 progressed, with synergies realized as planned, cost cutting initiatives at the legacy segments, and a focused reduction in capital spending. Earnings results confirmed management’s confidence in maintaining the substantial dividend. CenturyLink (CTL) is viewed more as a traditional landline business akin to overleveraged, lower-quality peers Frontier Communications and Windstream Holdings, but CTL’s declining legacy landline business is becoming less relevant to the company’s total value, as the mix shifts to the growing Enterprise services fiber segment. For decades, Southeastern has found opportunities in this kind of “good segment / bad segment” situation. CEO Jeff Storey and CFO Sunit Patel are focused on maximizing value in both parts of the business to benefit shareholders.

Mattel (+25%, +1.16%), the toy company, was another large contributor following a strong first quarter. In April, Chairman Ynon Kreiz became CEO. Kreiz arrives with an excellent track record of building and monetizing brands for children and has a strong plan to put Mattel’s intellectual property to best use. He has a big opportunity to restore margins by focusing on the company’s core brands and rationalizing the supply chain. Sales stabilized following the Toys “R” Us bankruptcy, with Barbie up 24% this quarter in her fifty-ninth year. Rumors of interested buyers continued, and we believe
the company is worth significantly more than its current price, with additional upside as Kreiz and his team execute.

Park Hotels & Resorts (+17%, +0.83%), the owned hotel REIT with multiple Hilton brands, also rose double digits, making it a major contributor for the quarter and YTD. The company’s Hilton Hawaiian Village, among the most unique and desired hotel properties in the world, put up another solid quarter of revenue and EBITDA growth. A majority of Park’s major metropolitan conference hotels performed well. CEO Tom Baltimore shrewdly sold Hilton Berlin for an attractive price and grew value by repurchasing discounted shares.

CNX Resources (+15%, +0.83%), the Appalachian natural gas company, rose again in the second quarter following its notable first quarter gain. At 36% year-over-year (yoy) growth, production came in ahead of expectations. With the majority hedged over the next four years, the stock's outperformance does not require higher natural gas strip pricing. Due to CNX's consolidated accounting following the intelligent purchase of its pipeline’s General Partner stake, the company’s net debt per share appears higher than the effective debt burden, and many ignore the value of that pipeline stake. Chairman Will Thorndike and CEO Nick Deluliis continued to improve operations and de-risk CNX’s balance sheet and production, growing the value of this pure-play gas business.

CK Hutchison (-10%, -0.69%), a Hong Kong listed conglomerate of telecommunications, health & beauty retail, infrastructure, global ports and energy was a detractor in the quarter. Italy’s telecom market had more aggressive competitive pricing than expected. Retailer Watson China’s comparable store sales growth in Q1 2018 was still slightly negative (-0.5%), despite gradually improving. The British pound and euro weakness impacted CK Hutchison’s numerous European assets. Additionally, concerns over a potential trade war between China and the U.S. not only pressured the company’s ports business, but also generated broad negative sentiment around Asian stocks. CK Hutchison’s well-balanced mix of businesses across the globe means that the short-term challenges facing some segments should not alter the long-term attractiveness of the entire portfolio. Overall, the company expects to deliver strong yoy organic earnings growth, partially helped by commodity price recovery. At 5x earnings, the acquisition from VEON of the 50% of the Italian mobile telecom operations that CK currently does not own will further boost earnings and accelerate merger synergies. In
May, Victor Li took on the additional role of Chairman from his father, the founder. Victor has proven his ability to run the business over the last four years, and we expect any market uncertainty about Li Ka-shing’s departure to be short-lived.

CNH Industrial (CNHI) (-13%, -0.49%), the maker of Case and New Holland agriculture equipment (AG), and Iveco trucks (CV), was also a detractor in the quarter. Negative currency translation from the weak euro to the strong U.S. dollar accounted for almost half of the impact. Trade tension between the U.S. and China indirectly affected the stock since China could impose tariffs on U.S. agricultural products, thus hurting farmers who buy AG products. We see this potential threat as less negative than the stock’s price move implies. Near term, many farmers may have locked in pricing for the current crop. Longer term, row crop equipment demand in the U.S. is low relative to historical standards, with current demand more tilted to the less discretionary replacement purchases. Because CNHI has balanced its channel inventory, the company is getting positive pricing and product mix. CNHI’s $700 million buyback program should allow management to build additional value per share by continuing to repurchase shares in this price pullback.

**Portfolio Activity**

Trading was relatively quiet during the quarter with no new or exited positions. We trimmed several holdings that performed well in the last six months to manage position sizes relative to the stocks’ discounts. We added to GE near its low for the quarter, before the welcome news of the company’s plan to separate and/or sell its Healthcare and Energy businesses. We also added to Comcast during the quarter, as the bidding for Twenty-First Century Fox heated up. We expect Comcast’s growing, profitable residential and small enterprise broadband to drive value growth at the company, whatever the conclusion to the Fox drama. The shrinking residential video customers are a minimal part of the value and do not impact the formidable broadband and NBCUniversal entertainment assets.

**Outlook**

The Partners Fund has the potential to deliver above average long-term returns with less risk because the Fund owns good businesses that sell materially below their values. The price-to-value ratio in the high-60s% offers excess return opportunity. Successful acquisition integration should help produce higher earnings at CTL, LafargeHolcim, FedEx, and United Technologies. Furthermore, at CTL, Park Hotels, CNX,
Fairfax Financial, Allergan, Alphabet and United Technologies, we expect under-earning or non-earning assets to contribute substantial additional earnings. We are confident that our companies’ increased earnings generation over the next couple of years in combination with the market’s more appropriate weighing of our investees’ values can yield important excess returns.

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The Longleaf 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.

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

REIT is a real estate investment trust.

As of June 30, 2018, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 10.0%; CK Hutchinson, 6.6%; CNX Resources, 6.4%; Mattel, 6.1%; LafargeHolcim, 6.1%; Comcast, 6.0%; FedEx, 5.7%; Fairfax, 4.9%; United Technologies, 4.9%; Park Hotels, 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.

LLP000776
Expires 10/31/18
Longleaf Partners Fund declined 2.61% in the first quarter, and the S&P 500 Index lost 0.76%. The threat of global trade wars in the face of U.S. tariffs, plus renewed U.S. inflation concerns offset optimism around lower tax rates and helped create long overdue volatility. Cash was a positive in the market's decline, and one-third of our holdings posted positive results. The Partners Fund fell, however, primarily due to pullbacks in several newer holdings and in businesses domiciled outside the U.S. In the last seven months, we have added five companies to the portfolio, two in 2018. All five are near or below our initial cost. Purchasing a new name at the very bottom is difficult, especially after stocks have had such large declines from peak to trough over a somewhat short timeframe - GE fell from $32 to under $13, Mattel from $48 to $13, Allergan from $339 to $144, Comcast from $43 to $33, and Park Hotels from $31.00 to $24. Because the long-term investment cases did not change from our initial entry (far below the peak prices shown), the pullbacks in the first quarter provided an opportunity to build several positions at lower cost.

International stocks, as measured by the MSCI EAFE Index, fell more than the S&P 500. The Partners Fund holds an abnormal number of companies based outside of the U.S. because over the past few years, as the U.S. market became increasingly expensive, we

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**Average Annual Total Returns (3/31/18): Since Inception (4/8/87): 10.40%, Ten Year: 5.68%, Five Year: 6.49%, One Year: 8.27%.

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, 2017, the total expense ratio for the Longleaf Partners Fund is 0.95%. The expense ratio is subject to fee waiver to the extent a fund's normal annual operating expenses exceed 1.50% of average net assets.
bought world-leading global businesses domiciled elsewhere at attractive valuations. Although no single foreign company was a large performance detractor, as a whole, non-U.S. holdings hurt returns in the quarter.

The Fund’s limited investment in technology stocks impacted relative returns as it has for 15 months. Tech was one of only two positive S&P sectors in the quarter, even after technology stocks lost steam in the last weeks of March. The other, Consumer Discretionary, would have been negative without online companies Netflix and Amazon. Related to Tech strength, growth stocks continued to far outpace value stocks.

The volatility that we had hoped for enabled us to purchase two “recycled” companies that we know well from our previous ownership and to increase our stakes in businesses we started buying in the latter part of 2017. These transactions reduced the Fund’s cash position, even after two exits in early January. Our on-deck list of prospective qualifiers also grew. We are hopeful that additional volatility will generate more opportunities to own discounted, dominant businesses with strong corporate leaders.

**Contributors/Detractors**

(Q1 Investment return; Q1 Fund contribution)

Wynn Resorts (+17%, +0.35%), the U.S. based luxury gaming operator, contributed positively to the Fund’s performance. Given the stock’s strong return over the last two years, we had begun trimming in late 2017, as the price moved closer to our appraisal. In January, we sold the Fund’s remaining shares when no margin of safety was left. Our timing was lucky. Days after our exit, revelations about Steve Wynn’s alleged sexual harassment history and his subsequent resignation occurred. We bought Wynn Resorts in early 2015, following the Chinese anti-corruption campaign that drastically reduced Wynn Macau’s VIP business. Our appraisal incorporated a longer view, emphasizing the company’s growing mass gaming earnings in Macau, successful Vegas resort and significant non-earning assets: properties under construction in Cotai (Macau) and Boston, as well as rare open acreage on the Las Vegas strip. Similar to some of our current newer investments, the stock price fell after our initial purchase as sentiment turned from bad to worse, and we increased the position at even more discounted prices, when Steve Wynn purchased cheap shares alongside us. As earnings rebounded with the growth of mass visitors and the Palace opening in Cotai
in late 2016, the stock rose sharply. Our 59% gain over the Fund’s less than three year holding period is an example of how our longer time horizon can drive investment opportunity when a stock is priced for temporary short-term disruptions.

CNX Resources (+5%, +0.33%), the Appalachian natural gas company, was among the larger positive contributors. Following the company’s becoming a pure-play gas company after its split from CONSOL Energy in late November, CNX bought back its extremely discounted shares at a 10%+ annualized pace, which CEO Nick Deululii and Chairman Will Thorndike intend to maintain into the 2020s. CNX bought out joint-venture partner Noble Energy to regain full operational control of its pipeline general partner at a favorable valuation. Additionally, hedges and a conservative balance sheet should help protect the company from natural gas price volatility for at least the next several years. Today, adjusting for salable assets (but not the company’s roughly one million noncore net acres), CNX trades at a mid-single-digit free cash flow (FCF) multiple, and earnings should grow above 10% annually in almost any commodity price environment.

Mattel (-15%, -0.74%), the global toy company that we bought in late 2017, negatively impacted the Fund’s results. Although retailer Toys R Us has appeared near insolvency for years, its March announcement that the almost 800 remaining stores are going out of business hammered the stocks of toy manufacturers. Toys R Us represents about 8% of Mattel sales. The liquidation is expected to be complete by the end of June, impacting Mattel’s and other toy companies’ short-term distribution, which will be replaced by healthier online and physical merchants over time. The industry grows mid-single digits globally with international sales expanding faster than in the U.S. Increasing demand for dolls, vehicles and infant toys – which surprises some who assume all toy industry growth goes to electronic devices – plays to Mattel’s core Barbie, Hot Wheels and Fisher-Price brands and should help the company increase share. Since becoming CEO in early 2017, Margo Georgiadis has cut costs, improved advertising, and released promising new toys. Additionally, the board has improved with several new members, including Todd Bradley, a supply chain and China markets expert, whom we have known through several other investments over the last decade.

General Electric (-21%, -0.68%), the industrial conglomerate, was also a new investment late in 2017. The stock detracted from first quarter performance after disappointing results in the Power segment and an unexpectedly large long-term care insurance
write down at GE Capital. Most important to our investment case, however, Aviation orders grew 11%, and the segment’s margins increased. In Healthcare, EBIT increased 13% with solid contributions from GE’s Imaging and Life Sciences divisions. The Aviation and Healthcare businesses are global leaders that, along with sustainable corporate cost cuts - $1.7B in 2017 and another $2B this year, comprise the appealing long-term opportunity that is substantially discounted for understandable short-term reasons. Since becoming CEO six months ago, John Flannery has worked to restore transparency and taken positive steps, including transforming the board into a smaller size with qualified, independent new members, restructuring management incentives and selling noncore assets to focus on Aviation, Healthcare, Power and a cleaner balance sheet.

**Portfolio Activity**

We bought Comcast, the leading U.S. cable company, which became discounted on the announcement of its bid for Sky plc. Southeastern owned the company in the mid-2000’s, and our engagement with CEO Brian Roberts, a substantial owner, gave us insight into his approach to capital allocation, which has earned superior returns for shareholders over time. While many analysts have compared Sky to Dish Networks to argue that Comcast is overpaying, our global investment team’s first-hand knowledge of the quality and value of Sky gave us an advantage in determining that Sky is significantly different and a far superior business to Dish. Sky owns the rights to top sports and original shows (approximately 40% of viewing comes from exclusive content versus less than 1% at DISH), and has a European subscriber base of 23 million. Most of our Comcast appraisal comes from the company’s existing 29 million U.S. customers. NBC’s network, cable channels, film franchises, theme parks, hockey team and one-third of online video platform Hulu make up the rest of our sum-of-the-parts appraisal. We are pleased with the long-term prospects at Comcast, whether or not Sky ultimately becomes part of the company.

We also added a new position in Park Hotels, the Hilton spin-off with 67 U.S. properties that we have owned several times through investments in Hilton. One of the primary reasons Park traded at a discount was the 25% stake held by HNA Group, a distressed Chinese financial conglomerate. Fears of how HNA might monetize its stake ignored the high quality of Park’s properties: the irreplaceable Hilton Hawaiian Village and a collection of top urban conference hotels. When HNA sold its shares in an
oversubscribed offering, we received a large allocation to build the Fund’s position. The value of the business is growing steadily, and we were pleased that the company also bought shares from HNA. CEO Tom Baltimore leads Park Hotels after a successful record in hotels and real estate.

In addition to our successful sale of Wynn, we exited our remaining shares of Chesapeake Energy. Despite our mistakes in Chesapeake, which resulted in a 65% loss over our holding period, we sincerely appreciate the company’s current leadership team, led by Doug Lawler and Chairman Brad Martin, for doing terrific work from a tough position to improve the company’s balance sheet and operational efficiency. They grew value per share where they could control it, but the present and future impact of Permian associated gas production on the long-term natural gas futures price swamped their great efforts. Management’s work enabled us to recover a meaningful portion of our losses, as we bought bonds and preferred shares for cents on the dollar during the maximum pessimism of the oil panic from 2015 to early 2016.

**Outlook**

The first quarter return did not reflect the progress that the Partners Fund made over the last three months. We traded a fully priced, successful investment (Wynn) and a levered company with limited value growth (Chesapeake) for the largest cable provider with a plethora of quality content (Comcast) and uniquely located hotel properties in difficult to build locations (Park). We also used some of our non-earning cash to increase stakes in market leading businesses (Allergan’s aesthetics franchise and GE’s Aviation and Healthcare) at deep discounts.

Our companies and management partners grew stronger. For example, CNX made important steps in growing the value of its superior pipeline business and increasing FCF per share. We also applauded the announcement that Jeff Storey would take over as CEO of CenturyLink six months ahead of plan. While inflationary pressures and tariff talk generated market concerns, broadly speaking we believe most of our businesses have the qualitative strength and pricing power to help mitigate higher costs, particularly versus peers. These types of external risks are one of the reasons that we insist on a large margin of safety in the price we pay for a stock.

The market remains elevated in our opinion, with some industries particularly richly priced. Additional volatility and short-term mispricing would enable us to put more of
the Fund’s 17% cash to work in investments that meet our Business/People/Price criteria and further reduce the Fund’s mid-60%s P/V. As the largest shareholder group in the Fund and long-term investors, we welcome the volatility and the investment opportunities it can bring.

*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 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. 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.

“Margin of Safety” is a reference to the difference between a stock’s market price and Southeastern’s calculated appraisal value. It is not a guarantee of investment performance or returns.

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 March 31, 2018, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 8.5%; CK Hutchinson, 7.2%; LafargeHolcim, 6.6%; FedEx, 5.8%; Allergan, 5.8%; CNX Resources, 5.4%; Park Hotels, 5.1%; Fairfax, 4.9%; United Technologies, 4.8%; Mattel, 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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Longleaf Partners delivered a strong absolute return of 15.51% in 2017 and 3.62% in the fourth quarter, exceeding our annual goal of inflation plus 10% for both periods and for the second consecutive year. Our discipline, which requires a material margin of safety between stock price and intrinsic worth, kept the Fund with high cash levels and out of most of the Information Technology (IT) sector that powered the index’s 6.65% return in the quarter and 21.83% for the year. Cash, which faced no risk of capital loss, and the Fund’s limited IT exposure accounted for almost all of the shortfall versus the index. The long-running bull market became more reminiscent of the late 1990s as IT dominated and started to leave other high quality companies with attractive discounts.

Most of our businesses contributed to the Fund’s solid absolute results. Investments that our management partners made in the last few years began to show anticipated returns including Wynn’s Palace Resort in Macau, new Ground distribution facilities at FedEx, Pratt and Whitney’s geared turbofan engines within United Technologies, and Fairfax’s investments in Asia. Substantial multi-year cost cutting programs also yielded results, moving margins up at CNH and FedEx’s Express unit. Our management partners pursued transactions to further entrench their competitive positions or capture value recognition. Scripps Networks sold at a solid price to Discovery Communications, United Technologies announced a plan to buy Rockwell Collins in September, and in the fourth quarter, CK Asset sold The Center, Hong Kong’s fifth tallest office building for an almost 2% capitalization rate — well above our carrying value. At the end of November, CONSOL Energy completed the split of its coal and gas businesses.

The absence of many detractors added to the Fund’s performance for the year and the fourth quarter. In the first half, Chesapeake declined along with other Exploration and Production companies as natural gas prices fell. Level 3, now CenturyLink (CTL), spent most of the year under price pressure with uncertainty over the deal’s outcome and skepticism over CTL’s dividend sustainability, but following the merger’s close and management’s renewed commitment to the dividend, the stock rebounded over 22% from its November low.

We focus on the fundamentals of the businesses we own rather than the stock market. In 2017, however, a few broad drivers had enough impact on the index strength that they are worth highlighting. As noted above, IT drove much of the S&P 500’s results. The sector far surpassed all others with a 38% gain and more than doubled any other sector’s contribution to performance. IT momentum chasing contributed to stocks that others define as “growth” far surpassing those categorized as “value,” 27% versus 15%. In the last four months, renewed optimism around the tax bill pushed up stocks. Companies in the index with current tax rates over 25% rose an average 12% since the end of August, whereas those with rates already lower gained just 6%.

We spent a good deal of time looking at the impact of the tax changes on our companies as well as how lower rates might affect other investment opportunities. In some cases, lower rates will benefit shareholders, but we believe the widespread earnings optimism is overblown. Companies in more competitive industries likely will give up any tax savings to customers through better pricing and/or to employees via higher wages and benefits, which was already demonstrated late in the year. The S&P 500’s multi-year run has resulted in our owning more qualifiers domiciled outside of the U.S. in the Partners Fund. We therefore did not participate as much in the tax rally because a number of our companies already pay lower rates or, in the case of CenturyLink, have net operating losses (NOLs) that offset taxes.

Portfolio activity ramped up in the latter half of the year. We sold three successful investments as the stocks reached our appraisals of their business values including T. Rowe Price in the fourth quarter, and exited one investment following a management change. More surprisingly, even as the market hit new highs, we bought four new companies — two in the last quarter. As a result, the Fund’s cash position ended the year at 23%, slightly lower than the balance held for most of 2017. Additionally, as fewer companies participated in the market’s new highs, our on-deck list of qualifiers grew.

Contributors/Detractors
(2017 Investment return; 2017 Fund contribution; Q4 Investment return; Q4 Fund contribution)

Wynn Resorts (+98%, +4.21%, +14%, +0.44%), the U.S. and Macau gaming company, was the largest contributor to the Fund’s 2017 performance with strong earnings growth in Macau and Las Vegas. Industry gross gaming revenues (GGR) in Macau accelerated in the second half of 2017 well beyond full year GGR growth expectations. With major infrastructure

Average Annual Total Returns (12/31/17): Since Inception (4/8/87): 10.58%, Ten Year: 4.74%, Five Year: 9.43%; One Year: 15.51%

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, 2017, the total expense ratio for the Longleaf Partners Fund is 0.95%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.
projects moving closer to completion, mass visits and spending increasing, and VIPs returning, concerns about potential oversupply from significant capacity additions in Macau turned into confidence that additional hotel and gaming properties will be well absorbed by the market. Steve Wynn continued to create future value with the Boston resort expected to open in 2019, new development around the Las Vegas golf course, and the chance to pursue casino development in Japan. After the stock more than tripled from its lows two years ago and moved closer to our assessment of the company’s value, we reduced the Fund’s position.

FedEx (+35%, +2.66%, +11%, +0.75%), the world-leading transportation and logistics company, added to the Fund’s strong fourth quarter and 2017 results. Express margins jumped to the company’s long-held goal of double-digit levels due to strong pricing and utilization of lower cost passenger plane space. Ground yield and volumes were strong, and margins seem to have finally bottomed after recent years of rapid expansion and investment. FedEx moved quickly to integrate acquired TNT into its global network as it deftly handled the effects of a significant TNT cyberattack. CEO Fred Smith continued to think far ahead and prioritize the business’s long-term competitive position, reinvesting most earnings into high-return expansions and improvements. We trimmed the Fund’s stake as the discount to intrinsic worth shrunk.

CNH Industrial (+57%, +2.49%, +12%, +0.55%), the maker of Case and New Holland agriculture equipment (Ag) and Iveco trucks (CV), helped the Fund’s fourth quarter and full year results. After declining for three years, Ag staged a turnaround with Q3 sales growing 12% year-over-year and operating profit margin expanding by 130 basis points. Accordingly, fiscal year 2017 sales and earnings guidance saw meaningful upgrades. The Ag cycle in the U.S. seems to have hit an inflection point in 2017 after peaking in 2013. CNH management successfully balanced channel inventory while taking costs out during the decline. When U.S. Ag volumes (especially for high horsepower tractors and combines) recover from the current trough levels, the operating leverage on incremental sales will be highly margin accretive. In addition, CNH was upgraded to an investment grade rating by S&P and Fitch, an important milestone that should allow the company to tap the commercial paper market, lower interest expense, extend the debt maturity profile and potentially release over $1 billion of excess capital in time, which our management partners could return to shareholders in the form of dividends and buybacks. We cut the Fund’s exposure to CNH as the gap between price and value narrowed following the positive company developments and stock’s more than doubling since its bottom almost two years ago.

Alphabet (+36%, +2.23%, +10%, +0.56%), the diversified internet company with strong positions worldwide in search (Google), video (YouTube), mobile (Android), and more, was among the largest Fund contributors for the fourth quarter and the year. As the discount to intrinsic worth closed, we trimmed, although the Fund maintained a full position because of the company’s strong value growth. Revenues in the U.S. and Europe grew in excess of 20% and over 30% around the rest of the world as the search moat widened. Google still has significant opportunities to expand its share of advertisers’ total spend beyond its current level. The company made significant progress towards monetizing the fifth of the world’s population who watch YouTube every month by improving advertising interactions and separating brands from the site’s worst content after a minor scandal. Despite the stock’s outperformance during our almost three years of ownership, frightening “FAANG” (Facebook, Apple, Amazon, Netflix, Google) hype and frothy IT valuations, Alphabet still sells below our conservative appraisal, which does not give credit for significant additional upside. Transformative work in 2017 could become future sources of value, including Artificial Intelligence applications for Photos and Cloud, Waymo autonomous cars, world-leading map software, emerging-market Android mobile penetration, and Verily Life Sciences’ global partnerships and expansion.

CK Asset (+46%, +2.08%, +6% +0.33%), the Hong Kong based asset holding company, was one of the top contributors for the fourth quarter and year. The company achieved strong volumes of residential property sales in both Hong Kong and mainland China, and in the first half of 2017, sold the highest volume of residential property in Hong Kong. Rather than pay elevated prices for land, CK Asset (CKA) diverted sales proceeds to value accretive share buybacks at prices substantially below our appraisal. CKA spent HK$6.9 billion to buy over 3.3% of its shares, making it one of the top three repurchasers on the Hong Kong stock exchange for the year. To mitigate the cyclical nature of cash flows associated with property development, CKA diversified into stable infrastructure type assets around the globe, including gas pipeline and electric distribution company DUET in Australia, building equipment services provider Reliance Home Comfort in Canada, and fully integrated sub-metering company Ista International GmbH in Germany. To reflect this strategy, the company changed its name from Cheung Kong Property to CK Asset. In November, CKA sold The Center, a prime office building in HK for HK$33,000 per square foot and a capitalization rate of less than 2.5%. This price far exceeded our appraisal of the property and confirmed what great partners we have in Li Ka-shing, his son Victor Li and their team.

CONSOL Energy (+7%, +0.49%, +16%, +0.94%), the former natural gas and coal company based in Appalachia, was a contributor to the Fund’s fourth quarter results. The company completed the long-awaited spin-off of its coal assets from its natural gas reserves, undrilled acreage, and pipelines — a move we had encouraged to enable others to fully appreciate the values of each business. The gas company now trades as CNX Resources Corporation (CNX), while the coal pure-play business retained the CONSOL Energy name. Our CNX appraisal assumes gas prices at today’s depressed strip, yet the stock price implies much less value for its undrilled resources and midstream assets than comparable peers receive. The company reduced commodity risk by hedging the majority of next year’s production above $3/mcf. CONSOL’S Pennsylvania Mining Complex is the low-cost coal producer in the eastern
U.S. Both companies announced large buybacks to address their undervalued post-spin prices. We believe our management partners will continue to take action to gain value recognition at both companies. In spite of rampant coal divestment by institutional investors, CONSOL’s stock jumped 84% after becoming a pure-play coal business.

United Technologies (+19%,+0.95%,+11%,+0.53%), the industrial conglomerate, reported gains across its segments, putting it among the Fund’s top contributors in the fourth quarter. Pratt & Whitney won large Delta and Dassault contracts for its new geared turbofan engine – business that will pay off for decades with lucrative servicing revenues. The company’s proposed acquisition of Rockwell Collins should boost its strong competitive position in fitting out and servicing the growing aerospace industry. Carrier benefitted from its leading position in air conditioning systems and ought to gain from digital Smart Home technological improvements over the next several decades. Otis Elevator, one of the most ubiquitous companies in the world’s cities, showed solid organic growth. CEO Greg Hayes has positioned each part of United Technologies for long-term performance and the ability to stand-alone as separate companies in the future. Although we sold shares as the stock’s discount decreased, the Fund kept a full position that reflected our longer term confidence in management and value growth.

Chesapeake Energy (-44%,-2.07%,-8%,-0.17%), one of the largest U.S. producers of natural gas and oil, was one of the Fund’s few detractors in 2017 during a tough market for closing energy asset sales. Overshadowing strong operational performance by CEO Doug Lawler and his management team, domestic gas oversupply weighed down strip prices. Chesapeake made progress delineating some of its newer plays, but the market continued to underestimate the company’s ability to sell meaningful assets, as it has done multiple times in the past. We reduced the position to reflect the broad range of outcomes dependent on commodity prices.

CenturyLink (formerly Level 3) (-10%,-1.12%,-5%,-0.52%), the global fiber and integrated communications network company, was the Fund’s largest holding and declined during the year and fourth quarter, even though the stock rallied by 22% from its November low after CTL’s purchase of Level 3 closed. Throughout, our investment case grew more compelling. The merger of Level 3’s fiber network with Qwest’s assets that CTL had previously acquired created a uniquely competitive global fiber network that has particular strengths in the higher margin, growing Enterprise segment. Level 3’s CEO Jeff Storey becoming President and COO and eventual CEO of CTL and Sunit Patel maintaining the CFO position in the combined company were critical to our support for the deal. Their leadership makes us confident that CTL management will be able to drive mid single-digit Enterprise revenue growth at high contribution margins, cut costs substantially and deliver the projected $1 billion in deal synergies, much of which will be created by moving traffic onto the company’s combined network from third parties. Despite CTL’s stronger positioning, the stock price fell, in part because Level 3 customers delayed new purchases until it was clear who would lead the combined company. But, the primary price pressure was due to fears that CTL would not be able to sustain its double-digit dividend yield (a valid concern without the Level 3 acquisition). This worry heightened after the stocks of two mostly unrelated and massively overleveraged regional operators which were more closely aligned with CTL’s legacy landline business than the fiber business, saw their stocks collapse after dividend cuts. Storey and Patel confirm that the dividend is safe based on the combined EBITDA of the Level 3 and CTL fiber networks, the synergies from the deal, and the use of Level 3’s NOLs to reduce taxes. By our estimates, once the synergies are realized, the company should deliver over $3/share of Free Cash Flow (FCF) after capital expenditures (capex), which will amply cover the $2.16 dividend. We see material additional upside not built into our appraisal based on Patel’s record of cost cutting after mergers and the multiple players that would benefit from owning this network. When the stock price dramatically disregarded the positive fundamentals and our assessment of CTL’s intrinsic value, we bought more, including in the fourth quarter. Management and the board appeared to share our enthusiasm as demonstrated by significant December insider purchases as soon as the blackout period that prohibited purchases was lifted.

**Portfolio Activity**

Activity within the portfolio increased during the year. It may seem odd that we made purchases given new market highs. We do not require a market correction to find qualifiers, just individual business value mispricing. And while the overall market had strikingly low volatility, a few good businesses’ stocks declined enough to enable us to buy four new companies – Fairfax in the second quarter, and three others in the last four months of the year. Late in the third quarter, we began buying Mattel, one of the world’s largest toy companies with iconic brands like Fisher-Price, Barbie and Hot Wheels. The stock had fallen almost 70% over the last few years as previous management made a number of mistakes. New CEO Margo Georgiadis, formerly President of Google Americas, took over with a plan to simplify a needlessly complex manufacturing process, focus on profitable core brands rather than dilutive growth, build a better global presence, and transform the company’s digital marketing. She cut the dividend to free up cash to invest in the business, which immediately led to a sharp collapse in the stock price and gave us an opportunity to build the Fund’s position. Shortly thereafter, the stock’s rise on a rumored Hasbro takeover confirmed the discount, but Mattel’s board appropriately dismissed any low ball offers. We are confident in management’s plan to restore margins and do more with the company’s leading franchises in a growing industry.

We purchased two undisclosed positions in the quarter. One, like Mattel, was a time horizon arbitrage opportunity where past mismanagement and a dividend cut obscured the longer term value and prospects for industry-leading businesses. The other was an example of how complexity often leads Southeastern to investments. A more traditionally associated segment of the company was under pressure industry-wide, taking the stock to a multiple similar to peers within that segment. In the case of this company, however, its most valuable segment consists of leading, protected brands that are growing in strength and demand.
We exited four positions during 2017 and trimmed some of the strongest performers whose discounts to intrinsic value had diminished. Earlier in the year we exited Ralph Lauren after the CEO departed. Mergers involving DuPont (Dow) and Scripps Networks (Discovery) drove prices to our appraisals, and we sold those investments in March and August respectively. During the fourth quarter, we sold investment firm T. Rowe Price as the stock approached our appraisal. Despite near-daily headlines on the death of active funds, T. Rowe grew assets under management and maintained its strong position in Target Date retirement funds. The stock gained 70% during our short 13 month holding period. We are grateful to CEO Bill Stromberg and Chairman Brian Rogers for driving strong performance during a challenging time for the industry.

Outlook
The Fund’s last two years’ 39% cumulative return outperformed the index and substantially beat our absolute goal of real double-digit returns. We believe we can continue to provide solid results even though the Fund’s 2017 return was below the S&P 500 and prolonged the active management debate. Our return was less than that of the inflated index primarily due to two decisions to avoid risk of loss: the Fund held between 20-30% cash throughout the year, which accounted for over 70% of the relative shortfall versus the market; and we did not own more of the pricey IT sector.

We are confident we can outperform over the next 5+ years. First, as was true in 2017, what we own — acts of commission — will produce our returns going forward. The Fund’s portfolio contains discounted strong businesses with growing values selling at an attractive P/V in the mid-70s% — a striking contrast to what we believe is an overvalued S&P 500 increasingly driven by momentum in a narrower group of companies. We expect our differentiation from the index (97% Active Share) to be a source of strength to relative results. Second, the Fund’s cash is temporary until we find qualifiers, and with lower stock correlations and the prospect of more volatility among stocks, we expect undervaluation opportunities will increase, as they did in late 2017, providing us additional investments that will drive future compounding. Third, through our 42 years at Southeastern and in studying market history, we know that most broad trends come in cycles that can either turn quietly or with unexpected force. Most of our businesses remain in the out of favor bucket. We believe the recent dominance of momentum investing, which reflects speculation at elevated prices, will likely turn back to a favorable environment for undervalued stocks.

It is our strong view that after a nine year bull run and at high historic multiples, the inflated index is more vulnerable to downside surprises than likely to continue double-digit gains. Ben Graham’s definition of an investment from Security Analysis written in 1934 has never been more relevant: “An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return.” As the largest shareholder group in the Fund, we aim to preserve capital and compound at a real double-digit rate of return by owning a limited number of undervalued, high quality, competitively advantaged businesses where we are engaged with capable and aligned management partners. We have no doubt that we can deliver good performance because of our understanding of the drivers of each company’s value growth versus the associated risks, our ongoing dialogue with management, and our discipline to hold cash when businesses do not meet our stringent criteria.

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**RISKS**

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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.

Cap rate (capitalization rate) is the rate of return on a real estate investment property based on expected income.

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.

Active Share measures how much an equity portfolio’s holdings differ from those of the benchmark index.

“Margin of Safety” is a reference to the difference between a stock’s market price and Southeastern’s calculated appraisal value. It is not a guarantee of investment performance or returns.

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

As of December 31, 2017, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 8.1%; FedEx, 7.6%; CK Hutchinson, 7.0%; LafargeHolcim, 6.4%; CK Asset, 6.1%; Fairfax, 5.8%; Mattel, 5.2%; United Technologies, 4.9%; Alphabet, 4.8%; CNX Resources, 4.8%. 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.
Longleaf Partners Fund Commentary

Longleaf Partners Fund gained 3.25% in the third quarter. This return exceeded our annual absolute goal of inflation plus 10% in spite of the Fund’s high cash level, which accounted for most of the performance shortfall versus the S&P 500 Index’s 4.48% rise. Most of the businesses we own had positive returns in the quarter with six stocks posting double-digit gains. The common thread across the Fund’s top performers was corporate partners who are pursuing transactions aimed at building and seeking recognition for value per share.

Discovery’s purchase of Scripps resulted in the Fund’s only exit over the last three months. We also trimmed four investments after strong price appreciation throughout 2017. We initiated a new position (still undisclosed) late in the quarter and increased our stake in Level 3 as the stock’s discount to value grew.

The high cash and limited purchases do not properly reflect the activity level of our analyst team or the opportunity set we are seeing. Our on-deck list of companies that meet our qualitative criteria and are within 10-15% of our required discount grew over the quarter. Dispersion created by the market’s increasing performance concentration in IT has opened up pockets of undervaluation in other areas. Our team has assessed numerous companies whose stocks reflect uncertainty, including a variety of businesses that may be impacted by Amazon’s retail model, the development of ride sharing and electric vehicles, continued low energy prices, the future of healthcare, and the multitude of viewing options for media content. Additionally, investors’ manic search for yield and dividend stability has created opportunities where companies have cut or are at risk of cutting their dividends.

The Fund’s long-term potential to outperform will be due largely to our concentrated, bottom up approach that makes the portfolio and performance drivers dramatically different from the index (as evidenced by the historic 95+ active share). We believe the Partners Fund is currently more attractively positioned than the S&P, which sells above average historic multiples and at record high levels. Information Technology (IT), where the Fund owns just one investment, has become over 20% of the index and accounted for almost half of its return in the quarter. By contrast, almost half of the Fund’s holdings, including two of the top three performance drivers in the quarter, are not components in the inflated S&P 500. The Fund’s cash is also an advantage, providing liquidity when we find new qualifiers, but also acting as a buffer in the event that the 9+ year bull market reverses course.

**Contributors/Detractors**

*(3Q portfolio return; 3Q Fund contribution)*

Scripps Networks, (+29%, +0.97%) the owner of leading cable channels including HGTv, The Food Network, and the Travel Channel, was the Fund’s leading contributor after Discovery offered to acquire the company for $90 per share in cash and stock. The price was above our appraisal, and we sold the position. We added Scripps in 2014 after a potential Discovery combination fell apart and when international investments obscured the sustained profitability of Scripps’s unique content. Over our holding period, Scripps added new viewers and grew advertising revenue, but industry-wide pay TV subscribers declined more quickly than we anticipated. We consequently lowered our multiple on the business. The margin of safety in our initial purchase price combined with the company’s conservative balance sheet helped preserve our capital, and we booked an 18% gain in spite of the industry challenges that developed.

Fairfax Financial Holdings (+20%, +0.94%), the Canadian based property and casualty (P&C) insurer and reinsurer, was among the largest performance contributors in the third quarter. As one of two new holdings in 2017, Fairfax illustrates that “recycled names,” businesses that we previously have owned directly or as part of another company, are a good source of new investments. Our level of conviction in recycled names is usually higher because we know the businesses and management teams more intimately after being owners. Fairfax’s quick appreciation occurred when several material corporate actions helped bring clarity to pieces of hidden value that CEO Prem Watsa had built. In India, Fairfax sold a portion of its stake in ICICI Lombard through an IPO and a private market transaction, producing a combined $950 million gain. In Singapore, Fairfax sold its subsidiary, First Capital, to Mitsui Somitomo, one of Japan’s largest insurers, at a price more than three times book value. This multiple, which was much higher than traditional U.S. P&C companies receive, highlighted the inherent value in some of Fairfax’s international insurance subsidiaries. The First Capital transaction not only generated a $900 million after-tax gain, but also provided Fairfax with a continuing 25% quota share in First Capital’s underwriting and with the potential

*Average Annual Total Returns (9/30/17): Since Inception (4/8/87): 10.54%, Ten Year: 3.44%, Five Year: 9.33%; One Year: 13.74%*

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, 2017, the total expense ratio for the Longleaf Partners Fund is 0.95%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.
to participate in the difficult to access Japanese reinsurance market through Mitsui Sumitomo. The proceeds from these transactions will help fund Fairfax’s newly announced share repurchase program and will also replenish capital from recent hurricane losses, putting Fairfax in an excellent capital position to take advantage of a potentially hardening P&C market after these multiple catastrophes.

CONSOL Energy (+13%, +0.70%), experienced significant price volatility over the last three months, but ended the quarter as a top contributor, in spite of reduced production and operating cash flow guidance for 2017 and forward gas prices remaining weak. To the positive, not only did CONSOL reiterate its 2018 gas production guidance, but management announced several beneficial transactions that investors welcomed. First, the company reached its target range for 2017 asset sales and intends to close more in the remaining four months. Second, the planned separation of the coal business should be completed via a spin off before year-end. Third, the board authorized a share buyback equivalent to 6% of the company. Because of the lower long-term pricing for gas, we reduced our appraisal of the company, but CONSOL remains among the most discounted businesses we own, selling below its peers and building value through its free cash flow coupon and management’s capital allocation.

Level 3 Communications (-10%, -1.08), the global fiber and integrated communications network company, was the only notable detractor from the Fund’s return in the quarter. The size of the position magnified the impact of the stock’s decline. We maintained a 10% weight and added in the quarter in anticipation of the close of CenturyLink’s (CTL) purchase of the company. Because we will receive approximately half of the transaction in cash, the combined company will become a more normal 5% position. In the quarter, Level 3’s price reflected concerns about final deal approvals and a potential CTL dividend cut post-deal (as inferior competitors have cut dividends this year). On the first day of the fourth quarter, the Department of Justice gave a key approval to the merger. The prospective cash flow from the combination with Level 3 should easily cover CTL’s current dividend which was otherwise in question given its declining legacy land line business. The dividend is irrelevant to the company’s underlying value and has taken on undue importance in this environment of intense yield chasing. We anticipate that the deal will close and believe the new CTL will be the preeminent global fiber network solutions company with an extraordinarily capable management team, including Level 3 CEO Jeff Storey.

Portfolio Activity
Cash grew during the quarter as sales exceeded purchases. In addition to selling Scripps, we trimmed some of the year’s strongest performers, including Wynn, CNH, and FedEx, to keep them at more normal weights. We remain enthusiastic about the quality of each of these companies and our management partners’ ability to drive value growth over the coming years. Wynn was the strongest performer by far year-to-date, up 74%, and gained 62% over the last 18 months after being one of the Fund’s worst performers in 2015 and early 2016. Wynn exemplifies how Southeastern uses our 3-5 year time horizon as an advantage when near-term fears dominate a stock’s price. In early 2016, Wynn Macau drove Wynn’s stock price as Macau experienced a substantial drop in VIP revenue following China’s anticorruption campaign. The price ignored the longer term increase in much more profitable mass gamblers and the growth in visitors that construction of the new Wynn Palace and infrastructure would bring. Less than two years later, the Palace has averaged over 95% occupancy in 2017, and mass gaming revenue has grown double digits. VIP visitors also have increased from their low levels. Wynn remains below our appraisal because of the value growth at its operating properties both in Macau and Las Vegas, and because of the time horizon arbitrage opportunity we now have between earnings over the next twelve months and higher profits over 3+ years as the current construction in progress (Boston area casino and Vegas golf course redevelopment) starts to generate revenues.

In addition to adding to Level 3, we initiated one new, undisclosed position. The company reached our requisite discount because of previous management’s missteps over the last several years, dividend uncertainty, and Amazon-related fears. This new investment illustrates some of the ways we can find quality businesses at deep discounts even as the broader market climbs to new highs.

Outlook
The Fund’s flexibility to look different from the index and our bottom up, valuation driven discipline should allow the Partners Fund to continue to earn strong absolute returns that we believe can outperform the index over the long term. The companies we currently own offer additional attractive upside given their P/V in the high-70%s combined with the value growth that our management partners are capable of delivering. The 28% cash position does not anticipate a market correction, nor do we require a downturn to find qualifiers. Our edge comes in identifying the best stock-specific opportunities rather than in investing in broadly discounted markets. Our growing on-deck list contains a number of prospective investments simply waiting on prices to move in our favour, which could happen if individual companies disappoint investors, dispersion within the market leaves areas of undervaluation, or a broad pullback occurs. Whatever way discounts emerge, we believe each new investment will provide the Fund additional foundation for successful future compounding.

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 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. 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.

Active Share measures how much an equity portfolio’s holdings differ from those of the benchmark index.

“Margin of Safety” is a reference to the difference between a stock’s market price and Southeastern’s calculated appraisal value. It is not a guarantee of investment performance or returns.

Operating Cash Flow (OCF) measures cash generated by a company’s normal business operations.

IPO is an initial public offering.

As of September 30, 2017, the top ten holdings for the Longleaf Partners Fund: Level 3, 9.8%, CK Hutchinson, 7.0%, FedEx, 6.6%, Alphabet, 6.0%, CONSOL Energy, 5.8%, CK Asset, 5.6%, Fairfax, 5.5%, United Technologies, 4.8%, LafargeHolcim, 4.8%, CNH Industrial, 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.
Longleaf Partners Fund gained 3.91% in the second quarter, exceeding both our absolute return goal of inflation plus 10% and the S&P 500 Index's 3.09%. These returns built on our strong results in 2016. Our year-to-date (YTD) return of 7.97% meaningfully exceeded our absolute goal but fell short of the index's 9.34% largely due to our cash position's impact. Much like the first quarter, performance was driven by positive returns and notable value growth at some of the portfolio's larger holdings. Our two energy companies were the primary detractors in the quarter. We closed the Fund to new investors on June 9, as we have done three other times in our history. While this is a comment on the relative lack of new ideas and higher-than-usual cash levels, we remain confident we can produce positive absolute and relative returns over the next 3-5 years.

The Fund’s outperformance is notable given our high cash weight and minimal exposure to what drove the index — a reminder that successful stock selection in a concentrated portfolio with high Active Share is a winning formula. Health Care and Information Technology were the largest contributors to the index performance by a wide margin, even after Technology’s retreat at the end of the period. The Fund had limited Information Technology investments and no Health Care, as we feel that the vast majority of companies in these two sectors, which make up over 35% of the S&P 500, are exhibiting dangerous signs of overvaluation. While cash held back the Fund’s return, we feel that this bottom-up decision and long-held discipline will benefit the portfolio as we find new qualifying investment opportunities, either through individual company mispricing or when broader market sentiment turns.

One of the improvements that we have made to our process in recent years is being slower to part with long-term holdings that have performed well and qualify at a superior level on business and people. We will always maintain our discipline by trimming position weights of investments that have approached our conservative appraisal value. However, we do not want to overlook the ability of qualitatively superior companies with discernable but hard to quantify upside like FedEx, Level 3, Wynn Resorts and Alphabet, to grow their values in ways that do not necessarily fit easily into a spreadsheet.

We bought one new investment in the quarter and did not add to any of our existing holdings. We trimmed five securities. While our on-deck list remains smaller than usual, we do have a few prospects that we could own at the right price. We also are analyzing multiple avenues for taking advantage of the sell-off in all things retail related, but as of yet, have not found any that meet both our qualitative and quantitative criteria.

Contributors/Detractors
(2Q portfolio return; 2Q Fund contribution)

**Wynn Resorts** (+17%; +1.04%), the luxury gaming and hotel operator with prime properties in Las Vegas, Macau, and Boston, was the largest contributor this quarter, as it was in the first quarter. As Macau’s rebound accelerated, Wynn’s Palace property continued to ramp up strongly without cannibalizing the company’s legacy Peninsula property nearly as much as the market previously feared. Wynn reported a solid quarter in Las Vegas and announced that phase one of its golf course redevelopment will be a much more prudent project than some had anticipated, once again illustrating the great partner CEO Steve Wynn has been since we invested. Construction is on track for the Boston property to open in 2019. Our appraisal grew in the quarter, but we trimmed the stock to a more normal weight as the gap between price and value narrowed.

**FedEx** (+12%; +1.00%), one of the world’s largest package delivery networks, contributed in the quarter. The company continued its excellent earnings momentum, driven currently by revenue strength and margin gains in the Express segment. The Ground segment revenues stayed incredibly strong, although margins were down as the company invested heavily in growth. We believe that the company is close to a point where Ground margins turn around and begin to grow as the large scale investment in new hubs slows. The company also communicated that the integration of its TNT acquisition from last year is going well, providing future earnings upside even though for now, TNT results are dilutive. Some of the investor panic around Amazon hurting FedEx as a competitor has also begun to subside, for logical reasons related to FedEx’s physical scale and last mile density. FedEx is heavily weighted as the Fund’s second largest position, reflecting our confidence in CEO Fred Smith and his team, as well as in FedEx’s competitive strength and long-term value growth. We did trim our stake in the quarter, however, following the stock’s appreciation.

Average Annual Total Returns (6/30/17): Since Inception (4/8/87): 10.52%, Ten Year: 2.96%, Five Year: 9.82%; One Year: 22.35%

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, 2017, the total expense ratio for the Longleaf Partners Fund is 0.95%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.
CNH Industrial (+19%; +0.92%), the maker of agricultural equipment, commercial vehicles and construction equipment, contributed again in the quarter. The core agricultural business reported its best results since 2013. This segment continued to see unit demand stabilize, and pricing power remained intact. The company expects margins to improve at all segments this year. The best news during the quarter was the earlier-than-expected upgrade of CNH to investment grade status, which is more meaningful for this company than most others we follow. The upgrade will increase the efficiency of the financing business while likely freeing up over $1 billion of now excess capital for more productive uses, including share repurchase. We are thankful for CEO Rich Tobin’s efforts on the operational front and believe that he will work with CNH’s significant owners at EXOR to continue to build value per share.

Cheung Kong Property (+19%; +0.86%), the Hong Kong and China real estate company, was another notable contributor. The company achieved strong volumes of residential property sales in both countries. In the first half of 2017, Cheung Kong Property was the largest seller of residential property in Hong Kong. Additionally, the value of Cheung Kong Property’s commercial Hong Kong properties was highlighted with the sale by the government of the comparable Murray Road property across from Cheung Kong Property’s Hutchison House. The transaction fetched a land premium that implied a price of HK$50k per square foot (psf) on a gross floor area (GFA) basis and a cap rate of less than 3%. Our appraisal of Hutchison House is around HK$16k psf, which reflects the 5% cap rate we use to appraise Cheung Kong Property’s office properties in Central, Hong Kong. Cheung Kong Property will begin redevelopment of Hutchison House which will allow the company to substantially increase the plot ratio from the current 22 story building to 38 floors. Managing Director Victor Li built value on two fronts by selling residential properties into a high price/high demand market and aggressively buying in Cheung Kong Property’s undervalued stock. YTD, Cheung Kong Property paid HK$6.9 billion to repurchase ~3.3% of outstanding shares at a substantial discount to our appraisal. In May the company closed its acquisition of Duet in Australia. In the same month, Cheung Kong Property took advantage of the low interest rate environment and issued US$1.5 billion 4.6% guaranteed senior perpetual capital securities, which are being used to repurchase additional shares.

Alphabet, (+10%; +0.74%), the diversified internet company with strong positions worldwide in search (Google), video (YouTube), mobile (Android) and more, was another contributor in the quarter. Revenue growth accelerated, and margins were better than expected. The company bought back shares and continued to simplify its Other Bets segment while growing its lead in driverless cars. The $2.7 billion European Union (EU) fine levied at the end of the quarter was a negative, but it remains to be seen exactly how the EU ruling will play out. Alphabet has been one of Southeastern’s best value-growers in recent years. While we trimmed the position slightly, we believe that the company’s core business growth will continue, YouTube and Other Bets offer additional harder-to-quantify upside, and the strong balance sheet with substantial cash provides attractive downside mitigation.

Level 3 Communications (+14%; +0.37%), the multinational telecommunications and Internet service provider, did not have a significant impact on the Fund’s performance but made a major announcement during the quarter. CEO Jeff Storey was named the successor to CEO Glen Post at CenturyLink, whose acquisition of Level 3 should close in a few months. With this announcement, we are thrilled that Storey’s stellar team, who created 182% in shareholder return since he took over in 2013, will be running operations at the new CenturyLink — a powerful combination of Level 3 with CenturyLink’s fiber network, most of which came through its 2011 acquisition of Qwest. Level 3 is the Fund’s largest position but will become a normal weight after the merger because at the current CenturyLink price, around 45% of the deal will be paid in cash.

CONSOL Energy (-11%, -0.64%), the Appalachian natural gas and coal company, was a detractor in the quarter. The operating items within the company’s control — production, costs, and smaller asset sales — were generally positive. However, weaker gas prices weighed on the stock and its peers. The uncertainty around the details of how the company’s announced plans to separate its gas and coal operations will play out likely also negatively impacted the stock. Two items highlighted the value in the company’s assets. First, CONSOL’s partner in the pipeline company Cone Midstream sold its interest at a price above where we carry CONSOL’s identical assets. This both demonstrates what this asset is worth and likely brings in a new partner that will be more willing to grow Cone’s value. Second, late in the quarter Rice Energy (an Appalachian gas company which is a good comparable for CONSOL’s assets) sold to EQT Corporation at a price that implied a significantly higher value for CONSOL’s gas operations than the current stock price. CEO Nick DeULiis and Chairman Will Th冒ndike remain focused on delivering the unrecognized value within CONSOL, and 2017 likely will be a pivotal year for the company.

Chesapeake Energy (-16%, -0.63%), one of the largest U.S. producers of natural gas, oil, and natural gas liquids, was a detractor. Weak commodity prices impacted the oil and gas group overall, but what was most striking about Chesapeake was the stock price’s extremely high correlation to oil prices instead of natural gas prices this quarter. Although Chesapeake’s production is primarily weighted to gas, a meaningful percentage of the company’s current earnings before interest, taxes, depreciation and amortization (EBITDA) comes from oil. Additionally, oil’s importance to Chesapeake going forward has increased with much of current drilling focused on oil, especially in the Powder River Basin and Eagle Ford Shale. CEO Doug Lawler and his team will make prudent asset sales when the price and time are right, as they have done in the past, but the lack of such reported sales this quarter also weighed on the stock price.

Portfolio Activity
We added Fairfax Financial, a Canadian based insurance and reinsurance operator, to the portfolio in the quarter.
Southeastern previously owned the company for over a decade, and both the Longleaf International and Small-Cap Funds had positions. CEO and Founder Prem Watsa has continued to increase Fairfax’s value since we sold three years ago, and the company has outgrown the small cap universe. Fairfax is underwriting more successfully than when we previously owned it, is about to complete a value-accretive merger with Allied World, and still has the investing prowess of Watsa and his team. Because the merger is on the come and Watsa is holding a large amount of cash that is not producing income, near-term reported earnings per share are well below the company’s long run earnings power. We are excited to partner with Watsa at Fairfax again.

**Outlook**

The Fund’s P/V ratio is higher than usual in the mid-70s%, as is our cash level at 26%. Our outlook remains much the same as last quarter. We believe that our current roster of companies has the ability to produce solid results, even in a potentially difficult environment. Our cash will turn into our next great investments, but we can never predict what they will be or when they will be bought. While the current elevated market can be frustrating, we take comfort in our long track record of patience and discipline eventually being rewarded. We are appreciative of the patience of our fellow shareholders as well.

We are pleased to announce that in recognition of his research productivity and successful investment contributions, Ross Glotzbach, who currently serves as a co-manager on Longleaf Partners Small-Cap Fund, joined Mason Hawkins and Staley Cates as a co-manager of the Partners Fund effective July 10.

*See following page for important disclosures.*
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RISKS

The Longleaf 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. 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.

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

Active Share measures how much an equity portfolio’s holdings differ from those of the benchmark index.

Cap rate (capitalization rate) is the rate of return on a real estate investment property based on expected income.

As of June 30 2017, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Wynn, 4.7%; FedEx, 7.6%; CNH Industrial, 4.7%; Cheung Kong Property, 5.4%; Alphabet, 5.7%; CONSOL, 5.1%; Chesapeake Energy, 3.2%; Level 3, 10.4%; Fairfax, 4.6%. 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.
Longleaf Partners Fund gained 3.90% in the first quarter, meaningfully exceeding our absolute annual return goal of inflation plus 10%, but falling short of the S&P 500 Index’s 6.07%. This performance followed almost 900 basis points of benchmark outperformance as well as strong absolute results in 2016. In the quarter, we saw value growth and stock appreciation at some of our higher weighted investments.

We trailed the index for three reasons. First, we mostly “missed out” on the rally in Information Technology, which is over 20% of the S&P 500’s composition and drove a large portion of its return in the quarter. While our one IT investment, Alphabet, performed well, we have not found other qualifiers in this higher hurdle sector. Second, our large cash weighting in a rising market held back returns versus the fully-invested index. Holding cash is never a top-down decision for us, but rather is a residual effect of selling investments that no longer qualify and not finding enough new opportunities that meet our criteria. Being disciplined and patient is the right thing to do at a time of 30-year high bullish sentiment combined with higher-than-normal multiples on high margins, but it can make for disappointing relative comparisons in the short term. Third, we had a few detractors in the quarter. Our two energy investments – while lower weighted in the portfolio than in recent years – declined due to commodity price fluctuations, even though our management and board partners continued to make the right moves for the long term. At Ralph Lauren, our case changed significantly after a management change, so we sold at a small loss to focus on better opportunities.

We did not buy any new securities or add to any existing investments in the quarter. We trimmed two holdings and exited another two. Our on-deck list is smaller than usual, but we are following closely a few capably led, strong businesses that would be in our buying range with just a little price pull back.

