Longleaf Partners Small-Cap Fund gained 0.17% in the third quarter, taking year-to-date (YTD) performance to 9.46%, ahead of our absolute annual goal of inflation plus 10%. The Russell 2000 Index declined -2.40% in the quarter and gained 14.18% YTD. Despite the current challenging performance endpoint, the Fund has delivered strong absolute returns and outperformed the Russell 2000 over the long term.

As one of the largest shareholders in the Fund, we are not pleased with our returns over the trailing 1, 3 or 5-year periods. Over the last 3 and 5 years, the Fund’s large cash holding (averaging just over 21% in both periods) and our relative underweight to the top performing information technology sector were together responsible for over 100% of relative underperformance in both periods. We have been early – and therefore wrong – in our view that markets were overvalued and due to correct. As a result, we missed the highest-flying sectors and held elevated cash balances, which has been a large drag on our relative returns. While this has been painful in the near-term, we believe that not holding these overvalued pockets of the market and having cash to

Average Annual Total Returns for the Longleaf Partners Small-Cap Fund (9/30/19):
Since Inception (2/21/89): 10.44%, Ten Year: 11.78%, Five Year: 5.56%, Three Year: 5.03%, One Year: -7.56%. Average Annual Total Returns for the Russell 2000
(9/30/19): Since Inception (2/21/89): 9.27%, Ten Year: 11.19%, Five Year: 8.19%,
Three Year: 8.23%, One Year: -8.89%.

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 southeasternasset.com. As reported in the Prospectus dated May 1, 2019, the total expense ratios for the Longleaf Partners Small-Cap Fund is 0.92%.
be a liquidity provider when opportunity arises have positioned us well prospectively to generate long term, risk-adjusted absolute returns.

While our trailing 1-year performance is ahead of the index, the negative absolute returns have been disappointing, with over 100% of absolute underperformance coming from three stocks: CenturyLink, CNX Resources and Realogy. CNX and Realogy were also the largest absolute detractors over the trailing 3 and 5-year periods. The drivers of stock performance for each of the three were unrelated and were a combination of company-specific and broader industry concerns (that also impacted their peers). Over the last 12 months, our values at CenturyLink and CNX have been stable to growing, and we have seen the quality of both investments improve. We have added to both positions and feel that these businesses help position the portfolio for strong future absolute and relative performance. 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 https://southeasternasset.com/podcasts/will-thorndike-on-cnx-outsiders-and-private-equity/. We also added to Realogy, but more recently its value has declined. It remains one of the most discounted positions in the portfolio today, but it is not a full weight in the portfolio.

We are confident in our ability to deliver strong future performance based on the high quality of the businesses in our portfolio, coupled with our management partners’ focus on closing the price-value gap. Some metrics would not suggest that our portfolio is high quality, but we define “quality” as competitively advantaged business that we can understand, run by great partners who will prudently grow free cash flow (FCF) per share over the long term. We do not focus on a trailing volatility measure or a projected revenue growth rate for the next one-to-two quarters. Over the last 10 years, many of our biggest winners were viewed as “low quality” in the short-term, with Texas Industries, DreamWorks and Sonic all far more shorted than their less-volatile peers before they ultimately sold to knowledgeable industry players at values above our conservative appraisals. Our partners at Madison Square Garden, Lamar Advertising and Dillard’s were also heavily bet against before they each took actions to grow and unlock value per share that were recognized by the market.
We strongly believe that our five most recent new investments – GCI Liberty, Summit Materials, Lazard, PotlachDeltic and Dillard’s – all increased the overall quality of our portfolio. GCI Liberty has great cable assets and top-tier people at Liberty Media whom we know well and have partnered with in multiple ways throughout our history. Summit has irreplaceable assets with pricing power in aggregates and cement, even if these were briefly obscured by bad weather and input cost inflation when we initiated the position. Lazard’s high return businesses are well-entrenched and are more defensive than the stock price would suggest. While it is the only one of the five recent purchases whose stock price is currently below our weighted average purchase price, it has been the largest share repurchaser in the portfolio this year, as management has taken advantage of this discount. We have owned the unique timberland assets at Potlach and Deltic three times before our most recent ownership, and the management today is the strongest we have ever seen. Dillard’s is generally discounted as a dying department store company run by a management team that doesn’t dance to the sellside’s quarterly tune, yet we had a great history with the Dillard family in our first round of ownership. We believe the value of the company is now tilted even more to its highest quality real estate; thus, it too is at an all-time high on quality.

**Contributors/Detractors**

(Q3 Investment return; Q3 Fund contribution)

Summit Materials (15%, 1.17%), the cement and aggregates company, was the largest contributor for a second quarter in a row. The company’s aggregates volume grew 4% and pricing grew 8% year-over-year, while cement volumes increased 3% with further positive pricing. Consolidated earnings are still depressed from the Mississippi River’s historically extreme flooding, which necessitates expensive truck and rail transport until water levels normalize. As these logistics challenges ease, Summit’s margins should rebound, and the company has maintained its strong local market positions and pricing power in a difficult period. Southeastern remains very engaged with multiple parties after filing a 13D last quarter.

CenturyLink (8%, 0.66%), the fiber and telecom company, was another strong contributor after reporting a relatively flat quarter in line with expectations and maintaining free cash flow guidance. We expect the improving sales department 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.

Neiman Marcus (-25%, -1.40%), the luxury retailer, was the largest detractor in the quarter as the bonds that we own fell after weak industry results and a lack of Neiman-specific clarity given that the company had yet to report fiscal year-end results as of 9/30. The company's next round of maturities comes due in two years and amount to less than one third of annual EBITDA. The fund's second and third lien notes mature in 2024, with both bonds currently trading at wide discounts to our anticipated recovery values. As high-end competition shrinks, Neiman has both margin help within its own control and several intriguing strategic options that could close the price to value gap quickly.

OCI (-14%, -0.68%), a leading producer of nitrogen fertilizers and natural gas-based chemicals, was also a primary detractor this quarter. The stock price weakness was primarily due to the decline in the methanol spot price, which is strongly correlated to oil, and one-off negative effects of an unplanned shutdown at the company's nitrogen fertilizer facility in Beaumont, TX. To the positive, OCI has significantly de-levered over the past years from >4x net debt/operating cash flow and is targeting a ratio in the 2x range next year. OCI's structurally lower cost position (as a result of low feed-in natural gas costs) and well-located plants, greater volume leverage and embedded optionality from asset monetization position the company well to outperform its peers going
forward. CEO Nassef Sawiris, an owner-operator focused on optimizing the capital structure and generating significant free cash flow, is always open to creative strategic outcomes for the company, which we believe are likely in the future.

**Portfolio Activity**

We added to heavily discounted Park Hotels and Realogy while continuing to buy our newest position in Dillard’s, which we initiated in the second quarter. We also trimmed strong performers GCI Liberty and Formula One Group, as both appreciated in the quarter. 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 price-to-value ratio (P/V) in the low-60s% and 13.9% cash, which we can put to work quickly as new opportunities qualify. We expect to see continued progress in our high-quality holdings, as our management partners pursue catalysts that could drive significant near-term payoffs. We believe our more recent purchases outlined at the start of the letter could soon join the “quality in retrospect” list of holdings that have historically gone from most hated to top performers. We are grateful for your long-term partnership and will continue to endeavor 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](http://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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

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.

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

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.

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 September 30, 2019, the top ten holdings for the Longleaf Partners Small-Cap Fund: CenturyLink, 8.8%; Summit, 8.5%; Kodak, 7.9%; Graham Holdings, 6.7%; GCI Liberty, 5.8%; Mattel, 5.1%; PotlatchDeltic, 4.8%; Lazard, 4.6%; OCI, 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.

LLP000950
Expires 1/31/2020
Longleaf Partners Small-Cap Fund declined -1.11% in the second quarter following the Fund's strong absolute return in the first three months of 2019. The 9.28% year-to-date (YTD) performance was well above our absolute annual goal of inflation plus 10%. The Russell 2000 Index added 2.10% in the second quarter and gained 16.99% YTD. Over shorter-term periods, relative returns can move dramatically, as we saw in 2018, when the Fund significantly trailed the Index in the first nine months but, by year-end, was well ahead. Rather than focus on price swings and single end points, the best indicator of investment success for owners of the Fund is performance consistency over longer periods. The rolling returns for all 5 and 10-year periods in Longleaf Small-Cap's 30-year history have averaged over 11% and outperformed the Index 76% and 92% of the time respectively.

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


Returns reflect reinvested capital gains and dividends but not the deduction of taxes an investor would pay on distributions or share redemptions. Performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by visiting longleafpartners.com. As reported in the Prospectus dated May 1, 2019, the total expense ratios for the Longleaf Partners Small-Cap Fund is 0.92%. 
Over Longlea Small-Cap's strong history, numerous stocks have moved up sharply with some type of management-led transaction serving as a catalyst. When stocks are at extreme discounts, shareholder-oriented corporate partners go on offense. In 2018, two holdings were acquired at fair prices, creating rapid payoffs, and one company announced it was going private. In the second quarter of 2019, activity was also notable. Kodak sold its Packaging segment and restructured its debt; Lazard issued 10-year debt to aggressively buy its severely discounted stock at a meaningful double-digit pace; Neiman Marcus restructured its debt; and, OCI announced the separation of its Middle Eastern assets into a joint venture. More recently, we filed a 13D to speak more directly with Summit's leaders after rumored third-party interest in the company.

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

Our confidence in future results has much to do with the ability of our corporate leaders to deliver self-help that grows value per share and ultimately generates rewarding payoffs. Any one or two potential catalysts mentioned could have meaningful impact on the Fund's return, as could announcements from other Fund investments that we did not highlight.
Contributors/Detractors
(Q2 Investment return; Q2 Fund contribution)

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

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

CNX (-32%, -1.37%), the Appalachian natural gas company, declined after reporting an increase in capital expenditures and missing sell-side quarterly earnings before interest, taxes, depreciation, and amortization (EBITDA) expectations by 10%. Lower natural gas prices and a few one-off factors were the primary reasons for the EBITDA miss. The capital expenditure change reflected a timing shift rather than a cost increase - CNX will invest more this year to begin production at three new wells but spend less in 2020 than previously planned. The business is on track to generate $500 million of FCF in 2020, while the market value of the company is below $1.5 billion. Our appraisal of CNX moderately increased on solid results from CNX Midstream and the decision of the board and CEO Nick Deluliis to repurchase the extremely discounted shares at an 8% annualized pace. Multiple directors also bought the stock personally.
Portfolio Activity
The Fund's holdings remained below our appraisal values, but we trimmed several stronger performers during the quarter to manage position sizes. Likewise, we added to five of the Fund's most discounted investments. We exited the preferred equity stake in Mytheresa that we received in the Neiman Marcus recapitalization. We also bought one new qualifier, which remains undisclosed. We successfully owned this company in the past, and management proved to be great partners.

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

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

See following page for important disclosures.
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund's investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS
The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

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

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

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

Funds distributed by ALPS Distributors, Inc.

LLP000913
Expires 10/31/2019
Longleaf Partners Small-Cap Fund Commentary
1Q19

Longleaf Partners Small-Cap Fund gained 10.50% in the first quarter, far outpacing our annual goal of inflation plus 10% but underperforming the Russell 2000 Index's 14.58% return. The market's rebound, following a double-digit fourth quarter decline in 2018, provided a tailwind. Most of the stocks in the portfolio made double-digit gains in the last three months.

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 largest contributors in the first quarter were among those stocks that hurt performance the most in the fourth quarter of 2018. These businesses, including fertilizer, toys, cement and luxury retail, have little in common, and their strong recent returns reflected positive progress specific to each company.

Information Technology (IT) stocks were the primary driver of the Index, as the sector gained over 20%. The Fund’s smaller IT exposure (8.5% average weight versus 15.0% for the Index)


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 ratios for the Longleaf Partners Small-Cap Fund is 0.92%. |
and mixed IT results (ViaSat up 31%, Kodak down 8%) accounted for 1.6% of the relative underperformance. CenturyLink, the Fund's single largest stock detractor, drove the Communications Services sector to account for 1.9% of underperformance.

We started the year actively assessing numerous new qualifiers, but the market’s rally shortened our on-deck list quickly. Cash rose to 22%, as we sold Hopewell and trimmed four positions but did not buy any new investments during the quarter. Even with the large return, we believe substantial upside remains in the portfolio, with only one holding selling at over an 80% price to value (P/V).

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

OCI (35%, 1.73%), a leading producer of nitrogen fertilizers and methanol, was a strong contributor. OCI grew free cash flow (FCF) 210% year-over-year and earnings before interest, taxes, depreciation and amortization (EBITDA) over 100%. Strong cash generation should continue to help the company rapidly deleverage - net debt declined $327 million, and Net Debt/Operating Cash Flow fell from 7x to 4.4x over the last year. Volumes stepped up 16%, with U.S. assets increasing production up to 115% of nameplate, as OCI grew into its new capacities. Multiple strategic options are available to the company, which sells well below the replacement cost of its assets, and rumours of Saudi interest in the methanol plants helped the stock. CEO Nassef Sawiris is an owner operator who remains focused on value creation and recognition.

Mattel (30%, 1.47%), 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.
GCI Liberty (35%, 1.46%), the cable holding company, contributed despite a tough quarter for GCI, its namesake Alaskan subsidiary. The bad news included an earthquake, a government funding cut and difficulties rolling out a new billing system. Meanwhile, Charter Communications, which constitutes two-thirds of GCI Liberty's net asset value, reported strong FCF and gains in residential and small-business subscribers. Charter CEO Tom Rutledge is completing the complex integration of the 2015 acquisitions of Time Warner Cable and Bright House, plus a costly network-wide improvement to 1 gigabit service, which should allow the consolidated Charter to grow its cash flows significantly for years to come. Despite the appreciation of GCI Liberty stock, it still trades at a double-digit percentage discount to the sum of its parts. The company repurchased GCI shares at a good pace, and Chairman Greg Maffei has additional strategic options to realize the growing value.