Contributors/Detractors
(iQ portfolio return; iQ Fund contribution)

**Wynn Resorts** (+33%; +1.99%), the luxury gaming and hotel operator with prime properties in Las Vegas, Macau, and Boston, was the largest contributor in the quarter. Macau’s rebound continued, as that market now has grown for several months, some at double-digit rates. Wynn’s Palace property is ramping up from non-earning status more quickly than expected and gaining share as the premium property in Macau. Las Vegas continues to be a steady market, and the company is making progress on developing and monetizing its under earning golf course land. Wynn also is likely to benefit from the NFL coming to Las Vegas. Construction on the Boston resort is moving ahead as planned. Wynn has a large amount of optionality, and we are confident that CEO Steve Wynn and his team can maximize our outcome. Given the price strength and the position size, we trimmed the stock in the quarter.

**CNH Industrial** (+11%; +0.61%), the maker of agricultural equipment, commercial vehicles and construction equipment, was another contributor in the quarter. The company once again reported higher pricing in the core agricultural equipment segment at a time of down units. We applaud CEO Rich Tobin for good cost controls, as margins came in better than we expected. There are early signs that the agricultural market is stabilizing after years of decline. When demand for equipment turns, the company’s strong incremental margins will be working in our favor. We believe that management and the board are open to further rationalizing the company’s assets, as our vested partners, large owner John Elkann and Chairman Sergio Marchionne, have done at other investments in the past.

**LafargeHolcim** (+13%; +0.60%), the world’s largest global cement, aggregates, and ready-mix concrete producer, also added to the Fund’s return. The company’s 4Q results demonstrated continued success in pricing, operating cost control, and disciplined capital spending which helped earnings before interest, tax, depreciation and amortization (EBITDA) grow 15.5% and free cash flow increase 107%. For 2017, Eric Olsen guided to 2-4% volume growth helped by resumed growth in India and Latin America and continued volume growth in the U.S. Improved volumes combined with pricing and cost controls should drive double-digit EBITDA growth and strong free cash flow (FCF) generation. FCF along with divestitures has fortified LafargeHolcim’s balance sheet, and the competitive landscape is positive with few slated capacity additions. We expect dividends and share repurchases to accelerate as cash flow grows.

**Chesapeake Energy** (-15%; -0.70%), one of the largest U.S. producers of natural gas, oil, and natural gas liquids, was the

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**Average Annual Total Returns (3/31/17): Since Inception (4/8/87): 10.47%, Ten Year: 3.37%, Five Year: 7.82%; One Year: 20.23%**

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, 2016, the total expense ratio for the Longleaf Partners Fund is 0.93%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.
largest detractor in the quarter. At the macro level, declines in oil and gas prices pressured the stock. We use the futures strip for both commodities in our appraisal of Chesapeake, even though they are currently trading below the global energy industry’s long run marginal costs. CEO Doug Lawler further improved the company’s financial strength and flexibility, closing two Haynesville deals and reporting another solid operational quarter. We believe he and his team will continue to execute additional asset sales and maintain both operating and capital expense discipline.

**Ralph Lauren**, (-15%; -0.62%), the upscale retail brand, declined following the departure of CEO Stefan Larsson after less than two years at the helm. Our case was built on the potential for Larsson and Lauren to form a complimentary business and creative team, and the early results were promising as they cut costs and rationalized unnecessary stock keeping units. But when these two leaders were not able to coexist, a big part of our case changed. Rather than wait to see if the operating plan could continue without Larsson’s guidance, we sold our position. The disappointing outcome had only a minor impact on our return during our seven month investment period because of the operating progress the company made in a short period and because we have begun sizing new investments at less than a full 5% position while we gain more in-depth knowledge of the business and people as an owner.

**Portfolio Activity**
In addition to selling Ralph Lauren, we also exited DuPont in the quarter. We earned a 60% gain in DuPont when price reached our appraisal. We bought the stock in August 2015 when questions surrounded both the business quality and management, but we believed the board, which was under shareholder pressure, would address the company’s leadership, cost structure, and capital allocation to help the conglomerate focus on its more dominant, growing segments. The businesses performed solidly, and the arrival of CEO Ed Breen with his cost cutting plans and smart merger with Dow turned the investment into a success. We will continue to watch the company and its spinoffs going forward.

**Outlook**
Our P/V ratio is higher than usual in the mid-70s%. We also are holding a 24% cash position. While both of these numbers could seem discouraging at first glance, we feel that the strong businesses we own and the superior management teams running them will be able to grow their values per share at above average rates. If times get tougher, we have stronger-than-usual balance sheets that will allow our investees to go on offense. Our cash will eventually turn into our next great qualifiers. We cannot tell you when that will happen, but we are confident that our patience will be rewarded as it has in the past.

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**RISKS**

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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. An index cannot be invested in directly.

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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.

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

As of March 31 2017, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Alphabet, 7.0%; Ralph Lauren, 0%; Wynn, 6.7%; CNH Industrial, 4.8%; LafargeHolcim, 4.9%; Chesapeake Energy, 3.8%; DuPont, 0%. 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.
December 31, 2016

Longleaf Partners Fund Commentary

Longleaf Partners Fund made substantial gains throughout the year, rising 20.72% in 2016, a large premium over the S&P 500’s 11.96% return. The Fund’s outperformance began in mid-February and occurred in spite of higher-than-normal cash in the portfolio. In the fourth quarter, the Fund appreciated 2.03% while the S&P 500 added 3.82%, most of which came following the presidential election.

The Fund outperformed in two distinct market environments. Over the first seven months of the year, the pursuit of high yield and low volatility dominated. Then more cyclical stocks took over, with over half of their last five month returns occurring in November. The Partners Fund’s successful performance had little to do with the index’s return. We had limited exposure to the markets’ preferences in either period.

Solid operational performance and smart capital allocation by our management partners who pursued value accretive transactions drove the Fund’s substantial results. The company-specific nature of our 2016 return reinforced the importance of investing with a long time horizon and aligned, shareholder-oriented capable corporate leadership. While it is difficult to predict near-term stock prices, if our businesses are selling at a meaningful discount to their intrinsic worth, are growing free cash flow over the long term, and are run by people who are motivated to build value per share, good returns can be expected. These same characteristics describe our current holdings, are the criteria required for new investments, and therefore form the basis for our confidence in our ability to continue to deliver solid results.

Annual Contributors/Detractors
(2016 investment return; 2016 Fund contribution)

Chesapeake Energy (+137%; +8.46%), one of the largest U.S. producers of natural gas, oil, and natural gas liquids, was the Fund’s top contributor to performance in 2016 and gained an additional 12% in the fourth quarter. Earlier in the year, we transitioned our equity position into heavily discounted bonds and convertible preferred stock, which offered equity-like returns higher in the capital structure and a potentially faster payback. As the bonds rose close to par, we exited them. At the end of the third quarter, we converted all of our appreciated preferred securities into common stock for an attractive premium. Over the course of the year, management executed beyond expectations, selling various assets, improving the balance sheet through discounted debt repurchases, reducing operating and capital expenditures, and renegotiating midstream contracts. The most recent asset sales in the fourth quarter included a portion of the company’s properties in the Haynesville Shale in northern Louisiana for proceeds of approximately $915 million. Signed or closed asset sales reached $2.5 billion in 2016, exceeding management’s original target of $1 billion. To further strengthen its balance sheet, the company secured a term loan and convertible debt offering, which raised more capital at better terms than expected. Since the beginning of 2012, Chesapeake has reduced debt by 50%, and its remaining fixed liabilities should be well covered in the coming years. The company has targeted a two times net debt over earnings before interests, taxes, depreciation, and amortization (EBITDA) with cash flow neutrality by 2018 and 5 to 15% of annual production growth by 2020. We salute CEO Doug Lawler and Chesapeake’s board, with Brad Martin as Chairman, for their successful pursuit of shareholder value in the face of massive headwinds.

CONSOL Energy (+131%; +3.96%), the natural gas and Appalachian coal company, also contributed large gains over the year. CEO Nick Deluliis, management, and the board, led by Chairman Will Thornhake, monetized assets and continued to cut costs in the pursuit of separating the coal and gas businesses which is expected to happen in 2017. Following the disposition of its metallurgical coal assets in the first half of the year, CONSOL sold its high cost Miller Creek and Fola thermal coal mines to a private buyer at a price above our appraisal. The company also delivered positive free cash flow (FCF) for the year, which many thought very unlikely at the start of 2016. In the fourth quarter, CONSOL announced the unwinding of a joint venture with Noble Energy in which the company received $205 million in cash from Noble while maintaining ownership of valuable EBITDA-producing properties. Recent transactions involving other companies’ gas assets in Appalachia, as well as CONSOL’s own midstream master limited partnerships’ (MLP) prices, support our appraisal of CONSOL, which is much higher than the stock price.

Wynn Resorts (+128%; +2.29%), the luxury gaming and hotel operator with prime real estate in Las Vegas, Macau, and Boston, was another significant contributor during the year, despite a slight retreat in the fourth quarter. The total Macau market reported higher gross gaming revenues year-over-year.
In most months of the second half, indicating stabilization and a return to growth. In August, the company opened the Wynn Palace in Cotai (Macau). The property has ramped up more slowly than some analysts had hoped, but Wynn has a history of careful openings and eventual success. During the fourth quarter, sentiment shifted up and down, as some positive industry level data points were offset by concerns over Chinese policy changes that could potentially impact Macau indirectly. In the U.S., Las Vegas had solid results, and the company received the final licenses necessary to begin construction of Wynn Boston Harbor, which is expected to open in 2019. Wynn also announced plans to develop part of its Las Vegas golf course property into a hotel, restaurants, and other attractions. In December, the company sold 49% of its retail assets in Las Vegas for over twenty times EBITDA, which was accretive to our value and well above where the stock trades. The sale was also further evidence of how our heavily-aligned partner, Steve Wynn, continues to build value per share and pursue value recognition for shareholders.

FedEx (26%; 2.16%), the global transportation and logistics company, was also a leading contributor for 2016 after gaining 7% in the fourth quarter. The company raised guidance for fiscal year 2017 and continued to buy back its discounted shares. Our appraisal increased as expense reductions in Express over the last several years helped raise margins. Investing in growth at Ground depressed margins in that division but should have meaningful payoff longer term. The TNT acquisition, finalized in May, should materially benefit profitability by increasing the final mile density of FedEx’s business across Europe. Management indicated that the integration of TNT should generate at least $750 million of annual synergies across its network over the next few years. We believe that CEO Fred Smith and his capable leadership team will continue to drive value growth for shareholders.

Scripps Networks (+32%; +1.92%), the media company whose three main brands are HGTV, Food Network, and Travel Channel, had solid advertising revenue gains during the year, and the stock continued its rise in the fourth quarter, gaining 13%. Ratings were strong overall in 2016, and HGTV ended up as the third most watched U.S. cable channel behind ESPN and Fox News. The company’s advertising has more exposure to stable categories than most competitors and also earns premiums per viewer over the competition. The year did see a decline in distributor fees paid to Scripps, but this was due to one-time items that will be lapped next year. Part of the stock’s discount is related to international expansion which has not yet produced profits but has created startup costs and non-cash amortization. Scripps’ high-profile lifestyle channels could be valuable content for other media and entertainment companies, as evidenced by AT&T’s recent bid for Time Warner at an attractive multiple relative to Scripps’ stock price.

Level 3 Communications (+14%; +0.31%), a global fiber and integrated communications network company was the primary contributor to the Fund’s fourth quarter return. The stock rose 22% with the announcement of a merger with CenturyLink, Inc., equating to $66.50 per Level 3 share, a 42% premium to the closing price prior to the announcement. This deal offers numerous benefits for shareholders. The combined company will increase the capacity and reach of CenturyLink’s domestic and Level 3’s global high-bandwidth fiber networks. Although CenturyLink has been tainted by the performance of its legacy landline business, its Qwest fiber network is a high quality asset. Projected synergies total $975 million, with $125 million in reduced capital expenditures and the remaining $850 million split in half between operating expense reductions and moving data usage onto the company’s own network. Additionally, Level 3 will get four directors on the new board. CenturyLink CEO Glen Post has announced that the new CFO will be Sunit Patel who has successfully integrated large acquisitions and managed balance sheets well in his tenure at Level 3.

CK Hutchison (-14%; -1.59%), a global conglomerate comprised of five core businesses (retail, telecommunications, infrastructure, ports, and energy), was the Fund’s only noteworthy detractor for the year. The stock declined in the first half of 2016 in the wake of the rejection by European regulators of its acquisition of U.K. telecom company O2, in addition to Brexit which created concerns about the impact on the company’s sizable operations in Europe and the U.K. Following a strong third quarter where the company announced a merger creating the largest Italian mobile operator, the stock lost ground in the fourth quarter after the U.S. election. A stronger U.S. dollar and expectations of tougher trade weighed on Hong Kong stocks in general and on the Hong Kong dollar’s relationship to the British pound and euro, where over half of the company’s earnings before interest and taxes (EBIT) originate. Our owner-operator partners, Victor Li and his father Li Ka-shing, continued to focus the company on its core competencies by selling its aircraft leasing business during the quarter.

Annual Portfolio Activity
Given the long running bull market and additional rise in 2016, finding new businesses that met our requisite discount proved challenging. Additionally, with our strong returns, prices of many holdings grew closer to appraisals, and some of the biggest performers became more heavily weighted in the portfolio. We trimmed a number of positions and exited McDonald’s, Aon, and National Oilwell Varco in the first quarter, as well as Phillips in the third quarter. Cash rose in the portfolio during the first quarter and remained in the teens throughout the year. We were able to buy two new investments in the Fund—Ralph Lauren in the second quarter and T. Rowe Price (TROW) in the fourth. TROW is a diversified investment advisory firm with a dominant position in U.S. target date fund retirement assets, which account for about twenty percent of assets under management (AUM). TROW’s funds have performed well and had net inflows, even with the active management headwinds the industry has faced. Over the last ten years, the company has put capital into building its international investments and distribution. The company currently has just below twenty percent of AUM in international funds and a mid-single digit percent of total AUM coming from offshore investors. As this business grows, margins should rise accordingly. The company’s balance sheet has net cash, and we are confident in the aligned management
team who has a record of prudent capital allocation

Outlook
The Fund’s price-to-value (P/V) in the low-70s% offers attractive upside. Much uncertainty remains as to how U.S. tax, trade, and regulatory policies will change in the new administration. More volatility, lower market correlations, and higher interest rates would likely unearth new opportunities for the Fund’s 18% cash. For example, we are already beginning to find more prospects in healthcare following the sector’s decline amid controversies around drug pricing and questions over the future of the U.S. system.

Most importantly, we believe our companies can grow their values substantially and have the ability to deliver good returns in a variety of scenarios. For example, our two largest holdings, Level 3 and FedEx, as well as LafargeHolcim, benefitted from merger activity in 2016 and have significant revenue prospects from their combinations that are not included in projected synergies, and they have skilled leadership with experience at successful company integrations. We hold numerous other businesses that have had meaningful capital investment programs over the last few years that should begin to generate returns in 2017 and beyond. These include Wynn’s newly opened Palace in Macau, United Technologies’ Pratt jet engines, T. Rowe’s international business, and varied projects at Alphabet. As 2016 showed, CEOs and boards who are competent and shareholder-oriented create value. Our corporate partners, as well as the quality of our businesses, give us confidence in our future prospects.

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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. An index cannot be invested in directly.

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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.

Master limited partnership (MLP) is, generally, a limited partnership that is publicly traded on a securities exchange.

EBIT is earnings before interest and taxes.

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

Brexit ("British exit") refers to the June 23, 2016 referendum by British voters to leave the European Union.

As of December 31 2016, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Chesapeake Energy, 4.5%; CONSOL, 6.1%; Wynn, 5.9%; Scripps, 4.8%; FedEx, 9.5%; Level 3, 9.7%; CK Hutchison, 6.1%; Ralph Lauren, 3.5%; T. Rowe Price, 2.5%. 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.
Longleaf Partners Fund delivered a hefty 11.07% in the third quarter, taking the year-to-date (YTD) return to 18.32%. In spite of above normal cash levels, our results far surpassed the S&P 500 Index’s 3.85% return for the last three months and 7.84% for 2016. Over the last twelve months, the Fund has more than doubled our annual absolute goal of inflation plus 10% and outperformed the index.

The sustained environment of slow economic growth and low interest rates has reduced capital costs associated with acquisitions and spurred consolidation that can increase not only revenues but margins. Most of our companies were positive contributors this quarter. Actual or anticipated successful integration of mergers and acquisitions, along with transactions that strengthened balance sheets, helped drive our strong performance. Chesapeake Energy sold assets and bought debt below face value. LafargeHolcim also reduced debt through asset sales and captured synergies from last year’s merger. FedEx raised guidance in anticipation of the benefits from its TNT acquisition and raised margins in its Ground and Express divisions. CK Hutchison gained approval for a merger that will create the largest mobile phone operator in Italy.

Capable management partners deserve particular credit for achieving returns of this magnitude when economic growth rates are not powering earnings. Assessing and engaging with management is an important part of our process with an emphasis on capital allocation options. We are gratified by the strong execution of our CEOs and boards as they focus on building value per share.

**Contributors/Detractors**

(3Q portfolio return; 3Q Fund contribution)

**Chesapeake (+112%; +4.0%)**, one of the largest U.S. producers of natural gas, oil, and natural gas liquids, was the top contributor to performance during the quarter. Early in the year we swapped our equity position for near-term bonds and preferred stocks which offered equity-like returns and a shorter horizon for value recognition. As management delivered good results, the bonds approached par. Consequently, we sold all of the remaining bonds over the last three months. On the final day of the quarter, we exchanged all of our preferreds into equity at a price well below our appraisal. In the quarter, both operating expenses and capital expenditures continued to improve, additional debt was retired below face value, and management reduced distribution costs through restructuring agreements with Williams and selling the Barnett assets. The company is pursuing more cost improvements and increased its asset sale target for the year to $2 billion after surpassing the original $1 billion goal. Asset sales plus proceeds from the recent upsized term loan and convertible debt offering, which raised more capital at better terms than expected, should cover the company’s obligations for at least three years. We remain confident that CEO Doug Lawler and Chesapeake’s board will continue to successfully navigate the company through this lower-for-longer commodity price environment.

**LafargeHolcim (+31%; +1.5%)**, the world’s largest global cement, aggregates, and ready-mix concrete producer, was also a top contributor. During the quarter, CEO Eric Olsen and his management team made progress with respect to divestitures, merger synergies, and pricing. The company sold assets in India, Sri Lanka, and Vietnam at attractive prices. These sales coupled with previously announced transactions in South Korea, Saudi Arabia, and China got the company to its 2016 CHF3.5 billion divestiture goal ahead of schedule and helped LafargeHolcim reduce its debt from CHF18 billion to CHF13 billion in 2016. An announced CHF1.5 billion of additional divestitures are targeted for 2017, which will move the balance sheet to investment grade quality and allow management to return free cash flow (FCF) to shareholders. Expected synergies from last year’s merger between Lafarge and Holcim have come through on target with an expected CHF50 million this year. Industry cement pricing is moving in the right direction. During the quarter, prices increased 2.2% sequentially versus 1.2% in 1Q 2016 and -1.6% in 4Q 2015. LafargeHolcim now has higher prices in almost 70% of its markets versus 2015 levels. Even though volumes did not grow in all markets, higher prices and large cost savings resulted in strong earnings before interest, taxes, depreciation, and amortization (EBITDA). Despite the stock’s rise, the company remains one of the more undervalued securities in the portfolio.

**FedEx (+15%; +1.2%)**, the global transportation and logistics company, was a leading contributor. The company reported strong results across the board, with an increase in margins in its Express and Ground divisions. Ground had 10% growth in average daily volumes year-over-year and announced a price increase of 4.9% in 2017, once again demonstrating the company’s strong pricing power even in a time of low inflation.

**Average Annual Total Returns (9/30/16): Since Inception (4/8/87): 10.44%, Ten Year: 3.77%, Five Year: 11.39%; One Year: 24.80%**

**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, 2016, the total expense ratio for the Longleaf Partners Fund is 0.93%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.**
Management indicated that the integration of TNT, which the company acquired in May of this year, would generate at least $750 million of annual synergies across its network over the next few years. The company’s tax rate should also benefit from more profits based in Europe. The company raised guidance for fiscal year 2017 and continued to buy back shares. Our appraisal increased, and in spite of the price appreciation, the stock remains significantly discounted.

CK Hutchison (+18%; +1.1%), the Hong Kong-based global conglomerate, was a top performer in the quarter. Following the initial shock of Brexit in late June, the company’s limited impact from a weaker pound became more apparent. Regulators rejected the company’s proposed acquisition of O2 by its UK mobile phone business Three UK, but CK Hutchison received approval in September for the merger of Three Italia with Wind in a 50/50 joint venture between CK Hutchison and VimpelCom. This combination will create the largest mobile operator in Italy with approximately 37% market share versus the two remaining primary competitors. CK Hutchison expects at least 5 billion euros of synergies from this merger, with most to be delivered within three years of the transaction closing in the fourth quarter of 2016. These projected synergies exclude any upside from selling assets and spectrum, utilizing tax losses, or refinancing expensive debt. CK Hutchison’s European businesses grew nicely, and the company expects to see solid global growth, particularly in its telecom and retail segments. Li Ka-shing and his son, Victor, continue to build value for shareholders.

CONSOL Energy (+19%; +1.1%), the natural gas and Appalachian coal company, added to the Fund’s return. CEO Nick DeLuca and the board, led by Chairman Will Thorndike, continued to pursue monetization of assets with the goal of ultimately separating the coal and gas businesses. Following the disposition of its metallurgical coal assets in the first half of the year, CONSOL sold its high-cost Miller Creek and Fola mines to a privately owned buyer who valued them higher than we did. The company also lowered costs across all segments and delivered positive free cash flow once again. Higher coal and gas prices drove strong returns at CONSOL’s holdings in coal master limited partnership (MLP) CNXC and midstream pipeline MLP CNXN. Sales of other companies’ exploration and production assets in Appalachia highlighted the value of CONSOL’s assets.

Level 3 Communications (-10%; -0.6%), the global fiber and integrated communications network company, was the Fund’s primary detractor in the third quarter. In spite of disappointing flat revenue growth, our appraisal increased with the company’s reported higher free cash flow coupon. In local currencies, the company’s Enterprise business grew across regions, with a particularly strong 10% rate in Latin America. Currency translations, however, created a significant drag in the quarter, turning Latin American and Europe, Middle East, Africa (EMEA) reported top line results negative. More importantly, total EBITDA in the quarter, as well as projections for the remainder of 2016, were exactly in line with expectations. The company’s growing cash position after over $260 million of free cash flow (FCF) in the quarter took net leverage to 3.5X EBITDA. We remain confident that CEO Jeff Storey and his team will continue to execute and will ultimately close the gap between the stock price and corporate value.

Portfolio Changes
We sold health and wellness company Philips in the quarter. Although we applaud actions management took over time to address the conglomerate discount, including the recent partial initial public offering of its lighting business, the execution took longer than expected and reduced our confidence in the case. Philips returned 159% over the course of our investment.

Outlook
After a multiyear bull market fueled by low interest rates, we continue to have difficulty finding new qualifiers. Our successful returns have meant portfolio sales as some holdings moved closer to our appraisals and became overweight. We managed to deliver double-digit returns in the quarter even though cash rose to 25%. Because our appraisals grew at many of our companies, the Fund remains attractively priced at a low-70% price-to-value (P/V). We believe that the qualitative and financial strength of our companies will be important if faced with a more challenging environment, and our aligned partners in our competitively advantaged holdings will continue to deliver outsized returns over time.

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Brexit (“British exit”) refers to the June 23, 2016 referendum by British voters to leave the European Union.

As of September 30 2016, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Chesapeake Energy, 5.4%; LafargeHolcim, 4.8%; FedEx, 8.6%; CK Hutchison, 6.6%; CONSOL, 6.2%; Level 3, 6.4%. 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.

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Longleaf Partners Fund meaningfully outperformed the S&P 500 Index in the first half of 2016, rising 6.53% versus the index’s gain of 3.84%. In the second quarter, the Fund returned 2.10% versus 2.46% for the index. Our energy investments were again the largest contributors following similar strength in the first quarter. Both Chesapeake Energy and CONSOL Energy benefited from managements monetizing assets and succeeding in reaffirming credit lines, as well as from improving commodity prices. CK Hutchison detracted most from performance in the quarter; European regulators denied approval of the company’s acquisition of U.K. mobile company O2, and weeks later, the Brexit vote weighed on CK Hutchison’s stock given its large footprint in European retail, ports, infrastructure, and telecom. Since the S&P is comprised of U.S. stocks which held up better than European shares following Brexit, the Fund’s three European-domiciled businesses weighed on relative returns, due in part to the dollar’s quick rise. However, the Fund’s relative performance benefitted from our limited investment in information technology, which was the index’s biggest detractor as its largest and worst performing sector.

The long-term effects of the United Kingdom’s decision to leave the European Union will not be known for some time, but with the exception of CK Hutchison, the companies in the Partners Fund generate less than 10% of revenues from the U.K. Even our European-based holdings, CNH Industrial, Philips, and LafargeHolcim, have the majority of their values outside of Europe. The strength of our businesses with European exposure should help them weather the eventual changes from Brexit, and our management partners have the skills, incentives, and balance sheets to take advantage of opportunities that the upheaval may create.

The second quarter illustrated the benefits of Southeastern’s distinct approach—intelligent, concentrated, engaged, long-term, partnership investing. Our management partners with whom we have engaged constructively over time helped drive long-term value growth through transactions, including at Chesapeake and CONSOL noted above; Philips, which split out the lighting segment via a partial initial public offering (IPO); FedEx, which purchased TNT to efficiently expand its European ground business; and LafargeHolcim, which is soliciting bids to sell its Indian assets.

Intelligent, long-term investing also was relevant in the fearful environment that developed following the Brexit vote. With our long time horizon, we hoped the reaction would provide more opportunities to buy strong companies with growing intrinsic values at deep discounts based on conservative appraisals of free cash flow and assets. With ample cash, including proceeds from trimming Wynn Resorts and Scripps Networks after their meaningful gains this year, we were able to build our stake in one new position initiated in the quarter.

### Contributors/Detractors

(2Q portfolio return; 2Q Fund contribution)

As stated earlier, **Chesapeake (+73%; +3.6%)**, one of the largest U.S. producers of natural gas, oil, and natural gas liquids, was the Fund’s largest contributor during the quarter. Earlier in the year, we swapped our equity for preferred stock and also added to our Chesapeake position via very discounted bonds and convertible bonds. This repositioning paid off in the quarter; the bonds appreciated more quickly than the stock as the company continued to lower its overall debt through purchases below par and debt for equity swaps. Additionally, in April, Chesapeake had its $4 billion revolving credit facility reaffirmed (90%+ untapped), with the next scheduled redetermination pushed out until June 2017. The company increased liquidity with the sale of about half of its mid-continent STACK (Sooner Trend Anadarko Basin Canadian and Kingfisher Counties) acreage to Newfield at a fair price of over $400 million. In total, net debt has declined by over 10% or $1 billion in 2016. Management projects additional asset sales this year and continues to renegotiate pipeline commitments toward better rates. The company has put on hedges that help mitigate its downside. We remain confident that CEO Doug Lawler and Chesapeake’s board will successfully navigate the company through this particularly challenging commodity price environment.

Also a top contributor, **CONSOL (+43%; +1.7%)**, the natural gas and Appalachian coal company, continued its positive momentum from the first quarter which saw the addition of new directors, the elevation of Will Thorndike to Chairman, and the sale of the metallurgical coal assets at a price accretive to our value. In the first quarter numbers reported in April, CONSOL reduced its coal and gas operating costs greater than expected, delivered free cash flow and guided for positive free cash flow, the remainder of the year. The company also had its borrowing base reaffirmed at $2 billion. Recent transactions confirmed the value of CONSOL’s high quality natural gas.
reserves and acreage. Our capable management partners continue to focus the company on its core natural gas assets while pursuing the monetization of non-core assets, with the goal of separating its coal company from its exploration and production business.

CK Hutchison (-14%; -1.2%), a global conglomerate comprised of five core businesses (retail, telecommunications, infrastructure, ports, and energy), was the primary performance detractor for the quarter. Referenced earlier, CK Hutchison’s plan for its Three mobile phone network to acquire U.K. telecom company O2 was denied by the European regulator. While CK Hutchison is Hong Kong-based, the stock also fell with the Brexit vote because of fears of the impact on its European and U.K. operations which generated over half of its pre-tax earnings last year. However, Chairman Li Ka-shing and his son, Victor, have demonstrated a compelling long-term record of building businesses, compounding net asset value at double-digit rates, and buying and selling assets at attractive prices, and their history includes intelligent capital allocation during previous market dislocations. We are confident our management partners will continue to grow and unlock value.

Portfolio Changes
During the quarter, we initiated a position in Ralph Lauren, a leading global apparel and retail company. The U.S. apparel industry has suffered with uncertainty around the future of department stores versus e-commerce and concerns about brands that are not either very high end or part of the current “athleisure” trend. Amidst these broader pressures, margins at Ralph Lauren have declined in the last few years. Yet, the company’s brands remain strong. We believe new CEO Stefan Larsson will materially bolster the company’s operating performance. He has an exemplary history of improving margins and reducing lead times in his previous jobs at H&M and Old Navy. His operating prowess, the creative abilities of owner-founder Ralph Lauren, and the strong balance sheet plus smart capital allocation position the company to deliver improved returns.

Outlook
The Partners Fund sells for an attractive price-to-value ratio in the mid-60s%. We own companies whose leaders are building long-term value and pursuing ways to drive prices closer to intrinsic worth. While cash stands at 14%, we believe we will continue to find new qualifiers, whether through choppy markets or company-specific opportunities. Over the long run, we and our fellow shareholders have been rewarded for patiently adhering to our investment discipline, and we believe our distinct, advantaged approach will continue to deliver strong results.

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**RISKS**

The Longleaf 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. 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.

Brexit (“British exit”) refers to the June 23, 2016 referendum by British voters to leave the European Union.

As of June 30 2016, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Chesapeake Energy, 7.3%; CONSOL, 5.5%; CK Hutchison, 7.6%; CNH Industrial, 4.3%; Philips, 4.7%; LafargeHolcim, 4.5%; FedEx, 7.9%; Wynn Resorts, 6.2%; Scripps, 4.9%; Ralph Lauren 3.1%. 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.
Longleaf Partners Fund posted a formidable 4.34% return in the first quarter, exceeding the S&P 500 Index’s 1.35%. A number of our stocks had double-digit gains, including several of our most undervalued businesses coming out of 2015. Most of our companies generated solid operating results, and management activity helped drive higher appraisals. Our two biggest positions declined slightly, and their portfolio weights made them among the notable detractors to our strong gains. Our investment cases and our high conviction for these companies remain unchanged. Not only were our absolute returns well beyond our goal of inflation plus 10%, but our relative results also benefited from our lack of exposure to health care, which was among the top performing index sectors in 2015 but was the S&P 500’s worst performing sector in the quarter.

Stock prices in the first quarter embodied Ben Graham’s description of “Mr. Market,” whose manic short-term swings are driven by investor emotions. The market fell -10.3% at its February 11 low point but then rallied over 13% by the end of March, a 2300 basis point swing. While economic and political uncertainties fostered the volatility, our appraisals proved much more stable, highlighting the importance of anchoring investment decisions to the long-term cash flows and underlying asset values of each company.

The volatility provided opportunistic points to add to two of our more undervalued stocks, sell three positions, and trim several positive performers as they became overweight and traded closer to our appraisal values. Our on-deck list of adequately discounted new investments is limited.

**Contributors/Detractors**

(gross return of the stock for 1Q; impact to Fund return for 1Q)

**Wynn Resorts** (+36%; +2.7%), the luxury gaming and hotel operator with prime real estate in Las Vegas, Macau, and Boston, was the largest contributor in the quarter. Wynn preannounced positive results to enable management to buy more stock. CEO Steve Wynn demonstrated his confidence in the business by purchasing nearly one million shares, bringing his total stake in the company to 12%. Wynn Las Vegas reported better-than-expected 4Q results. Although pressure continued in Macau’s lower margin VIP segment, mass gaming revenues in Macau stabilized, and year-over-year gross gaming revenue comps in February were the strongest in almost two years. Wynn remains well below our appraisal and offers a compelling long-term opportunity for significant growth with a proven owner-operator at the helm. The value of properties in the development pipeline is not yet reflected in the stock price. The opening of Wynn Palace in Macau later in 2016 could spark additional stock appreciation as capital expenditures (capex) ends and revenues begin.

**Scripps Networks** (+43%; +1.4%), the media company that owns cable channels, including HGT, The Food Network, DIY Network, Cooking Channel, Travel Channel, and Great American Country, reported a strong quarter with all six networks adding new viewers as millennial growth continued. Advertising revenue grew at a mid-single digit rate. The company’s advertising is better than most competitors, with more exposure to stable categories than others have. Affiliate fee revenue growth is expected to grow at a mid-to-high-single digit rate, and programming cost growth should continue to decelerate. Part of the stock’s discount is related to its international expansion opportunity which has not produced profits yet but has created startup costs and noncash amortization. The company purchased the remaining 35% of The Travel Channel that it did not own and sold its 7.25% stake in Fox Sports South & Southeast.

**CONSOL Energy** (+43%; +1.3%), the Appalachian coal and natural gas company that was among top detractors in 2015, added meaningfully to first quarter results. Management adjusted to lower commodity prices by adopting significant cost controls and expects positive free cash flow (FCF) in 2016. Early in the quarter, CONSOL announced it was lowering capex by more than 50% from previous guidance. The company also reduced operating expenses, effectively decreasing its Debt/Operating Cash Flow ratio from 3.8 to 3.6. As we continued our constructive dialogue with management regarding asset monetization, CONSOL announced the addition of three new board members, two of whom we suggested. Additionally, Will Thorndike, whom we previously recommended as a board member, replaced Brett Harvey as Chairman. Shortly thereafter, CONSOL sold its Buchanan mine and other met coal assets for $420 million to a private equity-backed firm. The sale was accretive to the value of CONSOL, and management is...
pursuing additional asset sales.

**CK Hutchison** (-4%; -0.6%), a Hong Kong-based global conglomerate comprised of four primary businesses (retail, telecommunications, infrastructure and ports), is our second largest position and was the main performance detractor in the quarter. China economic fears and weakness in the Hong Kong dollar (HKD) weighed on the stock. Conversely, the businesses’ values remained stable with less than 15% of its economic exposure in China and Hong Kong. Chairman Li Ka-shing and his son, Victor Li, have demonstrated a compelling track record of building companies, compounding net asset value at double-digit rates, and buying and selling assets at attractive prices. Last year, CK Hutchison announced plans for its Three U.K. telecom business to acquire U.K. telecom company O2. Although still pending regulatory approval, the deal would allow the company to recognize significant synergies, estimated at £3 billion.

**Portfolio Changes**

We exited three holdings during the quarter, including our successful long-term investment in **Aon**. We first purchased the stock in the second half of 2002, when the low point fell to near $14 per share. We bought again in 2009 and 2010 between the mid $30s and low $40s. Over time, the company went from being the second largest insurance broker in the world to the largest and also built its benefits and consulting business into a leading global competitor. Under the leadership of Greg Case, Aon grew revenues, expanded margins, reduced corporate taxes, and repurchased substantial shares at discounted prices. Value per share grew, and ultimately we exited in March at more than $100 per share. We are grateful for Greg’s superior stewardship, and we hope to have an opportunity to partner with him in the future.

We sold **National Oilwell Varco** (NOV), a global provider of equipment and components used in offshore and land drilling, negatively impacted performance before we sold it in March. When we initiated the position in the third quarter of 2015, we believed that NOV’s higher margin rig aftermarket business would grow, even as new oil rig purchases were canceled or delayed in the lower oil price environment. Our thesis did not hold up as rig operators cannibalized used parts from idled rigs, pressuring prices and ultimately lowering NOV’s aftermarket margins. We exited at a loss when the stock price partially recovered after oil moved from below $30 toward $40.

As discussed in our year-end report, we sold our small remaining position in global quick service restaurant operator **McDonald’s** as 2016 began. During the year plus that we owned the stock, it gained almost 30% and was among the strongest contributors to performance. We appreciate the board’s and management’s solid execution.

**Outlook**

We believe the strong absolute and relative returns we posted in the first quarter should be indicative of our expectations going forward. Many of our top performers rallied from unsustainably low levels to a more normal discount range and have substantial additional upside potential. The portfolio price-to-value (P/V) in the mid-60s% offers an attractive buffer between our conservative appraisals and our companies’ underlying stock prices, especially in a market where we are finding very few new opportunities. Our 19% cash position reflects the limited qualifiers but will enable us to take advantage of additional market volatility or the next great business that becomes deeply discounted. Many of our holdings have management teams pursuing operational improvements as well as strategic alternatives that can build material value.

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RISKS

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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.

Operating Cash Flow (OCF) measures cash generated by a company's normal business operations.

A basis point is one hundredth of one percent (0.01%).

As of March 31 2016, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Wynn Resorts, 6.1%; Scripps Networks, 5.1%; CONSOL, 3.9%; CK Hutchison, 8.5%; Aon, 0.0%; National Oilwell, 0.0%; McDonald’s, 0.0%. 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.

Funds distributed by ALPS Distributors, Inc.
Longleaf Partners Fund Commentary

Longleaf Partners Fund’s 5.47% advance in the quarter brought the 2015 return to -18.80%. These results fell below the S&P 500’s gains of 7.04% and 1.38% for the same periods. The Fund’s energy-related holdings were the leading detractors for the quarter and the year due to the sharp decline in energy prices. Since its inception, the Fund has outperformed the index.

Our energy companies dampened the Fund’s otherwise strong absolute and relative performance in the fourth quarter and drove the vast majority of negative returns and relative underperformance for the year. Although our energy price assumptions have been wrong, we believe that Chesapeake Energy and CONSOL Energy could rapidly rebound with major asset sales and when oil and gas prices correct as supply and demand eventually rebalance. At both companies, our management partners are taking action by cutting costs, increasing financial flexibility, and selling assets to ensure the companies can withstand the difficult commodity environment. The other large factor negatively impacting performance during the year was a higher-than-average exposure outside of the U.S., where we see larger discounts and greater opportunity for future growth. 31% of assets are in companies headquartered outside the U.S., and the conversion of prices to U.S. Dollars from weaker currencies cost the Fund over 4% in performance last year. Additionally, the portfolio had an indirect impact from revenues based outside of the U.S.—look-through revenue exposure to overseas developed markets was 21% and to emerging markets was over 31% of the portfolio. Like energy, the overseas exposure has been a driver of underperformance since late 2014, as U.S. markets, fueled primarily by larger cap momentum stocks, continued their outperformance over non-U.S. markets. While we believe both of these portfolio exposures offer more substantial discounts and greater upside than the S&P 500, the short-term negative performance masked the positive progress across the majority of our businesses in the year. When the sentiment turns, we believe the payoff can come quickly.

After being a top contributor in the fourth quarter and adding 25%, Level 3 Communications gained 10% for the full year. Over the course of the year, operating metrics continued to improve. During the fourth quarter, company segment Core Network Services’ (CNS) organic revenue grew 6% year-over-year. Within CNS, Enterprise revenue grew 8%. This revenue growth, combined with the synergies created by the merger with tw telecom, resulted in margin expansion. The high contribution margins, which are currently over 60%, have been one of the focal points of our Level 3 investment case and are one of the primary drivers of high growth in both EBITDA (earnings before interest, taxes, depreciation and amortization) and FCF (free cash flow) growth. In 2016, we believe the company will generate approximately $5.00/share of FCF before discretionary growth capital expenditures, which translates to approximately 10x FCF on current price. The company’s success-based growth capex is tied to new, high margin, revenue-producing contracts. Given management’s excellent execution, we expect leverage ratios to continue to improve from their current 4x debt/EBITDA levels into the 3x’s.

Also a top performer, DuPont rose 39% in the fourth quarter making it a significant contributor for the quarter and the year. Over the last four months much transpired. In October, Chair and CEO Ellen Kullman retired and board member Ed Breen assumed the CEO role, quickly articulating that deeper operating cost and capital spending savings were achievable, and announcing consideration of all possibilities for the Agriculture business. In December, DuPont and Dow Chemical announced an all-stock “merger of equals.” After the deal closes, the company plans to separate into three companies focused on agriculture, material science, and specialty products. This separation should allow more operational focus at each company and more efficient capital allocation. Our appraisal increased following the merger announcement.

Alphabet (formerly named Google) gained 51% for the year on the back of a 25% rise in the fourth quarter. The company reported strong revenue growth year-over-year across the U.S., U.K., and the rest of the world. The bear case that the move to mobile search would be detrimental to revenues and market share seemed to fade. Mobile queries now outnumber desktop queries in important countries, and mobile revenue per click is improving. Alphabet segment YouTube’s growth remained strong, and the company announced a new pay tier named Red. Disclosure should improve with new reporting of segments in January. During the fourth quarter, a new share buyback program was authorized, further affirming the company’s attention to capital allocation.

Average Annual Total Returns (12/31/15): Since Inception (4/8/87): 10.08%, Ten Year: 3.28%, Five Year: 4.97%, One Year: -18.80%

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.

The total expense ratio for the Longleaf Partners Fund is 0.91%. The Funds’ expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.
Another notable contributor in the quarter, Wynn Resorts, the luxury gaming and hotel company with prime real estate in Las Vegas, Boston, and Macau, was up 31% but down 47% since we first added the position earlier in the year. The stock became deeply discounted as China’s anti-corruption campaign pressured revenues in Macau where Wynn is among six current operators and is scheduled to open the Wynn Palace in Cotai in June 2016. During the recent quarter, Macau sentiment began to turn as revenues stabilized. CEO Steve Wynn demonstrated his commitment and confidence in the business, purchasing over one million shares in early December and bringing his stake in the company to nearly 11%. Year-over-year comparable gross gaming revenues should improve in 2016, and Wynn cash flow will be bolstered with the Cotai property coming online. Longer term, we believe the company can generate impressive returns. Macau revenues from mass and premium mass visitors should grow with added non-gaming attractions, needed hotel room supply, and infrastructure improvements that bolster arrivals. Additionally, the Wynn Everett is in early site preparation with a strategic location just outside of Boston, but its value is not reflected in the stock price because it is several years from opening. Opportunities to partner with proven value creators like Steve Wynn at such a large discount to our appraised value exist over time, but rarely do we see one where the near-term market extrapolations are so distinct from the long-term earnings power of the company.

CK Hutchison, a conglomerate comprised of the non-real estate businesses from the June merger between Cheung Kong and its subsidiary, Hutchison Whampoa, returned 23% during 2015 when combined with Cheung Kong Property. The corporate transaction helped remove holding company discounts and clarify business line exposures by splitting the conglomerate between the property business (Cheung Kong Property Holdings) and the non-property business (CK Hutchison Holdings). The transaction is likely to be viewed as a seminal event leading to improved governance and structure for other complex conglomerates in Asia. Chairman Li Ka-shing and his son, Victor Li, have demonstrated a track record of building businesses and buying and selling assets at compelling values.

During the quarter, we began exiting our successful investment in global quick service restaurant operator McDonald’s and completed the sale in the first week of 2016. The stock was a strong contributor for the year, up 31%, and the last three months, up 21%. When we initially purchased the company in late 2014, we believed management could overcome short-term obstacles and turn around same-store sales in certain struggling markets. Additionally, we saw optionality in the value of the company’s real estate assets. Over the course of our investment, McDonald’s hired a new CEO, Steve Easterbrook, a move welcomed by investors. His plan to revive the business both operationally and structurally helped drive the stock price. Although management and the board decided not to monetize the real estate assets, the stock price reached our appraised value in an unexpectedly short period. Over the year plus that we owned the stock, it gained 34% and was among the strongest contributors to performance. We appreciate the board’s and management’s solid execution. We hope that Mr. Market gives us an opportunity to partner with them in the future.

As noted, Chesapeake Energy, the second largest producer of natural gas in the U.S., declined 39% in the quarter and 77% for the year, making it the largest detractor of performance in both periods. Options accounted for 40% of our position and slightly half of our return. Fears related to further declines in energy prices drove the stock lower, despite CEO Doug Lawler’s progress in areas he could control. After reaffirming the company’s untapped $4 billion revolving credit facility and renegotiating a deal with Williams (pipeline operator), in the fourth quarter Chesapeake turned to restructuring its debt. Chesapeake offered to exchange various unsecured debt securities at a discount to par for secured debt with a later maturity. Pushing out due dates coupled with reducing overall debt outstanding should help the company weather a sustained low energy price environment.

Over the year we adjusted our appraisal of Chesapeake to account for the tumble in oil and natural gas prices. Even with the depressed energy prices of today and little growth in that price as indicated by the futures strip pricing, the company’s non-producing assets have value that is not reflected at all in the stock price. Asset sale transactions in basins where Chesapeake operates helped validate our appraisal. We expect the company will continue to reduce costs while also seeking asset sales at fair prices. We are mindful of the risks associated with commodity companies. Once the debt restructuring was announced, we added to higher parts of the company’s capital structure that became particularly discounted.

During the quarter, Brad Martin assumed the role of non-executive Chairman of the Board from Archie Dunham, who became Chairman Emeritus. Martin has been a productive partner for Southeastern in other successful investments including Saks, Dillard’s and FedEx. We are confident that management, coupled with the board, can navigate the company through what has been and continues to be a severely challenging energy price environment.

Also previously mentioned, CONSOL Energy, the Appalachian coal and natural gas company, was down 76% in 2015 after falling 19% in the fourth quarter as the company missed operating cash flow (OCF) estimates amidst declining coal and gas prices. Management is adjusting to lower commodity prices and adopted significant cost controls under zero-based budgeting while still growing natural gas production. We filed a 13-D during the third quarter to discuss with third parties as well as management and the board a potential monetization or separation of the valuable Marcellus and Utica gas assets. This has been a constructive process since filing, and we appraise these assets at worth demonstrably more than CONSOL’s total equity capitalization. CONSOL’s exploration and production (E&P) business is unique, with low cost reserves given the company’s fee ownership of many acres. CONSOL announced in the fourth quarter that its thermal coal business, which enjoys a low cost position, had contracted for 93% of production for 2016 at a confirmed price of $50-55 per
ton, providing near-term downside coal business risk mitigation. Multiple directors recently purchased shares.

In the fourth quarter, we sold Murphy Oil, an E&P company with a portfolio of global offshore and onshore assets, after the stock declined 51% and was among the Fund’s largest detractors for the year. Following several disappointing drilling results and a lack of management plans for near-term ways to go on offense, we redeployed this capital into the high-quality franchise of National Oilwell Varco.

We repositioned the portfolio during the year, exiting eight businesses (two in the fourth quarter) and adding seven new holdings (one in the fourth quarter). In the first half, we sold four top performers that reached our appraisals. Over the last six months, we sold an additional four businesses whose values declined, including Murphy Oil and Loews in the fourth quarter. Loews, the holding company owned and managed by the Tisch family, remained undervalued, but we found more attractive opportunities in companies that we believe can build value per share in the current environment. Among our new investments, Alphabet and DuPont have been strong performers in a short period. Wynn, Lafarge Holcim, and National Oilwell Varco had stable appraisals but became more discounted in the year.

Although our 2015 performance was disappointing, we believe the Partners Fund is well positioned for a strong rebound. The Fund’s price-to-value (P/V) ratio is in the high-60s%. The year’s three major detractors that we still hold sell for less than 40% of our appraisals, and our four largest positions, three of which were among our top contributors for the year, remain discounted with solid valued growth prospects. In addition to these discounts, the high quality of our businesses and the caliber of our management partners, who are pursuing all available avenues to drive value recognition, make us confident in future results. The Federal Reserve raised interest rates for the first time in more than nine years in December. We believe the portfolio can benefit from a rising rate environment since the large majority of our businesses have strong balance sheets, many with net cash, and most companies have pricing power or gross profit royalties on revenues. Higher interest rates will not lower our net present value (NPV) valuations because we have maintained an 8–9% discount rate. Additionally, the Fund does not own the segments of the market that have been driven by yield chasing and could shift rapidly with higher rates. As the largest investors in the Fund, we know it has been a difficult year to be a Longleaf shareholder, but we are confident that the Fund should reward your patience and ours. Thank you for your partnership.

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

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Operating Cash Flow (OCF) measures cash generated by a company’s normal business operations.

Net present value is the difference between the present value of cash inflows and the present value of cash outflows.

Derivatives may involve certain costs and risks such as liquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested.

As of December 31, 2015, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Chesapeake Energy, -0.8%(5.0% adjusted for close of options and purchase of underlying stock); CONSOL, 2.7%; Level 3, 10.2%; DuPont, 4.9%; Alphabet, 9.7%; Wynn Resorts, 7.5%; CK Hutchison, 10.7%; McDonald's, 3.0%; National Oilwell, -0.5%(4.6% adjusted for close of options and purchase of underlying stock); LafargeHolcim, 5.2%. 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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Over the last three months, several of our companies’ stocks suffered from the broad fears that China’s slower economic growth would negatively impact parts of their underlying businesses, but our energy investments continued to be a primary driver of underperformance. Oil prices fell more than 50% over the last year—something that has happened less than 2% of the time in the last 115 years.1

The portfolio’s largest contributor during the quarter, Google, rose 17% on the back of strong operating results and an announced new corporate structure. The company’s core search and display business demonstrated healthy, accelerating organic revenue growth. The move to mobile search is helping Google, rather than hurting it as some bears had feared. YouTube is also performing well, as its average viewing session per user on a mobile device is over 40 minutes, up more than 50% year-over-year. Beginning in the fourth quarter, Alphabet Inc. will replace Google Inc. as the publicly-traded entity. Google will become a wholly-owned subsidiary of Alphabet, and all outstanding Google shares will convert into the same number of shares of Alphabet. This means the company will report two segments—the search and YouTube core business and all other business lines. Management believes the new structure will allow for more management scale and accountability as each Alphabet subsidiary will have its own CEO. Larry Page, Sergey Brin, and Ruth Porat will remain in their same roles as CEO and Co-Founder, Co-Founder, and Chief Financial Officer.

Another top contributor in the Fund, McDonald’s stock gained 5% in the quarter, demonstrating the resiliency we saw in 2008 when it was one of two stocks with a positive return in the Dow Jones. Since taking the helm of the company, CEO Steve Easterbrook has announced initial plans to reshape and turn around the business. Comparable store sales are showing broad signs of improvement in key international markets such as Germany and China. On the capital allocation front, the company continued to repurchase shares at a strong pace (7% annualized) and indicated that pace should continue. The company is also undergoing a review of its capital structure and working to re-franchise stores at attractive values.

As one of our energy holdings, Murphy Oil, an exploration and production company with a portfolio of global offshore and onshore assets, was a primary performance detractor, down 41% in the quarter, with approximately half of the impact coming from the equity we hold and the other half from the options. This happened despite beating estimates on production and operating cash flow (OCF) and raising production estimates for the rest of the year. Murphy management is focused on driving costs lower and shortening drill times while improving production efficiency to reduce capex to cash flow levels. Furthermore, after disappointing international drilling results in recent years, the company will not invest in higher risk, higher cost wells at this time; instead, management plans to focus rig commitments and to allocate capital to higher return opportunities near lower-risk existing infrastructure where the company has had prior exploration success. Murphy remains well capitalized with diverse cash flow sources and an investment grade rating. It also has non-core pieces that could be monetized to unlock value. CEO Roger Jenkins continues to repurchase shares at the company level and invest personally.

Wynn Resorts, the luxury gaming and hotel company with properties in the United States and Macau, was down 45% in the third quarter. Wynn Palace-Cotai is expected to open in March, and the company commenced site remediation for Wynn Everett-Boston, yet the stock price reflects no value for these assets before they generate revenues. While gross gaming revenue continues to decline in Macau, bears are extrapolating poor results forward and ignoring the potential for Wynn to gain market share next year upon the opening of Palace. The company sells for roughly our appraisal of its Las Vegas properties plus its Boston concession, after net debt. The stock price implies almost no value for Macau, even though the depressed market value of its 72% stake in Wynn Macau (down YTD from HKD 21.85 to HKD 8.78) is worth around $50 per Wynn share. Even bear case analysts project higher visitors and revenues in Macau over the next five years, but the uncertainty of the next 12 months translates into minimal value for Wynn’s Macau properties today.

1 Source: globalfinancialdata.com

Average Annual Total Returns (9/30/15): Since Inception (4/8/87): 9.96%, Ten Year: 2.81%, Five Year: 5.96%, One Year: -21.89%

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.

The total expense ratio for the Longleaf Partners Fund is 0.91%. The Funds’ expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.
CONSOL Energy fell 55% in the quarter after disappointing revenue and earnings on weaker-than-expected thermal coal production and negative natural gas differentials versus the New York Mercantile Exchange. Management is adjusting to lower commodity prices with cost controls and took steps to recognize the value of CONSOL’s coal assets by offering shares in the master limited partnership (MLP) CNX Coal, which generated $200 million in proceeds. We filed a 13-D during the quarter to discuss with third parties as well as management and the board a potential monetization or separation of the valuable Marcellus and Utica gas assets. We believe these assets alone are worth demonstrably more than CONSOL’s total equity capitalization. They are unique, low cost reserves given the company’s fee ownership of many acres. CONSOL is exploring monetization paths for all of its assets, including thermal coal, metallurgical coal, pipelines, and the Baltimore port terminal.

One of the largest producers of natural gas, natural gas liquids, and oil in the U.S., Chesapeake Energy declined 34% in the quarter. In line with our exposure, about 60% of the impact came from the options we own and the remainder from the common equity. Concerns remain over the company’s liquidity profile, but management made major strides to improve realizations by successfully renegotiating two contracts with pipeline operator Williams that reduces transportation costs. Additionally, on October 1 the company announced the renewal of its $4 billion credit facility. Comparable asset sales in overlapping basins, such as Encana’s sale of Haynesville assets, further confirmed our appraisal of Chesapeake. The company’s shares remain more heavily discounted than its peers, yet CEO Doug Lawler is keenly focused on realizing value for shareholders even in this depressed energy price environment. Further reducing costs, including the recently announced 15% headcount reduction, coupled with asset divestitures, should lead to a stock price more in line with intrinsic value, which we appraise at twice the current price assuming the underlying commodity prices remain depressed.

Fiber and networking company Level 3 Communications declined 17% as concerns about near term top-line growth rates outweighed improvement in margins and free cash flow (FCF) generation. During the quarter, the company reported organic revenue growth across North America and EMEA (Europe, Middle East, and Africa) in line with expectations, while Latin America, which represents approximately 10% of consolidated revenue, had weaker growth mainly due to currency. The integration of tw telecom remains on track with synergy realizations ahead of schedule. Level 3 already has achieved approximately $15 million of annualized run-rate EBITDA synergies, and the company should achieve 70% or $140 million of its annualized synergy target by the end of the first quarter of 2016. FCF growth at Level 3 is ramping up and, we believe, marching toward explosive FCF growth on a per share basis in the next few years as a result of the business’ strong incremental margins, the aforementioned tw telecom synergies, and continued debt reduction and refinancing. During the quarter, major bond rating agencies upgraded approximately $11 billion of the company’s rated debt and credit commitments, further proof of Level 3’s improving business and financial profile.

We bought two new positions in the Fund during the quarter. Weakness in global agricultural markets provided an opportunity to purchase DuPont, a science-based company in agriculture, safety, high-performance materials, nutrition, electronics & communications, and industrial bioscience. With corn and soybean prices down significantly, less acreage is being planted worldwide. This lowers demand for DuPont Pioneer’s seeds and crop protection products that make up 50% of the value of the company. The company has spun off non-core units and accelerated cost reductions. After quarter end, CEO Ellen Kullman resigned. Interim CEO and board member Ed Breen has a great track record rationalizing and realizing value of business segments in his prior jobs.