Summit Materials (28%, 1.44%), the aggregates and cement company, meaningfully contributed. For the quarter, Summit's aggregates pricing increased 8%, while cement pricing gained $10 per ton. This year's FCF should be used to deleverage the balance sheet. While Summit has some sensitivity to unpredictable weather and cost inflation, its cyclical risk is moderate with the company's lack of exposure to high-rise and office tower construction. As the U.S. cement and aggregates industry consolidates, CEO Tom Hill will have numerous strategic options to close the stock's price-to-value gap. Hill bought additional shares in the quarter, increasing his ownership by 5%.

Neiman Marcus (31%, 1.16%), the luxury retailer, helped performance as the bonds that we own rallied in March when the company announced a restructuring agreement with a majority of creditors to extend its debt maturities past 2023. The extension allows additional time for Neiman's turnaround, which has yielded six straight quarters of positive comparable sales. As part of the agreement, bond holders, including the Fund, will receive a preferred equity position in Mytheresa, Neiman's high-growth e-commerce subsidiary.

ViaSat (31%, 1.09%), the consumer and military satellite communications company, contributed after reporting strong growth in revenues and cash flow. We believe ViaSat's government segment is on track to grow at a mid-teens or better pace this year once again. Residential broadband average revenue per user (ARPU) increased. Inflight took additional market share with 260 net global installations in the quarter, as its superior aircraft internet service continued to beat competitors. The third satellite in the ViaSat-3 constellation was announced,
which sets the company up to have a best-in-class, worldwide satellite broadband offering for airlines and governments in the years to come.

CenturyLink (-19%, -1.45%), 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**
Our on-deck list of prospective investments shrunk as the market rose. We added to a couple of positions and trimmed four holdings. We sold Hopewell Holdings, the Hong Kong-listed property company that was one of the Fund's largest contributors in 2018. In December, the founder, Gordon Wu, offered HK$38.8 per share to buy out other shareholders and privatize the company. We sold after shareholders approved the deal in March. Over the Fund's five-year holding period, the stock gained over 100%.

**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 re-deployed 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 subsequent rally is not surprising from such depressed prices. More encouraging is that rebounds from 50s% P/Vs historically continued over several years. With the portfolio trading at a mid-60s% P/V today, we believe there is substantial upside opportunity. We will deploy the cash as qualifiers emerge that are selling at substantial discounts. 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.*
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund’s investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS
The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

Leverage refers to the use of debt. De-leverage refers to a decrease in debt.

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

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

As of March 31, 2019, the top ten holdings for the Longleaf Partners Small-Cap Fund: Graham Holdings, 6.7%; CenturyLink, 6.2%; Summit, 5.9%; Mattel, 5.7%; GCI Liberty, 5.3%; Liberty Media, 5.1%; OCL, 5.1%; PotlatchDeltic, 5.1%; Park Hotels, 4.8%; Lazard, 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.
Longleaf Partners Small-Cap Fund fell -15.55% in the fourth quarter, bringing the 2018 return to -6.52%. The Fund significantly outperformed the Russell 2000 Index in both periods. The Index declined -20.20% and -11.01% respectively. Few stocks escaped the market decline in the fourth quarter as trade wars, U.S. interest rate increases, geopolitical unrest, fears of economic slowdowns in multiple countries, including China, and falling oil prices were among the primary headlines pressuring equity prices around the world.

The Fund's outperformance was primarily driven by transactions at two holdings during the year. Additionally, the cash position that previously had been a drag on relative returns became a benefit, not only because it helped buffer performance in the downturn, but also because it provided the liquidity to buy new positions as more qualifiers emerged. The Fund's negative absolute return came primarily from companies that missed expectations. The market punished companies that disappointed particularly severely in the fourth quarter.

2018 results did not reflect the progress in the portfolio. During the year, we sold four investments that successfully reached our appraisals. We deployed proceeds from these sales, plus a large part of the 22% cash in the Fund at the outset of the year, into five new qualifiers and several more discounted holdings. Cash ended the year under 9%. Portfolio repositioning and value growth amid stock price declines helped the price-to-value (P/V) ratio move into the 50s%, a somewhat rare level that has historically preceded strong absolute and relative

Average Annual Total Returns for the Longleaf Partners Small-Cap Fund (12/31/18):
Since Inception (2/21/89): 10.38%, Ten Year: 14.49%, Five Year: 5.34%, One Year: -6.52%. Average Annual Total Returns for the Russell 2000 (12/31/18): Since Inception (2/21/89): 9.03%, Ten Year: 11.97%, Five Year: 4.41%, One Year: -11.01%.

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 ratios for the Longleaf Partners Small-Cap Fund is 0.92%.
returns.

Just as performance did not reflect portfolio enhancements, the stock prices of most companies did not indicate what we view as positive progress made by our companies and management partners throughout the year. CEOs whom we view as stronger were secured at CenturyLink and Mattel. Park Hotels and Kodak agreed to sell assets for attractive prices. Forest City, Sonic and Hopewell were acquired or agreed to go private at strong premiums. Importantly, the primary business segments at most of the Fund’s core holdings grew – Enterprise at CenturyLink, Barbie and Hot Wheels at Mattel, Broadcasting and Kaplan International at Graham Holdings and North American Fertilizer at OCI. As their stock prices became more discounted, numerous companies in the Fund repurchased shares, thereby increasing the remaining value per share.

Choppy markets and the economic uncertainty that feeds them could last for a while. To manage investment risk, we incorporate conservative-to-skeptical assumptions about the future, invest in a limited number of companies, have a broad and deep research network and engage with managements. We believe that the Fund’s compelling P/FV, combined with the underlying strength of the businesses we own and the management teams leading them, can generate strong absolute and relative results going forward and that the payoff for 2018 company-level and portfolio-level progress is deferred but not lost.

**Contributors/Detractors**
(2018 Investment return; 2018 Fund contribution; Q4 Investment return; Q4 Fund contribution)

Sonic (61%, 2.26%, -, -), the quick service restaurant franchise, was the Fund’s largest contributor for the year. Southeastern first bought shares in late 2016, when competing brands’ discounting and unit expansion weighed down Sonic’s system-wide sales growth. CEO Cliff Hudson and his team did good work as they revamped marketing, improved the menu, sold company-owned stores to franchisees, released a mobile app and consistently bought back shares at low earnings multiples. In 2018, Sonic reported growing sales, sending the stock 30% higher in a week. In September, private-equity firm Inspire Brands announced its acquisition of Sonic near our appraisal, and we sold the stock at nearly double the Fund’s cost.

Hopewell Holdings (35%, 1.68%, 35%,1.60%) a Hong Kong-listed property company, was the primary contributor for the fourth quarter and among the top performers for 2018. On the final day of 2017, Hopewell announced the sale of its Hopewell Highway Infrastructure toll road company for 20% above our appraisal, and part of the proceeds went to a special cash dividend of HK$2 per share when the deal closed in April. In December, the founder, Gordon
Wu, offered HK$38.8 per share to buy out other shareholders and privatize the company. Independent shareholders will vote later in 2019 on the offer, and we are not opposed.