We also initiated a position via options in National Oilwell Varco, the leading global provider of equipment used in offshore and land drilling. Fear of a prolonged downturn in deep water rig orders is more than accounted for in the current price and is giving us an opportunity to invest in a high-quality franchise during a cyclical trough. The company holds a dominant market position due to its scale, trusted brands, and large installed base of equipment. Shareholders are benefitting from a 5% dividend yield while waiting for the rig building cycle to resume. Additionally, CEO Clay Williams is a strong capital allocator who we believe should continue to build value through share repurchases and acquisitions of distressed companies.

As we found more discounted opportunities in the third quarter, we sold Franklin Resources and Vivendi. We hope to partner again with CEO Greg Johnson if Franklin Resources’ large and broad global distribution network becomes significantly undervalued again. French media company Vivendi returned 4% since we purchased it in the third quarter last year. In that time, Chairman Vincent Bolloré sold non-core businesses SFR and GVT and returned capital to shareholders via special dividends. Despite our frustration over recent returns, we believe that the positive fundamentals of the companies we own will be reflected in their stock prices. The Fund has three categories of companies that we see driving returns. Roughly 60% of the portfolio is a collection of what we feel are industry leading businesses that have the competitive strength and management leadership to compound value per share at a potentially high rate. Based on our appraisals, as a group this category of holdings sells for below 65 cents on the dollar and, on average, less than 12X after-tax free cash flow (real cash P/E). Prospects for these holdings’ value growth, especially as a diversified basket, are greatly enhanced due to their combinations of pricing power and gross profit royalty status. Their management’s track records and ownership alignment suggest strongly that these steadily growing free cash flow streams should be reinvested to build even more corporate value.

In our opinion, this group includes the best global digital fiber network in Level 3 Communications, the highest-quality global conglomerate in CK Hutchison, the world’s number one insurance and risk broker in Aon, the world’s largest and superior search engine in Google, the world’s best delivery network in FedEx, the best U.S. cable channel company with HGTV and Food Network (via Scripps Networks), the world’s
most compelling real estate company in Cheung Kong Property, the world’s best casino developer and operator in Wynn, and the most dominant worldwide cement oligopolist in LafargeHolcim. These companies are among those that offer a combination of competitive advantages, business safety, balance sheet strength, and glaring undervaluation that gets lost in the focus on the few names that have hurt recent results. As the largest portion of the Fund, however, it is this group of holdings that we look to as the primary long-term driver of potential future outperformance.

The second category of holdings includes companies being led through transitions by strong partners who are focused on growing and unlocking values by highlighting their competitive business segments and/or reinvesting substantial cash in high-return opportunities. McDonald’s has discussed capitalizing on its increasingly valuable real estate and becoming a fee company; in our view, CNH Industrial should eventually become a pure-play agricultural equipment company, second only to Deere; Philips is heading toward becoming a leading healthcare company; and DuPont has multiple ways to refocus and improve. This group comprises about one-quarter of the portfolio and we feel should drive performance when the gap between price and value closes as our management partners lead these transitions.

The third category contains our energy holdings which, as a bucket, are down over 60% year-to-date (YTD), constituting a bona fide crash rather than a mere bear market. The momentum-driven heavy selling and shorting of this “crash bucket” has gotten so out of hand that we feel the companies’ recovery is a large part of our significant potential future return. Even though qualitatively Wynn is in the first category above, its severe undervaluation positions it similarly to our energy investments for a big near-term recovery. To be clear, we do not think these stocks will do well simply because they are down. We believe their long-term fundamentals under the stewardship of their capable leaders should drive prices as contrasted to the short-term perceptions. In the case of our energy holdings, we are not reliant on an energy rebound to move the stocks higher, as our appraisals are over twice the current stock levels based on current depressed commodity futures pricing. Should oil and gas prices move back to their much higher marginal cost of production, the values of these stocks would be materially more. These energy holdings represent less than 10% of the Fund, and while we put them in their own group, they share many of the same compelling attributes described in the second category above.

Although we cannot predict short-term prices, we believe the Partners Fund has reached an attractive level for long-term investors to add capital. The Fund’s price-to-value (P/V) ratio is in the low-60s%, and the sharp uptick in global market volatility, which has now reached its highest level since 2011, has been a precursor to strong Fund returns in the past. While a useful data point, this historic performance is not the basis for our confidence in returns going forward. The competitiveness of our businesses, our extremely capable management partners, and the attractive margin of safety in our companies’ stock prices make us highly confident that the companies we own can perform well and reward your patience and ours.

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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. An index cannot be invested in directly.

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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.

Dividend yield is a stock’s dividend as a percentage of the stock price.

Derivatives may involve certain costs and risks such as liquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested.

As of September 30 2015, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Level 3, 11.9%; CK Hutchison, 8.6%; Aon, 7.5%; Google, 6.4%; FedEx, 6.4%; McDonald’s, 5.5%; Loews, 5.1%; Cheung Kong Property, 5.0%; CNH, 5.0%, Philips, 4.9%, Wynn Resorts, 4.9%, DuPont, 4.2%, LafargeHolcim, 4.2%, National Oilwell, 0.0% (held via derivative, 3.2% adjusted for close of options and purchase of underlying stock), CONSOL, 2.7%, Murphy Oil, -0.7% (held via derivative, 1.8% adjusted for close of options and purchase of underlying stock) Chesapeake, 0.4% (held partly via derivative, 5.0% adjusted for close of options and purchase of underlying stock). 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.

Funds distributed by ALPS Distributors, Inc.
Partners Fund Management Discussion

Longleaf Partners Fund’s 2.98% decline in the quarter brought the year-to-date return to -4.03%. These results fell below the S&P 500 Index’s returns of 0.28% and 1.23% for the same periods. For the last three and five years, the Partners Fund exceeded our annual absolute return goal of inflation plus 10%, despite falling short of the index. The Fund’s disappointing results over the last year have negatively impacted our longer-term relative performance. Large swings in relative returns are not unusual in our concentrated portfolio and have contributed to our outperformance over 15+ year periods.

In the second quarter, the majority of our companies made positive business progress, as our management partners took smart actions to drive value growth. Double-digit returns at top performer CK Hutchison (formerly Cheung Kong) demonstrated how quickly share price can respond to productive corporate activity. However, much of our partners’ value-building efforts at the businesses we own is not being fully reflected yet in their stocks. Our energy-related companies, where a meaningful amount of beneficial activity has occurred and is ongoing, were the largest drag on relative and absolute performance in the quarter.

During the quarter, the portfolio’s largest contributor, CK Hutchison, merged with its 50% owned subsidiary, Hutchison Whampoa, and spun off their combined real estate businesses into Cheung Kong Property. With the stock’s move from HK$125 prior to the restructuring announcement in January to HK$196 for the combined pieces after the spin in June, this corporate restructuring succeeded in reducing two persistent discounts the market applied to CK Hutchison. First, the complexity of the corporate structure and diversified set of businesses within two layers of holding companies made valuing the company difficult. Second, market concerns related to property exposure in Hong Kong and China has weighed heavily on the stock. CK Hutchison was the largest constituent of the Hang Seng Property Index, yet many property investors could not own the stock given its significant non-property businesses. The restructuring creates a pure play property company – Cheung Kong Property – and moves CK Hutchison from the Hang Seng Property Index to the Hang Seng Conglomerates Index.

Also a top performer in the quarter, global capital goods company CNH Industrial rose 15%, as stronger corn prices helped the outlook for agricultural equipment and orders for commercial trucks increased. These short-term indicators are far less important to our investment case than CNH’s long-term competitive position alongside Deere. The company’s ability to raise prices during a time of huge unit declines is testament to its franchise strength. Notably, demand for the company’s IVECO commercial vehicles improved materially in the Europe, Middle East and Africa regions with the forward order book growing almost 20% year-over-year. IVECO has cut costs and rationalized its production footprint which should enable CNH to improve margins. In its agriculture equipment segment, CNH decreased production for high horsepower tractors and combines by around 40% to help control farm inventory. CEO Rich Tobin and his team have managed well through what has been a tough environment, especially for agricultural equipment.

French media company Vivendi returned 11% in the quarter after reporting top line revenue growth at underlying businesses Universal Music Group and Canal+. Vivendi received the initial payment for its 20% stake in SFR and completed its sale of Brazilian telecommunications company GVT for an enterprise value of €7.5 billion. Vivendi paid a €1 per share interim dividend in June, with another planned in February 2016. Chairman Vincent Bolloré increased his stake in Vivendi to over 14%. Effective March 2016, France will reward long-term owners by granting double voting rights on registered shares held for at least two years, and Mr. Bolloré received the rights at the recent annual general meeting. Given his
Partners Fund Management Discussion

Stock prices have yet to reflect past improvements or significant ones our managements are currently pursuing.

As noted, our energy-related holdings were the primary performance detractors. Over the last year we have adjusted our valuations for the more austere conditions following dramatic oil, gas, and coal declines. However, our asset quality and capable leadership teams make us confident that these companies should be meaningful contributors to strong returns. Any bounce back in commodity prices will be additional upside. The lower commodity prices have served as a catalyst to sharpen our management partners’ focus on how best to optimize the returns on their valuable assets. Our discussions with them have been ongoing and productive over the last few years, and have contributed to adding board members, monetizing assets, selling all or portions of reserves, and separating disparate segments. In spite of major progress, the work is ongoing. Stock prices have yet to reflect past improvements or significant ones our managements are currently pursuing. We expect to see additional value accretive activity in the remainder of the year, and we believe that our energy stocks could rise appreciably as they reflect these initiatives.

Chesapeake Energy, one of the largest producers of natural gas, natural gas liquids and oil in the U.S., declined 21% in the quarter. In line with our Chesapeake options accounting for slightly over half of our position exposure, the options accounted for a similar portion of the return. The company reported results in line with our expectations, but the stock was punished when Chesapeake failed to close the gap between operating cash flow (OCF) and capital expenditures (capex) as much as investors wanted. Full year expectations for 45% capex reductions versus 2014 remain intact, and the OCF gap is expected to close by year-end. The company maintains strong liquidity, irrespective of low commodity prices, with $2.9 billion in cash and a $4 billion untapped credit facility. The company’s valuable assets support our appraisal, which held steady in the quarter as oil and gas prices stabilized somewhat. CEO Doug Lawler has proven that he is willing and able to monetize assets at attractive prices, and we have a heavily vested board that is fully engaged to build and recognize value per share.

CONSOL Energy fell 22% in the quarter despite reporting OCF above Wall Street expectations and buying in shares at a 4% annualized pace. Positive gas basis differentials versus NYMEX and good cost control at the Buchanan metallurgical coal mine contributed to the solid results but could not overcome the continued pressure on coal prices. In adjusting to the current commodity price environment, the company announced several cost-cutting measures, including a move to zero-based budgeting. As expected, CONSOL monetized non-core thermal coal assets in the Bailey Mine Complex by offering shares in the master limited partnership (MLP) CNX Coal, which generated $200 million in proceeds. The price was below earlier expectations because of lower coal prices. Management is pursuing additional monetization opportunities where proceeds can be reinvested in higher return alternatives, including CONSOL’s deeply discounted shares.

Wynn Resorts, the luxury gaming and hotel company with properties in the United States and Macau, lost 21% in the second quarter. Although Wynn’s Las Vegas casino reported a disappointing quarter, the stock was most impacted by Wynn’s decision to cut its dividend from $6/share to $2/share to provide financial flexibility with the uncertain Macau environment where the Chinese government’s ongoing corruption crackdown has reduced gross gaming revenue (GGR) significantly. Over the next few years, the declines should reverse as new casinos with diverse non-gaming attractions and much-needed hotel room supply, as well as ongoing government investments in infrastructure, will facilitate more visitors to Macau. More immediately, the reversal of the transit visa restriction announced on June 30 is the first sign of supportive regulatory policy to improve
economic conditions in Macau. This should be positive for VIP and premium mass volumes. CEO Steve Wynn has positioned the company to weather the downturn while having a pipeline of casinos for future growth. Wynn’s Palace is under construction and set to open in Macau’s Cotai Strip in 2016, and the Boston-area casino is advancing through the planning stages. These construction demands on cash were a bigger driver of the dividend cut than the current level of cash flow from Macau.

We initiated a position in Lafarge during the quarter, and we sold our successful investment in Bank of New York Mellon as price approached our appraisal. Over our five-plus year holding period, the stock returned 83%.

We believe the Partners Fund is well positioned to meet our absolute goal and deliver strong relative performance. The price-to-value ratio (P/V) is in the low-70s%, with effective cash below 4%. The Partners Fund’s composition is dramatically different than the S&P 500’s with 30% of the portfolio in global companies domiciled outside the U.S. and 16% in two of the only broad industries that are dramatically undervalued – energy and Macau gaming. We believe these portfolio differences will help drive future outperformance as the U.S. market has no margin of safety, with mergers, acquisitions, initial public offerings (IPOs), and share buybacks near 2007 peak levels and at multiples well above our appraisals. We remain focused on owning discounted, strong businesses that can generate organic value growth and that have good managements who are pursuing opportunities to build and monetize value per share. We are engaged to varying degrees with our management partners and believe their near-term steps to close the gap in price will reward us.

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As of June 30 2015, the holdings discussed represented the following percentages of the Longleaf Partners Fund: CK Hutchison, 7.1%; CK Property, 4.1%; CNH Industrial, 5.8%; Vivendi, 3.9%; Chesapeake Energy, 1.9%; CONSOL Energy, 4.4%; Wynn Resorts, 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.

Funds distributed by ALPS Distributors, Inc.
Partners Fund Management Discussion

Longleaf Partners Fund declined 1.09% in the first quarter, trailing the S&P 500 Index’s 0.95% gain. While the Partners Fund has lagged the Index in the recent periods shown below, the Fund’s longer term outperformance over 15, 20, and 25 years reflects other stretches of falling behind the index followed by bursts of strong relative returns.

Cumulative Returns at March 31, 2015

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<tr>
<th></th>
<th>Since Inception</th>
<th>25 Year</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1821.17%</td>
<td>1302.92%</td>
<td>536.17%</td>
<td>224.51%</td>
<td>76.13%</td>
<td>71.19%</td>
<td>3.50%</td>
<td>-1.09%</td>
</tr>
<tr>
<td>(Inception 4/8/87)</td>
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<tr>
<td>S&amp;P 500 Index</td>
<td>1235.74</td>
<td>934.05</td>
<td>502.33</td>
<td>84.03</td>
<td>116.10</td>
<td>96.51</td>
<td>12.73</td>
<td>0.95</td>
</tr>
</tbody>
</table>

Average Annual Returns at March 31, 2015

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>25 Year</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>11.14%</td>
<td>11.14%</td>
<td>9.69%</td>
<td>8.16%</td>
<td>5.82%</td>
<td>11.35%</td>
<td>3.50%</td>
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<tr>
<td>(Inception 4/8/87)</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>9.70</td>
<td>9.79</td>
<td>9.39</td>
<td>4.15</td>
<td>8.01</td>
<td>14.47</td>
<td>12.73</td>
</tr>
</tbody>
</table>

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.

The total expense ratio for the Partners Fund is 0.91%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.

During the quarter the majority of our businesses had solid operating performance, coupled with value-accretive actions taken by our management partners. Many names were positive performers. Despite positive progress across the portfolio, the persistence of two broad headwinds – falling energy prices and U.S. dollar strength – weighed on returns. Our energy-related holdings were the largest return detractors and erased what otherwise was benchmark outperformance. We had positive local returns in our three European holdings, but the currency translation into U.S. dollars negatively impacted absolute and relative performance by 1.6%.

The Partners Fund’s largest positive contributor, CK Hutchison (formerly Cheung Kong), announced its intention to merge with subsidiary Hutchison Whampoa and spin out the combined property company. This latest savvy move by founder and CEO Li Ka-shing should lessen the holding company discount on the stock as underlying business exposures are clarified and the spin off highlights the value of the combined property business. The stock gained 22% during the quarter. An independent valuer recently appraised CK Hutchison’s property business 48% higher than stated book. The company’s high profile dramatic restructuring of a blue chip Asia conglomerate has the potential to unleash similar restructurings in the region. Fiber and networking company Level 3 Communications appreciated 9% after another strong quarter of margin and

Our management partners are taking actions to drive strong value growth and, in many cases, are creating catalysts for value recognition.

revenue growth. The integration with recently merged tw telecom is proceeding smoothly as the transaction enhances Level 3’s competitive positioning with a complementary product set and larger footprint. Level 3’s growth in its North American enterprise business remains solid as CEO Jeff Storey and his team invest in expanding its fiber network and portfolio of connected buildings.

The largest detractor in the quarter was Chesapeake Energy, one of the largest producers of natural gas, natural gas liquids, and oil in the U.S., which declined 27%. The company reported lower-than-expected price realizations and production in the fourth quarter. While the company cut 2015 budgeted capital expenditures (capex) over 40% versus 2014, the market was hoping for Chesapeake to balance lower cash flow with capex. The company maintains a flexible balance sheet, with $4 billion in cash and an additional $4 billion in an undrawn credit facility, which will allow CEO Doug Lawler to focus on driving the greatest value for shareholders for the long-term, either through the authorized $1 billion repurchase program, strategic acquisitions, or a combination of both. While our appraisal of the company has come down in the short-term with the collapse of oil and gas prices, the long-term thesis remains intact. Chesapeake’s second largest shareholder, Carl Icahn, recently increased his stake in Chesapeake by 10%, and Chairman Archie Dunham bought an additional $14 million at quarter-end. During the quarter we maintained our overall exposure to Chesapeake but switched half our position into options due to favorable pricing created by the panic and resulting volatility in energy markets. We also employed this approach to increase our exposure to Murphy. We viewed this as a rare opportunity to gain more downside protection while maintaining the upside benefit of higher stock prices. The Chesapeake options accounted for more than half of that position’s decline in the quarter. See page 15 for more detail.

CONSOL Energy was down 17% on weak natural gas and coal prices. During the quarter the company reduced its capex budget and grew production strongly. The company is uniquely positioned to navigate these prices with low cost reserves and plans to monetize non-core assets, including the thermal coal master limited partnership (MLP) in mid-2015 and the met coal initial public offering (IPO) in late 2015. CONSOL is one of our most discounted holdings, and CEO Nick Delulis expressed his agreement with a significant share repurchase announcement.

We added two new positions in the first quarter. Weakness in the Macau (China) gaming market provided the opportunity to purchase Wynn Resorts at a substantial discount to our appraisal. Wynn owns some of the world’s prime real estate through luxury gaming and hotel operations in Las Vegas and Macau as well as a future location outside Boston, Massachusetts. Through its 72% ownership of Wynn Macau, Wynn controls a gaming and hotel complex on the Macau peninsula and is completing an additional project in nearby Cotai. The company’s Wynn and Encore casinos are among the most profitable in Vegas, with a prime location on the Strip. Steve Wynn has been a successful owner-operator who has made money for shareholders over a long period. We bought Google as fears around a slowdown in the company’s dominant search and display advertising business became over-discounted in the market.

We sold three successful investments in the quarter. Abbott, a global healthcare company, reached our appraisal, resulting in a 120% return over our 4+ year holding period. We are extremely appreciative of the value that CEO Miles White built for shareholders during our ownership. Travelers, a leader in property and casualty insurance, also reached our appraised value. We made a 144% return over our 4+ year holding period. Jay Fishman is among the best operators and capital allocators in the industry, and his record at growing book value, even in challenging periods, greatly rewarded the Partners Fund’s shareholders. We sold Mondelez as price converged with our value. The stock returned 45% since our late 2012 purchase when Kraft spun out the global snacking and food brands, including Nabisco, Cadbury, and Trident, and renamed the company Mondelez. Although emerging market sales weakened, CEO Irene Rosenfeld preserved value per share through margin improvements, share repurchases, and value-accretive moves such as placing the coffee business in a joint venture with DE Master Blenders. This was our
third successful investment in Nabisco’s brands. Each time we were able to purchase this juggernaut at a readily ascertainable discount, directly or through a larger company. We hope for another opportunity down the road.

We believe the Fund is well positioned for strong future relative performance. The price-to-value (P/V) ratio is in the mid-70s%, with cash at 4% when adjusted for options. We believe the portfolio is invested in high quality businesses with greater FCF yields and stronger future growth potential than the S&P 500 Index. Our management partners are taking actions to drive strong value growth and, in many cases, are creating catalysts for value recognition.

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A master limited partnership (MLP) is, generally, a limited partnership that is publicly traded on a securities exchange.

Free Cash Flow Yield (FCF Yield) equals a company’s free cash flow per share divided by the current market price per share.

Derivatives may involve certain costs and risks such as liquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested.

As of March 31, 2015, the holdings discussed represented the following percentages of the Longleaf Partners Fund: CK Hutchison, 10.1%; Level 3, 10.6%; Chesapeake, 2.4%; Wynn Resorts, 4.5%; Google, 2.9%. 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.

Funds distributed by ALPS Distributors, Inc.

LL0000293
Expires 7/31/15
Partners Fund Management Discussion

Longleaf Partners Fund finished the year up 4.92% after a 1.46% gain in the fourth quarter. These results fell below the S&P 500’s returns of 13.69% and 4.93% for the same periods. During the first half of the year, the Fund kept pace with the Index despite having a greater than 20% cash balance. In the second half of 2014, the Fund lagged the S&P 500’s advance largely due to our energy-related holdings, which were leading contributors in the first half but sold off with the sharp decline in oil prices. We are disappointed in the recent performance, but remain confident in the quality of our businesses and management partners in the portfolio. For the last five years, Longleaf Partners Fund exceeded our annual absolute return goal of inflation plus 10%, despite falling short of the Index. Over longer term periods of 15+ years shown below, the Fund surpassed the Index.

Cumulative Returns at December 31, 2014

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>25 Year</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
<th>4Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1842.31%</td>
<td>1239.19%</td>
<td>617.02%</td>
<td>210.29%</td>
<td>76.15%</td>
<td>85.00%</td>
<td>4.92%</td>
<td>1.46%</td>
</tr>
<tr>
<td>(Inception 4/8/87)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>1223.16</td>
<td>893.51</td>
<td>554.75</td>
<td>86.48</td>
<td>109.47</td>
<td>105.14</td>
<td>13.69</td>
<td>4.93</td>
</tr>
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Average Annual Returns at December 31, 2014

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>25 Year</th>
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<tbody>
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<td>Partners Fund</td>
<td>11.29%</td>
<td>10.94%</td>
<td>10.35%</td>
<td>7.84%</td>
<td>5.82%</td>
<td>13.09%</td>
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<td>(Inception 4/8/87)</td>
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</tbody>
</table>

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.

The December 31, 2014 and 2013 total expense ratios for the Partners Fund are 0.91% and 0.92%, respectively. The expense ratios are subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.

Fiber and networking company Level 3 Communications gained 49% and led the Fund’s performance for the year and the fourth quarter, up 8%. Level 3 provides critical infrastructure that connects businesses and consumers to the internet, allowing them to move data, video, and voice. The company’s acquisition of tw telecom closed in the fourth quarter, significantly expanding its network reach in metropolitan markets and providing additional capacity to grow its enterprise customer base. Throughout the year, CEO Jeff Storey and his team delivered solid revenue growth, margin improvement, and higher free cash flow. The stock remains well below our appraisal of its operating networks and non-earning dark fiber and conduit assets and is the Fund’s largest holding.

FedEx rose 22% for the year and 8% in the fourth quarter. The company expanded operating
margins in its Express, Ground and Freight segments over the year and executed on profit improvement initiatives. EPS (earnings per share) grew as did our appraisal. The company repurchased close to 10% of its shares. FedEx moved to further entrench itself in Ground delivery through expansion capex and the acquisition of Genco, which handles reverse logistics for retailer returns. FedEx expects to benefit over the next year from a healthy U.S. economy and lower fuel prices, which improve the relative cost of faster delivery via planes at a premium versus slower shipping via boats.

Berkshire Hathaway appreciated 28% for the year after its fourth quarter gain of 10%. The company’s underlying operating businesses performed well. In insurance, GEICO revenues grew 10% driven 2/3 by units and 1/3 by pricing. Reinsurance endured no major catastrophes and some positive currency impact. BNSF grew 4% with gains in both volume and pricing. In the fourth quarter, Berkshire announced the acquisition of Duracell from Proctor & Gamble in a tax efficient exchange for appreciated Berkshire stock. The stock reached our appraisal, and we sold it. Berkshire rarely sells at enough of a discount to meet our criteria given its quality businesses and management, but we were able to purchase it for the second time in our history in 2012. The stock returned over 89% in our two year holding period.

Hong Kong based conglomerate Cheung Kong gained 15% in the year. Over the course of 2014, results at most of the company’s operating divisions were strong. Additionally, management made several value-enhancing asset sales across multiple business lines at low cap rates and used proceeds to opportunistically reinvest in discounted infrastructure deals outside of Asia with double-digit IRRs (internal rates of return). Management also returned proceeds to shareholders in the form of dividends. Most recently, in a joint venture with Mitsubishi Corp, Cheung Kong bought an airplane leasing portfolio. With its strong balance sheet, Cheung Kong can take advantage of Hong Kong land banking opportunities if prices correct.

For Aon, the world’s largest insurance broker and a leading benefits manager, increasing cash flow and healthy share repurchases helped our combined option and common stock position gain 8% in the fourth quarter and 14% for the year. Aon’s private health care exchange business increased its scale, adding more than a dozen clients and aggressively growing the market. The company, led by CEO Greg Case, used $1.8 billion to repurchase almost 7% of shares in the first nine months of 2014, the highest amount since 2008. Aon authorized an additional repurchase plan of up to $6.1 billion, roughly 24% of outstanding shares.

Four of the five primary performance detractors for the year were energy-related businesses that sold off with the 49% decline in oil in the second half. Our investments do not reflect any special affinity for oil and gas. We own a select combination of companies – Chesapeake, Murphy Oil, CONSOL Energy, and Boardwalk Pipeline Partners and Diamond Offshore via Loews – because we feel they have the asset bases, financial ability, and disciplined managements to reinvest in production and assets at returns well above their costs of capital. Our management partners are controlling costs and making value additive divestitures. Our conservative appraisals use the lower of the marginal cost of production or the futures strip to price oil and gas. Because the strip has fallen below the marginal cost, we lowered our assumptions, but our adjustments were much smaller than the stock price declines. The timing is unknown, but the upside from the current strip pricing combined with the proactive work of our CEO partners presents a compelling opportunity for long-term investors.

Chesapeake declined 21% for the full year and 14% in the fourth quarter. Since Chesapeake’s heavily vested Board took over in mid-2012, the company has delevered the balance sheet and improved production from its irreplaceable 10+ million net acres of oil and gas fields. CEO Doug Lawler is driving value recognition in ways he can control – selling assets at reasonable prices, reducing debt, and increasing operating efficiencies in both corporate and production
Partners Fund Management Discussion

activity. In the first half of the year, Chesapeake sold non-core acreage in Oklahoma, Texas, and Pennsylvania and spun-off its oilfield services business into Seventy-Seven Energy, which we sold. In the fourth quarter, Chesapeake closed the sale of Marcellus and Utica assets to Southwestern Energy for $5 billion. This amounted to selling roughly 8% of Chesapeake’s production for proceeds of nearly half its market cap. Management announced plans to use $1 billion of the proceeds to repurchase the heavily discounted shares.

Despite being up 1% in the fourth quarter, Loews, the holding company owned and managed by the Tisch family, sold off with energy and was down 12% for the year. The company’s CNA insurance unit generated strong cash flow, but its stakes in energy companies Diamond Offshore (DO) and Boardwalk Pipeline Partners (BWP) declined 30% and 29% respectively. DO has the strongest balance sheet among drilling rig operators and should be able to upgrade its fleet cheaply as distressed sellers seek capital. BWP cut its dividend to invest in additional service points along its pipeline and expand its ability to transport gas from the northeastern U.S. Loews repurchased shares amounting to approximately 3.5% of the company and has substantial liquidity to take advantage of undervalued opportunities including additional shares.

Murphy was down 20% in the year after an 11% decline in the fourth quarter. CEO Roger Jenkins took actions to recognize value including selling a 30% stake in Malaysian assets at a price above our appraisal. Murphy also bought back shares in 2014 and has authorization for more. The sharp decline in oil prices most heavily affected Murphy’s ownership in Syncrude’s Canadian oil sands, which represented less than 15% of our appraisal before oil’s drop and less today.

CONSOL Energy dropped 11% in the fourth quarter and for the year in full. CONSOL’s management team took productive action to increase shareholder value despite a difficult coal and gas environment. In the second half of the year, Chairman Brett Harvey and CEO Nick Deluliis completed an IPO (initial public offering) for a midstream MLP (master limited partnership) at metrics above our appraisal. CONSOL most recently announced it would form an MLP to house its thermal coal business and form a subsidiary to own its metallurgical coal properties. These transactions should bring the value of its coal assets forward, improve the transparency into the value of these assets, and provide additional vehicles to access capital markets, while allowing the company to control the assets and realize synergies across its businesses. In addition, CONSOL authorized a share repurchase program for up to approximately 3.6% of the company.

Philips fell 18% in the year and 8% in the fourth quarter. The company faced a number of short-term challenges including a one-time pension payment, a temporary suspension of production at its Cleveland, OH-based medical imaging plant, slower emerging market demand, and foreign exchange headwinds. Currency translation from euros into U.S. dollars accounted for approximately half of the price decline. The stock price does not reflect the ongoing transformation of the company under CEO Frans Van Houten, who has substantially improved operating margins and focused the company over his 3+ year tenure. Philips’ discounted share price provided management the opportunity to execute another massive €1.5 billion share repurchase. In 2014 Philips announced plans to sell or spin off its Lumiled and auto lighting businesses and to split into two companies: Lighting Solutions and HealthTech, which will be comprised of the current Healthcare and Consumer Lifestyle businesses. We applaud the split. The “conglomerate discount” should disappear as each business stands on its own and is easier to compare to more pure-play peers that trade at higher multiples. Separate reporting will commence in January 2015, and the split is expected to happen by 2016.

We initiated five new positions, all in the second half of the year. We bought Franklin Resources, McDonald’s, Scripps Networks, and Vivendi in the third quarter. In the fourth quarter, we bought agricultural equipment and commercial truck company CNH Industrial as weak U.S. corn and
soybean prices weighed on farming-related companies. Our four exits each approached our appraisal values, including DirectTV and Vulcan Materials in the first quarter. As mentioned above, we sold Seventy-Seven Energy when it was spun out of Chesapeake and Berkshire Hathaway when it reached our appraisal.

The Fund started 2014 with 22% cash and ended the year with 13%. Helped by our new names, the price-to-value ratio (P/V) improved to the high-70s%. Our on-deck list of qualified new names remains challenged with deep discounts proving elusive. We continue to see more compelling opportunities outside of the U.S. where more economic uncertainty and weaker currencies are weighing on stocks. Our foreign-domiciled holdings are 25% of the portfolio with a maximum limit of 30%.

As the Fund’s largest shareholders, we are not pleased with our 2014 performance or the impact it had on longer periods. The return, however, does not adequately reflect the underlying progress our companies made during the year. We are confident that our portfolio of high quality, industry-leading companies and our management partners who are taking action to build shareholder value will reward our long-term partners.

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 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. 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.

A master limited partnership (MLP) is, generally, a limited partnership that is publicly traded on a securities exchange.

Internal rate of return (IRR) is the interest rate at which the net present value of all the cash flows from an investment equal zero.

As of December 31, 2014, the holdings discussed represented the following percentages of the Longleaf Partners Fund: Level 3, 9.8%; FedEx, 4.0%; Cheung Kong, 7.6%; Aon, 2.0%; Chesapeake, 6.6%; Murphy Oil, 3.5%; CONSOL Energy, 5.2%; Loews, 7.7%; Philips, 6.2%; Franklin Resources, 3.2%; McDonald’s, 4.7%; Scripps Networks, 4.5%; Vivendi, 5.0%; CNH Industrial, 4.1%. 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.

Funds distributed by ALPS Distributors, Inc.
Partners Fund Management Discussion

Longleaf Partners Fund declined 3.4% in the quarter as macro pressures, including lower energy prices, impacted a handful of our holdings. The S&P 500 Index advanced 1.1%. Importantly, increased market volatility created several buying opportunities for the Fund, reducing the cash position that has dampened absolute and relative year-to-date (YTD) results, which were 3.4% versus 8.3% for the Index. In the bull market of the last five years, the Fund exceeded our absolute return goal of inflation plus 10%. Over longer-term periods of 15+ years, the Fund outperformed the Index.

Cumulative Returns at September 30, 2014

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>25 Year</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
<th>YTD</th>
<th>3Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>(Inception 4/8/87)</td>
<td>1814.37%</td>
<td>1160.75%</td>
<td>571.80%</td>
<td>204.27%</td>
<td>85.99%</td>
<td>91.14%</td>
<td>13.48%</td>
<td>3.41%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td></td>
<td>1160.96</td>
<td>866.34</td>
<td>523.88</td>
<td>104.15</td>
<td>118.05</td>
<td>107.30</td>
<td>19.73</td>
<td>8.34</td>
</tr>
</tbody>
</table>

Average Annual Returns at September 30, 2014

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>25 Year</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>(Inception 4/8/87)</td>
<td>11.34%</td>
<td>10.67%</td>
<td>9.99%</td>
<td>7.70%</td>
<td>6.40%</td>
<td>13.83%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td></td>
<td>9.65</td>
<td>9.50</td>
<td>9.59</td>
<td>4.87</td>
<td>8.11</td>
<td>15.70</td>
</tr>
</tbody>
</table>

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.

The December 31, 2013 total expense ratio for the Partners Fund is 0.92%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.

FedEx, the largest contributor for the quarter and a major contributor YTD, rose 7% and 13% respectively. The company reported strong operating results led by Ground, where revenue grew 8% year-over-year and operating margins expanded toward 20%. Express had healthy U.S. volumes, and Freight saw both volume and revenue increases. While Ground remains the majority of our appraisal, Freight’s results were notable with 70% operating income growth and double-digit margins. Sustained operating performance in this division would drive additional future value growth. During the quarter, the company continued to demonstrate its pricing power. The company repurchased 5.3 million shares, an annualized rate of 7%, and authorized an additional 15 million shares.

Another large contributor for the quarter was Berkshire Hathaway which rose 9%. YTD the holding advanced 17%. The company’s myriad of businesses performed well. In insurance, GEICO grew premiums 11% and wrote at a 92% combined ratio. Reinsurance was helped by few natural disaster claims. In rail, Burlington Northern’s revenues rose 8% as volumes increased and pricing improved, particularly in agricultural
products following a record grain harvest and limited supply given increased oil shipments. Berkshire’s U.S. and U.K. utility revenues also grew. The manufacturing, service, and retailing businesses increased sales and earnings. Overall, corporate revenues from these diverse businesses grew 6%, earnings increased 17%, and our appraisal increased.

Fiber and networking company Level 3 Communications’ 4% gain in the quarter took YTD return to 38%. Level 3 had a strong quarter with EBITDA (earnings before interest, taxes, depreciation and amortization) up over 20%, organic revenues up 7%, and positive free cash flow. The company’s purchase of tw telecom, announced in the second quarter, remains on track to close in the fourth quarter. Even after its gain, the stock sells for a deep discount to our appraisal and is an overweight position.

Bank of New York Mellon (BK) gained 4% in the quarter and 12% YTD. The asset management business grew steadily along with the markets but low market volatility and low rates this year have hampered revenue growth in asset services. The company emphasized the substantial earnings power that modest interest rate increases will create as money market fee waivers will end and net interest margins will expand. During the quarter BK repurchased almost 1% of outstanding shares, approximately one-third of the total buyback approved by the Federal Reserve.

Although Cheung Kong declined 7% in the third quarter, its 13% YTD return made this Hong Kong based conglomerate a large contributor for the year. In the first half, Hong Kong property sales were strong, and management made several value-enhancing asset sales across multiple business lines as well as returned capital to shareholders. More recently, Cheung Kong’s price was penalized amid protests and labor strikes in Hong Kong. Our appraisal remained intact. We are partnered with strong capital allocators who have not bought overpriced assets in China or Hong Kong. Cheung Kong’s strong balance sheet positions management to buy discounted land in the event of a real estate correction.

The performance bright spots were overshadowed by the negative impact of the energy sector which fell 9.1% in the S&P 500 Index as oil, gas and coal prices declined between 7-13%. Energy, including the roughly 50% of Loews’ value, is 18% of the Partners Fund versus approximately 10% of the S&P 500. Our appraisals of our energy-related holdings did not fall in spite of large stock declines, because our models already incorporated lower commodity prices based on the futures curve pricing and the marginal cost of production in our various plays. Chesapeake fell 20% in the quarter. While costs declined, capex remained on plan, and the company moved production estimates up slightly. During the two year tenure of the new board, balance sheet leverage has been reduced by $6 billion, primarily from noncore asset sales. CEO Doug Lawler is driving value recognition in ways he can control - selling non-core assets at reasonable prices, reducing debt, and increasing operating efficiencies in both corporate and production activity. He is building additional upside with the $2–3 billion of annual discretionary capital spending that management projects should deliver strong returns on capital, even without higher commodity prices. The company’s 4.8 million net developed acres and 7.5 million undeveloped acres of oil and gas fields cannot be replicated.

CONSOL Energy posted a negative 18% return in the quarter. Over half of our appraisal is attributable to the company’s gas reserves in the Marcellus and Utica shale plays. To monetize gas production value, Executive Chairman Brett Harvey and CEO Nick Deluliis successfully completed an initial public offering (IPO) for a midstream Master Limited Partnership (MLP) at metrics above both our appraisal and the projected price in the recent quarter. Approximately 40% of our appraisal is in CONSOL’s coal assets. As the low-cost producer in Appalachia due to its use of long wall mining methods, the company plans to shift more of its met coal sales to domestic customers – a competitive move that will pressure overleveraged, high cost producers. The company’s variety of assets, including the

The recent quarter performance set back is temporary and not indicative of our future opportunity.
Baltimore port terminal, provides multiple options for gaining value recognition without reliance on commodity price increases.

Over the last three months, Murphy Oil declined 14%. CEO Roger Jenkins made value accretive moves, announcing sales of its U.K. downstream assets and of 30% of the company’s Malaysian assets at a price above our appraisal. Moreover, Jenkins built value by repurchasing shares as they became more discounted, a move that he properly viewed as buying their proven barrels of oil for much less than it would cost to drill new wells or buy other plays.

For the YTD period Loews was the Fund’s primary performance detractor, down 13% after a 5% decline in the quarter. The stock fell because of pressure on its energy-related investments in Diamond Offshore, the drilling company, and to a lesser degree, Boardwalk Pipeline. Loews recently announced the sale of Highmount Exploration and Production in line with our anticipated price. Through the last reported period in July, the company aggressively repurchased shares.

We initiated four new positions in the quarter: McDonald’s Corporation, Scripps Networks Interactive, Vivendi, and Franklin Resources. Poor U.S. comps, food quality issues at McDonald’s China supplier, minimum wage pressure in the U.S., Russian challenges, and European macro concerns pressured the stock and enabled us to own the company’s valuable real estate and dominant breakfast business at a discount. Scripps, a multi-year holding in our Small-Cap Fund, owns various channels, including 100% of HGTV and 69% of The Food Network. Its market capitalization has grown enough for us to own this company in the Partners Fund, and our appraisal has kept pace so that the attractive discount remains. French company Vivendi consists of two key businesses – Universal Music Group, the world’s largest record label, and Canal+ Group, France’s biggest pay-TV operator. The recent sale of Vivendi’s Brazilian broadband business, GVT (Global Village Telecom), highlights Chairman and 5% owner Vincent Bolloré’s focus on creating value for shareholders. Southeastern has invested in Vivendi successfully twice before, and the company’s focus, asset quality, and management team has grown even stronger. We have owned the mutual fund distribution firm Franklin Resources several times and re-initiated a position in the company as the recent market turmoil helped drive its price to a discount. We did not exit any position during the quarter but trimmed several as their prices and position weights grew.

The combination of price declines, value growth, and portfolio transactions helped improve the price-to-value ratio (P/V) from the mid-80s% to the high-70s%. The Fund’s cash position also declined to a stated 14% but an effective 9% when considering options in the portfolio. In our opinion, we own strong businesses and have capable management partners who are driving value growth. We will continue to exercise discipline and patience as we search for additional qualifying opportunities. As the Fund’s largest shareholder group, we are confident that the recent quarter performance setback is temporary and not indicative of our future opportunity.

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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. An index cannot be invested in directly.

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As of September 30, 2014, the holdings discussed represented the following percentages of the Longleaf Partners Fund: FedEx, 6.2%; Berkshire Hathaway, 4.7%; Level 3, 8.6%; Bank of New York Mellon, 4.0%; Cheung Kong, 7.0%; Chesapeake, 6.0%; CONSOL, 5.5%; Murphy, 3.7%; Loews, 7.2%; McDonald’s, 4.0%; Scripps Networks, 2.5%; Vivendi, 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.

Funds distributed by ALPS Distributors, Inc.
Partners Fund Management Discussion

Longleaf Partners Fund returned 6.8% in the second quarter, outpacing the S&P 500’s return of 5.2%. The Fund slightly trailed the Index year-to-date (YTD), with the performance of each rounding to 7.1%. The Partners Fund remained ahead of the Index as well as our absolute return goal of inflation plus 10% in the trailing year, despite our elevated cash position.

Cumulative Returns at June 30, 2014

<table>
<thead>
<tr>
<th>Fund</th>
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<th>15 Year</th>
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<th>Five Year</th>
<th>One Year</th>
<th>YTD</th>
<th>2Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund (Inception 4/8/87)</td>
<td>1882.39%</td>
<td>1353.61%</td>
<td>633.13%</td>
<td>166.84%</td>
<td>86.87%</td>
<td>133.96%</td>
<td>29.06%</td>
<td>7.08</td>
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<td>S&amp;P 500 Index</td>
<td>1146.90</td>
<td>957.89</td>
<td>547.08</td>
<td>89.27</td>
<td>111.59</td>
<td>136.98</td>
<td>24.61</td>
<td>7.14</td>
<td>5.23</td>
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Average Annual Returns at June 30, 2014

<table>
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<tr>
<th>Fund</th>
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</tr>
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<tr>
<td>Partners Fund (Inception 4/8/87)</td>
<td>11.59%</td>
<td>11.30%</td>
<td>10.47%</td>
<td>6.76%</td>
<td>6.45%</td>
<td>18.53%</td>
<td>29.06%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>9.70</td>
<td>9.89</td>
<td>9.79</td>
<td>4.35</td>
<td>7.78</td>
<td>18.83</td>
<td>24.61</td>
</tr>
</tbody>
</table>

The index is unmanaged. 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.

The December 31, 2013 total expense ratio for the Fund is 0.92%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.

The biggest performance drivers in the quarter were among the companies that contributed most to YTD gains. Chesapeake, the U.S. oil and gas exploration and production company, rose 22% in the quarter and was up 15% YTD. During the quarter, the company announced better-than-expected production and cash flow and raised yearly guidance on both of these metrics. Management continued to execute on the capital efficiency strategy, highlighted by the spin-off at quarter-end of its oilfield services business into a publicly traded company called Seventy Seven Energy. The spin-off eliminated approximately $1.5 billion of net debt from Chesapeake’s balance sheet. Divestitures of noncore acreage in Oklahoma, Texas, and Pennsylvania were also completed. Our CEO partner, Doug Lawler, is positioning the company to focus on its strong assets in the Eagle Ford, Marcellus and Utica plays, while growing production profitably and keeping capital expenditures within cash flow.

Cheung Kong, the Hong Kong based conglomerate with businesses around the world, returned 15% in the second quarter, pushing the YTD return to 21%. Over the first half of 2014, management made value-enhancing asset sales across multiple business lines. In the first quarter, Cheung Kong Infrastructure spun off and listed Hong Kong Electric. Additionally, 50% owned affiliate Hutchison Whampoa sold 25% of A.S. Watson Group, the world’s largest health and beauty retailer. In the second quarter, the company paid a HK$7 special dividend with the proceeds of the Watson sale. Sales of residential property in Hong Kong accelerated after some relaxation in stamp duty regulations. With high land valuations, our partners at Cheung Kong exercised the discipline we have come to expect – not acquiring a
single piece of land in Hong Kong or China for over a year.

CONSOL Energy returned 15% in the quarter and 21% YTD. The company announced better-than-expected earnings due to lower coal costs and stronger gas pricing and guided gas production growth of 30% over the next two years. Management is focusing on building value per share through monetizing non-core assets and moving forward with a MLP of the midstream gas assets in the second half of 2014.

Fiber and networking company Level 3 Communications announced a deal to acquire tw telecom and returned 12% in the quarter and 32% for the first half. With the deal, Level 3 gets increased tax benefits for its historic NOLs (net operating losses) due to the company’s increased equity capitalization. The transaction also affords an identified $200 million in synergies, roughly half of which come from the traffic switched onto Level 3’s backbone. The deal is expected to close in the fourth quarter. Beyond the merger, in his first year as CEO, Jeff Storey and his team have delivered solid revenue growth, margin improvement, and higher cash flow.

In the first quarter, terrible winter weather hurt FedEx results, but the stock rebounded 14% over the last three months. When the price was weak, management repurchased almost 10 million shares at a discount, equating to a 13% annualized pace. The stock rose following strong revenue growth and profits in the Ground segment and higher package volume in Express. Management also set expectations for improved results at Consumer and Lighting but a continued drag from Healthcare. Management previously delivered on every aspect of 2013 targets and remains committed to 100-200 additional basis points (1 to 2%) of margin improvement by 2016. At quarter-end, the company announced plans to merge the LED and automotive lighting units into a standalone company with €1.4 billion in revenue and will explore strategic options for outside investment. This advances management’s “Accelerate” plan to concentrate Philips around Health and Wellness and fundamentally increase shareholder value.

Although Loews was flat in the second quarter, it remained a detractor YTD, down 9%. The first quarter price fell after underlying holdings Diamond Offshore (DO) and Boardwalk Pipeline (BWP) disappointed. In April, DO’s results improved, and the company announced its first share buyback since 2004. After being punished for cutting its dividend in February, BWP outlined several attractive potential projects going forward and recovered in the second quarter. Loews’ other major holding, CNA Financial, had a solid quarter. Loews ramped up its own share repurchases given the discount in the stock and the lack of high-return alternatives for the company’s large net cash of over $8.50/share.

The rampant merger and acquisition activity helped drive performance but also left few stocks selling at meaningful discounts.
Partners Fund Management Discussion

meet our criteria. A market pullback could help us invest our sizeable cash more quickly but would also impact short-term returns (not our preferred method of lowering P/V). We hope that an increase in market volatility, a few individual anomalies at specific companies, or companies with stagnant prices and high value growth give us enough qualifiers to invest the cash. While we are as committed as ever to identifying opportunities, we will maintain our investment discipline that has served us and other shareholders for four decades.

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 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. 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.

As of 6/30/14, the top 10 holdings in Longleaf Partners Fund – Level 3 (7.7%), Chesapeake Energy (7.3%), FedEx (7.3%), Loews (7.1%), Cheung Kong (7.0%), CONSOL (6.2%), Bank of New York Mellon (4.9%), Mondelez (4.9%), Abbott (4.6%), Philips (4.4%). Holdings are subject to change and are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

Funds distributed by ALPS Distributors, Inc.
Partners Fund Management Discussion

Longleaf Partners Fund gained 0.3% in the first quarter versus the S&P 500 Index’s return of 1.8%. The lack of new qualifiers and resulting higher cash position over the last twelve months dampened shorter-term relative performance.

**Cumulative Returns at March 31, 2014**

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund (Inception 4/8/87)</td>
<td>1756.23%</td>
<td>620.47%</td>
<td>185.23%</td>
<td>78.21%</td>
<td>177.40%</td>
<td>18.66%</td>
<td>0.27%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>1084.89</td>
<td>517.49</td>
<td>92.53</td>
<td>104.52</td>
<td>161.07</td>
<td>21.86</td>
<td>1.81</td>
</tr>
</tbody>
</table>

**Average Annual Returns at March 31, 2014**

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund (Inception 4/8/87)</td>
<td>11.43%</td>
<td>10.38%</td>
<td>7.24%</td>
<td>5.95%</td>
<td>22.64%</td>
<td>18.66%</td>
<td></td>
</tr>
</tbody>
</table>

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.

The total expense ratio for the Longleaf Partners Fund is 0.91%. The expense ratio is subject to a fee waiver to the extent the Fund’s normal annual operating expenses exceed 1.5% of average annual net assets.

Level 3 Communications gained 18% in the quarter, making it the Fund’s largest contributor. This fiber and networking company’s strong results exceeded expectations largely due to growth in the Enterprise business, and management issued higher 2014 guidance. Over the last year since Jeff Storey became CEO, the stock has risen 93% reflecting the expansion of operating margins and improved balance sheet. Level 3 is now cash flow positive with value increasing. The stock remains one of the most discounted in the portfolio even after the significant run up since Storey’s appointment.

DIRECTV (DTV) added 9% with strong U.S. subscriber and ARPU (average revenue per user) growth. U.S. churn was the lowest in five years. We sold the stock at price responded strongly to the company’s results and reached our appraisal value. As discussed in our letter to shareholders, we are especially grateful to CEO Mike White and his predecessor Chase Carey for driving the strong value growth that helped us earn over 385% in this investment since it began as GMH in 2001.

Cheung Kong and CONSOL Energy also contributed nicely in the quarter, each gaining 5%. Cheung Kong, the Asian based global conglomerate, appreciated as the company made value-enhancing asset sales and 50% owned affiliate Hutchison Whampoa (HWL) reported a 20% earnings increase. After almost a decade of investments outpacing disposals, Chairman and primary owner Li Ka-shing quickened the pace of asset sales during the quarter. China contracted land sales rose 27% year-over-year. EBIT (earnings before interest and taxes) margins on property sales in both China and Hong Kong were near 40%. Power Assets, majority owned by Cheung Kong Infrastructure, spun off and listed Hong Kong Electric to maximize cash distributions to shareholders and cater to yield-hungry investors. HWL announced the sale of 25% of A.S. Watson Group, the world’s largest health and beauty retailer, to Singapore fund Temasek Holdings at a price in line with our appraisal. Shareholders will receive a special dividend from the sale proceeds.

CONSOL’s long-term strategy to focus on natural gas exploration and production is well underway after the sale of five large thermal coal mines in West Virginia to Murray Energy. The company expects to grow gas production by 30% in 2015 as well as 2016. Management continues work on monetizing the company’s infrastructure assets. Insider purchases during the quarter signaled confidence in the company’s future. As expected, CONSOL announced that long-time executive Nick Deluliis joined the board and will be promoted to CEO and President replacing Brett Harvey, who will become Executive Chairman.

Loews, the diversified holding company owned and managed by the Tisch family, detracted from the Fund’s return in the quarter, declining 9%. Loews’ largest holdings are three publicly traded subsidiaries: property and casualty insurer
CNA Financial Corp. (CNA) (90% owned), offshore contract driller Diamond Offshore (DO) (50.4% owned), and natural gas pipeline Boardwalk Pipeline (BWP) (53% owned). During the quarter, CNA reported solid earnings and combined ratios, but DO and BWP disappointed. As large exploration and production companies reined in spending, demand for offshore drilling fell, reducing day rates and rig utilization at DO. Higher gas production in the Northeastern U.S. has reduced demand for pipelines serving that region while the cold winter lowered gas storage. BWP cut its dividend to invest in expanding pipeline reach for higher long-term EBITDA (earnings before interest, taxes, and amortization).

FedEx lost 8% after this shipping and logistics company reported a weak quarter due to weather-related challenges. The company took advantage of the short-term hit and bought back almost $3 billion in stock. As the aggressive cost improvements in the Express segment begin to materialize in the next year and management remains focused on disciplined capital allocation, the company is poised to see free cash flow growth.

Energy company Chesapeake retreated 5% in the quarter following a strong 2013. Short-term questions about production levels, the mix between gas and liquids, and additional asset sales pressured the stock. Our appraisal, however, grew slightly due to successful cost reductions. CEO Doug Lawler has made substantial progress since taking the helm last year, and we believe his capital discipline and operational effectiveness will reward shareholders.

Following the market’s appreciation over the last few years and with little volatility in the quarter, no new names met our investment criteria. In addition to selling DTV, we exited Vulcan, the aggregates company, as it reached our appraisal. We bought Vulcan in 3Q of 2010 during the U.S. construction depression. Our appraisal modeled volume improvement over time but never to the peak levels of 2006. Rock quarries have substantial barriers to entry that enable long-term pricing power, and the company sold far below prices paid for similar assets. As construction and confidence started to return, the stock rebounded. We made over 63% in our three-and-a-half year holding period.

At the end of the quarter, the P/V (price-to-value ratio) stood in the high-70s% and net cash was higher-than-normal at a reported 27% but an effective 23% given our AON options. We prefer to own investments that offer significant compounding opportunity rather than cash with meager returns. With our capital invested in the Fund, we will maintain our long-term perspective as we have in the past, and patiently wait to buy names that qualify rather than force the cash into less discounted or lower quality companies that would increase the risk of permanent loss.
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 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.

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As of 3/31/14, the top 10 holdings in Longleaf Partners Fund – Loews (7.4%), Chesapeake Energy (7.2%), Level 3 (7.1%), FedEx (6.7%), Cheung Kong (6.7%), CONSOL (5.7%), Mondelez (4.9%), Philips (4.9%), Bank of New York Mellon (4.9%) Abbott (4.5%). Holdings are subject to change and are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

Funds distributed by Rafferty Capital Markets, LLC. As of May 1, 2014, Funds distributed by ALPS Distributors, Inc.
Partners Fund Management Discussion

Longleaf Partners Fund produced strong absolute gains for the fourth quarter and the year, delivering 9.8% and 32.1%, respectively, and far surpassing our absolute annual goal of inflation plus 10%. The Fund’s 2013 results were 27 basis points behind the S&P 500 Index because of the short-term drag that our higher-than-normal cash level had on performance. The impact was more pronounced in the fourth quarter. More importantly, the Partners Fund significantly outperformed both our absolute goal and the benchmark over the last five years.

Cumulative Returns at December 31, 2013

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
<th>4Q</th>
</tr>
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<tbody>
<tr>
<td>Partners Fund (Inception 4/8/87)</td>
<td>1751.29%</td>
<td>644.70%</td>
<td>202.20%</td>
<td>79.86%</td>
<td>170.85%</td>
<td>32.12%</td>
<td>9.75%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>1063.85</td>
<td>483.53</td>
<td>98.54</td>
<td>104.30</td>
<td>128.19</td>
<td>32.39</td>
<td>10.51</td>
</tr>
</tbody>
</table>

See page 6 for additional performance information.

Chesapeake Energy was the largest contributor in 2013, up 59%. Together with new CEO Doug Lawler, the board that we helped seat in 2012 is instilling financial and operating discipline into the company. Over the last 19 months, the company reduced SG&A, sold a number of non-core assets, decreased capex, and committed to living within its cash flow in 2014. The company is focusing on its strong assets in the Eagle Ford, Marcellus, and Utica plays in order to grow production profitably. Even after the stock’s gains, Chesapeake’s oil and gas reserves sell for a discount to our appraisal. That appraisal would grow significantly in the long-term bull case for low cost natural gas replacing coal for power generation, fostering manufacturing renewal in the U.S., displacing some oil as a transportation fuel, and becoming a major export.

FedEx was a leading performer for the fourth quarter and the year, gaining 26% and 57%, respectively. Major cost initiatives gained traction as the company’s Express unit grew margins by 1.4% in its most recent quarter. The Ground unit delivered strong growth with volume increases from e-commerce and higher pricing. FedEx repurchased 7.2 million shares, a 10% annualized pace. The stock’s increase in the fourth quarter followed news that the company would begin a new 32 million share repurchase program. Management’s operating success and capital allocation combined to build the company’s worth through the year.

The shareholder approval of Dell’s management buyout generated a positive return of 31% for 2013 in spite of the disappointing investment outcome. Philips gained 44% during the year. CEO Frans Van Houten and CFO Ron Wirahadiraksa completed a €2bn stock buyback at discounted prices, as well as delivered higher margins as planned. Philips’ management team is pursuing additional cost reductions and believes the company has strong revenue and margin potential over the next two to three years in all three primary businesses: medical, lighting, and consumer lifestyle. They signaled their confidence in the future value growth of the business by announcing another €1.5bn share buyback.

For Aon, the world’s largest insurance broker and a leading benefits manager, increasing cash flow and healthy share repurchases helped our position gain 53% for the year. As noted in our third quarter commentary, higher interest rates should improve fiduciary income and help close the pension gap. Aon’s private health care exchange for corporate employees gained critical mass with the addition of Walgreens to the client base. CEO Greg Case and his management team have built value per share through their customer-focused, shareholder-oriented leadership.
Level 3 Communications was a key contributor in the fourth quarter, adding 24% and boosting 2013 gains to 44%. The company reported strong results following the appointment of Jeff Storey as CEO in April. Revenue growth and significant cost reductions improved margins. The company also refinanced $2.6 billion in debt. Large internet-based companies looking to control their customer connections highlighted the value of Level 3’s dark fiber, which is not reflected in revenues. As management continues to execute, value growth should be meaningful. Growing revenues will especially benefit Level 3 given its fixed-cost asset base, lower-than-average maintenance capital spending, and minimal tax liability.

The Fund had no detractors in the fourth quarter. Only one position declined in the year – potash and phosphate producer Mosaic. We bought and exited the stock in the third quarter when potash prices collapsed and changed our case.

In the fourth quarter, we trimmed several positions but made no new purchases or full sales. During the year, we added Murphy Oil in the first quarter and Cheung Kong in the second quarter. We sold four full positions: Disney and Franklin Resources in the first quarter and Dell and Cemex in the third quarter.

Following the Fund’s strong performance, the P/V ended the year in the low-80s%. Our 21% cash level (effectively under 17% considering the Aon risk reversal) is higher than we would prefer, yet we will not compromise our deep discount criteria just to be fully invested. Our research indicates that, historically, our holding cash levels over 15% has not penalized investors over subsequent five and ten year periods when compared to the indexes. In fact, holding cash has been a benefit to the extent it has permitted buying discounted names. Going forward, our patience and discipline should enable us to buy new qualifiers. In the interim, we are happy owners of a portfolio filled with many industry leaders and capable management partners who are building value per share.

The steep rise in stocks has turned the environment from one where discounts were abundant two years ago to one where more caution is warranted. Notably, the underlying leverage in the portfolio decreased in 2013. We sold Cemex and trimmed Chesapeake and Vulcan as prices rose. In addition to reducing our exposure to more levered businesses, we added strongly capitalized Cheung Kong. Within our portfolio companies, our CEO partners increased financial strength by selling assets, cutting costs, and reducing debt at Chesapeake, Level 3, and Bank of New York Mellon. In an environment priced for only good news, we believe that having lower leverage exposure is appropriate.

While we are not surprised by our strong 2013 results, we caution our partners not to expect annual 30+% performance over the next decade. With the liquidity we have to purchase the next compelling opportunities and the quality of our current holdings, we have confidence in our ability to meet our goal of inflation plus 10% over the long term.
Partners Fund Management Discussion

Longleaf Partners Fund delivered a substantial 9.8% in the third quarter, taking the Fund’s year-to-date (YTD) return to 20.4%. Both periods surpassed our annual absolute return goal of inflation plus 10% as well as the S&P 500 Index, which gained 5.2% and 19.8% respectively. The Fund’s formidable quarter added to our strong one year outperformance. We believe we are well-positioned to deliver additional good relative returns from this point, although the absolute numbers are unlikely to continue at a 20+% annual compounding rate.

Cumulative Returns at September 30, 2013

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
<th>YTD</th>
<th>3Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1586.90%</td>
<td>623.42%</td>
<td>226.39%</td>
<td>84.03%</td>
<td>61.07%</td>
<td>24.13%</td>
<td>20.39%</td>
<td>9.82%</td>
</tr>
<tr>
<td>(Inception 4/8/87)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>953.13</td>
<td>440.25</td>
<td>117.91</td>
<td>107.37</td>
<td>61.18</td>
<td>19.34</td>
<td>19.79</td>
<td>5.24</td>
</tr>
</tbody>
</table>

See page 8 for additional performance information.

Three of the Fund’s strongest performers for the YTD made large gains in the third quarter. Chesapeake Energy, the Fund’s largest position for most of the year, contributed to performance the most with the combined equity, convertible preferreds, and options rising 25% in the quarter and 53% YTD. Together with new CEO Doug Lawler, the board that we helped seat last June is instilling financial and operating discipline into the company. Over the last sixteen months, the company has reduced SG&A by 20%, sold and announced sales of over $10 billion in non-core assets, decreased 2013 capex by a projected 46%, and promised to live within its cash flow in 2014.

Philips also performed well in the quarter and YTD, advancing 19% and 27% respectively. We applaud CEO Frans van Houten, who completed a large stock buyback at discounted prices and continued delivering higher margins that approached year-end targets. Philips’ management team continues to do a terrific job focusing on the company’s three competitively strong segments: medical, lighting, and consumer products.

FedEx gained 25% over the last nine months after delivering 16% in the third quarter. The stock increase reflects some degree of confidence that management will execute planned cost cuts at the Express air delivery segment to adjust to the migration of more traffic onto ships and trucks due to high oil prices. While the stock has been volatile over the past year, our appraisal of the company has steadily grown, driven by the Ground segment. Subsequent to quarter-end, FedEx announced a share repurchase plan of 11% of the company.

Other strong performers in the quarter included Level 3, up 27%, and CONSOL Energy, up 25%. At Level 3, since taking over as CEO in April, Jeff Storey has implemented the necessary steps to grow top line and increase cash flow by reducing costs and focusing on higher margin enterprise customers. Brett Harvey, CEO at CONSOL, indicated that management is exploring the sale of assets and could potentially split the company into various parts: natural gas, coal, and infrastructure. Even with meaningful recent stock gains, both companies remain among our most discounted names.

For the YTD, Aon, the world’s largest insurance broker and a leading benefits management firm, was among the Fund’s largest contributors as the company’s lower tax rate and increasing cash flow helped drive a 35% return. Higher interest rates will increase fiduciary income and help close the gap in the underfunded pension. Although nascent, Aon’s healthcare exchange for corporate employees is gaining critical mass,
most recently adding Walgreen Co in the third quarter. We applaud Greg Case and his team for their customer-focused, shareholder-oriented leadership.

The Fund had only three detractors in the quarter: Mosaic, Abbott Labs, and DIRECTV, with only Mosaic negatively impacting YTD results. We bought and exited Mosaic during the third quarter. Our case changed quickly with the potash industry drama that caused prices to drop. Abbott was down 4% following FX headwinds, concerns over tougher rules for device approval in Europe, and issues at a dairy supplier leading to a meaningful product recall in the baby formula division in China. DIRECTV slipped 3% on increased subscriber churn amidst a challenged Brazilian economy. DIRECTV Latin America remains well positioned to benefit from rising pay-TV penetration in the region, and the mature U.S. business continues to generate higher ARPU (average revenue per user).

During the third quarter, we exited our position in Dell, which added 31% YTD. Michael Dell put his personal gain above other shareholders’ interests and eventually won approval of a management buyout well below the value of Dell’s free cash flow and assets. We recognized our errors in assessing Michael Dell as a partner, but we believed that fighting for our clients’ interests against the first MBO in our 38 year history would generate a better outcome than his initial offer, and it did. Our collective opposition with other institutional owners forced the board to postpone the vote three times to avoid defeat, change the record date, alter voting rules, and secure a higher offer to gain approval of the deal. Southeastern infrequently becomes an activist, but when we do, we cover all expenses incurred out of our own pockets – not the Longleaf Funds’ assets. Importantly, fighting for shareholders usually has delivered a superior result.

We sold the Fund’s small position in Cemex convertible bonds as well as Murphy USA, the retail station operation that was spun out of Murphy Oil. We trimmed four names - Aon, Berkshire, Chesapeake, and Philips – because either P/V gaps narrowed or position weights grew too large. For regulatory diversification purposes, we made slight trims of CONSOL and Travelers at quarter-end.

Given the Fund’s recent strong performance, the P/V of the portfolio is in the high-70s%. While higher than normal, we believe our current P/V ratio is more attractive than it appears because of the above average quality of our investees and the conservatism built into our appraisals in two important ways. First, we continue to use discount rates that are dramatically higher than today’s fixed-income rates. Second, at holdings such as Cheung Kong and Abbott, our appraisals reflect longhand multiples far below current private market transaction “comps.” With patience and discipline, we will find new qualifiers for the 15% in cash reserves. Our “on deck” list is limited, but we have several highly qualified opportunities that would become buys with a 10-15% price decline or value accretion. As we use our liquidity to purchase new, discounted investments, the P/V will also become more attractive.

With patience and discipline, we will find new qualifiers.
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

<table>
<thead>
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<th></th>
<th>Since Inception</th>
<th>25 Year</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>One Year</th>
<th>YTD</th>
<th>2Q</th>
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</thead>
<tbody>
<tr>
<td>Partners Fund (Inception 4/8/87)</td>
<td>1436.10%</td>
<td>1350.48%</td>
<td>591.29%</td>
<td>142.67%</td>
<td>74.24%</td>
<td>19.37%</td>
<td>9.62%</td>
<td>-1.80%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>900.65</td>
<td>923.41</td>
<td>426.59</td>
<td>86.46</td>
<td>102.25</td>
<td>20.60</td>
<td>13.82</td>
<td>2.91</td>
</tr>
</tbody>
</table>

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.
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.
Partners Fund Management Discussion

Longleaf Partners Fund gained 11.6% in the first quarter, surpassing the S&P 500 Index’s rise of 10.6%, and far outpacing our absolute annual return goal of inflation plus 10%. The Fund also delivered superior absolute and relative returns over the last year. The Fund’s five and ten year results remain hindered by the declines in the financial crisis in 2008. Since the Fund’s low on March 9, 2009, the Partners Fund has gained 182.7% versus 153.0% for the S&P 500. The Fund’s 25 year cumulative results are over 50% higher than those of the Index.

Cumulative Returns at March 31, 2013

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>25 Year</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>Since</th>
<th>One Year</th>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1464.24%</td>
<td>1451.11%</td>
<td>610.51%</td>
<td>156.91%</td>
<td>107.01%</td>
<td>26.87%</td>
<td>182.73%</td>
<td>15.22%</td>
<td>11.63%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>872.35</td>
<td>960.71</td>
<td>414.19</td>
<td>87.17</td>
<td>126.78</td>
<td>32.64</td>
<td>152.96</td>
<td>13.96</td>
<td>10.61</td>
</tr>
</tbody>
</table>

See page 6 for additional performance information.

Of the Fund’s 19 positions held during the quarter, 18 positively contributed to the strong returns. Dell was the largest driver with the stock up 42% as Michael Dell and private equity firm Silver Lake proposed to take the company private. We are fighting the buyout offer because it removes shareholders’ option to share in Dell’s future success by forcing them to sell at a price we believe is significantly below corporate worth and reflective only of the declining PC business, which represents less than 20% of our appraisal of the company. Long-term owners have supported Dell in its transformation to an Enterprise Solutions and Services (ESS) company as management spent over $13 billion on acquisition of non-PC businesses. Based on Dell’s 2014 estimates, ESS, a growing segment, will comprise over a third of revenue and almost 60% of Non-GAAP operating income. Dell’s price justification, however, focuses on the PC struggles, reversing in substance what management has been saying for the last three years about its transformation and Dell’s bright future. Shareholders who have paid the price to build the foundation for Dell’s future success deserve the right to participate in the rewards. In the event of no “superior proposal,” a proxy vote on the current offer will likely occur mid-summer. To pass, the go-private proposal must receive more than a majority of votes cast excluding Michael Dell’s approximately 15%. In mid May Southeastern and Icahn Enterprises submitted a letter outlining what we believe to be a superior alternative to the Dell / Silver Lake transaction, and also submitted nominees to replace the current Board in the event the take-private transaction is voted down. In either case, our goal would be to implement a leveraged recapitalization that allows shareholders to remain participants in the company’s future while giving them a choice about whether to receive a large special dividend in the form of cash or stock. As we go to print this report, the situation remains very fluid.

Over the last three months, Chesapeake gained 22%, driven in part by a rise in natural gas spot prices above $4/mcf. Chesapeake’s board announced that CEO Aubrey McClendon would step down and made progress on several other fronts, selling a portion of their Mississippi Lime play into a joint venture with Sinopec, and reducing capex to meet spending targets. The stock remains at a significant discount to our appraisal. Travelers, the property and casualty insurer, added 17% in the quarter helped by lower-than-expected catastrophe losses from Hurricane Sandy, as well as positive pricing and renewal trends. Management continued to return capital to shareholders, buying back $400 million of undervalued stock and paying $178 million in dividends. Mondelez, which we bought when this snack business was spun out of Kraft last fall, rose 21% with attention placed on the company by Trian’s newly-held stake. DIRECTV continued to
grow its cash flow through pricing in the U.S. satellite business and increasing subscribers in Latin America. The stock rose 13% as management used excess cash to shrink undervalued shares at a 16% annualized rate and walked away from bidding for Vivendi’s GVT, a Brazilian internet and phone business. Philips gained 13% as the company grew revenues and margins in its three core businesses of Healthcare, Lighting and Consumer. Philips sold its consumer electronics business and is dropping “Electronics” from the corporate name to better reflect its lighting, healthcare, and well being focus.

Level(3) posted the only negative return in the portfolio, declining 12%. Although the company achieved its goal of 2% sequential sales growth, extra costs reduced operating income versus expectations. Management lowered EBITDA guidance accordingly. Given our disappointment over the last several years in Level(3)’s results, we worked cooperatively with the company to add Peter van Oppen to the board, and his appointment became effective during the quarter. Peter owns a private investment firm focused on technology and telecommunications and has specific knowledge of both long haul and enterprise businesses. Additionally, his financial background and experience on multiple boards will bring added discipline. In mid-March, Jim Crowe announced his plan to resign, and by mid-April, COO Jeff Storey was appointed the new CEO. The solid board, combined with Jeff’s experience and operational focus, make us optimistic about the value of this company’s assets being recognized over time.

As the market rose, prices grew faster than values. We trimmed several holdings and sold three that approached our appraisals. Disney, which we first bought in 2001, gained over 280% during our twelve year holding period, in spite of a meaningful mark down in the financial crisis. The strength of ESPN provided steady growth, and theme parks, though more cyclical, also increased their value over time. Management repurchased undervalued shares periodically and otherwise made several large acquisitions that proved successful, including Pixar and Marvel. Because the company’s earnings can swing with movies and economic cycles, we hope to get another opportunity to own this company at the requisite discount sometime down the road. We also sold our Cemex converts, which we exchanged for our equity stake last year. These convertible bonds benefitted from both tightening spreads and a rising equity price, which rose to over $12 in the quarter from its low of under $3 eighteen months prior. While our appraisal took a hit in the economic crisis, Lorenzo Zambrano and his team did admirable work in restructuring the company to manage its debt and reduce costs in response to demand levels at half of peak. We held mutual fund firm Franklin Resources for a much shorter period, since late 2011. As markets rose, assets and profits grew, driving the stock closer to our appraisal. The Johnsons have been successful stewards of our capital in the past, and we hope to have a chance to partner with them again in the future. We identified only one new qualifier, Murphy Oil, in the quarter.

At the end of the quarter the Fund held 17% in cash awaiting our next opportunities. The average P/V on our sixteen positions was in the low-70s%. We expect our companies to continue to build their values, and with patience and discipline, we will find new qualifiers that will help drive future performance.
Partners Fund Management Discussion

Longleaf Partners Fund delivered strong absolute and relative returns in the fourth quarter and for the year. The Fund gained 3.1% over the last three months versus a loss of 0.4% for the S&P 500. The 16.5% return in 2012 exceeded our annual inflation plus 10% goal and beat the Index’s 16.0% rise. Since the 2008 financial crisis and recession, the Partners Fund has more than doubled, gaining 105.0% for shareholders versus a 72.4% return for the Index.

Cumulative Returns at December 31, 2012

<table>
<thead>
<tr>
<th>Fund / Index</th>
<th>Since Inception</th>
<th>Four Year</th>
<th>One Year</th>
<th>4Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund (Inception 4/8/87)</td>
<td>1301.23%</td>
<td>105.00%</td>
<td>16.53%</td>
<td>3.11%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>779.12</td>
<td>72.37</td>
<td>16.00</td>
<td>-0.38</td>
</tr>
</tbody>
</table>

See page 6 for additional performance information.

Over the course of 2012, most holdings rose. The largest contributor in the fourth quarter and the year, Cemex, a global cement company, had been among the largest detractors in 2011. The position rose 79% over the course of the year. As the combined position grew, we sold the equity and ended the year with a 5% position in the converts. Cemex benefitted from both company-specific actions and broader changes. Management successfully reduced and renegotiated debt terms without diluting shareholders, continued to cut costs, and IPO’d part of the growing Latin American business. Construction-related stocks moved up as recession fears declined, U.S. housing strengthened, and worldwide cement and aggregates prices rose. These dynamics also impacted Vulcan Materials, the U.S. aggregates company, which added 10% in the last quarter and 33% for the year. Management continued to cut costs and increased free cash flow even without volume increases. We trimmed our position to 4.8% of the portfolio.

Philips Electronics, the global medical, lighting and personal care company, rose 12% in the quarter and 31% over the year. In spite of economic headwinds around the world, revenues, margins, and income exceeded expectations across all segments. Hitting, if not surpassing, margin targets in a tough revenue environment for 2013 looks increasingly likely. Management also grew value through significant share repurchases of discounted shares throughout the year. Bank of New York Mellon appreciated 14% in the last quarter and 32% in 2012. Management surpassed Basel III tier 1 capital requirements and used excess cash to repurchase shares. Cost savings and strength in the asset management business helped convince investors that current earnings are sustainable. We trimmed the position to a 4.9% weight.

InterContinental Hotels and Disney both contributed significantly to 2012 results even after slight stock retreats in the fourth quarter. InterContinental gained 45%, and we sold the stock after management completed a $500 million special dividend and launched a $500 million repurchase. This worldwide hotel company met our buy criteria in August 2011 when macroeconomic fears drove down the price. In the fifteen months we owned the stock, REVPAR (revenue per available room) rose across all geographies and brands, and management announced a plan to sell the London trophy property. We made 84% over our relatively brief holding period. Disney gained 37% over the year, and we trimmed our position as the gap between price and value began to close. Results at the theme parks drove much of the positive news, and ESPN grew operating income at a solid pace. Management used excess cash flow to buy in shares and to acquire Lucasfilm, maker of Star Wars.

Of the names that lost ground in 2012, two of our core positions, Dell and Chesapeake, penalized results meaningfully. Dell gained 5% in the final quarter but fell 37% for the year. We wrote at length in the third quarter report about...
the End User Computing (EUC) segment’s decline as PC and notebook sales fell. Even though the higher margin Enterprise Solutions and Services (ESS) business grew, overall top line declined as EUC was a larger percent of Dell’s revenues. Over time these two divisions will trade places in terms of revenue importance, reaping higher margins and stronger long-term growth for Dell. Post year-end, the stock is up significantly following an offer to take the company private.

Chesapeake was the primary detractor in the fourth quarter, losing 10% and ending down 22% for the year. Low natural gas prices have hurt the stock and caused investors to question the company’s ability to cover expenses. In the second quarter, we participated in major governance improvements, essentially replacing five board members. Subsequently, the company has sold assets, reduced board and CEO compensation, cut G&A expenses, and subsequent to year-end, CEO Aubrey McLendon announced his retirement. Investors remain skeptical of additional asset sales and reductions in 2013 capex spending. We anticipate that the board, which collectively purchased substantial shares in 2012, will continue to implement decisions that protect and grow shareholder value, and that over time, supply and demand of natural gas will come into balance, causing prices to more closely reflect the marginal cost of production. In the interim, Chesapeake continues to increase its liquids production and reduce the output from its dry gas plays.

We identified five new qualifiers (CONSOL Energy, Berkshire Hathaway, Vivendi, Republic Services, and Mondelez) during the year, although none in the fourth quarter. We filled out our Mondelez position over the last few months as Kraft completed the spin out of these leading global snack brands including Nabisco, Cadbury, and Trident. We closed out our Republic Services position in the fourth quarter after we adjusted our appraisal of the second largest U.S. solid waste company to reflect a lower volume outlook. We also sold Liberty Interactive as the stock approached our appraisal. While the 2008 recession’s impact on QVC reduced our anticipated return in this investment, from the November 2008 low, the holding gained over 98% as management subsequently strengthened the balance sheet, bought in shares, and separated Liberty Ventures to create a simplified company. Also noteworthy is the split in Abbott Labs that occurred at the start of 2013. To maintain our position size post-split, we bought “when issued” shares of the new Abbott Labs and sold shares of AbbVie, the separated pharmaceutical company.

As we begin 2013, the portfolio trades at an attractive mid-60% P/V, and long-term value growth should add more opportunity for return. We primarily own industry leaders that have proven their strength through a challenging economic environment. Our management partners have shown their abilities to cut costs, take share, and build value in both good and tough times. We expect that several of our holdings will be controversial at any given point, but as management effectively address challenges, the skepticism will subside and value will begin to be recognized. For example, over the last year, both Cemex and Level(3) eliminated their debt challenges, and Chesapeake and Level(3) improved their boards. Our long-term shareholders remember other names that evoked controversy and eventually paid off. Even a successful year such as 2012 seemed more dominated by the two most controversial names rather than the remainder of stocks that actually drove our good returns. As long as we anchor our decisions on conservative business appraisals, ensure we have capable and shareholder-aligned management teams, and own businesses with sustainable competitive advantages, we can use patience and a long time horizon to our advantage. This has been true over our 38 years of investing, through numerous market environments and challenges, and nothing indicates that it will change over the next forty years.
Longleaf Partners Fund gained 5.6% in the quarter and is up 13.0% year-to-date (YTD), ahead of our annual goal of inflation plus 10%. The S&P 500 Index grew 6.4% and 16.4% over the same periods. One holding accounted for essentially all of the difference between the benchmark and the Fund. Although the last five years have reflected a substantial bias against value oriented stocks (Russell 1000 Value Index down 4.4% versus Russell 1000 Growth Index up 17.3%), the Fund’s long-term returns have far exceeded the S&P 500.

Cumulative Returns at September 30, 2012

<table>
<thead>
<tr>
<th></th>
<th>25 Year</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>Three Year</th>
<th>One Year</th>
<th>YTD</th>
<th>3Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1144.20%</td>
<td>643.71%</td>
<td>146.84%</td>
<td>89.25%</td>
<td>-10.18%</td>
<td>35.69%</td>
<td>24.92%</td>
<td>13.02%</td>
<td>5.61%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>688.27</td>
<td>411.55</td>
<td>99.11</td>
<td>116.15</td>
<td>5.37</td>
<td>45.07</td>
<td>30.20</td>
<td>16.44</td>
<td>6.35</td>
</tr>
</tbody>
</table>

See page 8 for additional performance information.

Almost all of our holdings appreciated in the quarter and for the YTD. The strongest contributors were names we bought or added to in the broad market downdraft a year ago. Cemex, which was among the most undervalued names, has contributed the most to Fund performance, up 61% YTD and 24% in the recent quarter. Positive sentiment regarding U.S. housing, infrastructure spending, and global construction as well as upward worldwide pricing trends helped cement and aggregates stocks. Specific to Cemex, management successfully refinanced the company’s bank debt, extending maturities and relaxing covenants, without diluting shareholders. Cemex also announced plans to IPO a portion of its Latin American business. With the stock’s large gains, we trimmed our position by selling the remaining equity and some of the convertible bonds. Vulcan also benefitted from the same positive U.S. trends, and its price rose 19% in the quarter.

Philips Electronics gained 18% over the last three months. The company reported that organic revenues grew in all three segments (lighting, medical, consumer lifestyle), and margins moved closer to 2013 targets. Management announced an additional €300 million in cost savings by 2014 as well as share repurchases. Intercontinental Hotels’ 12% rise in the quarter brought its YTD increase to 53%. We bought this global hotel company last August amid macroeconomic fears as the rebranding of Holiday Inn Express was coming to completion. Since then, REVPAR (revenue per available room) has risen across the company’s geographies (primarily North America and China) and brands (Holiday Inn, Crowne Plaza, and Intercontinental). Management put the Barclay Hotel in New York for sale and plans to sell other trophy properties with its London hotel a likely 2013 candidate. The company will return capital to shareholders in October via a $500 million special dividend and $500 million share repurchase. We trimmed the position as its weight and P/V rose. Disney also contributed to the Fund’s YTD return, rising 42%. Domestic theme parks had higher attendance and visitor spending; ESPN grew operating income strongly; and the studio released a big hit, The Avengers. We scaled back the stock given its appreciation.

Few stocks detracted from returns. Dell fell 21% over the last three months, and the stock’s 33% decline in 2012 made it the primary detractor to the Fund’s performance for both periods. The primary challenge over the last two quarters was a larger-than-expected decline in End User Computing (EUC) revenue due to several pressures. Tablets and other mobility devices displaced notebooks more rapidly than anticipated; demand in India and China shrunk, where Lenovo aggressively priced to take share in these geographies; and commercial purchases slowed because of general economic weakness and the anticipated release of Windows 8. In spite of the decline in notebooks and PCs, margins held up in EUC, a testament to the company’s successful cost cutting and variable cost structure. Far more importantly, the growing, higher margin Enterprise Solutions and Services (ESS) business had strong networking and server growth with servers gaining market share. While ESS represents about one-third of revenues, it constitutes over half of profits and a far higher share of our appraisal. The company’s transformation to a solutions-based company is well underway and leverages Dell’s direct distribution advantage of over 20,000 employees responsible for customer relationships with small and mid-size businesses. Interestingly, IBM successfully refocused its business over a ten year period starting in the early 1990’s from mainframe hardware to...
multifaceted technology solutions for large-scale customers. The head of IBM’s mergers and acquisitions was Dave Johnson, who joined Dell in 2009 to lead its strategy to enhance solutions offerings and has purchased a number of companies and products that have grown through Dell’s expansive distribution. If we assume that EUC continues its rapid decline and has no value, we appraise the remaining ESS business at over twice the current stock price. With adjusted cash earnings of $2.00/share and an enterprise value of less than $3.50/share (share price minus net cash and DFS), the stock trades at less than a 2X adjusted P/E for a growing business (ESS) with good margins and an owner/operator as CEO who is focused on growing value per share.

Chesapeake gained 2% in the quarter and rose 39% from its low point in May. The substantial governance changes we discussed in last quarter’s report not only lifted the stock, but also improved the prospects for more conservative capital allocation going forward. The company announced $6.9 billion in asset sales during the quarter and anticipates approximately $2 billion more this year. In spite of the company’s progress, the stock was down 14% YTD. Although the natural gas price moved up in the quarter, it remains below the marginal cost of production for most plays. Natural gas also impacted CONSOL, which was flat in the quarter but down 10% YTD. Continued switching to cheap gas has pressured coal prices, and CONSOL owns both natural resources. The supply/demand imbalance should self-correct as natural gas drilling has declined substantially in response to low price, and demand has increased at electricity plants. Longer term demand from industrial plants, LNG exports, and conversion of trucks to this clean and abundant energy source would support an increase in natural gas prices and a higher value for both Chesapeake and CONSOL.

In addition to the trims mentioned previously, we reduced our overall insurance exposure following price gains by scaling back Travelers and Aon and selling our small stake in Willis. When Liberty Interactive split off Liberty Ventures, we sold the new stock because it traded near our appraisal. We sold our small stake in Vivendi as price rose following the board’s decision to sell segments and after the company’s inability to sell its Activision games stake caused us to lower our appraisal based on this business’ market price. We added two new holdings, Republic Services, the waste collection and disposal company, and Mondelez, the snack business that Kraft spun out. Our on-deck list of prospective investments has become somewhat skinny with the market rally. We have a number of businesses that qualify qualitatively but sell at 70%+ P/Vs. The portfolio’s P/V is in the mid-60%, near the long-term average.

We believe the Fund will deliver solid long-term results given the market-leading positions of most of our companies and the capabilities and alignment of our corporate partners. Not only can our values rise in a slow growth economy, but following recent balance sheet improvements at several holdings, each of the companies we own has the financial strength needed for defense in the event of a dip. When economic recovery finally occurs, these businesses should benefit from both strong top line gains and operational efficiencies that our management partners have created through reduced cost structures.
Longleaf Partners Fund declined 5.2% in the second quarter, reversing the Fund’s outperformance of the S&P 500 in the first quarter. Year-to-date the Fund is up 7.0%. In comparison, the S&P 500 dropped 2.8% in the quarter and is ahead 9.5% for the first half of 2012.

Cumulative Returns at June 30, 2012

<table>
<thead>
<tr>
<th></th>
<th>25 Year</th>
<th>20 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>Three Year</th>
<th>One Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1135.43%</td>
<td>620.73%</td>
<td>57.04%</td>
<td>-16.19%</td>
<td>51.87%</td>
<td>-5.65%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>690.09</td>
<td>396.17</td>
<td>68.13</td>
<td>1.09</td>
<td>57.70</td>
<td>5.45</td>
</tr>
</tbody>
</table>

Macro-driven market environments that ignore company fundamentals often hurt short-term relative results for intrinsic value investors, but allow those who base investments on underlying business characteristics to construct portfolios at deep discounts, thereby laying the foundation for future compounding. The chart below shows that the Fund has delivered superior results following previous periods of five year underperformance.

Difference Between Longleaf Partners Fund and S&P 500 Index
For Rolling 5 Year Periods Since Inception

See page 8 for additional performance information.
Partners Fund Management Discussion

The Fund had several performance bright spots in a challenging quarter. Disney gained 11%, taking its 2012 return to 31%. Disney’s results were ahead of expectations with higher ad revenues at ESPN and the Disney channels, lower programming and production costs at ABC, and higher attendance and spending at the theme parks. We trimmed the position to a more normal weight. Travelers, among the top U.S. property/casualty insurers, returned 9% over the last three months as the company beat earnings expectations, raised its dividend, and repurchased 6 million shares. A lower combined ratio reflected stronger pricing and solid underwriting. We reduced the position as it became overweight. InterContinental, the world’s largest hotel operator under the InterContinental, Holiday Inn and Crowne Plaza flags, added 6% in the quarter and has been the largest YTD contributor, rising 37%. REVPAR (revenue per available room) grew 7% company-wide and should increase over the next few years given tight supply in the U.S. and growing demand in China. The company owns several trophy properties, including locations in London and Hong Kong. At the end of May activist fund Trian bought a stake. We scaled our position to a normal weight after its strong run.

In spite of retreating 13% in the quarter, Cemex remained among the Fund’s best performers for 2012 with a 30% gain. The peso’s recent weakness impacts the translation of Mexican earnings into dollars. Aside from currency fluctuations, results have been strong this year with increased volumes in the U.S. and South America and solid pricing in Mexico. The U.S. has turned EBITDA (earnings before interest, taxes, depreciation, amortization) positive for the first time since 2008, and the recent two year federal road bill extension will unlock needed funds for highway projects. Additionally, Cemex and the banks that comprise half of its debt were renegotiating and extending terms at quarter end. We exchanged some of our equity for convertible bonds to take advantage of the opportunity to move up the capital structure at an attractive yield to maturity and conversion price. We maintain a large percentage of Cemex’s upside while dramatically decreasing downside risk.

Dell and Chesapeake accounted for much of the Fund’s second quarter decline and became the largest performance detractors for the YTD. Dell fell 25% in the quarter making its 2012 return -15%. Disappointing earnings were primarily driven by a steeper decline than anticipated in notebook revenues. We lowered our appraisal to reflect slower notebook revenues and adjusted margin growth in the enterprise business to account for a larger sales force and the time lag to fully integrate acquired products. Our new appraisal equates to the company’s value a year ago. Results in the quarter supported the overall case for Dell transforming from low margin, declining hardware to growing, higher margin solutions. Enterprise grew 5% and represented over half of adjusted operating income. The broader migration to mobile and cloud computing will accelerate the transition pace. Michael Dell is one of the most vested and engaged CEOs we have as a partner. The company repurchased shares at a 4% annualized rate. Dell trades at less than 4.5 times free cash flow adjusting for the net cash.

Chesapeake, the U.S. oil and gas exploration and production company, fell 20% in the quarter and is down 16% YTD. As discussed in the Shareholder Letter on pages 2 and 3, decade-low natural gas prices, governance questions, and concerns over 2012 cash needs pressured the stock. The company owns some of the best oil and gas acreage in the U.S. at an extremely low cost. We became more active in the quarter to overhaul the board and encourage a focus on near-term financing and cost management. As a result, seven of the nine board members will have been pre-approved and/or submitted by Southeastern. This group is committed to prudently growing value per share and gaining recognition for that value. Following the governance transformation, we slightly increased our position via convertible preferreds which have an attractive yield and a convert price that is significantly below our appraisal.

In addition to the trims and additions mentioned above, we sold our Colgate-Palmolive option positions and added two new qualifiers, Berkshire Hathaway and Vivendi, both which we have previously owned. Colgate, which we held via a
five year “risk reversal” that gave us upside in the price over $80/share and an entry price of $65 if the stock traded down to that level, was around $77 when we took the position in early 2011. Because of low interest rates and the stability of this dominant oral and personal care products company, the net cost for our long exposure over $80 was only $3.50/share. We closed out the position for approximately $18.50/share because the stock approached full value based on our DCF model. When Berkshire Hathaway fell close to book value, we bought the stock for the second time. The company’s capital strength and investment success provide an advantage in its insurance businesses which comprise just over half of our appraisal, and the competitively entrenched operating companies include the railroad, Burlington Northern, and the utility and pipeline business, MidAmerican. We have superior partners not only in Warren Buffett, but also in the next level of management responsible for the different pieces. His recent share repurchase plan reflects his view that the stock is discounted. Additionally, the board is structured to insure a consistent approach and culture long past Buffett’s tenure. Vivendi moved out of our buying range soon after we started the position when the company announced that its CEO, who was thought to be against monetizing the company’s undervalued assets, stepped down due to differences over strategy.

The Fund primarily owns industry leaders with vested and capable corporate partners. The market’s macro-driven volatility continues to swing performance somewhat dramatically over short intervals but has provided opportunities to make important adjustments to existing holdings and to find new investment qualifiers. Likewise, many of our management partners are building value per share through repurchasing stock at deep discounts, taking advantage of “Mr. Market’s” manic moves. The Fund trades at an attractive P/V in the low-60%, and we expect values to continue to increase.
Partners Fund Management Discussion

Longleaf Partners Fund delivered a strong 12.91% for the first quarter of 2012, far exceeding our absolute return goal and outperforming the S&P 500’s 12.59% gain. In the three years since the market lows of March 2009, the Partners Fund has more than doubled while the Index has increased 88%, and the cumulative rate of inflation plus 10% has been less than half the Index.

Cumulative Returns at March 31, 2012

<table>
<thead>
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<th></th>
<th>Three Year</th>
<th>One Year</th>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>102.90%</td>
<td>0.87%</td>
<td>12.91%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>87.99</td>
<td>8.54</td>
<td>12.59</td>
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<tr>
<td>Inflation + 10%</td>
<td>42.61</td>
<td>12.63</td>
<td>na</td>
</tr>
</tbody>
</table>

See page 8 for additional performance information.

Many names delivered double-digit gains in the quarter, and only two detracted from performance. Four investments generated over half of the Fund’s return. Cemex continued to rally from its lows in the third quarter of 2011, adding 50% in the last three months and 155% since September 30th. The company had a fifth consecutive quarter of top line growth thanks in part to price increases in most markets as well as demand growth from infrastructure and housing improvements. Improved margins reflected lower energy costs and overall expense reductions. For the first time in four years sales and EBITDA grew in 2011. The company expects no debt covenant issues in 2012 given successful asset sales, and in February Cemex made an exchange offer for approximately $2 billion of debt which will lower absolute debt levels, push maturities further out while reducing dependence on bank financing, and provide more flexibility with banks. Intercontinental Hotels gained 31%. The dividend increased by 15%, and the value grew as REVPAR rose. Growth should continue for the next few years due to a healthy pipeline of hotels in development, launch of an upscale China brand, a new mid-scale U.S. brand and a repositioning of Crowne Plaza in the U.S. Level(3) added 51%. Results in the first quarter since the company’s merger with Global Crossing indicated that EBITDA growth in 2012 should be strong. Dell exceeded Wall Street’s expectations for a fifth consecutive quarter with a modest top line increase but substantial growth in operating income and profitability as the business mix moved further from pc’s to enterprise solutions. Philips declined 3% in the quarter as the company reported EBITDA approximately 5% below consensus expectations, primarily due to one-time issues in the healthcare and lighting segments. Although management firmly expressed a commitment to 2013 targets based on reduced costs and global GDP growth of 3%, their cautious stance on first half 2012 results and the concurrent buyback plan extension compounded skepticism over what the company will deliver. While Western Europe’s economic challenges are likely to last for some time, this area generates less than 30% of revenues. Philips’ consumer brands as well as its medical and lighting businesses are dominant and growing in emerging markets, which account for over one-third of revenues and should dwarf Europe’s importance to the company’s results over time. Willis, which we trimmed early in the quarter, dropped 9%. The company reported lower margins following a revenue decline in North America where some of the sales force departed as non-competes from previous acquisitions rolled off.

We trimmed six positions that have appreciated including Intercontinental and Dell, to maintain appropriate portfolio weights. Additionally, we sold some of our Cemex shares to purchase Cemex convertible bonds that offer an attractive yield and the longer-term upside of the stock whenever global recovery moves into higher gear. We sold NKSJ, a disappointment that we...
discussed in the Annual Report, and YUM! Brands, the Fund’s long-time holding, which was the top performer last year and approached our appraisal in the first quarter. Management did a tremendous job following the company’s spin from Pepsico in 1998 when we first took a position. They moved from a capital intensive owned restaurant model to a franchise model in the U.S. and used the free cash flow from franchise fees to invest in rapidly growing China. The company’s approach of hiring local management, adjusting menus to regional tastes, and controlling the quality of its supply chain made KFC the most successful non-Chinese brand in that country. Given the success of YUM’s overseas business, by the time we sold the company, the U.S. represented less than half of the company’s value. YUM exemplified an ideal investment: one purchased at a large discount where there was an experienced management team who built value per share at a strong pace by transforming the company through excellent operating and capital allocation execution.

The market’s overall strength kept most businesses’ prices above our required discount for purchase. We ended the quarter with just under 10% in cash which we will patiently deploy when we find companies that meet our qualitative and quantitative criteria. Even after the Fund’s strong return, the P/V remains in the low-60%s, below the long-term average, due to both value growth at many companies and reducing or eliminating some of our less discounted names such as YUM. With the low P/V, the quality of our companies, the capable work of most of our management partners, and the liquidity to add a few deeply discounted investments to the portfolio, we believe the Fund offers attractive compounding opportunity.

...since the market lows of March 2009, the Partners Fund has more than doubled...
Partners Fund Management Discussion

Longleaf Partners Fund gained 10.5% in the fourth quarter to finish the year down 2.9%. These results fell below our absolute annual return goal of inflation plus 10% as well as the S&P 500 performance of 11.8% and 2.1% for the same two periods. Over longer holding periods, the Fund has outpaced the Index. In the three years since the unprecedented market decline of 2008, the Fund’s absolute returns have far exceeded our goal.

Cumulative Returns at December 31, 2011

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<tr>
<th></th>
<th>20 Year</th>
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<th>Five Year</th>
<th>Three Year</th>
<th>One Year</th>
</tr>
</thead>
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<tr>
<td>Partners Fund</td>
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<td>44.35%</td>
<td>(13.48)%</td>
<td>75.92%</td>
<td>(2.85)%</td>
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<tr>
<td>S&amp;P 500 Index</td>
<td>350.12</td>
<td>33.35</td>
<td>(1.24)</td>
<td>48.59</td>
<td>2.11</td>
</tr>
<tr>
<td>Inflation + 10%</td>
<td>953.31</td>
<td>224.06</td>
<td>78.30</td>
<td>41.97</td>
<td>12.96</td>
</tr>
</tbody>
</table>

See page 10 for additional performance information.

Positive returns over the last three months helped the Fund recover from much of the third quarter slide. Both of the Fund’s building materials investments rose with diminished fears of a U.S. recession. Cemex gained 71% but remained among the worst performers for the full year. Vulcan Materials rose 43% after Martin Marietta (MLM) made an offer to acquire the company. We are encouraging Vulcan management to engage in talks with MLM to explore a combination that could be beneficial to both companies. (We hold MLM in the Small-Cap Fund.) A number of other companies gained over 20% in the quarter. Disney rose with positive results at the theme parks and at ESPN where revenues and operating income grew in the teens. We trimmed shares, which remain well below our appraisal, to a normal 5% position. Travelers continued its substantial repurchase program at discounted prices and reported increased premiums with pricing gains across all three lines of business. Pricing has been a challenge since 2008, and three straight quarters of increases in the business insurance unit indicates that the soft market has bottomed and started to turn. FedEx also reported pricing power across all segments as well as stock repurchases. The company expects to benefit from modest GDP growth around the world in 2012. Yum! gained 20% in the quarter and was the Fund’s largest performance contributor for the year. The company’s international business continued to drive results, primarily at KFC China.

We scaled the position on the stock’s strength, but the price does not fully reflect intrinsic value or future growth prospects including expansion in India and other emerging markets. News Corp gained 14% in the year, making the company a top contributor to the Fund’s 2011 return. We sold the position in the fourth quarter.

Most of the Fund’s businesses positively impacted performance in the fourth quarter, but four stocks declined. Chesapeake Energy’s (CHK) 13% retreat in 2011 occurred in the last three months. Natural gas fell below $3/mcf because of a warm winter and oversupply, and CHK traded in correlation with the commodity. As discussed in the shareholder letter at the outset of this report, we own the best set of U.S. natural gas assets and a rapidly growing portfolio of oil reserves and production at less than half of our appraisal, which assumes that gas prices follow the current futures curve. Chesapeake’s oil and gas reserves have increased in recent months. Level(3), which declined 24% in the quarter but gained 16% for the year, completed its acquisition of Global Crossing. The price fell after Global Crossing’s operating cash flow (OCF) came in slightly below guidance, even though Level(3) met top line expectations and exceeded OCF growth estimates. Because Level(3) provides only yearly guidance, Global Crossing did not indicate its expectations for the next quarter. This post-merger cessation of quarterly guidance for Global Crossing spooked the market but did not impact the combined...
company’s value which we appraise at almost three times higher than its current price. More disappointing has been NKSJ which lost 12% in the quarter and 30% over the year due primarily to losses incurred in the March earthquake and tsunami and the Japanese stock market decline which negatively impacted investment performance. We pared back our investment throughout the year and subsequently fully liquidated the position because management has failed to reap the benefits of the 2010 merger of NipponKoa and Sompo as promised; as Jim Thompson put it, “the only thing they’ve merged is their name.” Furthermore, they have used capital to buy fully priced overseas insurers rather than buying in their own extremely undervalued stock. We also sold our minimal remaining shares in TDS which was barely down in the quarter but fell 35% over the year. As we have previously discussed, our initial assessment of management was wrong, and the controlling Carlson family prevented us from being paid for the valuable wireless network and spectrum held by TDS and US Cellular. Although up 8% in the quarter, Bank of New York Mellon was also among the detractors from performance over the year. As discussed in the Fund’s third quarter report, the company’s results are being muted by low interest rates and capital market headwinds. We believe, however, that value will continue to build even in this challenging environment because of the underlying strength of the company’s dominant custody, treasury services, and wealth management businesses and because CEO Gerald Hassell is taking advantage of the stock’s extreme undervaluation by repurchasing shares.

In the fourth quarter, the market’s strength gave us few buying opportunities. The Fund has almost 6% in cash which gives us the liquidity to take advantage of new opportunities as they arise.

We begin 2012 with a compelling portfolio that we believe should deliver solid results. The companies we own have dominant industry positions and advantages over their competitors. Almost all of our management partners are heavily vested and have a record of building value. Because of the quality of our businesses and partners, the average value across the portfolio’s holdings grew at 10% in 2011, and we think that pace of growth is likely to continue or accelerate. The Fund’s P/V is at an extremely attractive and rare mid-50% level.
Partners Fund Management Discussion

*Longleaf Partners Fund declined 20.2% in the third quarter, taking the year-to-date return to a disappointing (12.1)%. The S&P 500 also fell in the quarter, losing 13.9%. The Index's performance in 2011 is (8.7)%. Although the last three months hurt both absolute and relative returns, the Fund has meaningfully outperformed the benchmark for holding periods of 10 years and longer.*

**Cumulative Returns at September 30, 2011**

<table>
<thead>
<tr>
<th></th>
<th>Inception</th>
<th>20 Year</th>
<th>Ten Year</th>
<th>One Year</th>
<th>YTD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>987.9%</td>
<td>585.9%</td>
<td>50.5%</td>
<td>(2.8)%</td>
<td>(12.1)%</td>
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<tr>
<td>S&amp;P 500 Index</td>
<td>577.8</td>
<td>336.3</td>
<td>32.0</td>
<td>1.1</td>
<td>(8.7)</td>
</tr>
<tr>
<td>Inflation + 10%</td>
<td>1862.5</td>
<td>963.6</td>
<td>223.1</td>
<td>13.9</td>
<td>na</td>
</tr>
</tbody>
</table>

*See page 8 for additional performance information.*

Only one name, Abbott, added positively to the quarter’s return as we added to our position at the stock’s lowest levels, and price subsequently rebounded a bit. Macro fears dominated sentiment, particularly in August and September with a cut in the U.S. debt rating and additional attention on the debt issues faced by western European countries. Within the portfolio, the pessimism most dramatically affected Cemex, which fell 63% over the three months for a total decline of 69% this year. Cemex, the global cement producer, faces three primary challenges — the inability of the U.S. government to pass a long-term transportation bill covering much-needed infrastructure improvements, low housing starts in the U.S. and other developed markets, and debt-related covenants and maturities in the next three years. The first two challenges will delay cash flows but will not impair either the long-term asset values of the U.S. cement facilities and aggregates that Cemex owns or the intrinsic worth of its non-U.S. markets which represent the majority of the company’s value. The company’s assets also support its debt and remain desirable to others even in this industry depression. Management faced much more severe challenges in 2008, yet the stock has fallen to lower levels. As owner-operators management did an excellent job reducing and restructuring debt while looking out for shareholders’ interests. Management is equally focused on protecting intrinsic value while managing the business and capital structure in this depressed environment.

Other names that contributed to the Fund’s poor performance in the quarter and have declined year-to-date are Philips and FedEx. Philips took impairment charges due to lowering growth assumptions and raising discount rates on two acquisitions made under the previous CEO. Additionally, the company reduced growth targets for the lighting business because of higher raw material costs and lower construction expectations. The company’s medical business posted higher revenue than expected, and the personal care and health segment of the consumer business grew at double-digit rates. We applaud management’s decision to accelerate the repurchase of €2 billion in stock, a move that will add meaningfully to the value per share given the stock’s current discount to intrinsic worth. FedEx also announced a share repurchase as its price declined. Operating income in the express business was lower than expected because weak consumer demand for electronics reduced Asian high tech shipments. The company’s ground business delivered strong results and accounts for the majority of our appraisal because of FedEx’s incredibly strong competitive position.

Bank of New York Mellon (BK) has also been among the largest detractors from the year’s performance, declining 38% year-to-date. The company has generated good top line results and
is reducing its expense structure. The stock is suffering under questions that emerged in the second quarter around standing instruction trading for foreign exchange settlement. Several public plans filed lawsuits related to FX trading in the quarter. This business comprises only 2.5% of BK’s total revenues, and our appraisal incorporates reduced profitability from this area. In the third quarter CEO Bob Kelly was replaced by Gerald Hassell, a respected long-time employee who already was running the company’s businesses other than asset management. Hassell is committed to maintaining BK’s strategy. The biggest challenges BK faces are continued low interest rates and capital market headwinds, but while the company waits for an improvement, management is using excess capital to repurchase depressed shares.

Although Level(3) and Dell hurt the Fund’s third quarter results (down 39% and 15% respectively), both have contributed positively to this year’s return. Level(3), which is up 52% year-to-date, has recently completed its acquisition of Global Crossing. The combined telecommunications fiber company will have lower operating and debt costs as well as larger revenue opportunities. The recent 39% stock decline did not reflect any change to the company’s prospects or the underlying value of its fiber assets. In fact, results released in the quarter included record gross and operating cash flow margins, helping the value of the company grow. Dell also enhanced its position in the quarter in spite of the stock’s movement. For the sixth consecutive quarter the company reported higher margins and earnings, reflecting the successful migration of the business from notebook and desktop computers to enterprise solutions. Dell trimmed top line guidance but outperformed earnings expectations because the company is focusing on its more profitable enterprise business. The company has used the stock’s weakness as an opportunity to repurchase extremely discounted shares, and the uncertainty around the direction of rival HP has enhanced Dell’s appeal to customers.

The volatility in the quarter gave us the chance to add to a number of holdings, especially in August and September. We swapped our position in Campbell Soup for a more attractive opportunity to own InterContinental Hotels (IHG) for a second time. Campbell’s great brands sold below our appraisal, but the ongoing challenges in the soup business coupled with a management change led us to believe that the qualitative characteristics at IHG were far more compelling, especially given the discounted price. The stock traded near full value at the outset of the year when the market believed occupancy and RevPar (revenue per available room) would continue to grow at both InterContinental, Holiday Inn Express, and Holiday Inn hotels. When sentiment turned in August, the company was priced as if RevPar would be negative, even though it is still growing at 6% per year and is likely to be positive in 2012. The Crowne Plaza backlog in China is increasing that brand’s already broad reach in an important growing market. Management has successfully rebranded Holiday Inn and is working on a similar effort for Crowne Plaza in the U.S.

The Partners Fund sells in the low-50s P/V range — a compelling level relative to Southeastern’s historic average in the high-60s. The strength of our underlying businesses makes the current P/V even more attractive since value growth this year has averaged 10% across the portfolio. Management teams are showing their confidence in their businesses and a commitment to value growth by spending cash on aggressive buybacks. Across the portfolio CEOs are shrinking shares at an average annualized rate of 6%. Our businesses are competitively dominant, and anemic economic growth can provide the opportunity for them to become more so at the expense of weaker players. We encourage our partners to add to their positions in the Partners Fund given the qualitative strength of our holdings and management teams and the substantial discount to appraised value.
Partners Fund Management Discussion

Longleaf Partners Fund rose 1.3% in the second quarter, bringing year-to-date return to 10.2%. The Fund’s performance outpaced that of the S&P 500 Index which gained 0.1% and 6.0% over the same periods. Over the last twelve months the Partners Fund’s 32% rise not only beat the Index, but more importantly, delivered over two times our absolute annual return goal of inflation plus 10%.

Cumulative Returns at June 30, 2011

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<th>Ten Year</th>
<th>One Year</th>
<th>YTD</th>
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<tbody>
<tr>
<td>Partners Fund</td>
<td>1263.9%</td>
<td>786.4%</td>
<td>62.9%</td>
<td>32.0%</td>
<td>10.2%</td>
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<tr>
<td>S&amp;P 500 Index</td>
<td>686.9</td>
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</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1808.8</td>
<td>967.5</td>
<td>222.1</td>
<td>13.7</td>
<td>na</td>
</tr>
</tbody>
</table>

See page 6 for additional performance information.

The continuation of strong operating results at several core holdings as well as positive reaction to Level(3)’s announced acquisition of Global Crossing helped performance. Level(3)’s 66% second quarter return took the stock’s first half gain to 148%. Combining these two fiber network businesses provides numerous benefits. Level(3)’s debt cost will dramatically decline as its debt/EBITDA ratio falls from over 6 times to 4 times. Global Crossing’s gross margins will rise meaningfully as the company moves much of its U.S. long haul business to Level(3)’s network. Further industry consolidation bodes well for long-term pricing. We also gain astute partners in the board room as Global Crossing’s majority owner, Singapore fund Temasek, will have three board seats and own roughly 25% of the company.

Dell surpassed margin and earnings expectations for a third consecutive quarter, making it a top Fund contributor for both the quarter and the last six months. The results reflect the company’s ongoing migration from end user computers to higher margin enterprise solutions. Additionally, supply chain improvements, product simplification, and better pricing have enabled the company to deliver profits in the consumer segment of the business. Dell also announced that it repurchased $1.1 billion of stock in the last two months — an especially high return choice for shareholders given that the stock trades for around half of appraised intrinsic value. DIRECTV, which was another of the Fund’s top performers in both quarters this year, grew its value with a share repurchase of over $1 billion funded mostly with cheap long term debt. The company delivered solid U.S. results and spectacular Latin American numbers with revenues rising over 40%, and operating cash flow growing over 50%.

In those names that negatively impacted performance, the market seemed to focus on short-term items or somewhat insignificant news. Because our appraisals remained steady or rose, we had the opportunity to take advantage of price weakness and add to several of these holdings. Controversy around the potential environmental impact of fracking and the economic viability of shale gas weighed on Chesapeake in the quarter. Although the fracking process is not risk-free, it has a safe track record over its 50+ year history. Our case for Chesapeake’s value does not rely on the outcome in the fracking argument. Drilling for and burning natural gas to generate electricity, however, compares extremely well environmentally versus the two primary alternatives — coal and nuclear energy. For transportation, natural gas is economically compelling versus oil. In late June an article questioning the economic viability of shale gas painted only a partial picture by failing to identify the main culprit for lower well returns — gas prices below $4/mcf. In the last few years E&P companies have drilled short-term non-economic wells to beat lease expiration deadlines and lock in attractive long-term assets that can be drilled at
a slower pace and higher prices in the future. The oversupply created from this drilling has driven gas prices below the marginal cost of production. The large price discrepancy between oil and natural gas should increase gas demand, and diminished drilling will decrease supply. A more normal supply/demand balance will increase gas prices and make shale gas production economically viable. Chesapeake’s sale of its Fayetteville reserves for $4.75 billion in the spring as well as multiple asset sales in the industry since 2008, including BHP’s purchase of Petrohawk in July, indicates the long-term value of shale acreage. In spite of the stock’s recent retreat, Chesapeake ranked among the Fund’s largest contributors in 2011 with a 15% gain.

Bank of New York Mellon’s (BK) strong revenue growth and share repurchases were overshadowed by higher expenses from integrating acquisitions and investing in longer term growth initiatives. The stock has also suffered from the controversy over currency trades that BK made on behalf of its custody clients to enable them to settle foreign securities transactions. Many clients use a standing instruction program for BK to execute these currency trades. Rather than charge commissions for these services, custodians collect the difference between their interbank rate and the rate the client pays. This currency settlement business represents a small portion of BK’s value, and our appraisal assumes lower revenues as we anticipate clients will move away from standing instruction FX trading. The controversy allowed us to add to our position at more discounted prices, but caused BK to weigh on the Fund’s performance this year.