Realogy (-43%, -2.28%, -29%, -1.41%), the owner of leading real-estate franchises like Coldwell Banker and Century21, fell during the year. The company missed third-quarter EBITDA (earnings before interest, taxes, depreciation, and amortization) expectations and lowered full-year guidance by 5% after weaker existing home sales in coastal markets hurt the owned brokerage and title insurance segments. However, Realogy’s franchise segment, the most important part of our appraisal, held up well despite the more difficult real estate environment in the wake of higher interest rates and changes in tax laws related to real estate deductions. CEO Ryan Schneider used the large free cash flow (FCF) coupon to repurchase shares at a mid-single digit FCF multiple. Realogy also launched two new brokerage brands for luxury and urban millennial sales this year. We remain confident that the value of this business will grow long-term with home prices and as millennials migrate to home ownership. Fears that online tools for viewing and advertising homes will displace realtors have been overblown as the use of realtors and online tools actually have grown in tandem. We believe that online home-selling economic models may be successful in areas where housing is somewhat standardized, but in most of the U.S., meaningful home variations by city, neighborhood, and even block do not lend themselves to purely online comparisons and transactions.

Mattel (-35%, -2.08%, -36%, -2.22%), 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.

Summit Materials (-34%, -1.60%, -31%, -1.50%), a U.S. cement and aggregates company, declined in the fourth quarter, making it a detractor for the year. We began buying the stock in the third quarter after the company’s moderate cut to EBITDA guidance led to a sell off. Flooding and hurricane recovery took longer than anticipated and cost inflation also impacted profits, though Summit had already begun to increase pricing as an offset. Slowing national home construction hurt U.S. building materials companies, but Summit’s stock felt more impact because of the company’s leverage and lower aggregates mix. Summit owns 2.5 million tons of cement capacity, 10 river terminals and 3.7 billion tons of aggregates reserves. U.S. cement demand is above current capacity, and much-needed infrastructure spending would increase demand substantially. In aggregates, Summit benefits from exclusive local positions in
several large urban markets where it commands significant pricing premiums to competitors who bear additional shipping costs. Summit is not significantly exposed to high-rise construction, the biggest cyclical risk to the industry. In the event of a recession, its public-sector exposure, which comprises 40%+ of its business, should prove more durable. CEO Tom Hill has a strong record of intelligent acquisitions and is using FCF to de-lever the balance sheet. We paid a single-digit FCF multiple and expect the coupon to grow substantially in coming years.

ViaSat (-21%, -1.49%, -8%, -0.44%), the satellite communications company, was a detractor for the year but declined much less than many businesses in the fourth quarter after reporting strong quarterly results. In the Broadband segment, subscribers, ARPU (average revenue per user) and margins all increased. In Government, revenues and earnings grew over 20%. For InFlight, Viasat gained North American commercial aircraft market share beyond 20% for the first time, doubling in only two years. We believe ViaSat's superior inflight internet product should continue to gain business from slower competitors. ViaSat-3, the company's most powerful satellites by orders of magnitude, are scheduled to launch in less than two years, allowing the company to service several thousand government aircraft and offer a competitive broadband product to rural customers around the world.

OCI (-19%, -1.32%, -36%, -2.78%), a global producer of nitrogen fertilizers and natural gas-based chemicals, was the primary detractor in the fourth quarter, primarily due to the decline in the methanol spot price, which is linked to oil. To the positive, non-methanol-related assets, which represent three quarters of the value, did well. African facilities resolved gas supply issues and achieved 95%+ utilization rates. The company sells for less than the replacement cost of its assets and our conservative estimate of the discounted cash flow value. CEO Nassef Sawiris is an owner-operator focused on optimizing the capital structure and generating significant free cash flow.

CenturyLink (2%, -0.04%, -26%, -2.15%), 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 FCF nearly doubled year-over-year. CenturyLink's FCF, which grows beyond inflation, is more than $4.00 per share, 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
We exited four successful investments, all prior to the fourth quarter. In addition to Sonic, we sold Wynn Resorts and CONSOL Energy, the coal company. We both bought and sold Forest City, a real estate company that was acquired within a few months of our purchase. We also bought GCI Liberty, Lazard, Summit Materials and one undisclosed position in the fourth quarter. Both Forest City and the undisclosed position are “recycled names” that we previously owned. 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 absolute return, but we firmly believe that the portfolio is positioned well for future absolute and relative results. First, in the relatively rare times when the Fund traded below a 60% P/V in the past, the following one, three and five-year performance averaged well over 300 basis points above the Index annually. More importantly, Fund annual returns averaged in the mid-teens, far exceeding inflation plus 10%*. Second, the Fund’s cash position is below 10%, and our on-deck list of prospective qualifiers has more than ten new possible opportunities. Third, we believe that a number of companies in the portfolio are good candidates over the next few years for the types of corporate transactions that have been an important source of the Fund’s success over time, including in 2018. Fourth, we anticipate that the results of the strong businesses we own and the management teams leading them can eventually translate into stock prices that properly reflect value, whether by investor re-rating, much higher earnings than are currently being delivered or corporate partners taking action to gain value recognition.

See following page for important disclosures.
Quarter-ends since 1993 were identified where the Small-Cap 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 Russell 2000 were calculated. Those returns were then averaged and the 3 and 5 year returns were annualized. The results were: 17.73% for 1 year, 15.05% for 3 year, and 16.53% for 5 year for the Small-Cap Fund and 14.36%, 10.79% and 12.81% for the Russell 2000. 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
The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

“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. Free cash flow coupon (yield) is a ratio calculated by taking free cash flow per share divided by the share price.

Earnings multiple, also called the price/earnings ratio, is the ratio of a company’s share price compared to its earnings per share.

Leverage refers to the use of debt. De-leverage refers to a decrease in debt. Aggregates are materials such as sand or gravel that are ingredients in concrete.
Spot price is the current market price at which an asset, like a commodity, can be bought or sold for immediate delivery.

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.

As of December 31, 2018, the top ten holdings for the Longleaf Partners Small-Cap Fund: Graham Holdings, 8.8%; Hopewell, 7.5%; CenturyLink, 7.2%; Liberty Media, 6.7%; OCI, 6.4%; Kodak, 5.1%; Summit, 5.1%; Lazard, 4.9%; Mattel, 4.8%; ViaSat, 4.7%. Fund holdings are subject to change and holding discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

Funds distributed by ALPS Distributors, Inc.

LLP000873
Expires 4/30/2019
October 12, 2018

Longleaf Partners Small-Cap Fund Commentary

3Q18

Longleaf Partners Small-Cap Fund gained 2.76% in the third quarter, while the Russell 2000 Index rose 3.58%. The Fund’s year-to-date (YTD) 10.69% return was slightly short of the Index’s 11.51% but is exceeding our annual absolute goal of inflation plus 10%, as did the 1 and 3-year returns. Because it has been a challenging time for disciplined value investors to buy discounted, quality businesses, the Fund’s cash has remained high.

With around twenty holdings, performance in any given quarter or year usually comes from just a few stocks. Company-specific events and management-led outcomes drive our investment results, which generally have little to do with what drives the broader index. Stock prices often spike in a short number of days as sentiment quickly changes. 100% or more of a stock’s multi-year return can occur in a matter of days. For example, in the third quarter, the announcements that Forest City and Sonic were being acquired moved their stocks to fair value in less than a day. As managements delivered results that many had doubted, CenturyLink and OCI posted large returns in the quarter, as did Park Hotels and Actuant earlier in the year. In spite of their rapid stock moves, these businesses remain below our appraisals, and we believe our partners can build additional value.