The two cement and aggregates producers, Cemex and Vulcan, were a headwind to performance with Cemex down 4% in the quarter and 16% for the year, and Vulcan off 15% over the last three months and 12% in 2011. The slow U.S. construction recovery remains the major challenge for both companies, even though most of Cemex’s international markets have improved. U.S. volumes are a fraction of 2006 levels. A possible highway bill delay past the 2012 elections has caused some concern about near term demand. Whether volume growth returns in one year or three, we own irreplaceable aggregate assets as well as production facilities that will not see new capacity threats for many years to come. Cemex and Vulcan sell far below both replacement value and prices recently paid for similar assets.

During the quarter we completed the sale of Pioneer Natural Resources, which we owned for over 13 years. We are especially grateful to management and the board for their work over the last two years as capital allocation strengthened the company, and along with rising oil prices, helped the stock go from a low of $12 to over $100. We used the proceeds from the sale plus some of our cash reserves to add to a number of holdings as prices started to pull back in the second part of the quarter. We rebuilt a full position in Philips. Short-term margin pressures created a deep discount to the collective value for one of the world’s leaders in both medical equipment and lighting plus numerous consumer electronics brands. Subsequent to quarter end, the company announced a 12 month €2 billion buyback plan that will retire 11% of the outstanding shares. The only new name that appears in the portfolio is a minimal stake in Global Crossing which we bought just after the Level(3) announcement.

We are continuing to see value growth across the portfolio as positive business results are coupled with accretive capital allocation decisions. In particular, the magnitude of share repurchases at many of our companies has been impressive. Even with the Fund’s 10.2% return this year, the P/V has moved from the high-60%s to a more attractive mid-60%s. We believe that value growth will continue to drive returns. We own high quality businesses that enjoy competitive advantages in their industries, and we have management partners committed to building value per share. We will use the market’s short-term irrational swings to strengthen the portfolio — adding to names that become more discounted and trimming holdings that grow closer to appraisal. Recent volatility has helped improve our on-deck list. We continue to look for new opportunities and have liquidity available to acquire a new qualifier.
Management Discussion

Longleaf Partners Fund appreciated 8.7% in the first quarter, far surpassing the S&P 500 return of 5.9%. The Fund also delivered a return well above our annual absolute goal of inflation plus 10% over the last year. The Fund has delivered substantial cumulative returns of almost double the benchmark over each of the last two decades.

Cumulative Returns at March 31, 2011

<table>
<thead>
<tr>
<th></th>
<th>Inception</th>
<th>20 Year</th>
<th>Ten Year</th>
<th>One Year</th>
<th>YTD</th>
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<tbody>
<tr>
<td>Partners Fund</td>
<td>1245.9%</td>
<td>796.6%</td>
<td>79.0%</td>
<td>19.9%</td>
<td>8.7%</td>
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<tr>
<td>Inflation plus 10%</td>
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<td>965.1</td>
<td>222.2</td>
<td>12.8</td>
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</tbody>
</table>

See page 6 for additional performance information.

Most names positively contributed to recent results, and two of our largest positions delivered almost half of the Fund’s return. Chesapeake rose 30% in the quarter. In January the company announced that Lou Simpson, the recently retired Geico investment chief with a strong capital allocation track record, would join the board. Additionally, the company committed to meaningfully reduce debt and drilling for natural gas. The first significant step toward debt reduction followed when BHP purchased Chesapeake’s Fayetteville reserves for $4.75 billion. The sharp price rise in oil relative to natural gas has improved the longer term outlook for Chesapeake’s natural gas reserves. Gas rigs will decline as more operators move to extract more profitable oil, and demand will increase as the cost to supplant other fuels with natural gas is more economically attractive. DirecTV, which gained 17%, reported double-digit free cash flow growth. ARPU (average revenue per user) rose in the US as customers migrated to high end services. The rapid pace of Latin American subscriber growth continued. Management raised $4 billion in low interest notes largely intended to retire more shares which are currently being repurchased at a mid-teens annualized rate. Level(3) rose 50% in the quarter as EBITDA and margins came in higher than expected, and the company indicated that it expects higher top line growth. Subsequent to quarter-end, the company announced it will buy Global Crossing. The transaction will strengthen Level(3)’s balance sheet, further consolidate fiber capacity, and reduce Global Crossing’s operating costs. Although our appraisal reflects current results, if the combination goes as planned, Level(3)’s value could grow dramatically. News Corp was up 21% as channels in the US, Latin America, and India all posted strong growth due to new subscribers, higher fees, and improved advertising revenues. Insurance brokers, Aon, and the much smaller position in Willis, appreciated 15% and 17%, respectively. Recent natural disasters including the New Zealand earthquake, Australian floods, and Japan’s massive earthquake and tsunami, will remove substantial capital from the insurance industry and enable higher pricing. Brokers have no underwriting risk, and their revenues will rise with premium increases.

Few of the Fund’s holdings declined, but two that had the most negative impact suffered short-term macro challenges that will create longer-term benefits. The slow pace of recovery in US housing weighed on cement and aggregates producers, and Middle East turmoil drove up their energy costs. Additionally, uncertainty around Cemex’s Egyptian operations further pressured the stock which fell 13%. Higher oil prices should provide longer term opportunity because the Mexican government’s oil receipts will rise and lead to more infrastructure and housing spending. As expected, during the quarter the company issued converts to gain more flexibility on its debt covenants. Management understands the impact of issuing discounted equity and bought calls that
effectively raised the strike price to above today’s intrinsic value. Buying these calls was a tangible indicator that management believes the intrinsic value of Cemex is much higher than the current price. Cemex paid about $200 MM, a meaningful amount of cash for a company currently constrained by debt, to buy calls far out of the money at an average strike price of $16.50. This unorthodox move would be completely unjustified if the company were worth anything close to either the current stock price or the converts’ strike price. On the other hand, if the company is worth our conservative appraisal, this is a low-cost way to remove the dilution pain from the converts while strengthening the company’s balance sheet. We applaud management for taking this unconventional and logical action.

Japan’s natural disasters pushed non-life company NKSJ down 7%, and we lowered our appraisal by a similar amount due to the combination of a reduced equity portfolio value and lower loss reserves. The company has ample capital to cover anticipated claims, which will be capped by the government’s stop-loss program, policy coverage limits and reinsurance. Longer term, pricing for insurance coverage will harden, benefitting NKSJ’s profitability.

Given the Fund’s strong performance in the quarter, sales dominated transactions. We scaled back DirecTV and Disney to reduce overweight position sizes. Both companies still sell at an attractive discount, and their values are rising. As Pioneer Natural Resources moved closer to appraisal with its well-timed sale of Tunisian assets and the rise in oil prices, we shaved this position. We also reduced TDS.

We found two new opportunities. Abbott’s price quickly moved from our limit as we started to buy. We added Colgate-Palmolive, a consumer brand behemoth in oral care products around the world, via options. When the stock sold in the mid-$70s, we used put and call options to effectively give us a long position in five years if the stock sells below $65 or above $80. Colgate’s exceptional business and capable management team should cause the company’s value to increase appreciably, driven by the stability of its massive international market share as well as its emerging market dominance. In five years we would be happy to be “put” the stock (have to buy it) at $65 since that price meets our required discount today and should be absurdly cheap by 2016. Likewise, our expectations for value growth mean a “call” on shares (right to buy) at $80 will be compelling in five years. If our Colgate appraisal proves incorrect, we have downside protection from the current price that buying the stock would not have provided. If something dramatically changes prior to 2016, we can simply close out the options contracts. To illustrate the upside return potential, if Colgate’s current value were around $100 and compounded at 12% per year, in five years the value would be approximately $175. Assuming the stock’s price reflected value, the call option would allow us to buy shares at $80 and sell them at $175 for a gain of $95 versus our net cost of the options at $3.50.

The Fund is well positioned for longer term compounding given the quality and strength of the businesses we own and a P/V in the high-60%s, near the historic average. Value growth has begun to accelerate and should lower the P/V. The Fund’s 7% cash will allow us to buy the next qualifying name and further enhance our return opportunity. We will wait patiently for market volatility, macro events, and/or corporate disappointments to pressure the prices of valuable franchises with capable management partners.
Partners Fund
MANAGEMENT DISCUSSION

The Longleaf Partners Fund’s 10.6% gain in the fourth quarter led to a 17.9% 2010 return, outpacing both our absolute goal of inflation plus 10% and the S&P 500 Index.

Cumulative Returns at December 31, 2010

<table>
<thead>
<tr>
<th></th>
<th>Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>10 Year</th>
<th>1 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1137.7%</td>
<td>920.1%</td>
<td>258.4%</td>
<td>64.0%</td>
<td>17.9%</td>
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<tr>
<td>S&amp;P 500 Index</td>
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<td>475.1</td>
<td>166.9</td>
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<td>1667.7</td>
<td>954.3</td>
<td>477.7</td>
<td>220.0</td>
<td>11.5</td>
</tr>
</tbody>
</table>

See page 12 for additional performance information.

Although intrinsic value and stock price do not always move together, in 2010 those names with double-digit value growth were among the Fund’s largest contributors to performance. Pioneer Natural Resources’ stock rose 34% in the fourth quarter and 80% for the year. Our appraisal of the company, which was substantially discounted at the outset of 2010, grew approximately 30%. The company’s success in the Eagle Ford and its subsequent monetization via a joint venture with Reliance Industries moved the value. Management also sold non-strategic assets at good prices and opportunistically hedged production. The 15+% rise in the price of oil over the year also helped the stock. (Our appraisal assumption held steady at $70 per barrel.) The recent prices paid for acreage in the Permian and Eagle Ford make Pioneer look undervalued even after its gain. Because the stock’s appreciation closed some of the gap between price and value, we scaled the position to a “normal” weight of 5%.

Yum! Brands gained over 40% in the year, and our appraisal rose at double-digit rates. Notably, Yum is among the few companies we own that have grown value in each of the last three years, including 2008. The largest increase in value has come from China where scale, widespread brand recognition of KFC, and a wealth of talented local managers give Yum significant advantages. Half of profits come from developing markets including China, India, and Africa, which are growing at a much faster pace than the U.S. and other developed international locations. Within the U.S., Taco Bell is Yum’s largest brand, comprising 60% of franchise fee income. Management has returned capital to shareholders via repurchases, but also has invested in high-returning new stores in China. Because the price moved closer to appraisal, we scaled this holding back to 5% of the portfolio.

Liberty Interactive’s appraisal growth of over 30% was reflected in its stock increase of 45% in the year (15% in the fourth quarter). Because the stock fluctuated significantly within the year, we scaled the position back early in 2010 and added to the position in the summer. Operationally QVC had meaningful growth both in television and internet sales as its superior lower cost model grew faster than almost all traditional retailers as
well as the ecommerce industry. On the capital allocation front, management added value through a tax-free exchange of IAC shares for cash and several internet businesses and through swapping Live Nation Entertainment shares for cash with Liberty Capital. The proceeds from both of these exchanges helped pay down debt. The company is on track to be fully spun out of Liberty in the first half of 2011. Board member, John Malone, recently added another $10 million to his personal stake.

DIRECTV, which began the year as the Fund’s largest position, gained 20% in spite of a slight fourth quarter decline. The appraisal grew over 10% and since the start of 2008 has increased by over 20%. Slowing U.S. subscriber growth is being offset by increasing demand for advanced, higher margin offerings. Fewer new subscribers means that free cash flow will grow at a faster pace because SAC (subscriber acquisition cost) will decline. The company’s scale with 19 million U.S. subscribers and almost 9 million in Latin America gives the company a programming advantage. Latin American growth rates remain robust as economies develop and satellite faces far less competitive threat given the prohibitive cost to build fiber networks. DIRECTV has been one of the most aggressive share repurchasers that we own, having retired over 20% of shares at meaningful discounts over the last two years. We scaled the position at various points in the year, but it remains overweighted and undervalued.

Negative returns at Level 3 and Dell detracted from 2010 performance. Level 3 fell 36% for the year but had a 5% gain in the fourth quarter following news of becoming a primary carrier for Netflix. Because of the 60+% contribution margin from additional revenues, the growing demand for internet video should add meaningful free cash flow over time. The company has been slower to deliver growth than projected, particularly in the metro business. The short-term cost of hiring and training new sales people has impacted costs but not yet revenues. The transition time from orders to revenues in wireless backhaul has expanded because newer products demand more set-up time, and carriers are taking longer to connect. At this point success depends on revenue growth. Major debt maturities are three years away. Given that the cost to build the network was over $25 billion and that today’s enterprise value (debt + equity) is less than $8 billion, the company’s assets are severely discounted with several possible rewarding eventualities. As we said earlier in the year, we are neither oblivious nor idle regarding Level 3’s results and stock performance.

Dell’s stock declined 6% over the year after rising 4% in the fourth quarter. Our appraisal also grew in the quarter. The company delivered strong margins and earnings that far outpaced market expectations thanks to reduced component costs and a strong corporate refresh cycle that the company had predicted as well as double-digit growth in the solutions side of its business. Although many focus on the small
consumer portion of Dell to evaluate the company’s prospects, strategic advantage and future growth are tied to Dell’s distribution strength which allows it to sell fast growing servers, storage, and services to small and mid size business as well as government and healthcare customers. While the company repurchased discounted shares in the year, much larger opportunity exists to do more. Michael Dell increased his own personal stake in the company by $100 million in December. Dell’s adjusted free cash flow yield is over 20% and the top line is growing, yet the market multiple on the stock implies a business in decline. We cannot think of any previous investee that has obliterated the Street’s EPS expectations by such a huge amount but had its stock lag. Our best guess is that the market’s yawn assumes the results are from a one-time corporate refresh when in reality, the earnings were broad-based.

Market volatility combined with stable and growing business values resulted in numerous portfolio transactions. Early in the year we sold Berkshire Hathaway and Marriott. Both were opportunities bought in the market crash, and both reached appraisal in a year’s time. InterContinental Hotels was another holding that quickly reached appraisal, and we completed the sale of the position just after year-end. We had the opportunity to buy Intercontinental which owned several trophy properties and was in the midst of a major overhaul of the Holiday Inn brand. After selling a few properties for a premium price and showing positive results from the rebranding, the company’s assets and franchise fees began to get credit for their true value. We also sold Verizon which we held for a very short time after being able to purchase a minimal amount of stock before the price rose above our required discount. As previously mentioned, we scaled back a number of positions that did well both in the spring and again in the fourth quarter. In the interim we had several opportunities to add to existing holdings and to purchase new ones. In addition to Verizon, we bought Campbell Soup, Loews, Travelers, Vulcan Materials, and most recently in the fourth quarter, Lockheed Martin and News Corp.

Given the strong performance of 81.1% over the last two years, it might surprise some that the Fund’s P/V is only in the high-60%s — equivalent to the long-term average. This attractive valuation is due to several factors: 1) the severe discount below 40% two years ago, 2) our ability to exchange more fully priced stocks for more discounted qualifiers, and 3) value growth in the last year. We anticipate that because of the high quality and competitive strength of our businesses, values will compound at much higher rates than the average over the last five years. Operational improvements made during the recession, excess production capacity, growing demand particularly outside of the U.S., and management teams focused on value growth and recognition are the basis for our view. Our confidence in the Fund’s future opportunity is evidenced in the largest collective share ownership stake we have ever had.
Longleaf Partners Fund gained 8.4% in the quarter, bringing the year-to-date return to 6.6%. By contrast the S&P 500 is up 3.9% for 2010 after adding 11.3% over the last three months. The Fund’s results for 10+ years are well ahead of the benchmark but below our absolute return goal following the “lost decade” for stocks which included 2008 markdowns.

<table>
<thead>
<tr>
<th></th>
<th>Cumulative Returns at September 30, 2010</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>4-8-87 IPO</td>
</tr>
<tr>
<td><strong>Partners Fund</strong></td>
<td>1019.6%</td>
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<tr>
<td><strong>S&amp;P 500 Index</strong></td>
<td>570.1</td>
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<tr>
<td><strong>Inflation plus 10%</strong></td>
<td>1622.6</td>
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</table>

See page 8 for additional performance information.

Volatility continued in the third quarter, enabling us to make productive changes to the portfolio. We filled the Campbell Soup and Loews positions initiated in the second quarter. We also scaled back several of the best performing stocks including DIRECTV (DTV), Yum! Brands (YUM), Pioneer Natural Resources, and Intercontinental Hotels. We sold Verizon because we were unable to establish a meaningful position before the price moved well above our buying limit. Proceeds from these sales as well as the cash we held at the outset of the quarter funded new positions in Travelers and Vulcan Materials. Travelers, one of the best managed insurance companies in the industry, is trading below book value as the combination of low interest rates and soft pricing have hurt earnings. CEO Jay Fishman is using the historically low multiple to aggressively retire shares and thereby grow value per share. Vulcan owns unusually high quality U.S. aggregate assets, which the current construction depression has allowed us to buy at a very cheap price.

Because the third quarter accounted for most of the year-to-date return, the largest performance contributors overlap for the two periods. DTV, up 23% over the last three months and 25% for the year, grew its subscriber base in the U.S. and increased ARPU (average revenue per user). In Latin America revenues rose over 20% and margins grew substantially. Not only have operating results added to DTV’s value, but Michael White has been aggressively retiring discounted shares while managing the balance sheet extremely well.

YUM rose 19% in the quarter bringing the stock’s return in 2010 to 34%. While the U.S. Taco Bell and Pizza Hut franchises have increased revenues, the company’s China business remains the highest return and fastest growing part of the company. YUM’s advantages in China include strong Chinese management, broad brand recognition, scale far exceeding any competitor, and a comprehensive supply chain
that the company controls. Because the value growth has been so strong, the stock still sells below intrinsic worth.

At Liberty Interactive, QVC grew across all geographies and gained share. The QVC spinoff has a target date of early 2011. Liberty Interactive rose 31% in the quarter and is up 26% for the year. Pioneer Natural Resources has appreciated 35% this year following a 9% gain in the quarter. Pioneer has seen increasing interest in the Permian Basin, where it has a strong position. Management and the board continue to focus on growing and monetizing value as evidenced by the sale of 45% of the company’s interest in the Eagle Ford earlier in the year.

Cemex and Level 3 fell 12% and 14% respectively, making them the largest performance detractors in the quarter and the year. Regarding Cemex, all construction remained weak in the U.S. with little residential and commercial construction coupled with slow stimulus spending and a delay in a transportation bill from Congress. Mexican volumes were somewhat light, but Latin America, the Middle East, and Asia grew. The company remains competitively entrenched in an oligopoly that has pricing power even amidst large unit declines. Cemex’s U.S. operations made $2.4 billion of EBITDA at the peak; today the U.S. breaks even. Without any help from one of its largest markets, the company is currently producing around $0.80 per share of free cash flow, and the stock is $8.50. Level 3 has irreplaceable fiber assets, and demand for bandwidth is growing rapidly with the increasing movement of data and video across multiple platforms. The company’s pace for adding new direct customers has been disappointing. The contribution margin from increasing top line growth is substantial. Translating obvious demand into strong organic revenue growth in the near term will determine success. We are unhappy with Level 3’s operating results and stock price. You can assume that we are neither oblivious nor idle.

Because of the Fund’s tax loss carry forwards, sales in 2010 will not trigger a capital gain distribution. The Fund’s remaining loss carry forwards equate to 7% of NAV. The Partners Fund’s P/V is in the low-60%s range, below the historic average. We continue to find new opportunities that meet our criteria, and we have added one new investment since the end of September. Value growth has returned as most businesses have improved from 2009 levels. Given the competitive strengths of our operating businesses and the value of the underlying assets at many companies, our capable management partners should be able to deliver double-digit value growth over the next several years even if economic growth remains anemic.
Longleaf Partners Fund declined 8.0% in the second quarter outperforming the S&P’s 11.4% fall. Year-to-date Fund results were (1.6)% versus (6.7)% for the index. The relative strength of the Fund did not, however, help in attaining our absolute annual goal of inflation plus 10%. Over long-term periods the Fund has delivered significant value versus the market.

<table>
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<th>Cumulative Returns at June 30, 2010</th>
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<td>Partners Fund  .........</td>
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<tr>
<td>S&amp;P 500 Index ........</td>
</tr>
<tr>
<td>Inflation plus 10%........</td>
</tr>
</tbody>
</table>

See page 8 for additional performance information.

A few holdings made gains in the quarter and have been meaningful positive contributors for the year. Pioneer Natural Resources’ 6% rise over the last three months brought its year-to-date return to 24%. The company sold a 45% interest in the Eagle Ford shale play to Reliance Industries. The board is committed to continuing to grow value per share. Yum! Brands grew its China operations at double digit rates, continued to expand its international franchise business, and improved domestic margins. Management increased value by repurchasing undervalued shares. The stock rose 2% in the quarter and 13% in 2010.

Most stocks in the portfolio lost ground in the second quarter with three names accounting for half of the Fund’s decline. Dell was down 20%, which also made it the second largest detractor for YTD performance. The impact of higher component costs on Dell’s gross margin overshadowed all the company’s positive news. Revenues rose over 20%, operating income increased almost 30%, and EPS beat expectations. Given net cash and receivables of over $5.00/share, a projected free cash flow coupon of around $1.75 per share this year, and a stock price of $12.06 at quarter-end, the company’s enterprise value of around $7.00/share ($12.00 – $5.00) implies an astounding free cash flow yield of 25%. The vested and capable CEO is repurchasing shares. The faster-growing, more strategic “Solutions” side of the business, which incorporates servers, storage, and services, represents over 25% of revenues and over half of gross profits. The company is among the cheapest in the portfolio, and the value is growing.

Liberty Interactive fell 31% in the quarter as retail stocks declined with fears of slowing consumer spending. The company has reported solid results and taken share over the last year. Liberty Interactive also announced that it will soon effect a spinoff to become its own company instead of being a tracking stock. In spite of the stock’s
recent retreat Liberty Interactive remains among the largest positive contributors for the Fund’s YTD performance.

Level 3 declined 33% in the quarter and is one of the largest detractors for 2010. The company reported disappointing results. Changes made in the business over the last year have not yet shown significantly positive revenue results. We believe the company’s additional sales staff and growing productivity will translate into increased contracts and revenues. Additional sales will deliver substantial operating profit improvement because of the company’s high contribution margin.

Chesapeake’s 19% decline in 2010 made the stock the largest detractor from YTD performance. Short-term natural gas prices remained depressed in the first part of 2010. The company issued preferred stock as part of its longer term plan to reduce debt and achieve investment grade ratings. This dilution lowered our appraisal slightly, but with investment grade ratings Chesapeake will be able to continue to opportunistically hedge production despite regulatory changes related to derivatives. Meanwhile, the company continues to pursue monetizing its assets. We were encouraged to see management and board members recently purchase stock in the open market.

Given the market’s volatility, our trading desk was busier than usual in the quarter. In April Marriott reached our appraisal, and we sold the position. We also scaled back Philips, Disney, DIRECTV, and Liberty Interactive after they had appreciated significantly. Going into May when stocks began their slide, we had over 20% cash and were able to add to Aon, BNY Mellon, and Dell. Additionally, we initiated three new positions that met our criteria of “business, people, price” — Campbell Soup, Loews, and Verizon. The Fund ended June with 14.5% in cash. Subsequently, our additional purchases have taken liquidity to less than 10%.

Because of the Fund’s tax loss carry forwards, sales in 2010 have thus far not triggered a likely capital gain distribution. The amount of carry forwards remaining are 12% of NAV. The P/V is in the mid-50s based on conservative appraisals, and we own the largest collection of industry-leading companies in our history. We believe the five year outlook for our investment partners is compelling.
Longleaf Partners Fund rose 6.9% in the first quarter, outperforming the S&P Index’s 5.4% return as well as our absolute annual goal of inflation plus 10%. These results added to the long-term cumulative performance of the Fund.

<table>
<thead>
<tr>
<th></th>
<th>Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1022.3%</td>
<td>719.5%</td>
<td>271.6%</td>
<td>89.6%</td>
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<tr>
<td>S&amp;P 500 Index</td>
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<td>(6.4)</td>
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<tr>
<td>Inflation plus 10%</td>
<td>1537.4</td>
<td>984.4</td>
<td>481.1</td>
<td>222.5</td>
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</tbody>
</table>

Please see page 8 for additional performance information.

During the quarter the market was volatile. Price fluctuations enabled productive trading within the Fund. Through the first two months of the quarter we added to several of the Fund’s most discounted names such as Cemex and Yum, and we were able to increase our underweighted positions in Aon and Intercontinental Hotels. By the end of March, this incremental buying showed gains. With the market’s moves later in the quarter we also scaled back positions including DirecTV, Philips, and Liberty Interactive. We sold Berkshire Hathaway as the company’s entry into the S&P 500 Index in the quarter pushed the stock up over 20%, approaching our appraisal. In the short year that we owned Berkshire, the Fund realized a 54% gain. In some ways we regret that the price reached appraisal so quickly as our sell discipline forced us to end our brief partnership with one of our most admired corporate partners.

Most names contributed positively in the quarter. Liberty Interactive and its primary holding, QVC, have emerged from the downturn much better than traditional retailers, as evidenced by the 25+% operating cash flow growth announced in the first quarter. The company also continued to simplify its structure, most recently transferring its stake in Live Nation Entertainment to Liberty Capital in exchange for an equivalently valued net amount of cash and debt obligations. After gaining almost 250% in 2009, the stock added another 41% in the quarter. Pioneer Natural Resources was the other large contributor, gaining 17% over the last three months following an almost 200% rally in 2009. Management has worked with the board, including the three independent directors whom Southeastern nominated last year, to take steps to grow and realize the value of the company’s valuable oil and gas assets. The company’s strong position in the Eagle Ford Shale has gained attention as drilling results are proving progressively better, and comparable land is selling well above Pioneer’s cost.

Cemex and Chesapeake were among the few stocks in the portfolio that retreated in the quarter. The 33% decline in natural gas prices was the primary culprit in Chesapeake’s 8% retreat. Management continues to preserve, increase, and monetize
shareholder value. They have done a number of VPPs at attractive prices, and at the outset of the quarter, the company sold 25% of its Barnett reserves at a price that both affirmed and grew our appraisal. The company has hedged over half of its 2010 production at nearly twice today's gas price. Chesapeake remains one of the most discounted names in the portfolio in spite of management's successful capital allocation and operating decisions.

Cemex fell 14% in the quarter. The company reported disappointing earnings, and stimulus funding may not impact the industry's revenues this year as had been anticipated. Non-residential construction in the U.S., one of Cemex's primary markets, continues to decline. These short-term challenges are reflected in both our appraisal and the stock price. Meanwhile, the company remains a dominant provider in the global cement business and has incredible assets in its aggregates division. Debt obligations are manageable, and our management partners are proven owner-operators. When infrastructure spending and real estate development pick up, Cemex's value should rise at a fast pace given the operating and financial leverage in the business.

Cash reserves have risen either as names have approached our appraisal, and we have sold, or as positions that have done particularly well have become overweight, and we have scaled them. While we have two new investments that we would like to own, the trading desk is waiting for price to reach our limit on one, and we are completing due diligence on the other. The P/V ratio in the Fund remains in the mid-60%s, below the long-term average. Finding qualifying investments to buy will further lower the P/V. We are working toward this end, but being patient and disciplined as you would expect. As the Shareholder Letter at the front of this report discusses, we are confident in our ability to achieve better-than-average returns over the next five years given the quality of what we own, the capability of our management partners, the discount at which our businesses sell, and the liquidity to add several more compounders to the mix.
Partners Fund
MANAGEMENT DISCUSSION

Longleaf Partners Fund gained 53.6% in 2009, the best return in the Fund’s twenty-two year history. Not only did the Fund far surpass our absolute goal of inflation plus 10%, but the result was the second largest outperformance of the Fund over the S&P 500 Index. The Fund’s 4.8% rise in the fourth quarter also bested our absolute goal. Below are the long-term cumulative returns of the Fund.

<table>
<thead>
<tr>
<th>Cumulative Returns at December 31, 2009</th>
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</thead>
<tbody>
<tr>
<td>Inception</td>
</tr>
<tr>
<td>Partners Fund</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
</tr>
</tbody>
</table>

Please see page 10 for additional performance information.

The Fund’s combined positions in Liberty Media Entertainment (LMDIA) and DIRECTV (DTV), which merged in November, contributed the most to the year and the fourth quarter. Not only was LMDIA up over 100% in 2009, but we opportunistically overweighted the position in late 2008 when the price traded at a 40% discount to that of DTV, the main underlying asset of LMDIA. Management of DTV added subscribers, increased ARPU (average revenue per subscriber), and bought in undervalued shares throughout the year. Although we trimmed some shares as price rose, DTV remains the Fund’s largest position and still sells at a steep discount to our appraised value. Truly discretionary free cash flow far exceeds reported earnings because the cost to gain net new subscribers, an optional investment with a high long-term return, is deducted from current profits.

Several other holdings more than doubled during 2009. Liberty Media Interactive rose almost 250% for the year as QVC’s results outperformed its traditional retailing peers. Management used the company’s improved results and a better credit environment to extend QVC’s debt maturities. Sun Microsystems gained over 130% when Oracle announced its plan to acquire the company last spring. Pioneer Natural Resources ended the year up 198% after rising 33% in the fourth quarter. Rising oil prices brought attention to the Spraberry field where the company is stepping up its drilling. Excitement is also growing about Pioneer’s position in the Eagle Ford shale play. Importantly, the company’s three new independent directors have increased the focus on growing NAV per share.

Several long-term core positions rallied nicely in the fourth quarter and ended the year among the top ten contributors to return. Disney, the Fund’s fourth largest holding, rose 17% over the last three months and 42% in 2009. The company’s purchase of Marvel was approved, and ESPN showed its superiority over other media
assets by actually growing earnings in 2009. The theme parks also proved to be more stable than many expected. Philips Electronics gained over 20% in the fourth quarter and over 50% for the year. The company beat expectations in the second half in all divisions. The healthcare business grew nicely in emerging markets, and top line declines slowed in developed markets within the lighting and healthcare divisions.

Although Chesapeake Energy’s stock declined in the fourth quarter, it rallied over 60% in 2009 even as natural gas prices were slightly down in the year. The company was highly productive — selling non-core assets, cutting capital spending, growing production, moving probable reserves to proven, and most recently, monetizing value through a minority stake sale in the Barnett Shale to Total S.A. Chesapeake, among our most discounted holdings, is the Fund’s second largest position.

NipponKoa, the only position that meaningfully detracted from the year’s return, fell 6% in the quarter and 23% in 2009. Japan was one of only five major world markets that did not compound at greater than 20%, rising only 6.8% for the year. NipponKoa maintained its strong balance sheet. Under the recently approved merger with Sompo, the new governance structure should hold management accountable for both underwriting and investing. We are confident that management is committed to the combined company being a best in class global non-life insurance business.

In the fourth quarter we sold Liberty Starz, which was spun out of LMDIA before its merger with DTV. Earlier in the year we sold Sun, eBay, and Walgreen. We added to a number of severely discounted names early in the year, and scaled back positions after prices rebounded strongly. In the second half of the year we found few qualifying names. Consequently, the combination of the sales and trims in the portfolio left us with 13% in cash at the end of 2009. We will patiently wait to deploy this liquidity until qualifiers emerge.

Because insurance was one of the few industries that did not participate in the 2009 rally, we found several opportunities in that area. We bought the world’s largest insurance broker, Aon, a previous holding, and Berkshire Hathaway in the first half of the year. More recently we added a small position in Willis, another major international broker. These companies are facing weak pricing as a result of both declining demand from reduced economic activity and the U.S. Treasury’s AIG bailout that enabled the company’s price discounting in an attempt to generate cash to survive. Irrational pricing at some point will be self-correcting. Until that time, we have the opportunity to own these high quality competitors with top notch corporate partners at meaningful discounts. We identified two additional new opportunities in the fourth quarter, Intercontinental Hotels and BNY Mellon. Although in different industries (lodging and financial services), each generates valuable fee streams and has
management with a record of building value per share. Both stocks have risen above our buy limit, and we therefore have not built full positions.

After such a spectacular year our partners might assume that the portfolio has little remaining upside. To the contrary, because the Fund began 2009 so deeply discounted, the record return has left us at a P/V in the low-60%s — below the long-term average. In addition to being quantitatively attractive, the Partners Fund has the best qualitative characteristics in memory. As you examine the 19 holdings, you will find primarily businesses that are dominant in their competitive arenas and have emerged from the recession in stronger positions versus many of their peers. You will find management teams who have cut costs and protected margins more than most expected in an environment of steep top line declines, and most are significant owners with us. Because of how well these businesses are positioned, secular revenue recovery should result in double-digit value growth, adding to the upside opportunity well beyond what the P/V implies.
Partners Fund
MANAGEMENT DISCUSSION

Longleaf Partners Fund delivered 18.2% in the third quarter, taking the Fund’s year-to-date return to 46.5%. Both periods far surpassed our absolute annual goal of inflation plus 10% as well as the benchmark index which gained 15.6% and 19.3% respectively. Below are the cumulative results of the Fund for longer periods.

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<tr>
<th></th>
<th>Cumulative Returns at September 30, 2009</th>
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<tbody>
<tr>
<td></td>
<td>Inception</td>
</tr>
<tr>
<td>Partners Fund</td>
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<tr>
<td>S&amp;P 500 Index</td>
<td>508.3</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1450.4</td>
</tr>
</tbody>
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Please see page 6 for additional performance information.

The names in the portfolio did not change, but we trimmed two overweight positions, Dell and Liberty Media Entertainment (“LMDIA”), as their prices rose. We reinvested some of the Liberty proceeds into DirecTV (“DTV”) to maintain a combined position of roughly 15% in these two stocks, which should become a single company in the fourth quarter.

The relationship between the price of DTV and LMDIA over the last year provides insight into how variably “Mr. Market” priced virtually the same asset. Liberty Media Entertainment owns just over half of DTV’s shares as well as several small assets, making the value of the two companies very close on a price per share basis. In November of 2008 DTV traded around $22 while LMDIA fell to around $11. The underlying assets did not change, and we exchanged half of our DTV position to overweight LMDIA. By May the trade paid handsomely. LMDIA rose above $25 and DTV sold for below $24. Because the stocks’ P/V ratios were similar, we equally weighted the positions. Since then, LMDIA has appreciated to over $30. We have trimmed the position and added some of the proceeds to DTV in the mid $20s. These portfolio changes reflect more trading than usual for Southeastern — we are long-term business owners. “Mr. Market,” however, has enabled us to own the same satellite television company through two different stocks at vastly different prices. Not surprisingly, Liberty Media Entertainment has been the top contributor to the Partners Fund’s performance this year, gaining almost 80% in 2009.

Chesapeake Energy gained over 40% in the quarter and has appreciated almost 80% this year. Management sold non-core assets, grew production, moved probable reserves to proved, and cut capital spending. The price of natural gas also rebounded from intra-quarter lows under $3/mcf to near $5/mcf. Liberty Interactive rose over 100% in the quarter and over 250% for the year-to-date. QVC results stabilized, and the company’s bottom line outperformed almost all of its traditional retailer peers over
the difficult last year. Management wisely waited until company results and the credit environment improved before they extended the maturities of QVC’s bank debt. Cemex gained almost 40% in the quarter and is ahead about 50% for the year. Management sold assets and successfully refinanced the business by issuing $1.8 billion in equity. In turn, maturities were extended at favorable interest rates. While cement unit demand has dropped precipitously with the global recession, local pricing is up in almost every market aside from the U.S. and Spain. Sales in developing markets are beginning to recover, and infrastructure stimulus spending is being released in more developed areas.

Technology-related holdings, Sun and Dell, round out the top performers for this year. We sold Sun in April after Oracle’s announcement of a takeover caused the stock to rise over 130%. Dell has gained almost 50% in 2009. The company’s cost cutting has helped margins improve even though revenues have declined. Dell announced it will acquire Perot Systems, whose IT services business complements Dell’s. Dell’s sales capabilities should meaningfully grow Perot’s top line.

Little has negatively impacted the Fund’s strong performance. In the quarter Level 3 reported disappointing revenues primarily caused by internet backbone customer deferred spending. As the economy improves and capacity utilization rises, cable operators and other wholesale customers will have to spend to manage growing demand. Level 3 announced a new board member, Rahul Merchant, who has a wealth of experience in the telecommunications and technology industries including being on the Sun board. Although the stock fell 8% in the quarter, it has almost doubled in 2009. For the year NipponKoa has declined 16%. The proposed merger with Sompo will be voted on in December, and Southeastern has been explicit with management regarding the terms we must see in order to support the marriage. We believe the company needs our votes for the merger to occur. If the joint company is structured as we advocate, a unique company will be created, and we should reap handsome returns. If the merger fails, shareholders have alternative options for closing the large gap between NipponKoa’s price and its intrinsic value.

We believe that the Partners Fund can deliver significant excess returns on top of leading year-to-date results. The P/V is in the high-50%s, well below the long-term average. Our management partners have proven records of building value. The businesses we own are competitively advantaged and are positioned to thrive when demand returns. Our cash position provides the liquidity we will need when we identify the next few opportunities. As the Fund’s largest shareholder group, we expect to be rewarded handsomely from here.
Longleaf Partners Fund completed its best quarter in the Fund’s 22 year history, adding 26.6% over the last three months compared to the S&P 500’s 15.9% return. For the year-to-date, the Partners Fund is up 24.0% compared to a 3.2% rise in the Index. The Fund is ranked the top performer in Morningstar’s “large blend” category for the first six months of 2009.* As your managers and the largest shareholder group in the Fund, we are pleased to report this good news, particularly after the dismal results of 2008. As the graph on page 6 shows, until last year we had attained our long-term absolute return goal of inflation plus 10% for most of the Fund’s history. For the Fund’s since inception numbers to again reach this goal, we must report additional strong results. We fully expect to achieve our target.

### Cumulative Returns through June 30, 2009

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<th>Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>10 Year</th>
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<tbody>
<tr>
<td><strong>Partners Fund</strong></td>
<td>747.3%</td>
<td>521.3%</td>
<td>213.4%</td>
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<td><strong>S&amp;P 500 Index</strong></td>
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<td>346.4</td>
<td>173.1</td>
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<td><strong>Inflation plus 10%</strong></td>
<td>1413.4</td>
<td>1012.6</td>
<td>488.8</td>
<td>229.0</td>
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Please see page 6 for additional performance information.

* See Morningstar footnote on page 1.

All stocks in the portfolio rose during the quarter, with a number gaining over 40%. Dell’s performance over the last three months made it the top contributor for the quarter and among the most impactful on year-to-date performance. Dell’s business did not change dramatically, though the company continued to make tangible progress on lowering expenses. Liberty Media Entertainment, which owns a majority of DIRECTV’s shares, announced that it will merge with DIRECTV later in the year, simplifying the structure and control of the dominant U.S. satellite television provider. The stock rose 34% in the quarter and is up almost 53% this year. Level 3 bought in more of its near-term maturities. The combination of solidifying its ability to meet obligations over the next several years and the general thawing of credit markets has improved investors’ view of the company. The stock rose over 60% in the quarter and has more than doubled this year.

We sold the Fund’s position in Sun when Oracle announced its bid in April. Last year our appraisal declined when the company’s financial customer base collapsed, but the price of the stock fell far below the company’s liquidation value. With the significant changes in the company’s selling environment after September’s events and the enormous difference between price and appraisal, Southeastern actively engaged Sun’s management. As the board considered its options and decided to sell to Oracle, the stock rose over 130%, making Sun among the strongest contributors to Longleaf’s results in 2009. We also sold Walgreen in April. The stock had risen closer to appraisal
while our case had become less compelling with a change in management, reduced new store expansion, and lower growth in both the pharmacy and front end of existing stores. Increasing competition for generic drug sales and the possibility of more government intervention also became threats. In June we sold eBay after the price had rallied over 60% from its March low and was closing in on our appraisal. The severe recession’s effect on the auctions business plus ever-tougher competition in fixed-price caused us to lower both our earnings projections as well as the multiple that the cash flow was worth. Our experience with all three of these companies reinforced the importance of both balance sheet strength and paying a deep discount to appraisal as protection against severe economic or other changes not anticipated in our initial assumptions.

Throughout the year property/casualty and insurance brokerage stocks have been weak. In the first quarter we had the rare opportunity to buy Berkshire Hathaway at less than 60% of our appraisal. In the second quarter we re-bought Aon, which we had sold last fall when it was the highest P/V in the portfolio, and other high quality businesses were substantially more discounted. We remarked in the Annual Report that “in normal times we would never sell at below 80% of value a business with a number one market share, high returns on capital, rising prices, and a management team who has built value so successfully.” All of these characteristics remain in place, the value has grown, and the price has declined almost 20%. We are thrilled to be able to partner with Greg Case and his team again so soon.

We believe that the Partners Fund offers an attractive opportunity even after the recent strong returns. The P/V is in the high-40%s, about 25% below the long-term average. In addition, the companies we own are financially sound, and we expect that values will grow from here at strong rates. Given our recent sales we have just under 12% cash which will enable us to add new names to the portfolio without having to sell companies we own that are not at full value. We have our eyes on several companies that we would love to own but that sell above our limit. We hope for some volatility to give us a chance to add one or two.

We are grateful to our investment partners who have remained supportive through a particularly trying period. We are pleased to report that your patience has begun to pay off, but strongly believe this is an early inning. We have much additional upside given the discount that remains in the portfolio, the quality of the businesses we own, and the competence of the management partners we have.
Longleaf Partners Fund ended the first quarter down 2.1% versus a decline of 11.0% for the S&P 500 Index. This strong relative performance ranked the Fund among the best performers in Morningstar’s Large-Cap Blend category. However, we are not satisfied with these results, and recognize that substantial positive returns are required to recover the market’s markdowns that our stocks suffered last fall. Those short-term declines have impacted the Fund’s longer term numbers dramatically.

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<th>15 Year</th>
<th>10 Year</th>
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<tbody>
<tr>
<td><strong>Partners Fund</strong></td>
<td>569.2%</td>
<td>436.2%</td>
<td>159.7%</td>
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<tr>
<td><strong>S&amp;P 500 Index</strong></td>
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<tr>
<td><strong>Inflation plus 10%</strong></td>
<td>1358.3</td>
<td>1013.3</td>
<td>484.1</td>
<td>227.0</td>
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*Please see page 8 for additional performance information.*

Fortunately, we think we own the building blocks required to recoup last fall’s damage and to deliver significant absolute returns over the next several years. At quarter-end the portfolio was trading at a P/V in the mid-30%s, over a 40% discount from the long-term P/V average in the high-60%s. In addition to this compelling quantitative case, the qualitative aspects of the Fund’s holdings are among the best ever. Most of these businesses are market leaders in their industries and will strengthen their positions as the recession pressures weaker competitors. With a few exceptions, our companies have the ability to go on offense with net cash or modest levels of debt, and no liquidity needs. We believe that the few companies we own that have more leverage have the ability to meet their near-term maturities and will see magnified returns once the recession ends and credit availability returns to normal levels. Most of our management partners are taking advantage of their competitive and financial strength, managing costs through the recession and allocating capital wisely in the bear market to build shareholder value.

While we are enthused about the Partners Fund's portfolio, we are not complacent. The market’s ongoing volatility gave us new qualifiers to review throughout the quarter, and we have some extremely interesting names on deck. During the quarter and into April we scaled back some positions by selling into market strength and redeployed capital into some of our most attractive holdings. Most of the re-invested proceeds have already shown gains.

In the first quarter we finished building the Fund’s Marriott position which was initiated in late 2008. Bill Marriott and his team are significant owners and have been wonderful partners of ours in the past. Our appraisal accounts for lower occupancy and room rates for the year, but Marriott should gain share in the recession as hotel owners re-flag to gain the higher occupancy that Marriott's brands generate. In addition, the
longer term pricing outlook has improved because supply growth obviously has slowed. Marriott’s management and franchise fee streams are less cyclical than profits from owning hotel properties, and almost all of the U.S. incentive fees are gone in 2009 but will return in the long term. The recession has dealt us the company’s dominant hotel brands at a low multiple to depressed 2009 free cash flow.

We bought a new position in Berkshire Hathaway. For the first time in our careers the stock fell and remained far enough below intrinsic value for us to buy. The company’s misunderstood derivative contracts created optically messy short-term results. In addition, some of Berkshire’s recent investments have been hotly debated, though it is far too soon to judge their ultimate outcome. The company’s book value (as well as our appraisal) incorporates the market price of Berkshire’s public equity stakes, which we believe are also selling for significant discounts to their intrinsic worth. We therefore are getting a double discount for a company that is financially and competitively advantaged, has a proven record of terrific insurance underwriting, owns a number of great brands in non-insurance businesses, and has two of the world’s best capital allocators at the helm.

Several names made meaningful positive contributions to performance in the quarter. Most significantly, Sun Microsystems rose over 90% as IBM reportedly pursued an offer to buy the company. Subsequent to quarter-end Oracle has agreed to acquire Sun, and we have sold our stake. Liberty Media Entertainment, the Fund’s largest position, rose double digits. The discount to the market value of the company’s DIRECTV shares started to close as LMDIA’s anticipated spinoff as an independent stock drew closer. Most importantly DTV sells at a large discount to its growing intrinsic value.

Two names drove most of the negative return, NipponKoa and Cemex. NipponKoa’s decline occurred in tandem with a proposed merger with Sompo, another Japanese non-life company. Arbitrageurs bet that a merger ratio would favor Sompo at the expense of NipponKoa. We consider this reaction premature because the merger ratio will not be set until July, and the merger will require approval by two-thirds of each company’s shareholders. The values of both firms have increased substantially since the merger was announced as their Japanese equity portfolios have rallied.

The peso’s decline against the dollar aggravated worries over how Cemex would pay its dollar-denominated maturities in late 2009. The company has an asset sale awaiting regulatory approval, and in an environment with demand for hard assets, Cemex could sell additional assets if needed. The company is working with its primary banks on financing alternatives and in the meantime, the peso’s recent strength and early signs of easing credit markets helped the stock rebound 55% from its first quarter low.
We sold the GM bonds throughout the quarter as we could own more attractive businesses with more certain outcomes. This disposition was completed April 1st.

We remain grateful for the support and patience of our investment partners. Your stability has enabled us to manage the portfolio based on investment opportunities rather than cash withdrawals. We hope that the rebound since the initial market low in November has given you some sense of the magnitude of the opportunity that remains and of the ability of the Partners Fund to generate sizeable returns from these levels. Since November 20th through the writing of this discussion on April 22nd, the Partners Fund has gained 38.7% while the S&P 500 is up 13.5%.*

* Please see page 8 for additional performance information.
The Partners Fund’s abysmal fourth quarter led to its worst yearly performance in history. The 12 month decline pulled down the Fund’s longer term returns to levels below our inflation plus 10% bogey. In spite of recent relative results, the Partners Fund has outperformed the benchmark over longer periods. We believe that performance can rebound just as quickly as it fell and that the long-term numbers will recover to exceed their levels of a year ago.

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<th>Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>10 Year</th>
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</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>583.5%</td>
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<td>175.0%</td>
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<td>S&amp;P 500 Index</td>
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<td>Inflation plus 10%</td>
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<td>1016.6</td>
<td>482.9</td>
<td>225.3</td>
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Please see page 18 for additional performance information.

The bear market enabled us to consider numerous new names. The economic environment drove serious reassessment of our existing holdings. We used pessimistic assumptions to reappraise businesses and stress tested their balance sheets as well. Turnover in 2008 was higher than normal given that the more pessimistic appraisals led to the sale of some names, and we had numerous opportunities to upgrade the portfolio. Earlier in the year we traded Sprint, Limited, and Comcast for companies with better business quality and/or managements.

We exchanged General Motors equity for bonds in August. Our assumptions about GM were wrong. Annual car sales that had been 17 million units sank to a 14 million rate in the first half of 2008 with high oil prices and a slowing economy. The company projected that this lower level would last another two years, which seemed a reasonable worst case given those 14 million units translate into an average car life of at least 15 years. Although gas prices then dropped more than 50%, the recession and withdrawal of consumer credit took the annualized sales rate to 10 million units, which is likely to continue throughout 2009. With GM’s fixed cost structure (operating leverage) and its debt, this almost 30% hit to already low volumes meant significant cash losses. Equally damaging to the GM appraisal was the simultaneous collapse in value at GMAC, of which GM owns 49%. Under this scenario we believe that the bonds are worth half of par on the upside or 33 cents on the dollar if the government has its way. They currently sell for 15 cents, and yield over 30%. We continue to review this investment against opportunities that are similarly discounted but have values that will grow and no dilution risk.

We sold Aon and UBS in the fourth quarter and re-deployed the proceeds into our most compelling investments, which were names we already owned. Adding to existing holdings with fresh capital highlights how strongly our stocks that “survived”
the upgrading process meet our investment criteria, rather than any unwillingness to consider other opportunities presented by this bear market. Aon is an example of the extremes in today's market. In normal times we would never sell at below 80% of value a business with a number one market share, high returns on capital, rising prices, and a management team who has built value so successfully. In the fourth quarter, however, we could swap Aon for businesses with equally compelling qualitative characteristics selling for less than 40% of intrinsic worth. We're grateful to CEO Greg Case for his excellent work. UBS, while statistically cheap, faced the possibility of further value deterioration given the company's leverage, the ongoing siege of credit markets, and early signs that its global wealth management brand was suffering impairment.

Over the course of the year the primary detractors from results were those companies that suffered collateral damage from the collapse of banks and withdrawal of credit. Financial services firms represented approximately 20% of Sun Microsystems' market for its superior high end systems. Those sales disappeared, and the recession caused other customers to delay purchases, leaving the company in need of adjusting its cost structure. The company's net cash amounts to over half of its market cap. We filed a 13D to allow more active participation in Sun's recognizing its significant asset value, which, after accounting for lower sales, remains over four times the current price. We also are appointing two new directors to the board.

The recession hurt Dell's sales, particularly in the US. The stock fell 38% in the quarter and 58% for the year. We assume a further decline in 2009 sales although several segments are growing. The company's extensive cost cutting continues, and margins have begun to reflect progress. Meanwhile, the company took advantage of the weak stock price in 2008 to retire 14% of its shares. Dell sells for less than 4X currently depressed after-tax free cash flow once one subtracts almost $5/share of net cash and DFS receivables. Over the longer run, worldwide laptop, server, storage, and services demand will grow, even if desktops never do. Dell is uniquely positioned to be the low cost, custom-order solution for commercial customers with its direct sales model, while offering consumers both direct sales as well as off-the-shelf alternatives.

When credit availability disappeared, the stocks of companies with short-term debt due cratered. A double whammy was dealt to those with consumer exposure —Liberty Interactive fell 76% in the fourth quarter, which made it the worst performer over the last three months and among those for the year. Liberty Interactive, controlled by John Malone, is a tracking stock for QVC, the television and internet shopping network. QVC has a unique retail model with significantly lower fixed costs than retailers, minimal inventory, and an almost instant gauge of product demand. In addition, the company has high repeat customers who comprise the large majority of sales. QVC buyers have been impacted by the recession and loss of consumer credit.
We have decreased our appraisal accordingly by reducing 2009 EBITDA substantially and lowering EBITDA multiples. The stock price has fallen much further than our appraisal drop and trades at less than 25% of the diminished value, and less than the current market value of Liberty’s non-QVC marketable securities. Liberty Interactive is buying back its short-term debt at levels well below face value, and we believe can cover its bank obligations with cash on hand plus over $1 billion in expected cash flow from operations next year.

The Fund’s exposure to oil and gas severely impacted fourth quarter returns, though did not have major impact on the full year’s results. Chesapeake Energy, the largest publicly traded independent natural gas operator in North America, sells for below 25% of our appraisal and less than 2X after-tax discretionary cash flow. This metric omits the arsenal of discovered, but not yet producing acreage, which was verified by recent minority interest sales in the Fayetteville, Haynesville, and Marcellus shales to major energy companies. Chesapeake is reducing drilling and leasehold acquisition costs in 2009 in the face of lower gas prices. Additionally, the company has hedged most of its 2009 and 2010 production far above current spot prices. Pioneer Natural Resources owns both oil and gas reserves that have twice the average life of most companies’ fields. The stock trades for 3X gross cash flow if the 20 years of existing reserves were harvested and no further exploration occurred. Longer term oil strip prices imply that Pioneer is a 25-cent dollar. We are actively encouraging management to review various alternatives for getting value recognized.

Level 3 (“LVLT”) is the low cost provider among the primary internet backbone transport companies as well as a major competitor in direct internet service to businesses within most major metro areas. Unit demand is growing rapidly, especially with increasing movement of voice, data, and video over the internet. We have assumed lower growth in business services over the next year due to the economy. Concerns over slower growth and the company’s debt hammered the stock price, which fell 74% in the quarter. The company bought over half of its debt maturing in the next two years at significant discounts. Level 3 successfully raised $400 million for this purpose, and the Partners Fund was among the investors offered the opportunity to buy 2013 notes with a 15% coupon, convertible at $1.80 per share. LVLT is cash flow positive with depreciation and amortization outstripping capital expenditures. Jim Crowe and Sunit Patel have continued to ably manage the company’s capital structure while growing the business.

Several companies positively contributed in 2008. We sold Symantec and Comcast when each was up in the first half. DIRECTV also gained over the year. In the fourth quarter NipponKoa rebounded 19% upon the announcement of a merger of several other Japanese non-life insurers. Ample opportunity for consolidation remains, and a
comparable transaction would fetch a price well above NipponKoa’s current stock level.

Throughout the year the sales we made were below full value, but we had the chance to add to higher quality opportunities that offered either less business risk, better management partners, higher value growth, or a substantially larger discount to appraisal. For the most part, the best opportunities were increasing our ownership in existing holdings. We did, however, add Marriott to the portfolio. Performance has yet to reflect the benefits of the upgrades. We believe that a P/V of less than 40% and a portfolio selling for over a 14% after-tax free cash earnings yield indicates the tremendous opportunity that is embedded in the Fund. In addition, our appraisals assume that business results in 2009 are meaningfully worse than 2008. From these assumed levels, values should grow nicely over the next few years, further adding to the compounding opportunity.

Had we known that the portfolio’s P/V would go from the low-60%s to the mid-30%s over the year, we obviously would have waited to re-open the Fund and to invest more of our own capital. We apologize to the many shareholders who were as early as we were. We firmly believe that we will again achieve double-digit long-term returns, even with 2008 results included. Closing the gap between price and value will more than make up the losses of 2008, and that does not account for any value growth delivered by high quality businesses and good partners.

Longleaf has the best shareholders in the mutual fund world. Your loyalty, confidence, and patience, particularly during such a terrible year, positively impacted the Fund as over $500 million in net flows during the year enabled us to take advantage of the price declines and add to the most qualified investments. Our buying during the downturn should pay off handsomely when prices recover, and we look forward to seeing your support rewarded. Until then, we continue to review current holdings and new qualifiers daily. We have aggressively added to our stake in the Fund because the P/V offers tremendous upside with little risk, and loss carryforwards will shield taxes from a large amount of future gains.
Partners Fund

MANAGEMENT DISCUSSION

Longleaf Partners Fund fell 17.5% in the quarter, taking the year-to-date return to a disappointing 24.3% decline. By comparison, the S&P 500 Index fell 8.4% over the last three months and is down 19.3% in 2008. In the history of the Fund, only three other times has quarterly performance been worse - December 1987, September 1990, and September 1998. We hope that history repeats itself. Within six months of these steep declines, the Fund had three of its four best quarters ever. The Fund continues its long-term benchmark outperformance even though over the last twelve months the absolute results have fallen below our goal of inflation plus 10%.

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<thead>
<tr>
<th>Cumulative Returns at September 30, 2008</th>
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<tr>
<td>Inception</td>
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<tr>
<td><strong>Partners Fund</strong></td>
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<tr>
<td><strong>S&amp;P 500 Index</strong></td>
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<tr>
<td><strong>Inflation plus 10%</strong></td>
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Please see postscript on page 6 regarding recent volatility and page 10 for additional performance information.

During the quarter only a few names positively contributed to performance. These included both Liberty Media Entertainment and its core holding, DirecTV. Chase Carey adeptly has led this satellite broadcaster by increasing subscribers and ARPU (average revenue per user), while also decreasing churn to its lowest level in history. DirecTV is also the largest positive contributor to the Fund for the year. Because of the strong operations and substantial share repurchases at discounted levels, this company has been among the best value growers in the portfolio. Thus, even though DirecTV has risen over 13% in 2008, both it and Liberty Entertainment sell for half or less of our appraisal. The combined position remains the Fund’s largest.

The two other positive contributors in the quarter were newly purchased Marriott, a familiar name to our longstanding shareholders, and FedEx. FedEx rose slightly as fuel prices began to decline, but falling energy prices hurt the Fund’s overall return as both Chesapeake Energy and Pioneer Natural Resources declined 46% and 33% respectively. Our appraisals, which already assumed lower energy prices, remained intact. We scaled back some Chesapeake early in the quarter when natural gas prices were near their peak. Later in the quarter we added to the position at much lower prices. We continue to believe in Aubrey McClendon as a strong and capable partner whose capital allocation prowess should reward shareholders. In the case of Pioneer, via Southeastern’s 13-D filing, we encouraged the company to lock in historically high oil prices. Unfortunately, their reluctance to meaningfully sell future production proved costly to Pioneer shareholders. However, in spite of its recent decline, Pioneer remains one of the Fund’s positive contributors this year.
Dell was another volatile stock within the quarter. Because of its overweight, we trimmed some of the stock when it rose above $25 in August, and by September, we had the chance to buy more in the mid-teens. While the company gained market share and continues to cut costs, its quarterly earnings miss in Europe caused the shares to plummet. The company is on track to make around $2.00 in cash earnings this year, has about $4.00/share of net cash and about $1.00/share of interest earning finance receivables at DFS, and sold for $16.48 at quarter-end. The stock is trading for about 6 times the cash earnings of the operating business after adjusting for the net cash and DFS receivables. While the late quarter’s decline made Dell one of the largest detractors from 2008 Fund performance, the price volatility this year at least has enabled the company to make substantial repurchases at severely discounted levels, a benefit for long-term holders.

NipponKoa and Cemex were the other two largest detractors from third quarter results. We lowered our appraisal of NipponKoa because the Japanese stocks that constitute the company’s book value fell. We believe, however, that book value materially understates the intrinsic worth of the company’s equity portfolio given the substantial undervaluation we see in the Japanese market. We are using our position as the company’s largest owner to persuade management to look at the vast opportunities for building and recognizing value. Cemex will see lower demand over the next year, and we have adjusted our appraisal accordingly. Because the market is punishing any company needing debt refinancing anytime soon, and Cemex took on debt to purchase Rinker last year, the price fell 30% in the quarter and even further into October. The company’s free cash flow (assuming a decline from 2008) will cover approximately half of the debt due over the next year. Given its free cash flow generation, assets, and Mexican dominance, we believe that refinancing any additional current debt will not be problematic for Cemex.

For the year, the Fund’s largest detractors have been Sun, UBS, and General Motors. We discussed each of these in earlier reports. Sun is the most discounted stock in the portfolio as our appraisal has held up much better than the price given the company’s net cash, portfolio of products, free cash flow, and majority of its customer base outside of the financial industry. In October we filed a 13-D to enable Southeastern to have more specific discussions with management and outsiders regarding how to unlock the company’s value. Although UBS remains cheap, its wealth management business has begun to show increasing net outflows. Given the company’s leverage and the list of other qualifying investments available, we sold the position subsequent to quarter-end.
During the third quarter, we sold General Motors stock and purchased GM bonds with the proceeds. When the company eliminated its dividend, we were faced with owning an extremely undervalued stock but one whose appeal slipped vis-à-vis the bonds. We moved up the capital structure of GM getting a more certain, risk adjusted, and equity-like return. At the time we also used options to allow us to capture the upside if the stock price moved to appraisal. It is difficult to believe that less than one year ago, just after the UAW deal was struck, GM traded over $40. In hindsight, we should have sold. However, at the time we did not account for gasoline at $4 per gallon. The resulting devastation in truck and SUV sales combined with GMAC’s subprime writedowns caused our value to decline substantially. Unfortunately, the price fell much more. Post quarter-end we sold the call spread as the equity’s value faces additional headwinds as well as dilution from recent equity-for-debt swaps by the company.

The other full sale in the quarter was Symantec, a company that we admire and whose CEO, John Thompson, is an all-star partner. Unfortunately the Partners Fund never got a full position in the stock before it began to appreciate. The company was a positive contributor to performance for the year-to-date. The proceeds helped us add to more substantially undervalued businesses.

As the market has declined, we have been weighing new qualifying investments against those we already own. Because the quality of the Fund’s holdings at the outset of 2008 was high, we have found few opportunities to upgrade the combination of business, people, and price. Even since the end of September when forced selling has decoupled prices from values market-wide, we have not found many qualitative upgrades that compensate for the quantitative cost of trading the less than 40 cent dollars that we own in exchange for things like the world’s best consumer brands that sell for 65% of value or more.

Although the price declines have been painful, we believe future returns from this point should be the most rewarding we have experienced. The Fund has gone from a P/V in the high-40%s at the end of the quarter to an unprecedented mid-30%s in mid-October. We know the Fund’s holdings and our management partners well, and have re-scrutinized our case on each. We have added more personal capital both at quarter end and since. We are the luckiest managers in the mutual fund world to have such loyal and long-term fellow shareholders who have provided net inflows as prices have declined. We have been able to put this new capital as well as proceeds from sales into those names that are the most compelling both in price and quality. For those with the conviction, fortitude, and time horizon to live through this volatility, we firmly believe that their patience will be rewarded.
Partners Fund
MANAGEMENT DISCUSSION

Longleaf Partners Fund gained 3.0% in the second quarter, bringing the year-to-date return to (8.2)%. These results outpaced the S&P 500, which declined 2.7% in the quarter and is down 11.9% year-to-date but the Partners Fund is well behind our annual absolute goal of inflation plus 10%. The long-term returns below reflect an impressive record. We believe that with today’s portfolio foundation the Fund could match or exceed historic results given the extreme discount (the P/V is in the high-50%s), the high quality of the businesses we own, and the management teams running them.

<table>
<thead>
<tr>
<th></th>
<th>Inception</th>
<th>20 year</th>
<th>10 year</th>
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<tbody>
<tr>
<td>Partners Fund</td>
<td>1169.7%</td>
<td>1098.9%</td>
<td>100.6%</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1294.9</td>
<td>1081.4</td>
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<tr>
<td>S&amp;P 500 Index</td>
<td>613.1</td>
<td>629.3</td>
<td>32.9</td>
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Please see page 8 for additional performance information.

During the quarter the Fund’s net inflows as well as the sale of Liberty Capital enabled us to add to several of the highest quality, most discounted names, including Cemex, Dell, FedEx, Liberty Media Entertainment, and Sun Microsystems. Liberty Capital, a holding company of various equities, was a minimal position created from Liberty Media’s split into three pieces. Although it was priced below appraisal, we sold the position because of its small size and the opportunity to round up core holdings with better value growth prospects. We happily remain partners with John Malone through Liberty Interactive and Liberty Media Entertainment, which controls 48% of DIRECTV. Liberty Media Entertainment shares combined with the Fund’s ownership of DTV shares make this satellite broadcaster the Fund’s largest holding. DIRECTV has been one of the strongest contributors to performance this year and remains significantly discounted due to its solid value growth. In the quarter DTV’s price-to-value ratio narrowed more than Liberty Media Entertainment’s, and we swapped shares while this disparity lasted.

Over the last three months the Fund’s two oil and gas holdings, Chesapeake and Pioneer Natural Resources, appreciated 43% and 59%, respectively as energy prices reached record highs. After two strong quarters, these two companies have been the biggest performance contributors for the year-to-date. Interestingly, because each company began the year at a steep discount, and both have identified substantial new potential reserves, these stocks still sell for a large discount to intrinsic worth even assuming oil and gas prices decline to a fraction of today’s levels.

In addition to Chesapeake and Pioneer, Level 3 and Dell, two of the worst performing stocks through March, contributed meaningfully to second quarter results. Each stock
Longleaf Partners Fund gained 3.0% in the second quarter, bringing the year-to-date return to (8.2)%. These results outpaced the S&P 500, which declined 2.7% in the quarter and is down 11.9% year-to-date but the Partners Fund is well behind our annual absolute goal of inflation plus 10%. The long-term returns below reflect an impressive record. We believe that with today’s portfolio foundation the Fund could match or exceed historic results given the extreme discount (the P/V is in the high-50%s), the high quality of the businesses we own, and the management teams running them.

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In addition to Chesapeake and Pioneer, Level 3 and Dell, two of the worst performing stocks through March, contributed meaningfully to second quarter results. Each stock
was extremely volatile through the quarter, but Level 3 ended up 39% and Dell up 10%. Neither company reported any significant news; our appraisals of Level 3 and Dell grew.

The same companies that hurt results most in the quarter also have been the largest detractors year-to-date. Sun fell 30% in the last three months when the company missed estimates. This shortfall came from deferred buying by several large U.S. customer segments. While the company believes this is a postponement rather than a competitive loss, we have lowered our appraisal to reflect a worst case scenario of sales for the coming year. The stock sells for less than half of our conservatively assessed value. We have confidence in Jonathan Schwartz and his team and applaud their substantial share buybacks as well as their strategy for creating competitive advantage through open systems.

General Motors fell almost 40% in the quarter. Higher fuel prices decimated sales of the company’s profitable SUVs and trucks in North America, and GMAC continued to work through its subprime exposure. The overseas car business, however, grew and produced annualized earnings per share of over $4 — almost half of the stock’s price. GM’s earnings power in 2010 is arguably $6-10/share given the discontinuation of UAW health costs, a smaller restructured GMAC, and current overseas earnings. Since quarter-end management has announced several initiatives to increase liquidity over the next two years. General Motors is deeply discounted versus any conservative estimate of its worth and earnings power in 2010 should be significantly higher than today. We have not added to the position because we have higher quality alternatives that sell at half of value, and those values should grow at double-digit rates.

UBS declined 19% over the last three months and has been the most disappointing stock in the Fund this year, not because of the price decline, but due to our substantial appraisal deterioration. We discussed our appraisal mistake in the First Quarter Report. We believe that Marcel Rohner is leading the company out of its credit woes with great skill. Further write-downs, if any, should be manageable and offset by earnings.

The on-deck list has become longer, broader, and more compelling since late June. Whereas earlier in the year most new opportunities emerged from a handful of areas — financials, real estate related companies, and retail — today’s list expands well beyond those segments. The higher quality opportunities make incoming cash flows all the more important to the Fund’s foundation as they enable us to purchase new opportunities without sacrificing returns from what we own. We continue to add to the Fund and encourage our partners as well as new shareholders to do the same.
Longleaf Partners Fund declined 10.9% in the first quarter. Over the Partners Fund’s 20+ year history we have had twenty down quarters including the one just ended. Each has been disappointing, but also each has aided our ability to deliver good long-term returns, which are reflected in the numbers below.

<table>
<thead>
<tr>
<th>Cumulative Returns</th>
<th>Inception</th>
<th>20 years</th>
<th>15 years</th>
<th>10 years</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Partners Fund</strong></td>
<td>1133.0%</td>
<td>1122.6%</td>
<td>460.0%</td>
<td>102.5%</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1230.8</td>
<td>1068.5</td>
<td>499.6</td>
<td>233.4</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>633.1</td>
<td>699.7</td>
<td>287.7</td>
<td>41.1</td>
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</table>

Please see page 8 for additional performance information.

Almost $300 million in net inflows in the quarter combined with lower stock prices enabled us to further strengthen the portfolio for above average long-term results. We added to seven holdings that have competitively entrenched franchises, capable management partners, and materially discounted prices. These additions included Dell, eBay, FedEx, Liberty Interactive, Sun, UBS, and Walgreen. We sold two residual small holdings, Sprint and Comcast, as well as an initial minute position in Limited to concentrate more heavily in higher quality more discounted businesses.

UBS, the biggest detractor from performance in the quarter, was a mistake. Our case assumed that new management led by Marcel Rohner would return the firm to its roots as the world’s best private bank at minimal cost. We were half right: Rohner has taken the steps required to focus UBS exclusively on its high-return, low-risk wealth management and asset management businesses. The cost, however, has far exceeded our worst-case estimates of how much the historically prudent and conservative Swiss bank’s board permitted the investment bank to over-leverage its balance sheet with questionable assets. Writeoffs of nearly $40 billion plus dilution associated with two rights issues have destroyed $100 billion of value, several times the capital committed to the investment bank in our initial appraisal. As you would expect of owner-operators, we have taken a fresh look at the Fund’s existing investment. The company has installed a new chairman and completely replaced the management who put its balance sheet at risk. We believe that current leadership is committed to protecting and building the valuable wealth management business, which has proven resilient. The role of investment banking has been reined in to serve solely as a support function to wealth management clients. If management acts as promised, UBS should be a tremendous investment from this point.
At Dell, which was down 19%, revenues are growing, margins are improving, the business produces an annual cash coupon of over $2 per share, and the company bought in 8% of its stock in the past quarter at less than half of our appraisal of intrinsic value. In addition, the company announced intentions to reduce annual costs by $3 billion — more than $1.00 per share after tax — over three years, which extends beyond the horizon of most Wall Street analysts. We do not fully incorporate these savings into our cash projections. We expect significant further repurchases given Michael Dell’s previous actions and his confidence in the company’s future. After netting out the $5 per share of net cash on the 2/1/08 balance sheet, Dell sells for less than 7x its cash net earnings.

Our appraisal of TDS was stable though the stock declined 35%. The telecom industry as a whole, and cellular operators in particular, fell. Level 3’s value grew in the quarter in spite of the stock’s 30% decline. The market overlooked the company’s progress in reducing its backlog of new customers and improving provisioning times. This positive news was overshadowed by the announcement of COO Kevin O’Hara’s departure. We are confident that Jim Crowe, the CEO, is the right person to lead the company and grow its value, and we are glad that CFO Sunit Patel, who previously planned to step down, has decided to remain in his role.

Several stocks in the portfolio advanced in the quarter, but none as dramatically as Chesapeake, which rose almost 18%. Energy companies have done well through the recent market volatility given record oil prices and rising natural gas prices. Few companies, however, have concurrently built value as rapidly as Chesapeake thanks in large part to Aubrey McClendon’s leadership and focus on growing value-per-share through efficient operations, successful exploration, and beneficial hedging. Aubrey is the consummate owner operator — he just completed the personal purchase of another $20 million of stock.

While we added to existing holdings, we did not buy any new names because owning more of the Fund’s best qualifiers was more attractive than other opportunities we identified. Shareholders will see a new name in the portfolio, however, as Liberty Capital spun out its DIRECTV stake into a separate tracking stock called Liberty Entertainment. This position together with the Fund’s direct ownership of DTV makes the satellite broadcaster our largest holding. The company has everything we covet as investment managers — a growing top line with simultaneous margin improvement, an increasingly entrenched franchise, two owner operators with proven track records in Chase Carey and John Malone, and a huge margin of safety of value over price.
The significant capital your partners at Southeastern have added recently to the Fund supports our belief that the Fund is quantitatively and qualitatively well positioned to deliver significant future returns. Given the opportunity set that still exists, the Partners Fund remains temporarily open. Current shareholders will benefit from our ability to add to high quality names that are selling below the portfolio’s already low P/V. We also have several names on deck. In spite of the frustrating recent performance, the opportunity is exciting:

- A P/V that is in the high-50%s, substantially lower than where it has traded in the last five years;

- Businesses that are growing value through substantial cash flow generation from, in a number of cases, top line growth and margin improvement in spite of a slower economy;

- Corporate partners who are meaningfully adding to value per share by aggressively buying in stock at steep discounts.
Partners Fund
MANAGEMENT DISCUSSION

Longleaf Partners Fund’s 8.6% decline in the fourth quarter erased the year’s earlier gains, leaving the Fund down 0.4% for 2007. The S&P 500 Index’s loss in the fourth quarter was 3.3%. The difference between the Partners Fund and the Index over the last three months accounted for most of the Fund’s 2007 underperformance. As the table below shows, the Partners Fund’s long-term cumulative results, which include periods of underperformance, have rewarded shareholders.

<table>
<thead>
<tr>
<th>Cumulative Returns</th>
<th>20 Years</th>
<th>15 Years</th>
<th>10 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners Fund</td>
<td>1489.6%</td>
<td>580.1%</td>
<td>158.1%</td>
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<tr>
<td>Inflation plus 10%</td>
<td>1060.5</td>
<td>496.9</td>
<td>229.8</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>833.4</td>
<td>346.8</td>
<td>77.6</td>
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Please see page 8 for additional performance information.

Recent returns were disappointing, but we welcomed the volatility in the fourth quarter. We were able to enhance the Fund’s return opportunity by scaling back several overweighted positions with higher P/Vs and adding several new names to the portfolio. In addition, the on-deck list of companies that are only slightly out of our price range grew to more than ten names. More importantly, 15 of the 24 businesses that we already own qualify as new money buys. While some of the discounts are due to value growth, many are attributable to recent price declines.

Nineteen of the Fund’s stocks retreated over the last three months. Level 3 had the largest impact. The company announced that orders were taking longer to provision resulting in revenue growth in the single digits versus the previously estimated mid-teens. We lowered our appraisal to reflect the delayed cash flows and to assume no improvement in the longer provisioning time. The combined third and fourth quarter stock declines made Level 3 the biggest detractor of 2007. The stock trades at a material discount to our conservative assessment of intrinsic value even though the prospects for Level 3’s future are much more certain than in recent years.

Several other stocks were meaningful drivers of the quarter’s negative performance. General Motors lost 32% as year-over-year North American sales declined, expectations for 2008 sales fell, oil went to new highs, and GMAC wrote off subprime exposure in its mortgage business, ResCap. GM now sells for 40% of our conservative appraisal which takes into account all of these factors. Sun Microsystems fell 19% because of flat reported revenue growth and skepticism about the company’s ability to improve margins. Given the significant revenue deferral on system sales as well as successful cost cutting, cash flow was strong.
Significant cash generation combined with Jonathan Schwartz aggressively buying back the cheap stock led to growth in our appraisal. At Dell, a price decline of 11% masked positive news in the quarter. The company filed its restated financials, improved margins, and announced a buyback equating to $4.50 per share by using some of the cash on its balance sheet. The ability to buy these shares almost $10 per share cheaper than in early November has hurt the Fund’s short-term performance, but is a big win for value growth and future long-term performance. eBay pulled back by 15% with no news driving the decline. Although analysts seem focused on a more competitive landscape, the company is still growing rapidly thanks to successful efforts to improve the site for buyers and for higher quality sellers. Paypal also showed huge growth. eBay continued to repurchase shares with its cash coupon. Sprint fell on a plethora of disappointments. Our fundamental case was impaired, primarily as a result of the actions of a management and board we mis-assessed. As the risk of value destruction grew through 2007, we reduced our position by half in the low $20s, somewhat above our cost. Subsequent to year-end, we have sold the Fund’s remaining shares in Sprint.

Of those stocks that most hurt fourth quarter performance, only Level 3, GM and Sprint had a significant impact on the full year results. In fact, eBay and Dell were up in 2007. Over the full year, Cemex and Comcast were also among the big decliners. Most of Cemex’s decline occurred in the third quarter as U.S. housing, particularly in Florida, weakened. The U.S. residential market represents less than 15% of Cemex’s value and will recover at some point. In the meantime, the company’s infrastructure and non-U.S. businesses enjoy pricing power that is producing some $5 per share in free cash flow. At the outset of 2007 Comcast sold near our appraisal, and we scaled back the Fund’s position. Subsequently, the stock fell 37% over the year as the competitive environment increased due to satellite’s success and Verizon’s entry in video. Our appraisal incorporates the competitive threats as well as sustained capital expenditures, but today’s stock price is far over-penalized by these factors, and the Roberts have the opportunity to grow value by meaningful repurchases.

Half of the stocks in the portfolio contributed positively to 2007 results, and the prices and values at three holdings grew over 20%. Each was also a major positive contributor in the fourth quarter. Chesapeake Energy, helped in part by rising energy prices, successfully expanded its natural gas production. Aubrey McClendon skillfully grew the company’s value through his hedging and financing strategies. In spite of the stock’s 36% rise, the company is close to a buy. Aon steadily rose throughout the year. Greg Case led the company’s efforts to grow market share and margins. He sold the underwriting businesses at attractive
prices and repurchased the company’s discounted shares. Aon trades well below its growing appraisal. Yum! Brands finished a positive year with a particularly strong fourth quarter. The company’s cash flow outpaced expectations, and China continued to produce amazing returns. In October, CEO David Novak announced a massive share repurchase.

In mid-November as market volatility began to unleash new opportunities, we sent a letter to shareholders encouraging them to add to their accounts. In mid-December we made the Partners Fund available to shareholders of Longleaf Small-Cap and International. Our appetite for putting capital to work was $2 billion when looking at the combination of adding to extremely discounted existing names and making several new purchases. Our partners responded with great support, and by year-end the Fund’s portfolio had increased its quality and the discount at which it sold. New inflows gave us the opportunity to buy new positions in UBS and Walgreen Company, and to significantly add to Symantec.

As we write this letter in mid-January, the opportunities have become more compelling. We hate the fact that our most responsive and supportive shareholders who added during the fourth quarter are looking at quotational losses of around 10% just a month later. We feel that pain as well, having invested significant money ourselves simultaneously. But the implied and expected returns for our long-term partners have increased. We have, therefore, temporarily reopened the Partners Fund to help us further improve the already attractive price-to-value metric. The P/V is in the mid-50%s compared to the historic average in the high-60%s. Recent market weakness has created angst for short-term oriented investors. We, however, view this as a tremendous opportunity because lower prices are allowing us to buy more and higher quality companies at larger discounts.

More importantly, our investees can increase value per share substantially by aggressively shrinking their shares at the current low cost. The Partners Fund’s holdings are among the highest quality, most liquid, largest free cash flow generating businesses that we have owned. The longer prices remain at steep discounts, the more probable that our corporate partners will use their balance sheets, cash coupons, and borrowing potential to repurchase shares, building value and increasing the Fund’s percentage ownership in those companies.
Longleaf Partners Fund’s 1.5% decline in the third quarter brought the year to date return to 8.9%, slightly behind the S&P 500 Index’s 9.1%. Over the course of 2007 the intrinsic worth of almost all Fund holdings has risen. The numbers below show that buying businesses with growing values at steep discounts has enabled Longleaf shareholders to outperform and build significant wealth.

<table>
<thead>
<tr>
<th>Cumulative Returns at September 30, 2007</th>
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</thead>
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</tr>
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Please see page 6 for additional performance information.

The brief but wide stock price fluctuations in the quarter provided meaningful opportunity for increasing the Fund’s long-term prospects. We added to five positions as the gaps between price and value widened. In addition we purchased Sun Microsystems. This activity positively impacted returns in quick order, as eBay, Sun, and Liberty Media-Capital rebounded and were the top contributors to third quarter performance.

Liberty Capital and eBay are also among the Fund’s top performing stocks for the year to date. John Malone has been masterful acquiring undervalued assets, building their values, and disposing of them at full prices while minimizing tax consequences. The exchange of News Corp. shares for DIRECTV shares early in the year meaningfully grew the value of Liberty Capital in a single transaction. DIRECTV’s intrinsic worth has also risen thanks to Chase Carey’s leadership and his team’s ability to grow subscribers, increase yield, manage churn, and expand offerings at the satellite broadcast company.

eBay, which rose 21% in the quarter, is driving profitable growth by focusing on improving the customer experience and raising fees. As customers find what they want more easily, gain confidence in the quality of sellers, and use PayPal for secure and simple payment, they are spending more at this dominant on-line auction site. Meg Whitman and her associates are deploying the growing cash flow into share repurchases at discounted prices, further increasing the company’s worth per share.

Year-to-date results have been helped by Aon and Chesapeake Energy, whose stocks also rose in the third quarter. Greg Case continues to increase market share and margins at Aon while simultaneously building value through astute capital decisions such as pursuing the sale of the company’s underwriting
Partners Fund - MANAGEMENT DISCUSSION

businesses and repurchasing discounted shares. Our partners at Chesapeake, led by Aubrey McClendon, are expanding natural gas production and funding it creatively rather than by diluting common equity holders.

After a substantial rally early in 2007, Level 3 declined 20% in the third quarter, making it the largest detractor for both the last three months and the year. The integration of the Broadwing acquisition has been more cumbersome than anticipated, creating longer provisioning times for orders. 2007 revenues have been delayed, but next year's sales should reflect the built backlog and growing demand. The longer term outlook for the company remains strong.

Also retreating in the quarter were Cemex and Liberty Media – Interactive. At Cemex, the combination of weakening U.S. residential demand and increased short-term exposure to that segment via their acquisition of Rinker hurt near-term results and sentiment towards the stock. Longer-term their product mix is excellent and the company will be well represented in various high-growth geographies. The stock’s decline gave us a chance to add to the Fund’s position at compelling prices. Liberty Interactive reported weaker performance than expected, particularly overseas. While the company’s results in the U.K. remained strong, Japan and Germany were weakened by factors (a regulatory change in Japan and a product mix misstep in Germany) that we believe will be overcome in the near term. These temporary setbacks gave us the chance to buy more stock at extremely discounted levels. Liberty Interactive has also been a strong repurchaser of its shares at prices above current levels and has indicated that stock repurchase remains attractive today.

The sale of Vivendi and partial scale-backs of several overweighted, more fully priced positions, combined with the cash that the Fund held going into the quarter, paid for purchases. The Partners Fund ended September with 2.7% cash, less than enough to fund a new position. We hope that several “on-deck” names will become discounted enough for us to buy. In that case to make the purchases we will have to raise cash from existing holdings and shareholders who add capital. This would be a good problem to have.

The combination of purchases, sales, value growth and certain price declines have resulted in a price-to-value ratio that is in the high-60%s, near the long-term average, and more attractive than at the end of June. The P/V alone, however, does not tell enough about our enthusiasm for the Partners Fund portfolio. In aggregate, the quality and strength of the businesses as well as the ability and acumen of our management partners is among the best we have owned. Thus, we believe that the underlying value growth in the Partners Fund will be higher than historic levels, and that many of our names will be “permaholdings.”
Longleaf Partners Fund gained 8.1% in the second quarter, bringing 2007 performance to 10.5%. These recent returns along with the Fund’s 23.3% rise over the last year significantly outperformed our absolute annual return goal of inflation plus 10% as well as the S&P 500 Index. More importantly, over the two decades since inception, the cumulative returns of the Fund have not only exceeded our absolute goal, but have more than doubled the return of the S&P 500 Index.

<table>
<thead>
<tr>
<th>Cumulative Total Returns at June 30, 2007</th>
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</thead>
<tbody>
<tr>
<td>Since Inception 4/8/87</td>
</tr>
<tr>
<td>Partners Fund</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
</tr>
</tbody>
</table>

Please see page 8 for additional performance information.

Most holdings have aided 2007 returns with over half of the stocks up 10% or more. Dell, the Fund’s largest position, gained 23% in the second quarter, making it the largest contributor to performance by a wide margin both for the quarter and for the year-to-date. Michael Dell returned to the CEO role early in the year and has added several strong members to the executive team. Results announced at the end of May were significantly better than Wall Street expected, due in part to stronger pricing and double-digit growth in Europe and storage products. In addition the company announced that headcount would be reduced by 10%. Dell began addressing concerns about the consumer market, which represents only 15% of revenues, by exploring alternative distribution channels and introducing new designs. While our appraisal has remained stable, sentiment has begun to improve, thus driving the stock’s appreciation.

General Motors was also up 23% in the quarter, making it among the largest year-to-date contributors as well. Overseas growth has outpaced expectations, and Cerberus’ agreement to purchase Chrysler has helped the market put a more realistic value on GM’s North American business. In addition, labor issues have settled down at Delphi, easing concerns of disruption to GM’s parts supply. Aon, which continues to gain share and has ample opportunity for margin expansion, has risen over 20% this year. Chesapeake Energy has had a meaningful impact on performance, although the stock remains well below our appraisal of its long-term natural gas reserves.
DIRECTV rebounded a bit during the last three months from its first quarter retreat. Even so, its 7% year-to-date decline makes it the only noteworthy detractor in 2007. During the second quarter both Liberty Interactive and Level 3 fell slightly following gains in the first quarter and in 2006. The fundamentals and long-term outlook for all three of these companies remain positive, and our appraisal of each is growing.

Very little activity has occurred in the portfolio during the year. We have been unable to find a new qualifying investment, although we have added to a few existing names. Stock prices have risen, but nothing has been sold due largely to the value growth at most of the Fund’s holdings. In the second quarter Disney spun out its ABC radio network and stations and merged these with Citadel Broadcasting, which we did not keep.

The Fund has 6.7% cash. We are diligently looking for opportunities, but finding little of interest because prices are not sufficiently discounted. The Fund’s price-to-value ratio has risen this year to the low-70%s. While higher than the long-term average, we believe our appraisals are particularly conservative given the multiples being paid for companies in buyout transactions, the relatively high discount rates we use in our free cash flow valuations, and the meaningful opportunities for value growth at a number of the Fund’s holdings.

Please see postscript on page 5 regarding recent volatility.
Longleaf Partners Fund gained 2.2%, outpacing the S&P 500 Index’s return of 0.6% in the first quarter, but falling short of the annualized rate of inflation plus 10%. The Fund’s longer term results over 10 and 15 years have markedly outpaced the benchmark and exceeded the absolute return goal. Recently Lipper ranked Longleaf Partners Fund the number one multi-cap value fund for the 15 year period ending 12/31/06. A difference in average annual returns of several hundred basis points may not sound dramatic, and in the short run, is not terribly meaningful. However, the cumulative effect over multiple years is huge and worth pointing out in the table below.

<table>
<thead>
<tr>
<th>Partners Fund</th>
<th>Inflation Plus 10%</th>
<th>S&amp;P 500 Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of $100,000 invested 3/31/92 . . . .</td>
<td>$788,876</td>
<td>$594,712</td>
</tr>
<tr>
<td>15 year cumulative return . . . . . . . . . . . . . . .</td>
<td>688.9%</td>
<td>494.7%</td>
</tr>
<tr>
<td>15 year average annual return . . . . . . . . .</td>
<td>14.8%</td>
<td>12.6%</td>
</tr>
</tbody>
</table>

Please see page 8 for additional performance information.

Level 3 was the largest contributor to the quarter’s results. The company’s competitive strength continued to grow as did its stock price. During the quarter we converted the 2011 notes into equity, receiving the full face value of all remaining interest payments as well as a premium for early conversion. Adept balance sheet management by the company has played an important role in the success of this investment.

Liberty Capital rose almost 13% in the first three months of 2007. The company’s exchange of News Corp shares for DIRECTV shares provided another example of John Malone’s prowess at growing shareholder value through both capital allocation and minimization of tax liabilities. DIRECTV represents the large majority of our appraisal of Liberty Capital. Early in the quarter DIRECTV shares were much more discounted via Liberty Capital than through direct ownership, and consequently, we sold some shares of DIRECTV, replacing them with Liberty Capital. All-in, DIRECTV is the Fund’s second largest commitment. Liberty Interactive also had a strong quarter, gaining 10%. QVC, which comprises most of the value within Liberty Interactive, grew its business as we expected, and its U.S. margins were particularly strong.

The Fund’s largest position, Dell, declined during the quarter. Kevin Rollins resigned and Michael Dell has taken the reins as CEO. Dell has brought in several new senior managers, is improving customer support, and is focused on restoring margins and sales growth to previous levels. While the outcome of the SEC’s investigation of Dell’s accounting is uncertain, we believe that the
company’s competitive advantages remain in place, i.e. being the low cost provider via the direct sale model and having an entrenched distribution network with unique access to small and mid-sized customers. Even in what was arguably a bleak year, the company earned $3.7 billion in free cash flow and had margins, albeit depressed, that were higher than its competitors (in the case of HP, this excludes the printer cartridge business.) Our appraisal is significantly higher than the current price, and as the business improves and the company repurchases shares, Dell’s intrinsic value should grow meaningfully.

DIRECTV, one of the Fund’s best performers in 2006, gave back some gains in the first quarter. DIRECTV continued to add high-quality subscribers and realize excellent pricing. Our appraisal of the company grew, and we watched Chase Carey exhibit his commitment to building value by repurchasing a large number of shares as they became cheaper.

Relatively little activity occurred in the portfolio over the last three months – no names were added and none were deleted. We scaled back a few holdings that were approaching appraisal, and as a result, cash grew to 7.6%. The list of “on deck” names that are close to our required discount is small. We are not unhappy, however, to have some liquidity in the event that we see more volatility as we did briefly in February or find a qualifying anomaly. The Fund is reasonably priced with a price-to-value ratio (P/V) in the low-70%s, and owns a collection of companies with growing values. We are happy with the outlook for long-term compounding.

1 Longleaf Partners Fund’s 15 year total return for the period ended 12/31/06 was number one out of 40 multicap value funds selected by Lipper, Inc. ©2007 REUTERS. All rights reserved. Any copying, republication or redistribution of Lipper Content is expressly prohibited without the prior written consent of Lipper.
Longleaf Partners ended the year up 21.6%, handily surpassing our inflation plus 10% goal and the S&P 500 Index’s 15.8%. In the fourth quarter the Fund rose 7.8% versus 6.7% for the Index. The results in 2006 added to the Fund’s successful long-term record. In the almost twenty years since inception, Longleaf Partners has achieved an average annual return of 14.3% while the S&P has produced 10.7%. Inflation plus 10% has been 13.0%. The line graph on page 7 demonstrates the tremendous difference a 360 basis point spread makes over a twenty year period, and reminds everyone why focusing on long-term absolute compounding is paramount.

Almost all of the names in the portfolio contributed to the positive return in 2006. The leaders were among those holdings that have been most controversial and most discounted over the last several years. Level 3 almost doubled over the last twelve months. Internet usage has grown with ever-increasing video, voice and data demand. Not only has higher capacity utilization slowed price declines, but the acquisitions that Level 3 has made, including Wiltel, Telcove and most recently, Broadwing, have helped consolidate the industry’s overcapacity while expanding Level 3’s direct reach to customers in metro areas. The stock remains well below our appraisal of corporate value, and that appraisal continues to grow at a fast rate.

The media-related companies that Wall Street despised in 2005 became heroes in 2006, although the business landscape changed very little. DirecTV rose 77%, Comcast was up 63% and Disney rose 44%. DirecTV, which was one of the Fund’s most discounted names at the year’s outset, performed well on every front. They steadily added subscribers while containing acquisition costs. They grew ARPU (revenue per user) with price increases and mix improvements. Free cash flow rapidly grew with higher revenues and lower capital expenditures. Value growth exploded because of the larger cash coupon and significant share repurchases. In the fourth quarter DirecTV’s stock rose 27% as News Corp agreed to swap its stake in DirecTV for Liberty Capital’s shares of News Corp. With John Malone’s oversight and Chase Carey’s operating prowess, the company’s value is likely to continue to grow at good rates, and the stock remains well below our appraisal even after its appreciation.

Comcast grew ARPU at double-digit rates, adding subscribers in digital video, broadband, and voice. They also completed their somewhat complex acquisition of pieces of the Adelphia system. Comcast has room for continued growth, and Brian Roberts’ ownership interest and management skills should help the value to increase as he buys in shares and operates the business effectively. After rising
14% in the fourth quarter, the stock was overweighted. We trimmed Comcast to a more normal weighting.

Disney reported good results across the company. Movies, ABC and the animation businesses, each of which impacts short-term earnings but are relatively small parts of the company’s value, had a good year. More importantly, ESPN and the theme parks generated strong and growing cash flow. Our appraisal rose during the year, and we expect double-digit value growth in 2007.

Although General Motors gave back 7% in the fourth quarter, the 64% return in 2006 helped reduce the hostility we felt from many shareholders about this position as the year began. Although we never viewed bankruptcy as a likely outcome, talk of this possibility died down as the company made significant progress on several fronts.

Three companies negatively impacted performance: Dell, Pioneer Natural Resources, and Sprint Nextel. Dell which we took to a double position when it traded at half of our appraisal, rose 10% in the fourth quarter, but declined 16% for the full year. Earnings over the last twelve months were disappointing and there is a question of whether some numbers will be restated. However, we believe Dell’s direct sale model is the most competitive over the long run, and that the operating problems related to consumer support and gross margins are less relevant than their strength in the corporate world and their rapid growth in foreign operations. Our corporate partners are both significant owners and smart capital allocators. Although we lowered our appraisal to reflect the last year’s troubles, we think the company’s normal earnings power is much higher than recent numbers, and the true value could be well above the appraisal we use.

Pioneer Natural Resources fell 22% during the year, primarily driven by declining oil and gas prices. Our appraisal is not predicated on high near-term prices, and despite energy’s retreat, our appraisal of Pioneer grew in 2006. The combined value growth and price drop make the stock very cheap.

Sprint Nextel has had a difficult time managing churn. This has also interfered with the speed at which they have been able to integrate the two businesses of Sprint and Nextel post-merger. With revenues lower than expected and costs higher than planned, the market has penalized the company and our appraisal has declined because free cash flow generation has not grown as expected. Gary Forsee, the CEO, is focused on fixing the business’ operating issues, and importantly, he has aggressively begun to buy in shares, which are trading at a substantial discount even against a lowered appraisal.
No significant activity occurred in the portfolio during the fourth quarter. Earlier in the year we sold the Fund’s stakes in Waste Management, McClatchy (formerly Knight Ridder), and Anheuser-Busch. We purchased a new position in Chesapeake Energy in the second quarter, and began buying eBay and Symantec in the third quarter.

These purchases and sales helped the P/V stay in the high-60%s at year-end, having begun 2006 in the mid-60%s. The value growth at a number of companies also helped maintain an attractive P/V in spite of a return over 21% in 2006. In particular, several companies boosted values at especially high rates. Some of these, such as YUM Brands!, DirecTV, and Liberty Interactive, aided the process through meaningful share repurchases.

The quality of the Fund’s holdings and management partners makes the portfolio attractive, even after 2006’s strong performance. We have some cash to allow us to buy the next building block for compounding when we identify it. We have a reasonable P/V, and believe that values will continue to grow.
Longleaf Partners Fund gained 3.5% in the third quarter, bringing the 2006 year-to-date return to 12.8%. The first nine months’ 8.5% return of the S&P 500 Index fell well behind the Partners Fund, although the Index had a steeper rise of 5.7% in the quarter. More importantly, the Fund’s results for the third quarter and year-to-date have exceeded our absolute annual goal of inflation plus 10%.

The Fund’s strongest performers for the year continued to do well in the third quarter. The combined bond and equity position in Level 3 has made the biggest impact on returns in 2006; the stock was up over 20% in the quarter. Operating cash flow has grown as pricing declines have slowed. The company’s acquisitions have enabled Level 3 to broaden its offerings from wholesale fiber backbone access to direct customer connectivity in many metro areas. Our appraisal has grown, and we believe that given the business’ operating leverage, the pace of value growth will be substantial. As the low-cost producer, Level 3 is also well positioned to make value-additive acquisitions in an industry that needs further consolidation.

General Motors rose at a double-digit rate over the last three months, gaining 71% since the year began. The stock remains significantly undervalued, and this year the company’s cost structure has meaningfully improved.

Comcast gained over 12% in the quarter and has risen 43% this year. Slowing capital expenditures as well as growth in ARPU (average revenue per user) driven by increasing sales of digital services, broadband connections and VOIP (Voice over Internet Protocol) have helped highlight the strength of Comcast’s business. Recent comparable sales of other cable assets confirm our appraisal. On the satellite side of content distribution, DIRECTV gained almost 20% over the last three months and remained among the largest contributors to 2006 performance. Chase Carey’s outstanding execution in both operations and capital allocation helped drive returns.

Most of the Fund’s holdings showed gains in the quarter. The biggest drag on performance was Pioneer Natural Resources. Oil price declines have not impacted our appraisal of the company’s oil and gas assets because the appraisal is not predicated on high near-term prices.

The most challenging name in the portfolio in 2006 has been Dell, which declined 7% in the quarter and is down 24% for the year. The company’s fundamentals as described in the Longleaf Semi-Annual Report remain intact. In addition, Dell’s customer service efforts have begun to show results. We believe that our overweight position will be extremely rewarding over the long run. The
short-term negative sentiment on Dell, which worsened dramatically over the summer, is typical for a new Longleaf holding. If anything, this sentiment helps explain why “Mr. Market” has thrown Dell into the bargain bin.

During the quarter we sold the Fund’s stake in Anheuser-Busch in order to help fund purchases of several extremely discounted existing holdings as well as two new names. The portfolio contains a collection of businesses that we feel are as high in quality as we have owned. In addition, the level of share repurchases by our management partners is helping accelerate value growth. The Fund’s P/V is attractive in the mid-60%. No holding sells within 15% of its appraised value. We view this as an opportune time to increase one’s stake in the Fund.
In the second quarter Longleaf Partners Fund held up better than the benchmark, but lost ground, declining 1.3%. The year-to-date return of 9.0% remained significantly above the S&P 500 Index’s 2.7% as well as the absolute annual goal of inflation plus 10%. The Fund has dramatically outperformed the Index over the last five and ten years. For the ten year period, the Fund has also produced real returns near 10%.

Rallies in many holdings that began the year at the lowest P/ Vs have driven much of the strong performance in 2006. Although Level 3’s stock fell 14% in the second quarter, both the equity and the convertible bonds have made significant gains this year. The combination of top line growth, increased operating cash flow and several solid acquisitions has generated value appreciation. In spite of the stock’s large rally, the price remains at less than 60% of our appraisal.

Much good news has emerged at General Motors. First, the company secured an agreement to sell 51% of GMAC. Second, the employee buy-out offers, which will be a big help in lowering costs, were more widely accepted than anticipated. Third, and most recently, the board is exploring an alliance with Renault and Nissan. GM stock rose 40% in the quarter and is up over 53% for the year.

The Fund’s media related holdings, including Disney, Comcast, DirecTV, and Liberty Capital (formerly Liberty Media), have gained ground in 2006. In the second quarter Comcast led the group, rising 25%. Fundamentals in the industry have not changed significantly, but sentiment has begun to improve. Fortunately, most of these stocks started the year at such a discount that even with the recent price increases, they trade at attractive price-to-value ratios.

Dell was the primary cause of the Fund’s loss in the quarter and its 18% price decline also made it the largest detractor from year-to-date performance. Although the consumer business has slowed, revenues attributable to corporate customers, including notebooks, servers, storage, peripherals and services, enjoyed larger gains. Dell’s overseas business, which is heavily weighted to corporate and government customers, grew sales at double-digit rates. Given the long-term prospects for Dell’s growth, the company’s low-cost advantage due to its direct sales model, management’s stock ownership and operating record, the tremendous level of share buybacks, and the extreme undervaluation of the stock’s price, we have added to the stock at these lower levels to overweight the position.

During the quarter two events resulted in portfolio sales. We received a combination of cash and shares, which we sold, from McClatchy’s acquisition of Knight Ridder. We also sold Embarq, Sprint’s land-line business, after its spin-
off. The proceeds from these liquidations as well as reductions in several holdings enabled us to add to some of our most undervalued holdings. In addition, we purchased one new company, Chesapeake Energy.

We are as excited about the positioning of the Fund as we have been in recent years.

- Cash is down to 1% of assets, and we have new names on the trading desk.
- The business quality of the holdings in the portfolio is higher than average.
- The magnitude of share repurchases by management teams is growing those companies’ values faster than organic growth otherwise would.
- Our management partners have huge personal stakes in many of the businesses we own.
- The “on-deck” list of companies that meet our qualitative criteria but are slightly above our price limit is growing.
- The P/V is in the mid-60% (versus Southeastern’s long-term average of the high-60%.

We encourage our partners to add to their ownership in the Fund. While the size of Southeastern’s combined assets in the U.S. big-cap mandate makes us hesitant to reopen at this point, limited inflows will allow additional purchases that will enhance the long-term opportunity for existing shareholders.
Longleaf Partners Fund posted a 10.4% return in the first quarter compared to the S&P 500's 4.2% performance. Over the last five years, the Fund has outperformed the index by almost 700 basis points annually, delivering 10.9% per year versus 4.0%. More importantly, the Fund finished the first three months of 2006 well ahead of our annual inflation plus 10% goal. A quarter is a short measuring period, but we welcome starting the year with strong absolute returns.

The good performance was accompanied by relatively little portfolio activity. No new names entered the Fund, and one company, Waste Management, was sold as it approached our appraisal. Knight Ridder announced that McClatchy would purchase the company later in 2006.

Most of the stocks in the Fund rose during the quarter with the largest contributor being Level 3. As the company reported higher operating cash flow for 2005 and increased guidance for 2006, the stock price responded. The financial results reflected our long-held belief that growing demand and industry consolidation eventually would stabilize pricing. Also, the company made a very important acquisition of Wiltel, and announced a smaller but favorable acquisition of Progress Telecom. The stock rose over 80% in the quarter and the convertible bonds purchased last year were up 50%.

Several other stocks contributed meaningfully to the Fund’s results including Aon, NipponKoa, Disney, Cemex, Philips, and DIRECTV. Because these companies sold so far below our appraisals at year-end, they remain attractively priced even after the recent gains. Aon grew market share and increased margins. At NipponKoa the market continued to focus attention on the company’s valuable investment portfolio, and the company’s operating business also performed well. Disney reported strong results, announced the purchase of Pixar, and continued to buy in shares. No particular major news emerged from Cemex or Philips, but solid business results helped both stocks maintain their upward movement. DIRECTV grew subscribers and ARPU (average revenue per user). Chase Carey and his team have positioned the company for ongoing double-digit value growth through strengthened operations and an aggressive share repurchase plan.

General Motors remained the most controversial and most asked-about name in the portfolio. The stock’s 11% rise in the quarter may have reflected the end of selling pressure, but did not represent improved sentiment. The company made progress in addressing some of its challenges in the last three months. Jerry York joined the board, a significant employee buyout package was offered to union members, the 51% sale of GMAC moved forward (and was announced just after quarter-end,) and GM continued to work with the UAW and Delphi to avert a strike. GM’s price remains far below our appraisal which does not include any
assumption of major improvements in the North American truck and car business.

Pioneer Natural Resources was the only holding that had a meaningful negative impact on performance. The stock fell 13% as oil and gas prices retreated and the company reported poor exploration results for 2005. Pioneer Natural Resources sells well below our appraisal, and for substantially less than comparable oil and gas companies due to the long life of its reserves.

The growth in the Fund’s NAV pushed the price-to-value ratio to the high-60%s, near the long-term average. We are hopeful that future returns can match those delivered since the Partners Fund opened in 1987.
Longleaf Partners Fund rose 0.9% in the fourth quarter and ended the year up 3.6%. This annual return was below inflation plus 10% and the S&P 500 which gained 4.9% in 2005. While short-term performance results were disappointing, the long-term prospects for the Fund improved greatly during the year. The Fund’s NAV performance was dwarfed by the 14% average value growth of the companies in the portfolio. In addition we added five new names, converting low-returning cash into high return opportunities. The price-to-value ratio (P/V) improved, and ended 2005 in the low-60%s, below the historic average.

Three primary sources drove the substantial decline in the P/V. First, most holdings posted strong business results. Revenues increased as did margins at many companies in the portfolio, and thus corporate values rose. Second, in a majority of companies our corporate partners invested capital most sagaciously. In particular, half of the companies in the Fund aggressively repurchased shares. If prices remain this discounted and cash flows this strong, we expect this level of activity to continue or grow in the next year. As long as our partners are buying a dollar of value at a meaningful discount, the Partners Fund’s return opportunity increases. The third source of P/V improvement came from productive portfolio management. Every new name and addition to existing holdings reduced the Fund’s overall P/V.

A number of stocks appreciated in 2005. Cemex led the pack throughout the year, rising 13% in the fourth quarter and 63% over the last twelve months. Cemex is one of the largest cement companies in the world, and we purchased the company at the end of 2004 when its stock fell with the acquisition of RMC in the U.K. Although we are normally wary of acquisitions, the purchase of RMC has produced phenomenal results. Not only has Cemex already reached savings at RMC that are 50% larger than predicted, but cement demand has continued to increase, aided by strong worldwide economic growth. The stock price somewhat reflects these results, but the best news for Longleaf shareholders is that our appraisal of Cemex has grown by over a third. The Fund holds an overweighted position in the company because, in spite of the stock’s rise, Cemex remains closer to a buy than a sell.

In addition to Cemex, Aon and NipponKoa extended their substantial gains for the year into the fourth quarter. The factors discussed in the Third Quarter Report, namely an improved outlook for insurance premiums and therefore brokers, and the market’s new-found obsession with Japan, remained in place and these stocks continued to rise as did our appraisal of each. Although Pioneer Natural Resources lost a bit of ground in the fourth quarter, the stock went up 46% during the year thanks to rising energy prices and exceedingly productive capital allocation by management. Our appraisal of the company grew even faster than the stock price, and thus the company is more discounted today than a year ago. The strong fourth quarter for Philips Electronics’ stock pushed it among the top five contributors for 2005 performance. Management continues to monetize
non-core assets while improving the core lighting, medical and consumer electronics businesses. Significant stock moves during the fourth quarter at FedEx and Level 3 also aided results during the last three months.

No name is as controversial or garners as many questions as our General Motors investment. Disappointing results and ongoing challenges in the North American car and truck business have received much media attention and taken pessimism about the company to historic levels. The stock fell 36% in the fourth quarter and 52% for the year. The North American challenges are real, and our appraisal accounts for them. GM is moving forward to improve the cost structure of the auto business and get value recognized by pursuing the sale of a majority interest in GMAC. We believe that management, the board, and other significant investors are focused on resolving the issues faced in North America.

A second stock performance disappointment occurred in the Fund’s broadcast and entertainment related holdings. Although each company we own in this industry has its own set of unique drivers and competitive advantages, the group as a whole fell out of favor. Wall Street appears uncomfortable with the uncertainty that a changing competitive landscape creates. The next five years will bring change, but today’s increasing cash flow at the best franchises such as Disney, Liberty Media, Comcast and DIRECTV, is driving up values. These investments have a much larger margin of safety between price and value than a year ago, and they are among the most discounted names in the Fund.

In the third quarter we bought Dell, which we have wanted to own for a number of years. The price declined after our initial purchase, hurting the Fund’s fourth quarter and full-year return. The bigger discount presents an opportunity to pay fire sale prices for this entrenched brand that is growing revenues and profits at double-digit rates. Dell is overweighted in the portfolio because the company is a high quality business and has management with proven operational and capital allocation prowess. Because of how aggressively Dell is repurchasing its stock, the price weakness is causing value to grow even more rapidly.

The Partners Fund is a much improved portfolio from a year ago. We have traded a high cash level for investments that we believe offer significant compounding over the long term, including Dell, Liberty Media, Anheuser-Busch, Nestle and Sprint in the fourth quarter. Each of these holdings has substantial competitive strengths and in each we have management partners with outstanding records of building shareholder value. We have a high level of confidence in the Fund’s long-term prospects given the new additions to the portfolio made in 2005, the quality of the companies we already owned, the management teams we have as partners, and the fact that we are fully invested with an overall P/V in the low-60%. We encourage our investment partners to add to their stakes in Longleaf Partners Fund.
Longleaf Partners Fund rose 3.9% in the quarter, bringing the year-to-date return to 2.8%. The S&P 500 Index rose 3.6% over the last three months and has posted 2.8% in 2005. The Fund’s results have fallen short of our absolute return goal of inflation plus 10%. Neither the strong value growth at our holdings nor the recent success at finding new investments is evident in these numbers.

In the quarter we added two positions, Dell and Anheuser-Busch, and began to buy a third. These recent purchases, combined with new positions in the second quarter as well as increased stakes in several existing holdings, dropped cash levels to 6% of the portfolio, down from 26% at the outset of 2005 and almost 16% in June. Replacing low-returning cash with investments offering high return potential is always a welcome prospect. Having had the liquidity to take advantage of these new investments served us well, even though we did not enjoy holding cash for so long.

Being more fully invested is only part of the story. As described in the initial Shareholder Letter of this report, the quality of the businesses we have been able to buy coupled with the caliber of management make us confident that waiting for qualifying stocks was the right decision. Both Dell and Anheuser-Busch have entrenched brand names, dominant market shares, and generous free cash flow. Top management at each owns a substantial stake and both are growing value by aggressively buying in shares at today’s depressed prices. Interestingly, the companies “on deck” that qualify qualitatively and are close on price, are of a similar ilk. We are glad to have more dry powder to take advantage of what we hope will emerge.

The stocks that drove the quarter’s positive performance are those that have contributed the most to 2005 results. Cemex’s 48% return this year and 23% in the quarter have only slightly outpaced the company’s rapid value growth. The integration of the RMC acquisition in England has produced results well beyond expectations. In addition, worldwide cement demand has continued to rise. Pioneer Natural Resources also has seen value growth in line with its strong stock price. The stock rose 31% in the quarter and 57% this year as the company has benefited from rising energy prices and very productive capital allocation. Aon has grown revenues as it moved past the overhang of Eliott Spitzer’s insurance industry scrutiny. Expectations about entering a “hard market” of higher insurance prices also have helped the outlook for this insurance broker. Our appraisal has grown at a double-digit rate this year, and the stock’s 28% return in the quarter helped make it one of the year’s top contributors. Lastly, NipponKoa has added to returns. The Japanese stock market has been particularly strong in partial recognition of positive trends discussed in the Longleaf Semi-Annual
Report. Most notable has been the change in attitudes towards the Japanese non-life stocks. After nearly a decade of neglect, NipponKoa has become an investment darling because of its exposure to the Japanese stock market via its large equity portfolio. To the extent that Wall Street paid any attention to this stock over the past decade, analysts cited this same market exposure and the related “overcapitalization” of non-life balance sheets as reasons to avoid the non-life sector.

Several stocks detracted from the Fund’s third quarter return including Liberty, General Motors, and Yum! Brands. There were no new developments in the quarter to account for the declines and our appraisal of each business remained the same or grew slightly. The two primary stocks that have hurt Fund performance for the year, Level 3 and Disney, are actually in better shape today than at the outset of 2005. Disney’s value has grown at a double digit rate with ESPN’s ongoing dominance, theme park success, and improvements at the ABC network. The transition to Bob Iger as the company’s CEO should eliminate the distraction of outsiders maligning Michael Eisner. Hints of firmer prices in Level 3’s IP and Transport businesses have begun to show in the most recent quarter’s financials. In addition, Jim Crowe and the company’s competitors have begun to see better pricing. We have not adjusted our appraisal yet, but are encouraged by the positive signs.

The conversion of low-returning cash into deeply discounted equities along with substantial value growth at many of the Fund’s holdings has caused the price-to-value ratio (P/V) of the Fund to drop to the mid-60%. That P/V is a significant improvement from earlier this year and is below the Fund’s long-term average for the first time in several years. As large owners of the Fund, we are quite pleased with the portfolio today both in terms of its undervaluation and its high quality.
Partners Fund - MANAGEMENT DISCUSSION
by Mason Hawkins, Staley Cates, and John Buford

The Partners Fund’s flat second quarter return held 2005 year-to-date performance at (1.1)%. The S&P 500 rose 1.4% over the last three months and stood at (0.8)% for the year.

Positive results at Cemex both in the quarter and the half made it the largest positive contributor to Fund performance for both periods. Ongoing strength in worldwide cement pricing increased cash flow at the company. The integration of the RMC acquisition in the U.K. has surpassed expectations. Rising oil prices along with well executed capital allocation helped Pioneer Natural Resources remain a large contributor to the Fund’s year-to-date performance, even though the stock price fell slightly in the second quarter.