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

Average Annual Total Returns (9/30/18): Since Inception (2/21/89): 11.11%, Ten Year: 12.64%, Five Year: 10.17%, One Year: 12.61%.

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 ratios for the Longleaf Partners Small-Cap Fund is 0.92%. 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.
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. Many current holdings offer significant
upside potential with our management partners pursuing restructuring/corporate actions
(Mattel, Formula One Group and Neiman Marcus), substantial repurchases at deep discounts
(Realogy and CNX) and sales of assets or entire businesses (Kodak, Park Hotels, Actuant and
Graham Holdings). At some holdings, such as ViaSat, other shareholders are actively pursuing
value recognition.

**Contributors/Detractors**
(Q3 Investment return; Q3 Fund contribution)
Sonic (27%, 1.45%), the drive-in quick serve restaurant (QSR) franchise, was the largest
performance contributor. Following improved sales growth and a large share repurchase
authorization that drove the stock up over 35% in the second quarter, the company
announced in the last week of September that Inspire Brands, a private equity-backed
company, is acquiring Sonic at a good price. We appreciate CEO Cliff Hudson and his team,
who built value by selling company-owned stores to franchisees, improving operations and
repurchasing a significant number of shares, while developing a mobile app to capitalize on the
chain’s unique drive-in format. The stock returned 96% during our 2-year holding period. Sonic
represents several common traits in Southeastern’s investments. First, the payoff was
company-specific with unpredictable timing, with all the stock’s 2018 return occurring across
just 5 days, following a period when the shares languished. Second, our engagement with
management was positive and highly productive, as we filed a 13D to talk more openly with
Hudson about ways to drive value per share. Third, large ownership stakes can help our
outcome without creating liquidity challenges. Our 17% ownership of Sonic played an
important role in our ability to constructively engage with the company, and we sold our shares
in one day upon the acquisition announcement at a tiny discount to the offer price, with some
shares selling above the offer because the stock was so heavily shorted.

OCI (18%, 1.22%), a leading producer of nitrogen fertilizers and natural gas-based chemicals,
was a strong contributor this quarter, as new projects continued to ramp up, and commodity
price strength came through. The methanol market should remain strong for the coming 4 to 5
years due to lack of supply and increasing demand. In the quarter, OCI completed its tender
for the remaining shares of OCI Partners, the master limited partnership (MLP) primarily made
up of a single integrated methanol and ammonia facility on the U.S. Gulf coast. The price paid
is already looking good, as methanol’s price has continued to increase since the deal was
announced. CEO Nassef Sawiris delivered value growth through this transaction, as well as the
successful completion and ramp up of major plants in Iowa and Texas in the last few years.
With large capital expenditure (capex) projects complete, free cash flow (FCF) should grow
meaningfully.
CenturyLink (17%, 1.21%), the global fiber infrastructure company, was a large 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 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.

CNX Resources (-19%, -1.01%), 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 MLP, removing an overhang and enabling CNX to operate the business more flexibly. CEO Nick DeIulis and CFO Don Rush continued repurchasing discounted shares at an annualized double-digit pace, which is very rare in the E&P world.

**Portfolio Activity**

During the quarter, we began purchasing two new businesses, which remain undisclosed, as we hope to build those positions. We exited three businesses, including the Sonic sale described above. Forest City, the diversified real estate company that we purchased in the second quarter, received a bid from Brookfield near our appraisal. In our short 3-month holding period, the stock gained 26%. We previously owned Forest City and knew its assets well. The stock became discounted after the company rejected an offer in April. We believed that, following the expiration of the 5-year tax penalty for transactions after its REIT conversion, a higher offer was likely. Given the discount, prospects for value growth and capable management team, we anticipated profiting regardless of whether the company ultimately was acquired. In late July, CEO David LaRue and CFO Bob O’Brien agreed to sell the company at a premium.

We also sold CONSOL Energy, the coal business that spun off from gas company CNX Resources in November of 2017. Since separating, the stock gained 93%, as strong production led to increased earnings guidance.
Outlook
The large move in small cap stocks since the tax bill passed last year has made finding discounted high quality companies more challenging. Our third quarter sales, two of which were due to buyouts, increased the Fund’s cash to 25%. Cash has been a headwind in this strong market, but we will remain disciplined buyers and seek to avoid putting capital at risk of loss.

The Fund’s low-70%s price-to-value ratio (P/V) is based on our discounted FCF appraisals, but to the extent we continue to have acquisitions, our appraisals are understated. Takeout multiples are higher than our long-hand math. We believe that over the next five years, we are likely to see other businesses we own get bought at premium prices, based on the quality of the assets that others would benefit from owning and the history of many of our management partners, who previously have sold either companies or business segments and/or have stated their desire to sell their current companies. We will wait patiently for 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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

“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.

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.

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.

REIT is a real estate investment trust.

As of September 30, 2018, the top ten holdings for the Longleaf Partners Small-Cap Fund: CenturyLink, 7.8%; OCI, 7.7%; Liberty Media, 6.3%; Graham Holdings, 6.2%; Mattel, 5.3%; Park Hotels, 5.2%; Realogy Holdings, 4.7%; ViaSat, 4.7%; Neiman Marcus, 4.7%; Hopewell,
4.3%. 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.

LLP000808
Expires 1/31/2019
Longleaf Partners Small-Cap Fund Commentary  
2Q18

Longleaf Partners Small-Cap Fund gained 8.86% in the last three months, far surpassing our annual inflation plus 10% absolute goal and outperforming the Russell 2000’s 7.75%. The Fund’s year-to-date (YTD) return of 7.72% was ahead of the Index’s 7.66% in spite of the portfolio’s significant cash holdings. The Fund’s strong results were achieved with less equity risk than the index, due to the cash reserves, which we expect to convert into future long-term compounders as we find qualifying investments.

The Small-Cap Fund and the Index both generated large returns, but the sources of those differed a great deal. Health Care and Information Technology (IT) comprised one-third of the Index and were its largest contributors. The Fund had no Health Care, and its two IT investments were slight detractors from performance, making the relative outperformance even more noteworthy.

Even as the Index rose, we found two new qualifiers in the quarter and added to three existing investments. We did not exit any of the Fund’s holdings but trimmed certain

Average Annual Total Returns (6/30/18): Since Inception (2/21/89): 11.10%, Ten Year: 10.93%, Five Year: 11.15%, One Year: 11.87%.

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 ratios for the Longleaf Partners Small-Cap Fund is 0.92%. The expense ratio is subject to fee waiver to the extent a fund’s normal annual operating expenses exceed1.50% of average net assets.
positions. Cash declined from 25% to 18% in the quarter, and a number of prospective investments are on the on-deck list.