In addition to Cemex’s gains over the last three months, General Motors, to which we added in the high $20s during the year, rallied. Several events positively impacted sentiment regarding the stock, although our appraisal remained stable, and far above the $34 price at the end of June. Kirk Kerkorian made a tender offer at $31, talks progressed with the United Auto Workers regarding health care costs, management announced cost cutting initiatives, and “employee pricing” helped increase sales in June.

The Fund’s performance in the second quarter and for the first half was hurt by FedEx’s price decline. Our appraisal has grown over the last six months, making FedEx a much more attractive investment today. The one-time cost of converting FedEx Kinko’s stores around the country has hurt short-term earnings but should yield a satisfactory return once conversions are complete. Customer fuel surcharges have followed rising fuel costs, but the lag time between the two created a short-term margin hit. Fears also surfaced about tougher pricing in the express business; we will see how that actually plays out.

Recent disdain for media stocks also hurt the second quarter returns of the Fund, but had no impact on the long-term fundamentals of the companies we own. Disney’s stock fell 12% while ESPN maintained its dominance, theme park attendance increased, and the ABC network gained share. Comcast, the largest U.S. cable operator, grew digital and broadband subscribers, and moved forward in its push to add customers for voice over internet service. Pricing rose at a solid rate. Recent cable transactions, including the purchase of Adelphia, occurred at multiples that imply Comcast’s value is well above its price. Insider moves to take Cox and Cablevision private also highlighted the intrinsic value of cable assets.

The negative media sentiment hurt the Partners Fund’s second quarter performance, but also aided our ability to make a new investment, Liberty Media. Liberty holds a number of mostly liquid entertainment and on-line businesses in a
somewhat complex structure. QVC dominates television sales channels, and its size provides a meaningful advantage. Liberty's ownership of News Corp. shares gives us a high quality asset that we have owned before and that itself is discounted. Discovery with its related networks is being spun out as a means to unlock its large and growing worth. John Malone has a strong history of creating value, and his significant ownership of Liberty aligns him with shareholders in his desire to minimize taxes and gain value recognition.

Two other changes occurred in the portfolio during the quarter. The Level 3 convertible bond purchase, which was described in the First Quarter Report, closed. Although Level 3 fell only slightly in the quarter, its first quarter decline left it as the largest detractor for the Fund’s 2005 performance. The other transaction involved Telephone and Data Systems splitting shares into two separate pieces. The new TDS Special Common is expected to be used to buy in the remainder of U.S. Cellular.

As we close the first half of 2005 we are encouraged by the progress made. The purchases mentioned above as well as additions to several undervalued holdings have helped lower our cash position to 15%. In addition, the price-to-value ratio (P/V) of the Fund is more attractive as values grew and we added more discounted investments. The P/V is now near its long-term average in the mid-to-high 60%s. While our “on deck” list is limited, there are several highly qualified investment opportunities that would become buys with less than a 10% price decline or value accretion.
Longleaf Partners Fund declined 1.1% in the first quarter while the S&P 500 fell 2.2%. Although the Fund’s return was below the annual inflation plus 10% absolute return goal, this short-term result does not indicate any downgrade in the quality of the portfolio or change our long-term expectations for performance.

Several stocks performed well in the quarter. Pioneer Natural Resources rose 22%, and its value increased. Management demonstrated outstanding capital allocation prowess as the company sold the rights to future production of some of its reserves at impressive prices. The price per barrel of oil equivalent (BOE) that they received substantially exceeded both the market’s valuation of the company and our appraisal. The company is using the proceeds to pay down debt and repurchase shares.

Yum! Brands rose 10% in the quarter. The company’s U.S. stores continued to perform well, and the overseas results exceeded expectations once again. After a research trip to China in January, our confidence in the company’s ability to sustain its Asian success via KFC and Pizza Hut grew stronger. Management’s attention both to the operational details and to returns on capital from opening new stores should continue to drive our appraisal north.

Level 3’s performance hurt the Fund’s return during the quarter, falling 39%. The company announced a higher cash burn rate for 2005 than many expected, as well as higher capital expenditures related to growth in new business. Given this growing demand coupled with Level 3’s low cost position among its competitors and the long overdue consolidation occurring among telecommunications service providers, we believe that Level 3’s stock remains undervalued and that its prospects over the next three to five years are compelling. We acted on this belief by participating with six other firms in the private placement of a convertible bond that is due in 2011 and yields 10%. The offering raised $880 million, which will allow Level 3 to maintain over $1 billion in cash reserves throughout the year and to have flexibility to act on opportunities that may arise. The quarter-end portfolio of the Partners Fund does not reflect this purchase, which closed April 4th and reduced cash reserves by 2.5%.

GM declined 26% in the first quarter when the company announced that earnings would be below expectations in 2005 based on lower sales and higher healthcare costs in North America. The announcement did not affect our appraisal of GM because we believe the value of the company rests not in North America, but in GMAC and its overseas operations, which are both performing on target. Management is aggressively addressing the North American challenges.
Because the stock sells for less than half of our appraisal, we added to our position during the quarter.

Another buying opportunity during the quarter emerged as the stock of DirecTV fell 14% while the value increased. The value growth has come from the company's success at raising ARPU (average revenue per user) through higher prices and the addition of services, while also rapidly adding profitable new subscribers.

Telephone and Data Systems made progress worth noting. Management agreed to issue a new share class which could be useful in purchasing the remaining outstanding shares of U.S. Cellular. We reported at year-end that we were pursuing a proxy fight to force the company to consider various ways to gain value recognition, specifically correcting the structure of U.S. Cellular. We are pleased with the new flexibility to alter the minority ownership structure of the cellular business, and have discontinued alternative proxy moves.

Making the purchases mentioned above in addition to completing our position in Cemex helped lower the cash position in the Fund from year-end. These purchases along with ongoing value growth at a number of companies helped the price-to-value ratio in the Fund decline to the high-60%. Not only is the Fund better positioned after the first three months, but the prospects for new investments have improved. Since the end of the quarter, we have closed the Level 3 private placement and found a new investment that meets our criteria. We also are closely following and/or completing our research work on a couple of other companies that look promising. We have a bit of renewed optimism about our ability to put some of the cash in the Fund to work.
Longleaf Partners Fund finished the fourth quarter and the year up 7.1%. The S&P 500 Index rose 9.2% and 10.9% respectively for the two periods. For the first time in five years the Partners Fund underperformed the market. The amount of the return difference was a fraction of the overall performance variance over the five year period. Since December 31, 1999 the Partners Fund has delivered a cumulative return of 76.2% versus (11.1)% for the S&P 500.

We focus more on the absolute numbers which did not meet inflation plus 10% in 2004. While a couple of stocks in the portfolio hurt returns, the large cash position, which began the year at 15% and ended at 26%, hindered performance. We closed the Fund to prevent new inflows. As the year progressed, several stocks reached our appraisals. The resulting sales of Trizec, Hilton, and Marriott in the fourth quarter pushed cash higher just as our list of potential buying opportunities diminished with the market’s overall rise. We were able to identify one anomaly, however, and purchased Cemex, an international cement producer.

As your partners in the Fund we are extremely frustrated to be earning the meager returns on cash. We are not willing, however, to buy equities for the sake of being invested when the risks outweigh the rewards. Accepting low quality businesses, incapable managements, or richly priced stocks is a formula for capital loss – a fate much worse than single-digit positive returns.

Most holdings contributed positively to the 2004 results. Increased revenues and margins grew earnings and cash flow, pushing several stocks in the portfolio to returns over 30% during the year. FedEx, Yum! Brands, Vivendi, and the combined lodging positions of Marriott and Hilton added the most to the Fund’s performance.

After being one of the largest positive contributors to 2003 performance, Level 3 detracted from 2004 results. Level 3 fell 40% for the year despite a 30% fourth quarter rally. We believe the company is the lowest cost and highest service level provider of fiber optic backbone services, but faced two specific challenges in 2004. The managed modem business that serves dial-up customers suffered from a re-sizing of ports by AOL. While broadband usage increased demand for fiber backbone capacity at rates approaching 100%, price competition driven by overcapacity left revenues flat. These two dynamics hurt our appraisal of the business by pushing cash flow growth further into the future, but the stock price fell much more dramatically. We remain large owners of Level 3 because we believe that top line growth is a question of when, not if. Strong broadband demand should continue since only about a fourth of U.S. homes currently have this type of connection. Additional services such as voice over IP and video on demand will further increase capacity utilization. As this combined growth...
Partners Fund - MANAGEMENT DISCUSSION
by Mason Hawkins, Staley Cates, and John Buford

absorbs capacity, prices should stabilize because competitors with older networks cannot justify capital outlays at today’s prices. We believe that Level 3 has the longest staying power while waiting for pricing to turn because:

- Their cost structure is the lowest in the industry.
- The structure of the company’s leverage is formidable with no bank debt, and its first notes not due until 2008. The company recently bought back much of its obligation for 2008 after a successful placement of 2011 notes.
- The company has been adding customers, and incremental revenues have contribution margins of 60%. The potential to buy another, weaker competitor as they did with Genuity offers additional revenue opportunity.
- The management team led by Walter Scott and Jim Crowe has a strong operating and capital allocation history, they have practiced conservative accounting, and they are substantial owners.

Another investment that hurt 2004 performance was GM, which our contrarian goggles would project as the Fund’s biggest potential winner given that it is the most asked about and most hated stock in all of our client meetings. Our investment involves not sentiment, but an appraisal that is substantially more than the current price. We are aware of the negatives in this business – it is cyclical, capital intensive, and has high labor costs. These negatives warrant a low value that does not grow for the North American and European car businesses. Three other areas, however, are worth a substantial and increasing amount – the light truck and SUV business, GMAC, and the Asian operations. The following considerations help confirm that the company is cheap.

- The entire company sells for less than our conservative appraisal of the finance company.
- The company trades at multiples far below most other auto companies.
- GM pays a 5% dividend yield while we wait for value recognition.
- Rick Wagoner, John Devine, Bob Lutz, and the rest of management have done an admirable job of focusing on profitable businesses, aggressively cutting costs, designing better products, and shoring up the pension plan.

Telephone and Data Systems appreciated over 20% in 2004, but remains deeply discounted due in large part to both its dual share class structure and the sub-optimal form of its U.S. Cellular ownership. In the fourth quarter we submitted a shareholder proposal to convert to a single class of stock. We will continue to
pursue ways for TDS to achieve value recognition of its land line and U.S. Cellular businesses.

We are encouraged that the Fund’s P/V is in the low-70% range, down from the mid-70% range a year ago. The quality of most holdings also gives us reason for optimism. We do not, however, know how long it will take us to find qualifying opportunities for the large level of cash reserves, and the P/V remains higher than the long-term average.
In the third quarter Longleaf Partners Fund fell 3.0% leaving the Fund flat for the year-to-date. The S&P 500 Index fell 2.0% in the quarter and has posted a 1.5% return in 2004. While we have made no progress this year toward our return goal of inflation plus 10%, the downward price pressure over the last few months combined with growing appraisals at most holdings enabled us to add to several positions in the quarter. We have not, however, uncovered any new holdings that qualify. Our “on deck” list of names that are close to meeting our qualitative and quantitative investment criteria is larger today than in the last eighteen months. If just a few become more discounted, we will make a dent in our 25% cash level.

Early in the quarter we sold most of our Marriott position when the stock approached our appraisal, more than doubling our initial investment. The sale was bittersweet. The company had been a core holding for a number of years and it is extremely difficult to replace companies that consistently grow value and are led by great partners like Bill Marriott. With little prospect of re-investing the sale proceeds, and cash already at high levels, we closed the Partners Fund to new investors in mid-July. The Fund will remain closed until cash inflows from new investors would benefit existing shareholders.

Although the Fund declined in the quarter, several holdings performed well. Telephone and Data Systems rose over 18% making it the largest positive contributor to the Fund’s quarterly return. The stock has also made a substantial impact on year-to-date results, appreciating almost 35%. The company’s very strong balance sheet combined with steady cash flow from its land line business and market growth at U.S. Cellular have helped the stock’s performance, but the price remains well below our appraisal.

YUM! Brands rose 9% in the quarter. The company has been among the Fund’s top performers throughout the year helped by solid U.S. results and dramatic growth abroad, particularly in Asia. The Partners Fund’s other two top performers for the year-to-date, FedEx and Aon, were up in the third quarter, but most of their return came in the first half of the year.

Level 3 has been the largest detractor from Fund performance, falling 26% in the quarter and over 54% this year. It’s our view no news other than the ongoing short raid precipitated the recent decline. The company’s strong growth in demand for its fiber backbone capacity continues to be offset by stiff price competition. Based on our appraisals the stock is the most undervalued in the portfolio.

Philips went down 16% in the quarter. The stock’s 21% decline in 2004 has also made a substantial impact on the Fund’s year-to-date results. The market appears
to have focused on disappointing results across the volatile semiconductor market. Semiconductors, however, are only part of Philips’ overall business. Solid results in its other businesses such as medical instruments, consumer electronics, and light bulbs have built corporate worth. The lower stock price and higher value gave us an opportunity to add to our position at a very attractive price. Philips is now the Fund’s largest holding.

Several stocks that posted strong results in the first half slipped in the third quarter, including Disney, Vivendi, and NipponKoa. Positive business results at all three have helped values build, and we believe each company offers substantial return opportunity.

Because of the unique competitiveness of most holdings in the portfolio, and their implicit value growth we believe we are well positioned as long-term investors. The price-to-value ratio has come down meaningfully since the beginning of the year, and is now in the high 60’s. Our challenge remains finding additional equity investments that will build the foundation for future compounding. Our wish list is long — we hope that pricing inefficiencies give us a chance to buy a few.
Longleaf Partners Fund rose 1.9% in the second quarter versus the S&P 500 Index’s 1.7%. In the first six months of 2004 the Fund was up 3.1%, close to the S&P’s 3.4%. The Fund’s returns, which were below our annual goal of inflation plus 10%, masked the progress many of our holdings made in building value. The growth in value improved our return opportunity in the Fund’s equities by helping to lower the price-to-value ratio from the mid-70’s at the beginning of the year to the low-70’s six months later.

FedEx contributed meaningfully to the Fund’s return both in the second quarter and the first half, rising 9% and 21%, respectively. The company continued to see growing revenues and margins in its Express business, particularly in international shipping. The ground and freight businesses also reported improved results. Increased top line growth over the largely fixed cost base led to expansion of free cash flow, and our appraisal of the company expanded likewise.

Three other stocks, Vivendi, Aon, and NipponKoa, also significantly augmented the Fund’s six month return. Most of the price increase of each occurred in the first quarter of the year. Vivendi’s ongoing restructuring continued to lower debt and enhance results. Aon grew operating income and projected significant margin improvement in 2004. NipponKoa’s price fell slightly over the last three months, but the stock’s 18% year-to-date rise reflected continued strength in both its underwriting and investment operations, which benefited from the rise of Japan’s equity market.

Over the last three months both lodging stocks in the portfolio, Marriott and Hilton, rose substantially. Occupancy and room rates continued to improve as travel, particularly business travel, returned to vibrancy. These two companies were the largest contributors to the Fund’s second quarter return, and with their recent rise, have also had a positive impact on year-to-date performance.

Level 3 detracted from the Partners Fund’s return both for the first half and in the last three months. Early in the year the company reduced expectations in its managed modem business because of the decline in AOL’s dial-up traffic. Price competition continued to neutralize the rapidly growing Internet Protocol (IP) volume. In response to Level 3’s announcements in the first quarter, we reduced our appraisal to reflect lower cash flow in 2004, but our long-term assessment of the company and its prospects remained sanguine. We believe that expanding capacity utilization from both broadband customers and new services such as voice-over-IP will create firmer pricing in the next few years, and that Level 3 is strongly positioned to be a low cost beneficiary.
Because we have scaled back and sold several holdings and have found no qualifying new investments in 2004, cash has risen to 25% (after adjusting for the settlement of a pending Treasury Bill purchase). We are closing the Fund to new investors until we believe that new cash would once again benefit existing shareholders; that would be the case if we had the requisite qualifying and underpriced investments to accommodate current and additional cash resources. Most of our partners know that the Fund has been closed twice before under similar circumstances, from September 1995 – October 1998, and from June 1999 – February 2000. In each case, exercising patience and controlling growth in the interim rewarded shareholders, i.e. opportunities evolved. We expect this time to be no different.
Longleaf Partners Fund rose 1.2% in the quarter, pushing the Fund’s twelve month return to 37.9%. The S&P 500 Index gained 1.7% over the last three months and has moved up 35.1% over the last year. The Fund did not make remarkable progress during the first quarter towards our annual goal of inflation plus 10%, but the one year return is over three times the bogey.

With the superior compounding of the last twelve months, the portfolio sits at a markedly higher price-to-value ratio than it did a year ago (77% versus 59%) and contains substantially more cash. Opportunity in the Fund can improve in three ways:

- Selling businesses that approach appraisal lowers the P/V (although cash increases.) In the quarter we finished selling ADP and scaled back Marriott, Pioneer Natural Resources, and Disney when they became overweighted as a result of rising prices. These sales made the P/V somewhat more attractive. Today, four of the Fund’s holdings are selling for over 90% of appraisal.

- The P/V will decline as we add companies priced at 60% or less of value. Over the quarter we failed to find any new qualifying investments and only one existing holding currently sells for below 60% of appraisal. Cash reserves, which are not part of the P/V calculation, are 24% of assets, equating to over four new positions when we find companies that meet our criteria.

- As the companies we own grow their intrinsic values, our expected return will increase. A number of holdings reported good results over the last three months and the P/V improved with the value growth.

During the quarter many stocks added to performance. NipponKoa led the contributors driven largely by the significant rise in the Japanese equity market. NipponKoa’s book value increased as its investments rose. Ongoing positive results at Aon, Vivendi, and FedEx drove their stocks up enough to also make a meaningful impact on the Partners Fund’s return.

Level 3 Communications hurt the Fund’s results. Lower operating cash flow expectations for 2004 precipitated a 29% price drop. The managed modem business will decline because AOL is decreasing its Level 3 business following revisions in AOL’s dial-up growth expectations. In addition, pricing competition in the Internet Protocol segment has remained terrible for longer than anticipated. Although demand for IP traffic is growing, revenues are flat. On the other hand, transport revenues are rising at a healthy rate. Our appraisal of Level 3 remains well above its price because we believe that beyond 2004 the company
will make up in broadband what it loses in dial-up service, will benefit as pricing becomes more rational, and will continue to see massive increases in demand with the growth of newer applications such as voice-over-IP and wireless communications.

Two holdings received much attention when Comcast bid for Disney. We cannot anticipate the outcome, but at each company we have leaders who are well aware of their business' intrinsic value and are owner-operators whose interests align with our own. We expect that Michael Eisner and the Disney board will be reluctant to sell such high quality and irreplaceable assets for less than true worth. Brian Roberts has a strong record of being a disciplined buyer and not overpaying for assets. Both companies sell for prices below our appraisals of their entrenched and growing businesses.

We continue to monitor if and when to close the Partners Fund to new investors. Cash rose during the quarter but we believe the magnitude of inflows has not been harmful to shareholders. We are happy to have some liquidity in the Fund to give us the ability to act quickly when we identify the next great investments. Greed is far more prevalent today than fear, but many decades of market history instruct that at some point that will reverse.
Longleaf Partners Fund had a stellar year, returning 34.8%, or almost three times our absolute return objective of inflation plus 10%. The results also surpassed the overall market’s results of 28.6% as measured by the S&P 500. In the fourth quarter, the Fund added 12.3% while the S&P posted 12.1%. As large owners of the Partners Fund we are thrilled to report these results. As the Fund’s managers we urge our partners to view compounding at almost 35% in a twelve month period as unusual and not likely to recur soon.

We began 2003 with a portfolio that was selling at a steep discount to appraisal in spite of our belief that the portfolio contained quality businesses with good management teams. The 2002 Annual Report highlighted the opportunity we saw. In the first three months of 2003 prices moved lower even as most of our appraisals grew. In the second quarter, however, sentiment changed and stocks began a rally that moved many businesses from undervaluation to fair valuation over an eight month period.

Early in the year before the rally we were able to buy a position in Philips Electronics for the second time in the Partners Fund’s history. We managed to capture the especially large discount being given to the semiconductor business. Philips was the largest contributor to the Fund’s return in 2003 as the stock rose over 50% from our purchase point.

Disney, one of the most controversial stocks we own, produced the second largest gain for the Fund, increasing 43%. While a number of headlines lambasted Michael Eisner and his disagreements with former board members, the company was producing solid results. The theme parks and ABC each made progress, the movie business had several successful releases, and ESPN continued to further entrench its brand and produce substantial cash flow. We believe that Eisner and his team, who have significant ownership stakes in the stock, will continue to create value.

Level 3, which is the Fund’s largest position, made important strides. In June we exchanged our 9% convertible notes for equity. The company successfully integrated the Genuity business it purchased and restructured debt for a more flexible financial structure. The management team plans to pursue further organic revenue growth as well as larger scale through acquisitions that make financial sense. Level 3 was the third largest contributor to the Partners Fund’s return, and the stock remains undervalued when compared to our appraisal.

Comcast gained over 38% during the year. Brian Roberts and his team have exceeded expectations in their successful integration of AT&T’s cable business, stemmed losses in telephony, and reaped substantial margin gains in cable service.
Comcast has dominant competitive strength with over 21 million subscribers. As internet user growth continues and digital cable and telephony revenues build, Comcast has the capability to increase its value for quite some time.

The fifth largest contributor to the Fund’s results in 2003 was GM-Hughes whose stock rose over 50%. The company began the year with a new management team focused on improving operations following a year spent working on the failed merger with Echostar. The effort paid off as subscriber growth increased and revenues per subscriber rose. In addition, News Corp agreed to buy control of Hughes, a transaction that closed at year-end. (This changed the General Motors Hughes name to Hughes Electronics, and created a new stock in the portfolio, News Preferred.) Given the results that management has shown and the strength of News Corp’s experience, Hughes’ annual value growth could be in the mid-teens.

The Partners Fund portfolio saw relatively little activity during the year. We purchased Philips as discussed above as well as smaller positions in Diageo and ADP early in the year. In addition we increased our stakes in a few existing holdings when their prices fell. Earlier in the year we completed the sale of Plum Creek and sold Allied Waste and Rayonier.

The Partners Fund ends 2003 in a much different state than it began. The price-to-value ratio of the Fund’s stock holdings is close to 80%, near its historic high. Cash levels are over 15% because we cannot find investments that meet our criteria, with price being the substantial obstacle. The Fund owns several companies selling at over 90% of our appraisal. We are closely monitoring the Partners Fund to determine whether and when to close to new investors. Inflows have been positive but not overwhelming, and with a high P/V, today’s level of available cash could significantly benefit shareholders when new opportunities arise.
Longleaf Partners Fund finished the third quarter up 4.0%, bringing the Fund’s year-to-date return to 20.1%. These results compare quite favorably to the S&P 500’s 2.6% gain in the quarter and 14.7% return in 2003. More importantly, the Partners Fund is far ahead of our inflation plus 10% goal for the year.

Most holdings appreciated over the last three months and several contributed meaningfully to performance. NipponKoa was up 40%. Because the company’s large investment portfolio resembles the Nikkei, that Index’s rally over the quarter helped NipponKoa’s stock. In addition, the insurance operations remain solid and management continues to make positive strides in capital allocation.

The improving U.S. economy made analysts more optimistic about occupancy and rate increases at both Hilton and Marriott. Hilton rose 27% in the quarter, and Marriott increased 12%. Philips delivered on most operating fronts and the stock posted a 20% gain. The lighting business reported better-than-expected results; the medical equipment business made progress; and the outlook for semiconductors improved with increased capacity utilization across the chip sector. GM Hughes grew its value over 20% with double-digit net subscriber additions and higher revenues per subscriber. The stock rose 12%.

Although Level 3 has been the largest contributor to the Fund’s year-to-date return, the stock declined 19% during the quarter. Our appraised value of the company was unchanged and our corporate partners remain some of the most capable we have seen. Level 3’s revenues fell primarily because of management’s effort to eliminate the unprofitable portion of Genuity’s business (Level 3 acquired Genuity earlier this year.) Our appraisal assumed this run-off, and our expectation for the company’s cash flow growth is unimpaired. Level 3 has also announced a plan to replace its bank debt with bonds to provide a more flexible financial structure to aid in purchasing additional customer revenues to run over Level 3’s fixed cost structure.

Aon dropped 13% without any significant news or changes. Skeptics continue to warn that the insurance premium cycle has peaked, but Aon’s cash flow is growing and its intrinsic worth should build nicely even in a downturn. We took advantage of the larger disparity between price and value by adding to our position. This was the only purchase we made during the quarter.

We sold our stake in Rayonier when our efforts to persuade management and the board to consider various options to realize shareholder value succeeded and the price approached our appraisal. The company announced plans to convert to a REIT structure.

Our cash position has risen to 14%, and our price-to-value ratio is in the low 70’s, slightly above the Fund’s historic average. While we prefer to own equities in the long-term, we are patient in the short-run as we look for qualifying investments to buy. The current liquidity will allow us to add 60-cent or better dollars and further improve the outlook for all of our partners.
Longleaf Partners Fund rose 16.7% in the quarter and 15.5% for the six months ended June 30, 2003. The Fund outperformed the S&P 500 returns of 15.4% and 11.8%, respectively, for the same periods and it exceeded our annual absolute goal of inflation plus ten percent in a single quarter. As we cautioned in the front of this report, the results of the last three months should not raise our partners’ expectations. Unfortunately, we do not expect to extrapolate the quarter’s return.

All of the stocks in the portfolio rose during the quarter. The largest contributor to performance was Level 3 Communications. In June we converted our bonds into equity, receiving additional shares to compensate for the interest payments we were giving up. The company strengthened its financial position when we agreed to convert and take the net present value of those future interest payments. This stronger balance sheet further improves the quality of the equity which we now own. Because our investment in Level 3 has been extremely successful in the twelve months since we did the private placement, the company is the Fund’s largest holding.

Not surprisingly, some of our most undervalued businesses had the strongest rallies during the quarter. For example, Vivendi rose over 30%. The entertainment assets have received higher interest than expected from outside bidders. The board is currently reviewing the offers.

During the quarter we did not uncover any new investment opportunities, and those we had been considering moved above our price limits. We scaled back our Comcast position when the stock, which we had overweighted, rose significantly. We sold Allied Waste which was less than half a percent of the portfolio.

The Fund is selling for approximately 70% of our collective appraisals of the businesses we own. While this is a meaningful increase from several months ago, the price-to-value ratio is close to the long-term average. We believe that the overall quality of the businesses we own is excellent. As a result, we expect Longleaf Partners Fund to benefit from value growth as well as from the discounted prices that we have paid.
Partners Fund - PERFORMANCE HISTORY and PORTFOLIO SUMMARY

AVERAGE ANNUAL RETURNS for the periods ended June 30, 2003

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In prior reports, the Partners Fund has also shown the Value Line Geometric Index (“VLG”). Going forward, the Partners Fund will show inflation plus 10% and its required broad-based securities index, the S&P 500, in order to encourage focus on absolute rather than relative returns. The VLG’s performance for the year-to-date, one, five and ten year periods ended 6/30/03 is 13.31%, (7.79)%, (8.90)% and 0.72%, respectively.

Past performance does not predict future performance. The Fund’s performance results in the table shown above do not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares. The S&P 500 Index is shown with all dividends and distributions reinvested; the Value Line Index is not available with reinvested dividends. These indices are unmanaged and are not hedged for foreign currency risk. The U.S. Bureau of Labor Statistics compiles the monthly CPI-U values used to calculate inflation.

FIVE LARGEST HOLDINGS (Represent 32.2% of Net Assets)

Level 3 Communications, Inc. (LVLT) 8.9%
Provides telecommunication and information services, including local, long distance, data transmission, and Internet services.

The Walt Disney Corporation (DIS) 6.3%
A media and entertainment company consisting of ESPN and other cable channels, the ABC Network, theme parks, and movie studios, as well as other assets.

FedEx Corporation (FDX) 5.8%
Integrated air-ground transportation company providing time-definite delivery of packages worldwide.

Vivendi Universal SA (V) 5.6%
French conglomerate with numerous entertainment, media and telecommunications assets as well as Vivendi Environmental.

Comcast Corporation (CMCSK and CMCSA) 5.6%
Largest broadband cable operator in the U.S. with over 21 million subscribers.

PORTFOLIO CHANGES January 1, 2003 through June 30, 2003

<table>
<thead>
<tr>
<th>New Holdings</th>
<th>Eliminations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automatic Data Processing, Inc.</td>
<td>Allied Waste Industries, Inc.</td>
</tr>
<tr>
<td>Diageo plc</td>
<td>Level 3 Communications, Inc.</td>
</tr>
<tr>
<td>Koninklijke (Royal) Philips Electronics N.V.</td>
<td>Notes (converted to stock)</td>
</tr>
<tr>
<td>Koninklijke (Royal) Philips Electronics N.V. ADR</td>
<td>Plum Creek Timber Company, Inc.</td>
</tr>
<tr>
<td>Level 3 Communications, Inc. (from Note conversion)</td>
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</tr>
</tbody>
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The Partners Fund’s (1.0)% return in the first quarter (the S&P 500 posted (3.1)%)) could lead shareholders to the conclusion that we have made no progress in 2003. The opposite is true. Most of the companies we own have grown their values and we have strengthened the portfolio with three new purchases. As a result, the Fund’s quality of holdings has improved and the price-to-value ratio of 59% has become more attractive. Even though recent results are not satisfactory, being fully invested in superior businesses with a low P/V ratio implies strong long-term future returns.

We thought it would be useful to highlight specific recent progress our investees have made. While some prices rose in the quarter, each of these businesses still sells for a meaningful discount to its intrinsic worth. In several companies’ cases, fundamental improvements were unrecognized and their stocks declined over the last three months. The following stocks had the largest impact on the Fund’s first quarter performance.

- Comcast: Began integrating the AT&T broadband acquisition and deleveraging by announcing the unwinding of its Time Warner Entertainment venture. Stock rose 21%.
- Aon: Continued double-digit growth in insurance brokerage revenues at increased margins. Stock rose 10%.
- Level 3: Purchased Genuity at a price that was immediately value accretive, adding high margin revenues over a uniquely low fixed cost communications system. Stock rose 5%.
- Disney: Improved ABC’s programming, helping produce higher ad revenues. Stock rose 4%.
- General Motors – Hughes: Strengthened operating management at DirecTV and pursued discussions with interested acquirers. (Since quarter-end News Corp. has announced its plan to acquire control of GMH.) Stock rose 5%.
- Waste Management: Cut fixed and variable costs and reinvested significant free cash flow in value-building stock repurchases. Stock fell 8%.
- Hilton: In spite of near-record low occupancies, Hilton maintained its sizable free cash flow “coupon”. Stock fell 9%.
- Telephone and Data Systems: Used a debt free balance sheet to initiate a major stock buyback program. Stock fell 13%.
- NipponKoa Insurance: Retired shares, strengthened investment management, and continued underwriting profitably. Stock fell 13%.
Vivendi: Closed purchase of controlling interest in Cegetel, restructured debt for better financial flexibility, worked on further divestitures to reduce debt, and attracted bidders for entertainment assets. ADR’s fell 17%.

In spite of the corporate improvements, our companies remain underpriced in the market. The uncertainty of the war and the U.S. economy added intermittent psychological pressure to our stocks. The volatility over the last three months presented three new investment opportunities that we purchased using our cash reserves combined with proceeds from the sale of Plum Creek and net inflows of over $140 million that the Fund received (thanks to our great partners). We have previously owned two, Diageo and Philips Electronics, which have become stronger companies since we sold them at full value. Diageo owns the top spirits brands in the world and has a market share twice its strongest competitor. Superior distribution and consumer preference have enabled them to both grow the units sold and increase prices even in a somewhat depressed environment. Paul Walsh and his team have built value by focusing on the alcohol beverage business and selling other assets such as Pillsbury and Burger King.

Philips has continued to sell non-core operations, redeploy capital in businesses that are number one or two in their respective industries, and move manufacturing to low cost locations. The company’s important semiconductor division has huge earnings ability when the chip cycle turns, and the stock market currently affords it negative value.

We encourage our partners to increase their stakes in the Fund. In addition to taking advantage of this high quality, underpriced portfolio, taxable investors should know that the NAV at quarter-end contained no distributable realized gains and relatively minor unrealized appreciation. Encouraging cash inflows is an opportunistic recommendation, and not part of a strategy to grow the Fund’s size. In general a larger pool of assets can make trading more difficult and shrink the universe of available stocks by eliminating smaller market caps. We are always mindful of protecting our existing shareholders, especially since we are one of the largest. We do not have a proactive sales effort to attract new assets, and we will only encourage our partners to add capital when the Fund’s incremental investment opportunities would lower the overall P/V. Conversely, if size begins to inhibit our long-term success or if new cash would otherwise be detrimental to shareholders, we will close the Fund as we have twice before.
The Partners Fund’s 6.3% rise in the fourth quarter was not enough to end the year positively. While the Fund’s (8.3)% return in 2002 significantly out-performed the S&P 500’s decline of 22.2%, your partners at Southeastern are disappointed and humbled to report a down year. Our long-term returns, however, remain among the best in the industry. Both the Wall Street Journal and USA Today listed Longleaf Partners Fund among the 20 best performing equity funds for the last 10 years excluding sector funds. The Partners Fund was also one of only four funds to appear in each of the last three years on the Forbes “Honor Roll” – a short list of funds that have protected capital in down markets and have delivered strong long-term, after-tax performance overall.

The portfolio’s changes in 2002 occurred over two distinct periods. In the first few months we sold Diageo as well as our remaining shares of Coca-Cola Enterprises and Aetna, scaled back Plum Creek, and began liquidating Host Marriott which we finished selling in November. By late spring we had plans to close the Fund because cash levels were over 20%, the price-to-value ratio was approaching 80%, and no qualifying investments were available below 60% of appraisal.

Late in the second quarter the environment changed and within four months we had bought new positions in Vivendi, Comcast, Aon, and Level 3 Communications via a convertible bond. We also more than doubled our stake in Disney. These new purchases now comprise four of the Fund’s top five holdings. Each of these positions is capable of double-digit value growth because of the combination of their competitive entrenchment and top caliber management. In addition, Level 3 produced the largest positive contribution to the Fund’s performance in the year, rising 44% over our cost.

Two other stocks, Pioneer Natural Resources and Hilton, had a meaningful positive impact on performance. Pioneer gained over 30% in 2002 as cash flows from their successful exploration activity moved closer to reality and as oil prices rose with concerns of war in the Middle East. We believe the stock remains materially below its intrinsic worth, and Scott Sheffield and his team continue to build value.

Hilton’s rally came early in the year as the cloud from the 9/11 terrorist attacks began to lift, and the company reported faster recovery than expected. Our Hilton appraisal, which we had marked down after the attacks, grew over 15% last year, and the stock rose 16%. A large margin of safety remains in today’s price, and we expect continued value accretion because of the combination of owned trophy properties such as the Waldorf and Hawaiian Village, entrenched branded franchises such as Hampton Inns, Hilton, and Embassy Suites, and the proven, vested management team.
While a number of investments were flat or slightly up, their impact was not substantial enough to offset the large declines in several stocks. Telephone and Data Systems was the largest detractor of the Fund’s performance, falling 48% during the year. The market penalized any company in the telecommunications arena, and TDS was no exception. Although the company’s land line operations performed as expected, the price of TDS’s substantial stake in U.S. Cellular plummeted as did their shares of Deutsche Telekom, which TDS recently liquidated. We lowered our appraisal of TDS to reflect declining value at Deutsche Telekom, but the cellular and land-line business values held steady. The stock’s overly discounted price enabled us to add to our position. TDS has the lowest price-to-value ratio in the Partners Fund today, and could grow its value meaningfully depending on how the Carlson family invests the cash proceeds from the Deutsche Telekom sale.

Waste Management fell 28% during the year but our appraisal grew slightly as the company reinvested its substantial cash flow coupon into buying in shares. Revenue growth has been slow with the weak economy, but Maury Myers and his team have succeeded in dramatically improving the company in the three years they have been there. The irreplaceable landfills and more efficient operations position the company to continue to produce a large cash coupon that should increase substantially when economic growth returns.

Trizec Properties faced management and industry challenges, and the stock declined 40%. The lower intrinsic value stemmed from non-core assets like international, retail, and co-location facilities. Office properties, despite soft leasing conditions, have retained almost all of their worth. The Sears Tower’s value, however, declined given higher cap rates being paid for trophy properties and increased insurance costs for terrorism. Our revised appraisal is well below replacement costs and is a conservative 8X FFO (funds from operations.) The company’s conversion to an office REIT should help assure investors that the business is focused on class A office properties in the U.S., and that they will receive a somewhat reliable yield. The new management team has a proven real estate track record, and Trizec sells for almost half of our revised appraisal.

In spite of a fourth quarter 17% rally, General Motors-Hughes hurt the Fund’s 2002 results. Much of the stock’s decline came amidst the overall market rejection of cable and media related businesses. The company also spent most of the year in limbo regarding the proposed Echostar merger that dissolved in the fourth quarter. Although our appraisal was not dependent on the merger, the planning distracted management somewhat from its focus on adding subscribers and improving margins. With a new management team the company is on track
whether it operates independently or as part of someone else. DirecTV sells for a huge discount to smaller competitor, Echostar.

The disdain for cable stocks also drove down the price of Comcast. We began buying the stock late in the second quarter and added to our position as the price fell further. In November Comcast completed its purchase of the cable business that we owned through our stake in AT&T (we liquidated the remainder of our AT&T after the sale.) Comcast has competitive advantages, pricing power, a largely completed infrastructure, and the opportunity to dramatically expand revenues over its fixed cost structure by adding new subscribers and providing new services such as internet access, telephony, and video on demand. Comcast is the largest cable operator in the country run by one of the best operating teams.

Our disappointment in the Fund’s 2002 return should not overshadow our pleasure with the foundation we were able to build in the portfolio. A large part of our success was due to the quality of our fellow shareholders. In 2002 the Fund received over $700 million in net inflows which were steady throughout the year. We took advantage of bear market price discounts without having to sell undervalued businesses to raise cash for purchases. With a 61% price-to-value ratio and a large number of high quality investments, we believe our capital in Longleaf Partners Fund is well protected with significant return opportunity.
Longleaf Partners Fund fell 12.4% in the quarter and the S&P 500 dropped 17.2%. The Fund’s 10-year average annual return places Longleaf Partners Fund among the top 15 mutual funds over the last decade (excluding sector funds) according to the Wall Street Journal. We were also pleased that for the third consecutive year the Partners Fund made the Forbes “Honor Roll,” ten funds that offer top long-term performance as well as protection in down markets.

While we are unhappy with our recent results, we are optimistic about our opportunity. Today’s price-to-value ratio of approximately 50% is almost the lowest we can expect, and the quality of our businesses is at least equal to that at previous low P/V’s.

As July began we had 18% in cash reserves and over the next three months we received an additional $110 million in net inflows. We put this liquidity to work by substantially adding to our stakes in Comcast and Walt Disney at extremely low prices. In addition we participated in a private placement of Level 3 Communications notes yielding 9% convertible into common at $3.41 per share (see June 30 report for more discussion). We also bought full positions in Aon and Vivendi.

Level 3 and Aon were two of the Fund’s three holdings that appreciated in the quarter. AT&T also bounced back from its lows of the second quarter. Unfortunately, the prices of the other companies in the portfolio did not fare as well.

Four companies made up almost half of the drop in Longleaf’s value. We began purchasing Vivendi at 50% of our appraisal. We believed that the new CEO, Jean-Rene Fortou, would quickly resolve short-term liquidity needs, and would begin to reduce total debt. The market was less convinced, and the price fell to dramatic lows. The value of the company’s entertainment, publishing, environmental, and other businesses remained intact, and we bought more. The price recovered 20% but is still substantially below half of our Vivendi appraisal.

The price of Trizec Properties, the U.S. office property REIT, fell 32% in the quarter. There was much controversy about Chairman Peter Munk and a CEO change. We believe that the end of the boardroom soap opera will enable investors to focus on the value of Trizec’s class A office buildings once the newly structured company begins paying a normal dividend.

GM dropped 26%. Ironically, the truck and car business is performing better than it has in years, while GMAC has held up far better than most similar financial services companies. The market, however, is terrified about the long-term consequences of price discounting, and that the weakness in the used car
market portends horrible new sales. In addition, we get at least one question per day about GM’s well-publicized pension deficit and massive post-retirement health care payments. We not only agree with all of these negatives, but in some cases our assumptions are more pessimistic than the conventional wisdom. Yet, after incorporating these issues into our evaluations, we believe that the company is worth more than double its stock price.

Marriott International has been affected by the economic slowdown, although it owns the strongest set of brands in the hotel industry. Short sellers have put downward pressure on the stock and have tried to raise questions about Marriott’s accounting for volume discounts it receives from suppliers. Marriott’s accounting is among the most transparent we have found, and after talking with hotel owners and franchisees, our appraisal of Marriott is almost twice its price. Our stellar management partners have taken advantage of the stock’s weakness by repurchasing a significant number of shares.

We believe that recent price declines represent gains deferred, not lost, since our appraisals have held steady or grown. Besides enthusiasm about historically low price-to-value ratios, we are even more excited by the quality of the investments in the Partners Fund. Our investees’ competitive advantages improve the probability that the growth in corporate values will be a meaningful part of our future investment returns. Specifically, our newly acquired and unique assets are:

- ESPN, the most powerful cable network, and Disney theme parks, which will receive growing royalty payments from foreign countries throughout the upcoming decade with little invested capital;
- the Aon insurance-brokerage franchise that dominates its world alongside Marsh & McLennan;
- the lowest-cost provider of broadband wholesaling (even after competitors’ debts get washed away in bankruptcy) through Level 3;
- the powerful Comcast cable systems; and,
- Universal entertainment properties.
These proprietary businesses are added to existing holdings such as:

- Marriott and Hilton hotel flags and fees;
- fee streams from KFC, Taco Bell, and Pizza Hut, plus the #1 American brand in China, KFC;
- Waste Management’s dominant and impossible-to-replicate landfills; and,
- the similarly irreplaceable FedEx global logistics network.

These superior investments at fire-sale prices encouraged us to aggressively add to our existing Partners Fund investment. We believe our partners should do the same.
Longleaf Partners Fund declined 8.2% in the second quarter. The S&P 500’s 13.4% loss and Value Line’s drop of 14.2% provided little consolation. While those focused on relative returns may view being down “only” 1.6% in 2002 as good, we assure you that as substantial owners of the Fund, we disagree.

Pioneer Natural Resources helped the Partners Fund’s results. The stock was up 17% in the quarter. Given its successful exploration and proven reserves, the cash flows at Pioneer will increase substantially in the next two calendar years, and the value of the company remains much above its price.

The Fund’s returns were hurt primarily by our two telecom investments, AT&T and Telephone and Data Systems (TDS). We lowered our appraisal of AT&T by approximately 10% when the company issued shares to protect its debt rating. The price, however, fell much more in the quarter, making the stock one of the most discounted in the portfolio. TDS’ value reduction was related to our lower appraisal of its stake in Deutsche Telekom. Both TDS’ and AT&T’s 31% price declines had much more to do with the fear associated with telecom and cable industry troubles than with specific company issues. Because prices became extremely discounted relative to our lowered values of these two companies, we added to our positions in each.

Most cable and satellite stocks were hurt by the disclosure of Adelphia’s problems. GM Hughes went down 37% in the quarter. Although DirecTV lost share to EchoStar, new subscriber additions and churn rates were better than expected. The merger of GM Hughes and EchoStar is still awaiting regulatory approval. Hughes sells for far less than its intrinsic worth, with or without the merger.

Comcast’s stock was also impacted by the industry’s woes. We took advantage of this opportunity to partner with some of cable’s best operators. When Comcast completes its acquisition of AT&T’s broadband business, we will own a full position in the combined company at a very attractive price.

After the close of the quarter, the Partners Fund, together with Berkshire Hathaway, Legg Mason, and Longleaf Partners Small-Cap Fund, completed a private placement in Level 3 convertible notes. Although typically we neither own corporate bonds nor do private placements, this was a compelling opportunity that the Fund’s flexible policies allowed us to pursue and that we did not want to forego. The ten-year notes position Longleaf ahead of the common equity, pay a 9% cash coupon, and are convertible at any time to common equity at $3.41 per share — a price that is under the stock’s current level, and is far below the company’s growing intrinsic value.
Level 3 owns the best fiber telecommunications network in the industry. Importantly, most of its competitors struggle with huge debt levels and further significant capital expenditure requirements. Many are now in bankruptcy. Customers are universally worried about their service providers’ reliability, financial integrity, and ability to provision future needs. Level 3’s superior network infrastructure, its servicing capabilities, and its capital resources position the company to become the clear industry winner. As we said in the press release announcing the placement, “We invested in Level 3 to take advantage of consolidation opportunities in the telecommunications arena. We believe these opportunities are substantial. Level 3 is uniquely and competitively positioned, and its management team, led by Jim Crowe, is most able.”

After recent purchases, the Partners Fund is almost fully invested and the price-to-value ratio is back below its historic average. This is a significant change — it has been a very long time since price-to-value ratios and cash positions improved so dramatically in such a short period. We hope our partners share our enthusiasm for the portfolio’s strength.
Longleaf Partners Fund returned 7.1% in the first quarter versus a flat return for the S&P 500 Index. The absolute returns for the long-term owners of the Partners Fund continue to be rewarding. Those who have owned the Fund for five years have compounded their capital at a 15.9% annual rate, and over the last decade shareholders made a 17.4% average annual return compared to respective gains of 10.2% and 13.2% for the S&P 500 Index.

During the first quarter the improving economic environment helped raise the market’s expectations for several of our businesses, and most of our holdings’ stocks appreciated. The hotel companies we own have reported improving results since 9/11/01. In the first quarter Hilton and Host Marriott each rose over 30%, and Marriott International’s price was up 11%. General Motors reported strong sales of its trucks and cars, largely at the expense of its domestic rivals. GM gained 26%.

Waste Management’s shares fell 15% during the quarter despite better than expected cash flow numbers and progress in service improvements and cost reductions. While commercial volumes slowed with the economy, overall pricing improved. The company has been tainted with recent headlines regarding SEC charges against former management who led the old corporation prior to 1997. The investigation has nothing to do with today’s Waste Management, nor its current management team.

As mentioned in the 2001 Annual Report, we finished selling Coca-Cola Enterprises and Aetna early in the quarter. We also sold our position in Diageo, booking an 85% return over the two years we owned the company.

We have not found any new businesses that qualify for investment this year, and these sales have driven the cash in the portfolio to 20%. Moreover, several holdings have moved closer to our appraisals as indicated by the Funds’ relatively high 79% price-to-value ratio. The letter on page 1 of this report explains that we will patiently look for businesses that meet our investment criteria and will not compromise your capital or ours by loosening our disciplines.
Longleaf Partners Fund posted an outstanding fourth quarter, up 15.2%, besting the S&P 500’s 10.7% gain. For 2001 the Partners Fund returned 10.3% while the S&P lost 11.9%.

Broad anticipation of economic recovery combined with good results at a number of our holdings helped to drive the Fund’s strong fourth quarter. Several of our largest positions led the gain including Marriott, FedEx, and Tricon Global.

Tricon Global’s fourth quarter strength was a continuation of its momentum throughout the year. The stock gained 49% in 2001, making this franchisor and owner of Pizza Hut, Taco Bell, and KFC restaurants the largest contributor to the Partners Fund’s return. Tricon Global’s new leadership at Taco Bell improved results through operations and financing help for some franchisees. Tricon also continued to earn high returns on the overseas expansion of KFC restaurants. Because Tricon Global was one of the few businesses in the portfolio that grew its worth during the year, the stock remains undervalued even after its 2001 performance.

Georgia-Pacific Timber Group completed its merger into Plum Creek Timber in the fourth quarter. Becoming part of a REIT structure will increase the company’s cash flow and, for taxable shareholders, will reduce tax rates on distributed income as dividends from the sale of timber become taxed as long-term capital gains instead of ordinary income. The stock reflected the benefits of the merger, and Georgia-Pacific Timber, now Plum Creek, was the second largest contributor to the Partners Fund’s 2001 results.

FedEx rebounded 41% in the fourth quarter and was up 30% for the year. The company’s cost structure has greatly improved, and yields were positive despite terrible volumes. When the economy rebounds, higher revenues leveraged over the lower cost structure will increase margins and cause the company’s value to grow rapidly.

AT&T’s plan to break the company into four separate companies made progress, reflected in the stock’s 36% rise. We received AT&T Wireless shares which we sold as their price rose to our appraisal. AT&T has accepted Comcast’s offer of $55 billion for the broadband business, a price we think reflects fair value. AT&T has announced its next step toward separating its operating businesses, creating a tracking stock for its consumer long distance services.

Waste Management completed most of its new systems implementation and made a number of operational improvements during 2001. In spite of slowing revenue growth due to the recession, Maury Myers and his team drove costs down and
improved margins. The stock increased 15% over the year. The systems and operations changes being implemented should drive strong results in 2002.

Several companies detracted from the Partners Fund’s 2001 performance. General Motors – Class H (Hughes) experienced lower new subscriber growth at DirecTV as negotiations for selling the company dragged on longer than anticipated. We enter 2002 with an agreement to be merged with EchoStar, a combination that could create substantial additional value.

Host Marriott fell 25% during the year in spite of its 28% rise in the fourth quarter. Travel declines after 9/11 especially affected central business district high-end hotels such as those owned by Host Marriott. The company experienced negative REVPAR (revenue per available room) which hurt both the corporate value as well as the stock price. Chris Nasetta and his team are managing the company well through this challenging time. As business travel improves, and REVPAR numbers indicate this is happening, Host Marriott should see a rapid cash flow recovery.

Telephone and Data Systems (TDS) suffered along with the rest of the cellular industry amid fears over industry capacity outpacing new subscriber additions. Even with this headwind, TDS remains extremely undervalued, thanks in part to its huge ownership of rural wireline companies and a large stake in Deutsche Telekom.

During 2001 the Partners Fund portfolio remained stable with only 18% turnover. We purchased Disney, GM-Hughes, and TDS, and added to several businesses we already owned. Early in the year we sold Canadian Pacific and parted with DeBeers when it was taken private. More recently we liquidated our positions in AT&T Wireless, Coca-Cola Enterprises, and Aetna as each approached our appraisals. We have completed our sales of the latter two businesses since the end of the year.

Our low turnover partially reflects the challenge we are having finding qualifying investments. We are diligently looking for a home for our 10% cash position. Through hard work and patience we will protect our capital and yours by investing only when we find a business that we believe qualifies both qualitatively and quantitatively.
Longleaf Partners Fund lost 13.6% during the quarter with almost the entire decline occurring in September. Beating the S&P 500 Index, which fell 14.7%, provides little comfort. The last month’s results have caused the Fund to fall below its inflation plus 10% goal for 2001. In spite of the recent returns, the Partners Fund has successfully compounded capital at a 16.4% rate over the last ten years, and the Fund’s relative results over all periods have been steadily impressive. The table that follows summarizes the Fund’s performance.

While most stocks lost ground in the month of September, hotel stocks had the largest impact on performance. Marriott, Hilton, and Host Marriott had risen during the year as many investors were looking past the economic slow-down of 2001 into a better 2002. When the terrorists attacked on September 11th, occupancy and room rate optimism became total pessimism. The stocks of these three companies fell on average by more than a third. We reassessed our appraisals assuming a prolonged recession and REVPAR (revenue per available room) declines far worse than any others in history. Our appraisals declined an average of 25%. Since prices fell much further than values, the margin of safety in our hotel companies widened. In spite of the near-term outlook, we continue to believe that in this no-new-supply environment the franchise and management fee business combined with dominant hotel brand names and top-notch management offer one of the highest quality long-term investments anywhere in the market, especially at today’s prices.

General Motors and General Motors Hughes each fell over 30% during the quarter. Recession fears reduced expectations for car and truck sales. Rick Wagoner and his team are managing through the current environment, and thus far GM’s sales have been higher than predicted. At Hughes, DirectTV has reported a lower growth rate in new subscribers. Management is pursuing either selling the company to allow owners to capture value or merging into a new entity that will build value more rapidly.

On a positive note AT&T helped performance during the quarter, rising 14%. AT&T Wireless was spun off, and management is having discussions with various prospective buyers of the cable business after an unexpected offer from Comcast. The company continues to trade at a material discount to its intrinsic worth.

During the quarter we scaled back a few positions when their prices rose closer to appraisal, and we added to several holdings whose prices declined. We built a full position in GM Hughes and purchased a new position in Walt Disney Company.
We believe that Longleaf Partners Fund contains the foundation for attractive long-term compounding with very little risk. The Fund is almost fully invested and sells for an aggregate price-to-value ratio of about 60%, below the historic average. The portfolio contains a group of competitively entrenched, dominant brands across many industries. Many of our management partners are actively pursuing value recognition through spin-offs, asset sales, and mergers. Our appraisals are conservative by assuming that post-recession most companies return to 1999 operating levels. As one of the largest owners of the Fund, we are excited about the opportunity we see for our partners and ourselves.
Longleaf Partners Fund rose 11.3% in the second quarter, contributing to the twelve month return of 30.4%, and far surpassing our annual inflation plus 10% target. By contrast the S&P 500 Index grew 5.8% over the last three months, bringing its loss to 14.8% over one year. We are pleased that our partners have been greatly rewarded, but caution shareholders to lower both absolute and relative return expectations.

Our top holdings contributed significantly to the Fund’s second quarter performance. GM is pursuing a sale of Hughes, which owns the valuable DirecTV business. While auto sales have slowed from peak levels, GM has increased share in its more profitable truck and SUV lines. With focus from Rick Wagoner and John Devine the company continues to report progress in reducing auto costs and increasing productivity. GM’s stock rose 25% over the quarter but remains the cheapest company in the Partners Fund portfolio.

At Waste Management, Maury Myers is achieving the steady progress he predicted by implementing new information systems, streamlining operations, improving employee morale, and providing better customer service. His initiatives have produced strong and growing free cash flow that is building corporate value and driving the stock price north. In the quarter Waste Management gained 25%, and over the last fifteen months the stock has risen from its $13 low to almost $31. We have reduced Waste’s weighting in the portfolio from as much as 18% to 8% as the price has appreciated closer to appraisal.

Marriott’s stock increased 15% over the last three months as the market outlook for the hotel industry past 2001 improved. Marriott’s superior fee stream business model, its dominant brands, and its capable management have continued to reward shareholders.

Georgia-Pacific Corporation – Timber Group rose 25% this quarter as its acquisition by Plum Creek neared completion. After the August shareholder vote The Timber Group will change from a corporate structure that pays taxes on profits at corporate rates and distributes dividends taxable to shareholders at high personal rates to a REIT structure that incurs no corporate taxes and pays distributions which are taxed at primarily long-term capital gains rates. Pete Correll and Don Glass have done a tremendous job building value, allocating our capital, getting some of that value recognized, and merging into a much more tax efficient vehicle. We thank them.

At Aetna, Jack Rowe and Ron Williams are focused on improving margins which are well below industry averages, but the market is skeptical and the stock declined 28% in the quarter. As the company improves its pricing and underwrit-
ing as well as its patient management system, we should begin to see improved results.

The companies that comprise the Fund’s top holdings remained the same during the quarter. We sold our position in De Beers. Management’s final bid with Anglo American was a victory for De Beers shareholders and a tremendous outcome for Longleaf owners.

With the portfolio selling close to its historic average price-to-value ratio, our long-term return opportunity should be comparable to our historic results. We will use the cash in the portfolio to reduce the P/V when we find qualifying opportunities.
Longleaf Partners Fund ended the first quarter slightly down, (0.4)%, as compared to (11.9)% for the S&P 500 Index and (6.2)% for the Value-Line Index. Over the last twelve months the Partners Fund delivered both requirements of an investment — safety of principal and an adequate return — with a 27% one-year gain. The market, by contrast, as measured by the S&P 500 has fallen 21.7% and the average stock represented by Value-Line has given up 13.9%.

Several of our stocks posted strong results during the quarter. AT&T rose 23%. The benefits of breaking the company into three separate entities should continue to help value recognition, and eventually lead to strengthened management at the subsidiaries. Among the positive announcements in 2001 have been the hiring of a new leader for the long distance business and a more favorable ruling from the FCC regarding cable divestitures.

Tricon Global’s stock appreciated 16% in the quarter, but this owner of KFC, Pizza Hut, and Taco Bell brands remains one of the most undervalued holdings in our portfolio. CEO David Novak is working with Taco Bell franchisees to improve their capital structure and ensure that restaurant operations remain solid. Expansion overseas, especially in Asia, continues to deliver high returns.

We have seen a quick return in our De Beers investment which is a combination of owning De Beers stock and shorting our exposure to what we believe are fully valued Anglo American shares, which constitute a portion of DeBeers’ value. Currently, Anglo American and the Oppenheimer family are making a joint bid to purchase De Beers. The offer on the table is inadequate.

Although their values remained stable, stock declines at two of our businesses meaningfully detracted from the Fund’s return. Waste Management was down 11% during the quarter after appreciating 61% last year. Maury Myers and his team continue to make operational and systems improvements, and we expect the company to achieve normal industry margins by late 2002. The company has used proceeds from asset sales to pay down a substantial amount of debt.

Pioneer Natural Resources fell 20% in the quarter after posting a 120% gain in 2000 and in spite of the material increase in the value of its proven oil and gas reserves. Although energy prices have fluctuated, Pioneer has locked in significant amounts of its cash flow over the next few years through futures contracts. Scott Sheffield and his team are using the cash to pay down debt, buy in shares, and pursue exploration.
The only significant change in the portfolio during the quarter was our sale of Canadian Pacific when the stock approached our conservative appraisal. The proceeds from CP as well as inflows have resulted in a cash position over 10%. We believe this liquidity will serve us well as the prevailing market volatility creates new investment opportunities.
Longleaf Partners Fund concluded a successful year, returning 20.6% after posting a 12.1% gain in the fourth quarter. By contrast, the S&P 500 Index fell 9.2% in 2000, losing 7.8% in the final quarter. The Fund’s significant appreciation came after the first two months of the year when the dot.com bubble began to burst. From NASDAQ’s peak on March 10th through year-end, Longleaf Partners Fund delivered a 40.1% return while the S&P dropped 4.9% and NASDAQ lost 51.0%.

Our top holding throughout the year, Waste Management, led the Partners Fund’s performance. Wall Street increasingly gained confidence that Maury Myers could fix the systems problems, improve operations, and capture firm waste disposal pricing. By year-end after Waste had traded up 61% to $27.75, many analysts began to issue “buy” reports. Waste was our largest position throughout 2000, moving from 16.4% to 12.3% of assets. While Waste Management remains our largest holding and we believe the value can grow to double today’s price, trimming our position enabled us to purchase AT&T.

An inefficient stock market gave us an opportunity to buy AT&T at approximately half of the mid-$30s net value we ascribe to the combination of its four component businesses. The very capable board, including John Malone, Amos Hostetter, Sandy Weill, and Lou Simpson, has elected to distribute the cable, wireless, consumer, and business network companies to shareholders in order to surface their values. These independent entities should be able to more effectively compete for management and capital and to account more responsibly to their owners.

Pioneer Natural Resources rose 120% during the year as energy markets tightened. Numerous oil and gas transactions confirmed our appraisal, which is well above the current price. Scott Sheffield continued to build value at the company with efficient development, exploitation, and exploration programs that increased production and reserves.

Marriott International, which franchises and manages hotels, and Host Marriott, which owns hotel properties, each contributed significantly to the Partners Fund’s performance. Results at both companies exceeded our expectations, and earlier investor concerns that hotel oversupply would hurt these two proved incorrect. Marriott, which is our second largest holding, rose 34% in 2000 and Host Marriott, with its dividend, returned 71%. Both remain undervalued and we are delighted to have Bill Marriott and Chris Nasetta as our partners working to build intrinsic value.
Early in the year when it appeared that only technology stocks were going up, some of the best consumer brands in the world became available at most attractive prices. We added Diageo and a small amount of Nabisco. Kraft soon bought Nabisco for twice our purchase price. At Diageo, Paul Walsh intelligently grew value by exchanging its Pillsbury brands at an attractive price for significant cash and a one-third interest in General Mills. Additionally, Walsh worked to improve franchisee relationships at Burger King, purchased core spirits brands from Seagram to complement Diageo’s leading industry position, and expanded international demand for Guinness. The market responded to these moves and the stock rose 63% from the time we bought it through year-end.

Although most of our holdings added to performance, several stocks penalized our results. General Motors, our third largest position, fell 30% during the year as analysts focused on shrinking market share and demand in the car business. Our appraisal assumes a pessimistic outlook for cars and a slow-down in trucks. When trucks and autos are combined with the company’s net cash and investments, its AAA-rated GMAC finance business, and the rapidly growing DirecTV business of Hughes, GM sells for less than 40% of our appraisal of its intrinsic worth. The board has appropriately taken advantage of the stock’s undervaluation to aggressively buy in shares, further enhancing value per share.

UCAR suffered as higher energy costs pressured margins and a declining Euro benefited its main competitor, SGL of Germany. Today’s stock price, however, woefully fails to recognize UCAR’s normal earnings power and the exciting prospects for fuel cell technology at its Graftech subsidiary.

In the first half of 2000 we sold seven positions, enabling us to buy Diageo and Nabisco, to increase our ownership in several existing holdings, and to meet redemption requests. We had sold most of Philips Electronics and United Health Care in 1999 as the stocks exceeded our appraisals, and we completed these sales in early 2000. In addition we sold our relatively small positions in Crestline Capital, Alexander & Baldwin, and Boston Properties because the stocks were not cheap enough to add to, and their small weightings meant little impact on the portfolio. We sold Pioneer Group after the company had risen 198% from its February low and subsequent to its merger announcement with Unicredito Italiano. We also liquidated our Yasuda Fire and Marine and moved half the proceeds into the better-managed Nippon Fire & Marine. In the fourth quarter we initiated new positions in De Beers and Coca-Cola Enterprises.

Although some of our portfolio weightings changed during the year, the core holdings in the Partners Fund did not dramatically differ. Turnover was a low
20% and the Fund went from 24 to 21 names. Most importantly, even after a 20.6% return, the aggregate price-to-value relationship of the Partners Fund’s investments is a low 59%, just two percentage points above where it began the year. We were able to move from more fairly valued equities into more discounted opportunities throughout 2000 and the values at many of our companies built faster than the stocks appreciated. The quality of our holdings improved over the last twelve months and their prices remain well below appraisal.
Longleaf Partners Fund completed a second consecutive quarter of strong absolute and relative performance. The Fund rose 4.9% over the last three months while the S&P 500 declined 1.2% and the Value-Line appreciated 2.9%. Year-to-date the Partners Fund is up 7.6% versus -2.2% for the S&P and -2.6% for the Value Line.

Several holdings contributed to our successful quarter. Nippon Fire and Marine’s stock appreciated 39%. Ken Matsuzawa is transforming Nippon from a well-capitalized and well-operated Japanese non-life insurance company to one that is also focused on building shareholder value. To that end, Nippon has repurchased significant amounts of its undervalued shares, established share ownership requirements for management, and is reviewing a stock option plan and bringing outside members to its board. Meanwhile, many competitors have made capital allocation blunders by investing in undercapitalized banks and life insurance companies. While the market has partially recognized Matsuzawa’s operational and asset-management efforts, the company continues to trade at a dramatic discount to its liquidation and ongoing business values.

Our hotel businesses also posted strong returns with Hilton and Host Marriott both rising over 20% in the quarter. Each company has delivered better than expected results, benefiting from having top branded hotels in supply constrained markets. Demand for rooms has been much stronger than plan, and new supply growth is slowing. In spite of the progress, both Hilton and Host Marriott sell for extremely low prices.

FedEx had a successful quarter; the stock advanced 17%. Fred Smith and his team are strengthening the domestic business with the integration of air, ground, and home delivery capability. Overseas volume growth continues to exceed optimistic projections. The focus on improving yields and achieving high returns on capital has benefited shareholders. Additionally, fuel surcharges and hedging are helping protect margins against rising fuel prices. The price remains well below our appraisal.

Georgia Pacifiﬁc Timber Group’s stock jumped when Plum Creek, a timber REIT, announced its intention to purchase the company. The proposed merger awaits approvals. The new structure offers substantial tax beneﬁts to shareholders as well as the opportunity to own some of North America’s best timberland at well below its private market value.

Waste Management gave up some of its second quarter gain, retreating 8% in the quarter on nothing but positive news. Two-thirds of the decline occurred on the
Partners Fund - MANAGEMENT DISCUSSION
by Mason Hawkins, Staley Cates, and John Buford

final trading day of September amid frantic quarter-end portfolio window dressing. On the first day of the fourth quarter the stock regained almost half its third quarter loss. Trading frenzy notwithstanding, Maury Myers and his management team continue to make solid progress. Non-strategic asset sales have generated in excess of $2.1 billion thus far; the company’s unit growth remains firm, implying pricing opportunity; improved systems are enabling better tracking and financial management; Waste is canceling unprofitable collection contracts; and reported results continue to meet expectations. The stock sells for less than half of our conservative appraisal.

In July Aetna announced the sale of its financial services and international assets to ING for $7.7 billion. Shareholders will receive $35 per share in the fourth quarter plus a new share of a well-capitalized healthcare management business. The board has recently appointed John Rowe as CEO, who is well qualified to lead the turnaround of the health business. Our appraisal of the current combined Aetna is in excess of $90 per share; the stock sells for $58.06.

The Partners Fund portfolio was mostly unchanged in the quarter. We sold our small stake in Nabisco when the price reached appraisal upon the company’s sale. We own nineteen competitively entrenched businesses run by quality managers. In aggregate our portfolio sells for 55% of our appraisal; no holding is priced at more than 80% of value. We are fully invested and have several new ideas ready for new cash. Our confidence and enthusiasm reflect how well positioned we are for continued good results. It is a particularly opportune time to add to your Partners Fund investment.
In the second quarter Longleaf Partners Fund rose 8.5% while the S&P 500 Index and the equally weighted Value-Line Index declined 2.7% and 4.9%, respectively. Several holdings meaningfully contributed to the Fund’s return.

Waste Management, our largest position, posted solid first quarter results that indicate Maury Myers and his new management team have stabilized the business. The stock rose 39% in the second quarter. The company has reported both volume and pricing increases and an improved working capital position. Non-strategic asset sales are on target to raise $3 billion. The company received a favorable settlement with the SEC, and a lead plaintiff has been chosen for shareholder suits. We are delighted but not surprised by the progress. WMI remains deeply undervalued relative to the free cash flow it currently generates. We anticipate rapid value growth as Waste fully converts its computer systems and Myers implements operational best practices throughout the company.

Our hotel companies also helped the Partners Fund’s performance. Marriott was up 14% in the quarter, and Hilton rose 21%. REVPAR and occupancy numbers remained strong, and new supply concerns moderated. The franchise and management fee businesses are ahead of expectations for the year. At Hilton the owned properties, primarily in central business district locations, have not been seriously threatened by new supply, and the company is realizing synergies from last year’s Promus merger ahead of plan. Marriott and Hilton, as well as Host Marriott, sell well below our appraisals, and Bill Marriott, Steve Bollenbach, and Chris Nasetta are working diligently to build their corporate values.

Many of our management partners took action to capture their economic values. Jack Cogan and the board of Pioneer Group negotiated the sale of the company to Unicredito Italiano. The stock rose from its January low of $12.88 to over $41.50, exceeded our appraisal, and we sold our position. Nabisco, where we had acquired only a small stake, was auctioned for $55 per share to Phillip Morris. Aetna is currently discussing selling its financial services business with interested buyers. Peter Munk has sold TrizecHahn’s Canadian properties and is using $500 million of the proceeds to repurchase shares. Diageo has announced plans to take a portion of Burger King public.
FedEx’s share price remained flat in the quarter although the company’s international volume grew dramatically, worldwide yields improved, and customer fuel surcharges have ameliorated higher fuel prices.

Several stocks in our portfolio had a down quarter in spite of unchanged or increased values. Most dramatic was General Motors, which fell when the company’s offer to swap Hughes shares for GM shares was oversubscribed. Many traders bought GM as an inexpensive way to receive Hughes, and before the swap both stocks were selling at around $90. When the company announced that only one fourth of tendered shares would be swapped, the arbitrage players who never cared about owning the businesses or the underlying values rapidly sold their GM shares. While the price of Hughes remained stable, GM shares fell to $58. Because the company used fairly valued Hughes shares to purchase substantially undervalued GM shares, the value-per-share of General Motors increased.

Our two timber-related holdings, Georgia Pacific Timber and Rayonier, also declined in the quarter as ongoing interest rate increases boosted concerns that stumpage demand would slow. While a short-term decline in the timber harvest impacts current cash flow, the remaining timber reserve base builds. Tree growth adds volume to the even larger asset base for future cutting. When demand returns, larger, older stands will yield a more valuable product mix. As long-term owners, a dip in current cash flow is acceptable because cash flow a few years out will be more than correspondingly larger.

During the quarter we sold several holdings including previously mentioned Pioneer Group. We sold both Alexander & Baldwin and Crestline, which were less than one percent positions, to concentrate in more compelling opportunities. We also sold our stake in Yasuda Fire and Marine, a Japanese non-life insurer. Although this company remains statistically cheap, numerous visits with management caused us to question their commitment to building value for shareholders.

The quality of the businesses we own and our corporate partners are as good as they have ever been in the Partners Fund, and the Fund sells for only 55% of our appraised value. We look forward to reaping the benefits.
Partners Fund - MANAGEMENT DISCUSSION
by Mason Hawkins, Staley Cates, and John Buford

In a frustrating quarter Longleaf Partners Fund declined 5.4% while the S&P 500 Index rose 2.3%. Although technology stocks faltered in the final days of March, the quarter’s results reflect the contrast between dot.com valuations (NASDAQ up 12.4%) and mainstream businesses (Dow Jones Industrial Average down 4.7%).

Four holdings accounted for much of the Fund’s decline — Waste Management, Tricon, Knight Ridder, and Hilton. We remain confident in our case on Waste Management (see the previous two quarterly reports for details). The right CEO is in place, industry fundamentals remain strong, and operating cash flow is on target, even before the company’s systems are fixed well enough to enable Maury Myers to optimize operations. With all the bad press hovering over the stock, however, Wall Street will require a couple of good quarters before believing.

The negative sentiment towards Waste Management is similar to that surrounding Seagram when we bought it in 1997. We paid prices in the low-to-mid $30’s for Seagram in the face of unfavorable views of management. We believed the negative assessment to be unwarranted, just as we view the current negative opinion of WMI’s management “credibility” due to the prior team as overdone. A year after that Seagram purchase, although fundamentals remained sound, the stock traded in the mid $20’s, a sizable paper loss. Less than six months later in the spring of 1999 Seagram had appreciated to $65, almost twice our cost, and we sold the stock at our appraisal.

This comparison is not meant to suggest that we will double our money on WMI in only six months. It does highlight how volatile stock prices are, how quickly sentiment can change when justified by fundamentals, and how we attempt to take advantage of irrational swings between fear and greed. While the bad press is one theory that has kept WMI at a steeply discounted price, negative PR is not reason enough for us to walk away from attractive business characteristics and significant undervaluation.

The Seagram experience also illustrates that big returns do not happen in a straight line. If returns could be timed or if stocks rose in even increments, we could wait for favorable price momentum and then jump in. Because the markets do not accommodate this kind of wishful thinking, we must be early and patient.

Two of the other three “laggards” in the first quarter are operating exceptionally well. Tricon’s stock is weak because of horrible same-store comparisons that the company will report for the first few months of this year. However, even with those comps Tricon will report earnings and free cash flow up over 20% in 2000, after last year’s 43% gain in EPS and 22% gain in free cash flow. Due to this amazing disconnect between business performance of their KFC, Pizza Hut, and
Taco Bell brands, and the stock price, management bought in a whopping 3 million shares in January alone.

Knight Ridder reported EPS up 20% in 1999 and will post a double digit gain again this year, and was rewarded with a stock price drop. Like Tricon, KRI is taking advantage of this drop by buying in substantial shares and thereby adding even more to existing intrinsic value per share. KRI sells substantially below our appraisal of around 9X EBITDA. Our confidence in that appraisal was boosted by Tribune’s agreement to pay 11X EBITDA for Times Mirror, which we believe has lower growth characteristics and a weaker Web presence than Knight Ridder.

Hilton’s stock has been weak due to poor performance at its Doubletree segment and disappointing margins in 1999. The core properties and fee businesses, however, are doing very well. The trophy hotels such as the Waldorf Astoria and the Hawaiian Village are insulated from the industry’s new supply threats, and new hotel capacity is a positive rather than a negative for the fee businesses. Management owns a substantial amount of the company, and Steve Bollenbach is focused solely on building and recognizing value.

Our 13D filing on Aetna speaks for itself, and this is not the time to comment further. In due course we will communicate the case in more detail.

While at the end of this quarter we report to you disappointing results, we also report two things that we strongly believe will outweigh the current underperformance over the long-term. First and most important, we have never seen this kind of widespread undervaluation of fine businesses. Our composite price-to-value ratio is below 50% for the first time ever, compared to a long-term average in the high 60’s. Just getting back to average would provide a return that more than compensates for the past year, while putting us on a platform from which we have historically generated high long-term absolute returns. Second, we have never seen this level of company share repurchase activity. Almost every company in the Fund is taking advantage of today’s fire sale prices and adding even more value to their shares by taking out sellers at prices way below fair worth.
Longleaf Partners Fund ended 1999 up 2.2% following an almost flat (-0.5%) fourth quarter. The equally weighted Value Line Index rose 3.2% in the quarter, but declined 1.4% in 1999. By contrast, the S&P 500 Index, dominated by a few large, mostly technology-related stocks, rose 14.9% in the quarter and ended the year up a commendable 21.1%. (Please refer to the table on page 12 for specific contributions to the Fund’s 1999 performance.)

The Fund’s meager return for the year is attributable primarily to Waste Management. We reviewed our reasons for owning WMI in the third quarter report, and the business case remains valid. Subsequent to our last report, the company has moved aggressively to solve its two main challenges. First, Maury Myers was appointed Chairman and CEO. Maury has successfully turned around three struggling companies with financial constraints significantly more severe than at Waste. He has strong logistics and systems expertise, which are critical to making the merged Waste Management and USA Waste operate as a single, efficient company. He has the leadership experience and skill to improve corporate morale and customer service. His compensation package is heavily tied to the stock’s performance. Second, a new MIS team with vast experience has been assembled and is several months into a 12 to 18 month systems project that will solve many of the problems that caused WMI to stumble.

The market’s disdain for real estate also negatively impacted performance last year. Host Marriott, discussed on pages 3 and 26 of this report, and Trizec Hahn declined during 1999. The stocks’ performance contrasted sharply to operating results and earnings, which increased over the past twelve months at these companies.

Our investment in Nippon Fire and Marine, the Japanese non-life company, declined in 1999. Value has grown as the company’s equity investments increased substantially and its underwriting businesses remained profitable. Japanese banks and life insurance companies’ major liquidity-driven sales of non-life stocks depressed Nippon’s price.

The Partners Fund had several successes that helped the year’s results. Philips Electronics, which we bought in 1996 and again after steep declines in 1998, rose over 115% during 1999 to $135 per share. Over the 27 months we have owned the business, not only has the price risen well above our original mid-$30’s cost, but management’s ability to rapidly build value has enabled us to defer taxable gains by continuing to own the rising stock without sacrificing our margin of safety.
Early in the year we discussed our successful sales of Seagram, News Corp, and MediaOne where we made 2-3 times our original investments. Several of our long-time holdings added to performance. Knight Ridder benefited from higher ad sales and margins. The recovery of oil helped Canadian Pacific. Marriott continued to report increased fees as new hotels opened under the Marriott brands, and Bill Marriott used his free cash flow to aggressively repurchase inexpensive shares. In the first half of 1999 we reduced our 14.7% FDX position as the price approached our appraisal, and we reinvested the proceeds in more undervalued businesses. When the price declined in the Fall, we again increased our stake in FDX. (See page 4 for comments.)

One recent purchase, General Motors, has begun to appreciate, although it remains well below our appraisal. We also bought a full position in Georgia-Pacific Timber Group, a collection of valuable timberlands with a proven, shareholder-oriented management. Our other new full position, Tricon Global Restaurants, was spun off from Pepsi and owns the KFC, Taco Bell, and Pizza Hut brands. As a stand-alone company, management has focused on improving restaurant operations and franchisee relations. We are pleased to be partners with David Novak who has the right experience and stock ownership incentives to make Tricon successful.

As stated earlier in this report, the Partners Fund has rarely owned this many high quality companies and never at prices this discounted. The portfolio’s composite price-to-value ratio began the new year at the lowest level of any year since the Fund opened in 1987. When the gap begins to close between share prices and the large and growing corporate values at our companies, we should see significant returns.
Longleaf Partners Fund is up 2.7% in 1999 following a 15.3% decline in the third quarter. As one of the largest shareholder groups in the Fund, we would have preferred to avoid the short-term hit to our net asset value. Occasional volatility must be endured, however, to succeed as long-term investors. The trick is to turn episodes of market mispricing to our advantage using soundly based appraisals.

Along with a number of our corporate management partners, we used the quarter’s price declines to make attractive purchases. As investors, we added substantially to our stakes in the Partners Fund. As portfolio managers, we increased a number of existing holdings and purchased a new core position, General Motors. Management at FDX, Marriott International, and Host Marriott announced and began major new share repurchase initiatives. Because these companies are selling at large discounts to their corporate intrinsic values, the stock buybacks will enhance earnings per share and value per share materially.

The Fund is extremely well positioned today.
• We have one of the lowest composite price-to-value ratios ever seen in the Partners Fund.
• We own businesses with excellent competitive positions.
• Many of our corporate partners have begun buying back their undervalued stock.
• We have a meaningful stake in some of our best ideas.
• We are fully invested.

Half of our decline in the quarter was attributable to Waste Management, Inc. At June 30, WMI was our fifth largest holding, comprising 5.2% of assets, and was trading at just under $54. Today, at one-third its former high and less than half of our appraisal, Waste Management is the Partners Fund’s largest holding. A company usually gets this cheap only when it faces either insurmountable debt or extinction risk to its fundamental business. WMI has neither problem.

We have committed a meaningful amount of our capital to Waste Management based on the following:
• The company has the best landfill and collection assets in the industry.
• Its assets are impossible to duplicate in today’s environmentally conscious society.
• Waste Management is a dominant operator in all of its regional markets.
• The industry’s economics are good and improving with limited supply and growing demand.
• The industry has become an oligopoly with most markets having only one primary competitor, creating an environment for firm pricing.
Significant cost savings and revenue opportunities remain from the merger of the old Waste Management and USA Waste.

The net cash earnings over the next twelve months should be over $2.50 per share; and, in three years, after-tax free cash flow should exceed $4.50.

The Board of Directors will find a capable CEO to capture the cost and revenue opportunities, install adequate MIS systems, and lead and motivate a good field organization.

Hiring a CEO and establishing an adequate computer management and accounting system are fixable and evanescent problems.

FDX also contributed to the portfolio’s decline. FDX has outstanding business prospects and substantial cash flows. Fred Smith, one of the most capable and vested partners we have teamed with in 25 years, leads the company. When FDX announced earnings, they were two cents short of Wall Street’s expectations, and the stock dropped over 12% in a day. The company’s discussion of the quarter neither surprised us, nor impacted our value. Both the company and we have taken advantage of the irrational reaction by purchasing shares.

The third negative impact to the Fund’s performance was our combined lodging holdings: Marriott International, Host Marriott, and Hilton. The investment world continues to abhor anything related to real estate. These three companies have reported better than expected results. They either own, franchise and/or manage some of the strongest brands in the industry. Their hotel properties are among the best in the country. Hilton announced the purchase of Promus (which we own in the Small-Cap and Realty Funds). The company will be stronger and more valuable, yet the price has declined since the announcement.

We cannot explain the tremendous discount that others have placed on this industry, but we know we are teamed with stars such as Bill Marriott and Steve Bollenbach, who repeatedly have proven their ability to build value per share.

A case in point is Hilton’s spin off earlier this year of its gambling operations into Park Place Entertainment. Bollenbach’s move generated Wall Street approval, and the stock quickly rose to its value. We were paid our appraisal when we sold most of our stake in Park Place during the quarter.

Our cash position has declined from 30% to 5% in the last three months. In addition to adding substantially to some of our existing holdings, we acquired a full position in General Motors. We never thought we would own an auto company, and think of this more as a high-quality conglomerate. The jewel is GM’s controlling position in Hughes Electronics, whose largest asset is DirecTV. GM also owns GMAC, the profitable leasing and finance company. GM has made
major strides in improving the margins at its car company. The Board consists of some of the smartest shareholder stewards in America. Together with management, they have allocated capital intelligently, spinning off non-core businesses and aggressively buying in undervalued shares. We are excited about the long-term prospects for this investment.
During the second quarter, Longleaf Partners Fund rose 14.2%, more than twice the S&P 500 Index’s 7% return. The Partners Fund is up 21.3% for the first six months of 1999. We would gladly accept our current performance for all of 1999.

Our top five holdings at the quarter’s outset — FDX, Marriott, Philips, United Healthcare, and Seagram — provided over 40% of the quarter’s return and have contributed almost 60% of 1999’s performance. We continue to be rewarded for our buying activity in 1998’s third quarter market decline when we purchased UNH and added substantially to FDX, Marriott, and Philips.

In April we sold our stake in Seagram at prices between $50 and $65 per share versus our original cost of $28. The negative opinion that the investing public had of CEO Edgar Bronfman, Jr. enabled us to buy Seagram at a substantial discount to our appraisal. Looking past public opinion, we determined that his capital allocation record was excellent, and took solace in the Bronfman family’s 30% ownership stake. During our investment tenure Mr. Bronfman substantially increased the value of the firm through the acquisition of Universal Entertainment Group, the sale of Tropicana, and the sale of USA Networks.

We also sold our stake in News Corp. early in the quarter after it appreciated to our appraisal. We shifted our ownership in the Japanese non-life companies by selling one entirely and reinvesting the cash into our two remaining positions. As the depth of our overseas research grows, we are better able to assess our management partners and their attention to building shareholder value, and we can concentrate more confidently in fewer companies.

We began the quarter with 21% cash and ended it with 31%. Two-thirds of the increase came from portfolio sales. As we discussed in the Letter to Shareholders, few new investment opportunities emerged. We began buying Georgia Pacific Timber Group, but the price rose before we could establish a full position. We added to several of our holdings when their stocks dipped below 60% of our appraisals. We closed the Partners Fund again when cash inflows began to increase. We wanted to limit any dilution of our existing shareholders’ positions before it happened.

As significant owners in the Fund, holding cash is not our preference. Buying businesses without the requisite margin of safety, however, appeals to us even less. In past times when elusive qualifying investments caused cash to rise above 20%, we found hard work and long patience very rewarding. We should also emphasize that most of the Fund’s assets are invested, and the companies we own have very attractive appreciation opportunities.
The Partners Fund posted strong absolute and relative performance in the first quarter – up 6.2% versus 5.0% for the S&P 500. In a period when most value managers had difficulty, Longleaf Partners was fortunate to post solid returns.

The concentration of our assets into qualified companies with capable management partners continued to drive the Fund’s success. Appreciation in Seagram, Philips, Marriott International, United Health Care, MediaOne, FDX, News Corp., and Hilton accounted for all of the first quarter’s return. These eight companies comprised over half of the Fund’s assets at the beginning of the year.

We sold our large and successful MediaOne position when its price reached, and rapidly surpassed, our appraisal. Our MediaOne experience is illustrative of much that we seek:
- a bright, capable, shareholder-oriented CEO in Chuck Lillis,
- a competitively entrenched, good business with growing free cash flow, and
- an entry price that reflected neither of the above qualities.

We established a double position (10% of assets) in late 1997 when MediaOne’s stock was in the high teens and low twenties. Less than two years later, the price rose beyond our $56 appraisal.

We have begun liquidating several other holdings which have reached their values. Proceeds have increased cash to 21% of assets, and at current price levels, we have more to sell then we have to buy. Two companies currently qualify as investments and our trading desk is working hard to purchase meaningful stakes. We are challenged to find good, large cap businesses run by management teams we want as partners, and priced with the requisite margin of safety.

The irony is that the portfolio’s composite price-to-value ratio is relatively low, and the Fund offers a good return opportunity. While a few holdings are approaching their values, several companies that we own are selling below 60% of our appraisal. We are buying more of those shares where we can.

We do not know when the market will offer more investment opportunities, but we will remain patient until we find qualifiers. If cash levels continue to rise, we will consider closing the Fund again.
Longleaf Partners Fund completed another successful year with a 14.3% return in 1998. The Fund gained 18.5% during the fourth quarter. Our investment partners have compounded their capital at high rates. The average annual return for the last five years was 19.8%, and for the last three years was 21.1%.

We strive to preserve our capital and earn a 10% premium over inflation over long holding periods. We are not driven by performance relative to any index. We recognize, however, that some are concerned that the Fund has not matched the unprecedented gains in the S&P 500. As owner operators with a large stake in the Fund, we are aware of this divergence, but it does not concern us. Equities as measured by this index have never performed this well for this long. The S&P has never sold at today's elevated valuation levels. The market-weighted S&P Index is selling at over 27x current normalized earnings, and several of the large companies that dominate the index sell at 60x – 80x earnings. Owners of this index have no margin of safety between the price they are paying and the value of the businesses they own. The Partners Fund’s portfolio, by contrast, is well positioned to generate high returns because we own good businesses run by capable managements at large discounts to their appraised value.

Several holdings drove the Partners Fund’s successful results in 1998. MediaOne Group, which was our second largest holding at the year’s outset, added $228 million to the Fund’s return. We purchased this cable company in late 1997 when Wall Street disdained both the industry and the company structure (it was a target stock of US West). The business subsequently was spun out, and cash flows have increased as the company leverages its infrastructure by selling more services. During the year this position rose to 15% of the portfolio. We realized a portion of the gains when they became long-term to properly re-weight the portfolio and to redeploy cash into lower priced opportunities. MediaOne still has unrecognized value which is growing. We are happy to remain partners with Chuck Lillis and his team. The company is our fifth largest holding.

We purchased significantly more FDX both in 1997 when it suffered under the Asian crisis, and in August of 1998 when the stock fell dramatically with the threat of a pilot strike and the market decline. Federal Express has spent over twenty-five years building its worldwide infrastructure to deliver time-sensitive packages. As their capital expenditures flatten and volumes increase, FDX should experience large operating profit leverage. The company’s cash flows are growing steadily, and Fred Smith is a shrewd partner. Our position in FDX contributed $183 million to the Partners Fund as the investment world began to understand that few companies will benefit as much from the growth of electronic commerce.
The company remains significantly undervalued, and enters 1999 as the largest holding in the Fund.

ALLTEL became a holding in 1998 when the company bought 360° Communications, which we began purchasing in April 1996. As wireless communications have rapidly grown, Wall Street has begun to appreciate the growing cash flows at these businesses, highlighted by several large mergers. The price reached our value in the Fall, and we sold it, realizing a long-term gain in 1998 of $90 million.

Not all the Fund’s holdings were successful in 1998, and several negatively impacted our return. We began buying Pioneer Natural Resources in January after the stock had fallen by half. The market’s third quarter decline coupled with additional oil price decreases caused the stock to fall further. Scott Sheffield has his entire worth in the company, and his track record for rewarding shareholders is outstanding. He is cutting costs and has several alternatives for increasing cash flows. At the current price, Pioneer Natural Resources sells for less than 40% of our appraisal which does not depend on oil prices rebounding.

The Fund also has a temporary loss in our new position in UCAR International. UCAR is the world’s largest producer of graphite electrodes which steel mini-mills consume in melting scrap. The business has very strong competitive attributes with dominant market share, low new supply, long-term pricing opportunity with customers, and prospects for growth. The company’s stock declined amid concerns over a Justice Department investigation which led to $300 million in fines for price fixing ten years ago. Although the settlements were completed, the stock continued to fall as overseas steel makers harmed UCAR’s customers by dumping steel in the U.S. and Europe. Cutbacks in U.S. steel production have hurt UCAR’s sales. We have confidence in the new management team’s ability to manage through this short-term contraction, and expect the company to recover well once mini-mills restore their growth.

Host Marriott owns full service and resort hotels with Marriott and Ritz-Carlton brands in some of the best locations in the U.S. The company suffered as the lodging sector’s prices declined over 50% in 1998 amid fears of recession, oversupply, and changes to laws that govern a few paired-share REITs. Even if these fears become reality, Host Marriott’s supply-constrained locations and overbooked, premium properties should protect the company’s cash flows.

In 1998 the Partners Fund turnover was higher than our historic average. We sold Kansas City Southern, Quaker Oats, and Ralston Purina when they reached our appraisals. These long-term holdings returned 214%, 76%, and 188%, respectively, over the time we owned them. We also scaled back Knight Ridder
when its price appreciation overweighted it in the portfolio. We sold several fully valued businesses that were spun off from existing holdings. We liquidated some very small positions which we could not increase, and bought more attractive businesses where we could own a meaningful stake.

We used proceeds from these sales as well as our cash reserves to buy several new holdings and add to existing positions at compelling prices, especially in the third quarter. We added major stakes in Marriott International, United Healthcare, Hilton Hotels, and Canadian Pacific.

At the outset of 1999 our investment partners own a concentrated portfolio selling at a very low price-to-value ratio with minimal cash reserves. The strength of the businesses we own and the capabilities of their management teams make us very optimistic about the Partners Fund’s long-term prospects.
Partners Fund - MANAGEMENT DISCUSSION
by Mason Hawkins and Staley Cates

In most business endeavors not much changes in a quarter. The investment world for the Partners Fund, however, changed dramatically in three short months. Just ninety days ago equity bargains were elusive, the Fund had 15% cash, and greed was driving up an already overvalued market. Today, we have many compelling investment ideas, the Fund is fully invested, and palpable fear has caused U.S. stocks to fall precipitously from their highs.

We have made significant long-term progress in the third quarter, despite nauseating short-term performance. The Fund fell 18% from June through September. The Fund’s composite price-to-value ratio (P/V) delineates the attractiveness of our portfolio. Because the ratio compares today’s stock price to our appraisal of underlying corporate value, we think the Fund’s P/V is the single best indicator of our future performance. A lower ratio implies more upside potential and a larger margin of safety in the portfolio. Exactly one year ago the Fund’s composite P/V was over 80%. Today it has improved to almost 50%. With the price-to-value ratio at its historic low our five-year return expectations are much higher than they have been since 1990. While we do not know if or when values will be recognized, we do know the following: a move to 100% of appraisal from 80% yields a 25% return; a move to full value from a 50% P/V ratio produces a 100% gain. Thus, without the benefit of corporate value growth factored into the compounding equation, our appreciation opportunity has increased four-fold.

Some might assume their position has not improved because the lower price-to-value ratio came with a 6% decline in Fund performance over the last year. While the Fund’s price did reduce the P/V (not the way we prefer it to happen!), three quarters of the significant improvement came from better positioning of the portfolio. We sold companies that reached full value earlier this year and recently replaced them with more significantly undervalued securities. Our corporate partners also have grown their businesses’ intrinsic values. We believe our improved long-term positioning will boost future performance by an amount that far exceeds our short-term hit.

It may be surprising that new holdings or existing positions which we significantly increased caused most of the damage to the quarter’s performance. In Longleaf’s history, many of our biggest long-term winners began as short-term disappointments. When a company has some kind of temporary or perceived problem (otherwise it wouldn’t be cheap) and already sells far below its highs, statistically one has low odds of buying at the absolute bottom. Consequently, stock prices of the companies we purchase often get worse before they get better. It is usually well worth the wait. While we would love to be able to time acquisitions better,
the opportunity cost of staying out of that rare find is usually higher than the short-term penalty.

Of the companies that have penalized our results the most since June, several positions were established in the portfolio in the last six months. We purchased new holdings such as Hilton, Pioneer Natural Resources, and UCAR International after their prices had dropped significantly; their free falls continued after we bought. We added heavily this quarter to existing positions in FDX and Marriott after their stocks had declined; their price drops then resumed. We knew these five were undervalued when we purchased them; the fears driving their declines, however, became more pronounced and inflicted even more short-term price damage. In all five cases the long-term free cash flows and asset values are intact. These five are clearly more compelling at their current 40¢ on the appraised dollar than they were 90 days ago at 60¢. Each has an attractive business, and our partners such as Bill Marriott, Fred Smith, and Steve Bollenbach have some of the best records in corporate America for building shareholder value and getting it recognized.

We have recently increased our personal stake in the Partners Fund to seize this rare and tremendous opportunity.
Partners Fund - MANAGEMENT DISCUSSION
by Mason Hawkins and Staley Cates

Over the last quarter and throughout 1998 Longleaf Partners Fund has delivered strong absolute and relative performance in spite of our large cash component. The Fund grew 4.0% during the second quarter versus 3.3% for the S&P 500. Year-to-date the Partners Fund is up 18.1% compared to the S&P’s 17.6%.

The equity market appears fully valued and homogenous to many, yet we have always contended that good analysts can uncover wonderful long-term opportunity. The power of identifying and buying significant stakes in a few very compelling and undervalued companies cannot be overemphasized. The flexibility our shareholders approved last year to allow more concentration enabled us to make large commitments to MediaOne, News Corp., and Waste Management in the second half of 1997. These three companies illustrate our beliefs and have driven the Partners Fund’s 1998 performance. Each of these businesses has competitive economics, was disdained by Wall Street when purchased, and continues to sell at a discount to intrinsic value.

MediaOne, formerly U S West Media Group, has become the only publicly traded broadband cable company that offers one class of shares, has little debt, and is managed equally well for all owners. Our investment in MediaOne has more than doubled. News Corp.’s portfolio market value is almost twice our cost as the company has gone from Wall Street dog to darling with Rupert Murdoch’s sale of TV Guide and proposed public sale of 20% of Fox’s assets. Waste Management will soon merge with USA Waste, and our stake has materially appreciated. The strength of John Drury and his management team at USA Waste combined with the assets of Waste Management will create the strongest company in the solid waste industry.

During the quarter the portfolio had a number of transactions, but few were sizeable. Several companies split into their component parts. When Chicago Title was spun off by Alleghany, Chicago Title quickly reached full value and we sold it. The same was true when Sodexo Marriott Services split from Marriott. Ralston Purina and Agribrands separated, and we liquidated our long-term Ralston holding at appraisal. With great reluctance we sever our ten year partnership with Bill Stiritz and his team. Few have been better stewards of corporate assets for us. He is at the top of the class in our hall of fame. We all owe a great debt of thanks to Bill and his very capable management team.

Since quarter end Alltel closed its purchase of 360° Communications. We look forward to our new association with Joe Ford, Dennis Foster, and their team.
Over the past year we have explicitly discussed the market’s high levels and our corresponding difficulty finding undervalued and qualifying investments. The corollary to this should be that our partners decrease their return expectations. Below is a brief recap.

Over the past 25 years we have faced three other periods (1972, 1980, and 1987) where it has been extremely difficult to find qualifying investment ideas. — March 31, 1997

Investors are paying peak multiples for peak levels of profitability. — June 30, 1997

The composite price-to-value ratio of these two Funds [Partners and Small-Cap] are at their highest levels... We would welcome a market correction. — September 30, 1997

The United States equity markets, in closing out 1997, have just completed the longest uninterrupted period of compounding in the twentieth century... You should clearly remember our recent 1990’s experience. We firmly believe it is unlikely to be repeated soon, if ever again in our lifetimes. — December 31, 1997

In spite of our naysaying, Partners Fund performance for the last twelve months, up 42.6%, exceeds any calendar year return in the Fund’s history. As owners we are pleased. As portfolio managers looking for discounted prices, we are stymied. Our warning stands — this pace of compounding will end. The historical norm for cyclical market declines has been approximately 25%. We would gladly suffer the short-term consequences to uncover the underlying opportunities that would arise.

The first quarter was newsworthy for several of our companies. Alltel announced its acquisition of 360° Communications. USA Waste and its very capable management team are bidding for Waste Management. U S West Media Group will soon be an independent company renamed MediaOne.

Our three holdings, Philips, FDX Corp. and Seagram, whose prices were hurt the most by the Asian turmoil in 1997, have recovered nicely. Their collective gain added almost $100 million to the Partners Fund in the quarter.

We sold Kansas City Southern as it reached our appraisal. We thank Landon Rowland and his team for their many capital allocation and management decisions that increased corporate value. It is bittersweet to part with such wonderful corporate partners who have been instrumental to our prosperity. We currently have several long-time holdings which are approaching full value. We have redeployed some of our cash proceeds into two very interesting new positions, UCAR International, Inc. and Pioneer Natural Resources.
1997 was a productive year for Longleaf Partners Fund. In addition to returning 28.3%, we found qualifying investments for much of the Fund’s liquidity. While volatility from the turmoil in Asia hindered our returns in the fourth quarter, it should be positive for the long-term owners of the Partners Fund because we gained opportunities to own businesses at very attractive prices.

The Fund’s 1997 performance benefitted substantially from our concentrated approach. Four of our five largest holdings at the outset of 1997 provided $265 million or over 40% of the Fund’s total $651 million gain. Knight Ridder had a very good advertising year and successfully integrated its papers acquired from Disney. The reforms instituted by Cor Boonstra at Philips continued to improve free cash flow and earnings. Before the market’s pullback in October we had begun to reduce our stake in Philips, following our discipline of selling companies as they approach full value. Subsequently, the Asian crisis created fears about the future of some of Philips’ segments, and its price declined. The potential problems from Asia have been over-discounted, and we are excited to retain our Philips position at the current price. Federal Express also lost ground with the recent Asian turmoil. Longer term, however, the Far East offers great growth potential for FedEx. Both the residual business FedEx maintained after the UPS strike and the acquisition of Caliber (which competes head-on with UPS’ core business), add significantly to intrinsic value. Finally, Wall Street rewarded Quaker Oats for its sale of Snapple and the announced search for a new CEO. Throughout the Snapple debacle, the value of Gatorade and Quaker’s food brands continued to grow strongly.

Kansas City Southern also made a significant impact on performance adding a combined $101 million in realized and unrealized gains. The company benefitted from both the expansion of its railroad business as well as growth at its mutual fund companies. The price rose dramatically when KSU decided to split those two businesses into separate companies. During the year we sold part of our holdings, maintaining a core position in the portfolio. We also sold a number of smaller holdings as their prices approached fair value. The combined contribution to 1997 performance from those divested companies was $97 million.

Two of our long-term holdings hindered the Fund’s return by a combined $31 million. 360° Communications had a year that disappointed Wall Street. Although cash flow grew nicely throughout the year, 360° remained very undervalued. Seagram lost ground in the fourth quarter as sales in Asia were threatened. Longer term, Asia is much more an opportunity than a negative to the company. Seagram also made a sagacious deal to combine its television production business with Barry Diller’s HSN.
The last three years have presented a challenging environment for finding 60¢ dollars. However, we do not spend our time worrying about or predicting market levels. We look for individual businesses that meet our criteria. When we find one, we buy it. In 1997 we added nine new names to the Fund, and those investments have already benefitted shareholders. The combined contribution to performance from new holdings in 1997 was $130 million or 20% of the total gains. US West Media Group had the most significant impact. We purchased a double position (10% of assets) during the third quarter when the company became mispriced. The cable industry fell out of favor in general, and Wall Street particularly disliked this target stock which is controlled by a regional phone company. US West’s announcement that it would spin out the cable company, combined with strong operating results, enabled US West Media Group to provide over $79 million to the Fund’s gain. News Corp. is another exciting new opportunity. Rupert Murdoch has delivered incredible returns to his long-term shareholders. The stock became undervalued on fears that Murdoch was overpaying for acquisitions and he received negative press for his U.S. satellite efforts. News Corp.’s assets in broadcasting, certain newspapers and foreign satellite companies are unique and very valuable. Finally, we bought Host Marriott in the fourth quarter. The company owns high-end resort and urban hotels under the Marriott and Ritz-Carlton brand names. It reduced the gains of the Fund by $22 million as hotel and paired-share REITs stole the limelight and their C-Corp. peers were ignored. Host Marriott is a great example of what we look for - a wonderful business with competitive advantages and strong brand names, run by capable owner-operator partners, that is temporarily mispriced for irrational reasons.

The table on the following page provides a more detailed accounting of contributions to performance in 1997.
Longleaf Partners Fund (LLPF) produced a 21.02% total return in 1996. The Fund’s cash position ranged from 14% to 26% during the year as several holdings reached full value and were sold, and we were challenged by the reinvestment process given our disciplines. LLPF remained closed to new investors because of the relatively high cash position.

Fourteen companies were sold during the year, contributing to the Fund’s performance. Hilton Hotels provided 15.8% of LLPF’s gain. Hilton is a company which Southeastern has followed for many years and has previously owned. In January the company was selling at approximately 60% of our appraisal, largely due to the cancellation of plans to separate the gaming and lodging businesses into separate companies. Wall Street’s view of Hilton dramatically changed when the company announced that Steve Bollenbach, then CFO of Disney and previously with Trump, Marriott and Holiday Inns, was becoming CEO of Hilton. The company reached our appraisal of full value quickly and was sold.

In addition, we sold two of our investment management companies as they became fully valued in the generally bullish market. Franklin Resources and Mellon Bank contributed a combined $37.8 million to LLPF performance in 1996. Hasbro was sold early in 1996 when the price appreciated during Mattel’s attempt to buy the company. This contributed 3.1% of the Fund’s performance. Coca-Cola Enterprises, the large bottling company, significantly grew its business through major acquisitions during the year, and the market rewarded these moves. LLPF’s profit increased $11.5 million in 1996 from the sale of this holding. The only meaningful realized loss in 1996 resulted from the sale of WellPoint which we liquidated shortly after cancellation of the proposed merger with Health Systems.

Several of our long-time holdings contributed substantially to 1996 performance. TrizecHahn which was formerly Horsham added $57.7 million to the year’s return. Horsham announced it was buying the remaining half of Trizec that it did not already own. This began the transformation of the company from a holding corporation owning companies in three different industries to one of the world’s largest and most strongly capitalized real estate companies. The strength and focus of the newly named TrizecHahn was applauded by Wall Street and provided a strong gain to LLPF. The market rewarded Knight-Ridder’s improved earnings from increased advertising revenues and decreased newsprint costs, and the company provided 10.9% of LLPF’s return.

During the year the Fund added six new companies to the portfolio, and several contributed to LLPF’s returns. Nabisco Holdings, spun off and majority owned by RJR, was saddled with concerns about the potential effects of tobacco litigation against RJR. During the year, the market became more comfortable with the separation of the two companies and the limited liability. The price appreciation provided almost $19 million to the Fund’s unrealized return. United Healthcare added $15.5 million to performance when Wall Street calmed from its overreaction to the “demise of the HMO industry.”

The table on the following page provides a more detailed accounting of contributions to performance in 1996.
The following table delineates the specific dollar contributions of individual holdings to the 21.02% total return for 1996.

<table>
<thead>
<tr>
<th>Realized Gains:</th>
<th>Contribution in 1996</th>
<th>Percentage of Total Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hilton Hotels Corp.</td>
<td>$64,044,730</td>
<td>15.8 %</td>
</tr>
<tr>
<td>Franklin Resources, Inc.</td>
<td>25,306,098</td>
<td>6.2 %</td>
</tr>
<tr>
<td>Hasbro Inc.</td>
<td>12,690,210</td>
<td>3.1 %</td>
</tr>
<tr>
<td>Mellon Bank Corporation</td>
<td>12,484,309</td>
<td>3.1 %</td>
</tr>
<tr>
<td>Coca-Cola Enterprises, Inc.</td>
<td>11,528,992</td>
<td>2.8 %</td>
</tr>
<tr>
<td>WellPoint Health Networks, Inc.</td>
<td>$(8,909,519)</td>
<td>(2.2) %</td>
</tr>
<tr>
<td>All others, net</td>
<td>1,719,063</td>
<td>0.4 %</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>118,863,883</strong></td>
<td><strong>29.2 %</strong></td>
</tr>
</tbody>
</table>

Increase in unrealized appreciation:

**From securities held at December 31, 1995:**

<table>
<thead>
<tr>
<th>Company</th>
<th>Contribution in 1996</th>
<th>Percentage of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>TrizecHahn Corporation (formerly The Horsham Corporation)</td>
<td>57,690,931</td>
<td>14.2 %</td>
</tr>
<tr>
<td>Knight-Ridder, Inc.</td>
<td>44,388,400</td>
<td>10.9 %</td>
</tr>
<tr>
<td>Federal Express Corporation</td>
<td>23,131,610</td>
<td>5.7 %</td>
</tr>
<tr>
<td>PaineWebber Group, Inc.</td>
<td>19,201,813</td>
<td>4.7 %</td>
</tr>
<tr>
<td>The Quaker Oats Company</td>
<td>14,673,165</td>
<td>3.6 %</td>
</tr>
<tr>
<td>The Seagram Company Ltd.</td>
<td>10,518,750</td>
<td>2.6 %</td>
</tr>
<tr>
<td>Ralston Purina Group Common Stock</td>
<td>9,311,500</td>
<td>2.3 %</td>
</tr>
<tr>
<td>The Washington Post Company</td>
<td>8,409,688</td>
<td>2.1 %</td>
</tr>
<tr>
<td>All others, net</td>
<td>13,345,948</td>
<td>3.3 %</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>200,671,805</strong></td>
<td><strong>49.4 %</strong></td>
</tr>
</tbody>
</table>

**From new holdings in 1996:**

<table>
<thead>
<tr>
<th>Company</th>
<th>Contribution in 1996</th>
<th>Percentage of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nabisco Holdings Corp.</td>
<td>18,898,686</td>
<td>4.7 %</td>
</tr>
<tr>
<td>United HealthCare Corporation</td>
<td>15,514,298</td>
<td>3.8 %</td>
</tr>
<tr>
<td>Phillips Electronics NV</td>
<td>9,374,864</td>
<td>2.3 %</td>
</tr>
<tr>
<td>All others, net</td>
<td>8,978,743</td>
<td>2.2 %</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52,766,591</strong></td>
<td><strong>13.0 %</strong></td>
</tr>
</tbody>
</table>

Net realized and unrealized gain on investments | 372,302,279 | 91.6 % |
Net investment income | 34,373,697 | 8.4 % |
Net increase in net assets resulting from operations | **$406,675,976** | **100.0 %** |
Longleaf Partners Fund (LLPF) produced a 27.5% total return for shareholders in 1995 without exposure to technology stocks which are difficult for us to value. As the market rose, well managed and good businesses selling at attractive prices became elusive. LLPF’s cash position built as a result.

LLPF booked material gains from the sale of two companies. Multimedia’s plan to sell itself elevated its price and contributed almost $22 million to LLPF’s realized gains. John Labatt’s sale to the Dutch company, Interbrew S.A., provided the portfolio with over $18 million in realized gains.

With turnover of only 12.6% most of our 27.5% return was derived from tax deferred unrealized gains in companies that remain in the portfolio. Several holdings benefitted from the market’s renewed interest in the financial services industry. Mellon Bank, with its growing reliance on fee based businesses through Dreyfus and the Boston Company, contributed over 9% of the year’s performance. Kansas City Southern Industries, the railroad and mutual fund company, provided an additional 6.2% of performance. Franklin Resources which manages and operates the Franklin and Templeton mutual fund families contributed 6.1% to the year’s results.

Several of our long time holdings significantly added to 1995 results. The market rewarded our largest holding, Knight-Ridder, as management changes brought renewed attention to the company’s valuable assets and its strong free cash flow. This resulted in an addition of over $23 million to performance. Ralston Purina Group contributed $15 million in unrealized appreciation as the market recognized the company’s improving pet food profitability and its international growth opportunities at Eveready.

A new holding, The Seagram Company, contributed substantially to LLPF, adding over $16 million to 1995 returns. The price of this Canadian-based beverage and entertainment company declined significantly when Wall Street penalized the company’s decision to sell its dividend yielding stake in DuPont to purchase MCA. With the deal’s close and the exodus of dividend oriented shareholders, new investors emerged who valued the company’s operating businesses and its assets.

The following table provides a detailed accounting of each company’s contribution to performance in 1995.
The following table delineates the specific dollar contributions of each individual holding to the 27.50% total return for 1995.

<table>
<thead>
<tr>
<th>Contribution in 1995</th>
<th>Percentage of Total Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multimedia, Inc.</td>
<td>$21,984,806</td>
</tr>
<tr>
<td>John Labatt Limited</td>
<td>18,310,698</td>
</tr>
<tr>
<td>All others, net</td>
<td>3,721,317</td>
</tr>
<tr>
<td></td>
<td><strong>44,016,821</strong></td>
</tr>
</tbody>
</table>

Increase in unrealized appreciation (depreciation):

<table>
<thead>
<tr>
<th>From securities held at December 31, 1994:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Mellon Bank Corporation</td>
<td>27,056,250</td>
</tr>
<tr>
<td>Knight-Ridder, Inc.</td>
<td>23,587,857</td>
</tr>
<tr>
<td>Kansas City Southern Industries, Inc.</td>
<td>18,385,438</td>
</tr>
<tr>
<td>Franklin Resources, Inc.</td>
<td>18,029,461</td>
</tr>
<tr>
<td>Ralston - Ralston Purina Group</td>
<td>15,025,375</td>
</tr>
<tr>
<td>Federal Express Corporation</td>
<td>14,332,666</td>
</tr>
<tr>
<td>McKesson Corporation</td>
<td>13,770,000</td>
</tr>
<tr>
<td>Paine Webber Group, Inc.</td>
<td>11,816,500</td>
</tr>
<tr>
<td>Coca-Cola Enterprises, Inc.</td>
<td>11,756,713</td>
</tr>
<tr>
<td>Whitman Corporation</td>
<td>9,120,000</td>
</tr>
<tr>
<td>The Quaker Oats Company</td>
<td>7,535,227</td>
</tr>
<tr>
<td>The Washington Post Company</td>
<td>6,199,734</td>
</tr>
<tr>
<td>WMX Technologies, Inc.</td>
<td>6,191,268</td>
</tr>
<tr>
<td>American Express Company</td>
<td>5,818,750</td>
</tr>
<tr>
<td>Alexander &amp; Alexander Services Inc.</td>
<td>(7,055,685)</td>
</tr>
<tr>
<td>All others, net</td>
<td><strong>27,491,550</strong></td>
</tr>
<tr>
<td></td>
<td><strong>209,061,104</strong></td>
</tr>
</tbody>
</table>

From new holdings in 1995:

| The Seagram Company Ltd.                 | 16,399,650       | 5.5 |
| All others, net                          | 7,512,210        | 2.5 |
|                                         | **23,911,860**   | **8.0**                       |

Net realized and unrealized gain on investments: 276,989,785 (93.1 %)
Net investment income: 20,371,114 (6.9 %)
Net increase in net assets resulting from operations: $297,360,899 (100.0 %)