**Contributors/Detractors**

(Q2 Investment return; Q2 Fund contribution)

Sonic (+37%, +1.54%), the quick serve restaurant (QSR) franchise, was the Fund’s largest contributor in the quarter, after beating the market’s negative expectations, reporting flat comparable sales for the quarter and growth in May. Low-single-digit growth projections for the fourth quarter also encouraged investors. Management converted more owned stores to franchised, and the board substantially increased the share repurchase authorization to $500 million, roughly half of the market cap at the time of announcement. The stock went up over 30% in a single week, a good example of how our ultimate outcomes are uncorrelated with market trends. The value should grow from here with the repurchase of undervalued shares, the successful implementation of their mobile app, and new franchise store openings. Over the last several years, CEO Cliff Hudson recognized the value of the business when others did not and repurchased over a third of outstanding shares at discounted prices below where Sonic trades today. In the quarter, we signed a non-disclosure agreement to further our positive engagement with Hudson and his team.

Mattel (+25%, +1.19%), the toy company, added to the Fund’s return 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.

CenturyLink (+17%, +1.14%), the global fiber telecommunications company, made notable gains in the quarter and was the largest contributor for 2018, 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.

OCI (+17%, +1.07%), a leading producer of nitrogen fertilizers and natural gas-based chemicals in the U.S., Europe and the Middle East, made gains. The company refinanced its debt, pushing out maturities and lowering cost. OCI has reached a deleveraging phase, as free cash flow will ramp up materially with the methanol plant now online, the completion of major capital expenditure projects, and a positive pricing environment. The Iowa plant benefited from fertilizer pricing’s “Midwest premium” to New Orleans (NOLA), which CEO Nassef Sawiris indicated is likely to increase, given the logistics of getting product to the Corn Belt. Methanol’s 2Q contract prices were strong at $490 (vs. mid-$300s last year). Global demand for both nitrogen and methanol is increasing. The pricing outlook is strong for the foreseeable future with no new capacity coming online in the next 4-5 years and Chinese exports down 80% with the possibility of going away completely, given their cost disadvantage to U.S. natural gas and the Chinese government's shutdown of higher polluting coal plants. In the quarter, OCI tendered for the remaining shares of OCI Partners, the master limited partnership that is majority owned by OCI, primarily made up of a single integrated methanol and ammonia facility on the U.S. Gulf coast. OCI sells for well below the replacement cost of its assets. Sawiris is an owner-operator focused on value creation and recognition, as well as optimizing the capital structure and generating significant free cash flow.

Realogy (-16%, -0.81%), the U.S.'s top real-estate brokerage, was the only notable detractor in the quarter. Rising interest rates created concerns over slower housing sales, and the company had a terrible first quarter due to what Realogy hopes is the last catchup quarter in paying realtors a higher cut of commissions in the owned brokerage segment. (This is not a factor in its larger, more valuable franchised brokerage segment.) CEO Ryan Schneider responded wisely to the decline by repurchasing shares. Schneider, a recent arrival from Capital One, has focused on
organizing Realogy’s powerful internal data to improve its lucrative franchise business. Beyond having the industry’s most trusted brands, Realogy will increasingly offer top brokers the best proprietary data. The company has excellent franchise economics and should benefit long-term from favorable demographics, as an increasing percentage of millennials purchase homes. The other macro fear pushing Realogy to an incredibly low multiple of free cash flow relates to the capital flowing into various concepts that seek to disintermediate realtors from the home transaction equation. We believe that the need for realtors may decline in areas where properties are extremely similar. But, we see a continued important role for realtors in the great percentage of the country where homes, streets and neighborhoods are disparate enough to not lend themselves to formulaic buying and selling of the vast majority of families’ most valuable asset. At Berkshire Hathaway’s annual meeting, Warren Buffett, whose Berkshire Home Services is the #2 competitor to Realogy, made interesting comments that also signal a belief in the long-term viability of the industry.

**Portfolio Activity**

We added two new positions – an undisclosed communications company and Forest City Realty Trust. Both stocks present excellent time arbitrage opportunities, with several uncertain quarters overshadowing substantial payouts likely to materialize in the years ahead. Both have multiple segments and complexity that requires more work to arrive at an appraisal. Forest City, a REIT, owns various types of properties across the U.S., including apartments, office buildings, retail and land developments in various stages. Included in the mix is highly demanded Life Sciences lab space in Cambridge, MA. The stock pulled back when the company announced that its strategic review did not result in a sale. Management is building value and structuring the company in attractive ways with a new board, discounted repurchases, land development and joint venture and ground lease buy-ins. At the start of 2021, after the company has been a REIT for five years, Forest City will be free to sell assets or the entire company without any tax penalty.

In the last year, we have found several new opportunities in real estate related companies, a sector that has been under pressure in the higher interest rate environment. We believe the three real estate related holdings added since 2017, as well as existing holding Hopewell, have quite different return drivers over the next 3-5 years. Hopewell, whose management recently monetized its Highway investment, owns
Hong Kong commercial real estate and has a large non-earning asset in its current remodel of one of its primary properties. Park Hotels owns hotels, primarily the trophy Hawaiian Village and a handful of convention center properties in major cities. The company’s two San Francisco hotels should see a boost in revenues when the neighboring Moscone Center in San Francisco re-opens in 2019 after major renovations. Realogy is a fee business tied to residential home sales, which we think will grow, as the millennial population moves from renters to owners. The most recent purchase, Forest City, is more diversified across different types of properties. In fewer than three years, the company will be even more valuable to interested buyers after the expiration of the tax penalty related to transactions post-REIT conversion. We do not focus on the Fund’s sector weight versus the Index, but we are mindful of our collective real estate exposure. We believe the returns for each investment will be predominantly determined by each company’s specific attributes.

**Outlook**
The Small-Cap 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 mid-70s% offers excess return opportunity. At Park Hotels, CNX, Mattel, ViaSat, OCI, Graham Holdings, Hopewell and Forest City we expect under-earning or non-earning assets to contribute substantial additional earnings. Successful acquisition integration should help produce higher earnings at CTL and Liberty Media/Formula One. Additionally, the values of CTL’s and Kodak’s wonderful businesses are dwarfing their poorer segments that created the misperceptions for us to invest. Our patience, discipline and ability can produce additional qualifiers for the Fund’s liquidity, as volatility and a narrower market have helped grow our list of prospective opportunities. 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.

See following page for important disclosures.

Before investing in any Longleaf Partners Fund, you should carefully consider the Fund’s investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit
longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS
The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

“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.

REIT is a real estate investment trust.

As of June 30, 2018, the top ten holdings for the Longleaf Partners Small-Cap Fund: CenturyLink, 6.9%; Park Hotels, 6.9%; OCI, 6.6%; Liberty Media, 6.4%; Graham Holdings, 6.3%; Sonic, 5.5%; Mattel, 5.4%; ViaSat, 4.9%; CNX Resources, 4.8%, Neiman Marcus, 4.7%. Fund holdings are subject to change and holding discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

Funds distributed by ALPS Distributors, Inc.

LLP000777
Expires 10/31/18
Longleaf Partners Small-Cap Fund declined 1.05% in the first quarter, and the Russell 2000 Index fell slightly, 0.08%. Concerns over U.S. tariffs plus renewed U.S. inflation concerns offset optimism around lower tax rates and helped create long overdue volatility. The Fund’s cash was a positive in the market’s decline, and half of our holdings posted positive results. The Small-Cap Fund fell, however, primarily due to double-digit declines at two holdings. Relative results were impacted by the Fund’s minimal exposure to the index’s only three positive sectors in the quarter – Healthcare (0 holdings), Information Technology (2 non-internet related holdings), and Financials (0 holdings). Momentum has propelled those areas for an extended period and also explains the Fund’s relative results over the last 12 months.

In the increased market volatility, smaller cap companies did not experience as much of a pullback as larger or foreign stocks. We added to two of the Fund’s most recent investments during the quarter but did not purchase any new companies. These transactions reduced the Fund’s cash position even following the sale of Wynn Resorts in January. Our on-deck list of prospective qualifiers grew. We are hopeful that

Average Annual Total Returns (3/31/18): Since Inception (2/21/89): 10.88%, Ten Year: 10.02%, Five Year: 9.83%, One Year: 3.77%.

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 ratios for the Longleaf Partners Small-Cap Fund is 0.91%. 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.
additional volatility will generate more opportunities to own discounted, dominant businesses with strong corporate leaders.

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

Neiman Marcus (+16%, +0.69%), the luxury retailer whose bonds we own, contributed to the Fund's performance as the company exceeded low market expectations during the very important holiday period and delivered a second consecutive quarter of positive comps. Texas stores, which represent 20% of sales, showed notable improvements, and the growth of online sales to over one-third of revenues contradicted a commonly held image of dying retailers. Neiman Marcus is generating enough cash to service the interest payments and has ample liquidity via its revolving credit facility to continue investing in the business.

Graham Holdings (+8%, +0.49%), the media, education, and services company that is the Fund's largest position, contributed with strong quarterly performance. Television margins improved - the Graham family has been one of the very best operators in the business for several decades and continued to improve here. Kaplan Education received regulatory approval for its groundbreaking online deal with Purdue University. Additionally, CEO Tim O'Shaughnessy repurchased the company's discounted shares.

ViaSat (-12%, -0.94%), the satellite company, detracted from the Fund's performance despite solid operating results and the start of full commercial service on its recently launched, technically superior ViaSat-2 satellite. ViaSat's government business, primarily a secure communications channel for militaries, grew earnings before interest, tax, depreciation and amortization (EBITDA) by 20% year-over-year, a number only slightly ahead of the segment's growth rate over the last twenty years. ViaSat's consumer broadband business lost subscribers while transitioning to new service plans, but we believe this was a temporary drop rather than a sign of long-term weakness. InFlight should install Wifi service on over 150 planes this year, and its backlog continued to expand.

Mattel (-15%, -0.73%), 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.

OCI (-8%, -0.51%), a leading producer of nitrogen fertilizers and natural gas-based chemicals, was another detractor in the quarter. The stock declined in spite of higher methanol prices and debt refinancing that will reduce interest costs. A main source of short-term price pressure in the quarter was that a relatively large holder (Abraaj Capital) had to sell in order to raise capital for its other businesses. OCI has six production facilities located in the Netherlands, United States, Egypt and Algeria, and its new U.S. methanol plant in Texas will ramp up in 2018. As major capital expenditure projects come to completion, cash flow will accelerate meaningfully. The company sells for well below the replacement cost of its assets. CEO Nassef Sawiris is an owner-operator who remains focused on value creation and recognition, as well as optimising the capital structure and generating significant free cash flow.

Formula One (-10%, -0.50%), the global sports and media company, detracted. Its investment in LiveNation stock declined following a weaker than expected quarter. Additionally, Formula One had several one-time costs in the transition under its new leadership which is investing heavily for improvements in 2020 and beyond with a new OTT streaming service and improved schedule of races. Formula One is an example of a business that quantitative models miss because of the upside in its transformative acquisition by John Malone and Greg Maffei’s Liberty group and the abilities of new CEO Chase Carey, who is among our most respected partners for his prior work at DirecTV.
**Portfolio Activity**

During the quarter, we increased our stakes in Park Hotels and Realogy, both new purchases in 2017, but did not purchase any other companies. In January, we sold Wynn Resorts, which, after a large return over the last two years had no margin of safety 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 mid-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 124% gain over the Fund’s 2.5 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.

**Outlook**

The first quarter return did not reflect the progress that the Small-Cap Fund made over the last three months. We sold a fully priced, successful investment (Wynn) and used some of the non-earning cash to increase stakes in market leading businesses at deep discounts. Our on-deck list of prospective qualifiers grew. Notable leadership changes also improved the long-term outlook at several companies where we have been engaged. In addition to Mattel’s adding Todd Bradley to its board as mentioned above, Actuant appointed two new directors suggested by Southeastern because of their relevant industry and transactional backgrounds. We applauded the announcement that Jeff Storey would take over as CEO of CenturyLink six months ahead of plan. Many of the companies we own have the qualitative strength and pricing power to help mitigate some inflationary pressures, particularly versus peers. Given the quality of our companies and our motivated management partners, a number of holdings have strong prospects over the next few years not only for organic growth but also for being attractive businesses to other companies.
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 25% cash to work in investments that meet our Business/People/Price criteria and further reduce the high-60%s price to value (P/V). As large shareholders 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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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.

As of March 31, 2018, the top ten holdings for the Longleaf Partners Small-Cap Fund: Graham Holdings, 6.9%; ViaSat, 6.6%; CenturyLink, 6.5%; Park Hotels, 6.5%; OCI, 6.0%; Hopewell Holdings, 5.4%; Neiman Marcus, 4.8%; CNX Resources, 4.8%; Realogy Holdings, 4.7%; Kodak, 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.

 LLP000757
Expires 7/31/18
Longleaf Partners Small-Cap Fund delivered 8.99% in 2017 and 1.74% in the fourth quarter. These results fell short of our annual absolute goal of inflation plus 10% and the Russell 2000’s 14.65% and 3.34% for the same periods. The Fund’s 26% average cash position was a drag on the absolute return and accounted for approximately half of the shortfall against the index. The Russell 2000’s gains were powered by Healthcare and Information Technology (IT). Our discipline requires a material margin of safety between stock price and intrinsic worth and kept us out of most of the companies in these two sectors. The Fund’s longer term 12.60% five year return exceeded our absolute return goal, but because of 2017 results, fell below the index for one of the few times in the Fund’s history, as shown in the following chart.

Most of our businesses produced positive returns in 2017, and only one investment, Kodak, was a notable detractor. Investments that our management partners made in the last few years that were non-earning assets (NEAs) began to show anticipated returns including Wynn’s Palace Resort in Macau and OCI’s Iowa nitrogen fertilizer plant. Acquisitions, real and rumored, as well as other transactions added to performance. Scripps Networks sold at a solid price to Discovery Communications; Deltic Timber sold to Potlatch near our appraisal; Graham Holdings entered into a unique transaction with Purdue University to strengthen its Kaplan education business; Mattel was rumored to have been approached by Hasbro; at the end of November, CONSOL Energy completed the split of its coal and gas businesses; and on the final day of the year, Hopewell announced the sale of its Hopewell Highway Infrastructure toll road company for 20% above our appraisal, which did not impact 2017 results but was a good way to start 2018.

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, Healthcare and IT comprised over half of the index’s return and far more than any other sector. We rarely find a qualifier in these two industries, particularly in smaller companies. Their lower diversification, greater business risks and shorter track records make it difficult to have a high degree of confidence in any competitive advantage five years out, which leads to uncertainty about the terminal value. IT momentum chasing contributed to stocks that others define as “growth” far surpassing those categorized as “value” in the Russell 2000, 22% versus 8%. In the last four months, the market also rose with renewed optimism around the tax bill. The two-thirds of Russell 2000 companies with current tax rates over 25% gained an average 12.5% since the end of August, compared to 9.9% for the third with already lower tax rates.

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 more of 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. Some of the Fund’s holdings already pay lower rates because of the global nature of their businesses or, in the case of CenturyLink (CTL), net operating loss (NOLs) that offset taxes. Those that we believe will reap the biggest benefits for shareholders from the new tax law are Graham Holdings and ViaSat.

Even as the market hit new highs, our buying activity increased in the latter half of the year. We built all three new positions after late June, with the anticipated tax changes directly leading to one in the fourth quarter. We also added to CTL and CNX Resources (CONSOL Energy’s gas company). We sold eight investments, including two in the fourth quarter. The Fund’s cash position ended the year at 23%, slightly lower than the balance held for most of 2017.

Average Annual Total Returns (12/31/17): Since Inception (2/21/89): 11.02%, Ten Year: 8.79%, Five Year: 12.60%, One Year: 8.99%

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 ratios for the Longleaf Partners Small-Cap 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.
Contributors/Detractors

(2017 Investment return; 2017 Fund contribution; Q4 Investment return; Q4 Fund contribution)

Wynn Resorts (+98%, +3.89%, +14%, +0.45%), 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 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.

OCI (+44%, +2.22%, +8%, +0.54%), a leading producer of nitrogen fertilizers and natural gas-based chemicals, added to the Fund’s 2017 and fourth quarter results. The stock’s strong performance in the last year closed much of the gap between price and our appraisal value, and we reduced the Fund’s stake in the fourth quarter. The company’s earnings grew as its new Iowa plant, a particularly large NEA, ramped production and fertilizer commodity prices recovered from 2016 lows. OCI has six production facilities located in the Netherlands, the United States, Egypt, and Algeria, and its new U.S. methanol plant will ramp up in 2018. As its major capital expenditure (capex) projects come to completion, cash flows should accelerate meaningfully. CEO Nassef Sawiris is aligned with shareholders and remains focused on value creation and recognition.

Scripps Networks (+26%, +1.01%, −, −), the owner of HDTV, Food Network, and other cable channels, contributed to performance when Discovery announced its acquisition at a price near our appraisal, and we reduced the Fund’s stake in the fourth quarter. The company’s earnings grew as its new Iowa plant, a particularly large NEA, ramped production and fertilizer commodity prices recovered from 2016 lows. OCI has six production facilities located in the Netherlands, the United States, Egypt, and Algeria, and its new U.S. methanol plant will ramp up in 2018. As its major capital expenditure (capex) projects come to completion, cash flows should accelerate meaningfully. CEO Nassef Sawiris is aligned with shareholders and remains focused on value creation and recognition.

ViaSat (+13%, +0.90%, +16%, +1.06%) the satellite company, was the fourth quarter’s largest contributor and helped 2017 results. The company launched its promising new ViaSat-2 satellite. Despite losing broadband subscribers in the Exede segment, the company raised average revenue per user (ARPU) and invested for future growth. The valuable government segment grew revenues and earnings substantially. CEO Mark Dankberg has built significant shareholder value by bringing competence and a rare long-term owner mindset to the company.

CONSON Energy (+7%, +0.42%, +15%, +0.87%), 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. We believe 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. We increased our stake in CNX after the spin-off. In spite of rampant coal divestment by institutional investors, CONSOL’s stock jumped 84% after becoming a pure-play coal business, and we reduced our ownership after the stock more appropriately began to reflect the company’s value.

Neiman Marcus (-0.02%, -10%, +0.64%, +14%) the luxury retailer, contributed to the Fund’s fourth quarter. The distressed debt that we own rose as Neiman improved sales and stabilized gross margins after solving an inventory management problem that had weighed down profits. The company has limited exposure to retail killer Amazon because of its high end brand focus, meaningful on-line presence and high-touch service experience. Upside remains in its NEA Hudson Yards store in New York City, scheduled to open in 2019. Despite a sizable debt load from its 2013 private-equity takeover, the bonds imply an enterprise value significantly below our appraisal of the company, and we added to our position before the bonds rallied.

Kodak (-32%, -1.97%, -18%, -0.91%), the imaging company, was a notable detractor from the Fund’s results in the fourth quarter and the year. The largest challenge was the decline in its Printing Systems Division (PSD), exacerbated by a spike in aluminum prices that reduced margins. PSD was the primary driver of the stock price with its disappointing earnings, but Kodak is an example of a complex company being undervalued because of the need to unravel its parts. Most analysts simply look at the shrinking PSD segment and overall complexity of the entire company and walk away. But underlying all of that is a profitable Packaging business which is basically immune to the competitive risk of digital imaging because of the package surfaces involved, and which is growing cash flow at double-digit rates. There are also assets unrelated to Kodak’s core business including tax loss carryforwards, real estate, a brand that will increasingly be monetized via royalties from others’ products, earnouts from prior dispositions, and material sciences intellectual property (IP) (as distinct from the digital imaging IP which was auctioned off in bankruptcy). Kodak has no Wall Street coverage and is unlikely to get credit for its different pieces until they are monetized or start driving earnings higher. With our position primarily in preferred shares, we are less reliant on the stock price. We are confident that CEO Jeff Clarke and his board are focused on value
CenturyLink (formerly Level 3) (-12%, -1.14%, -7%, 0.71%), declined during the year and fourth quarter, even though the stock rallied over 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 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 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 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

We made three new purchases and added to some of the Fund’s more discounted investments during the year. As fewer companies participated in the market’s new highs, our on-deck list of qualifiers grew. 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. The undisclosed fourth quarter purchase became undervalued as investors worried about the tax law impact on its industry, but this company’s fee based business, strong brands, and capable new CEO make us confident in the ability to grow value per share.

At the end of the second quarter, we began buying Park Hotels, the Hilton spin-off with 67 U.S. hotels. Park owns differentiated properties in supply-constrained markets, many of which cater to large conference business that is resistant to competition from Airbnb and a wave of travel start-ups. The company’s Hawaiian Village resort is maybe the most valuable non-gaming hotel in the world. Other properties in key coastal cities have strong barriers to entry. Industry veteran CEO Tom Baltimore has several opportunities to upgrade underutilized real estate. Park has a strong balance sheet but trades at a lower multiple than inferior peers and at a price substantially below replacement cost.

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. Mattel is similar to the Fund’s previous investment in DreamWorks which faced near-term depressed earnings and had no dividend when we purchased the stock, but over time, management succeeded in monetizing the value of the company’s strong brands. We are similarly confident in Mattel’s plan to restore margins and do more with the company’s leading franchises in a growing industry.

We sold six companies earlier in the year and Deltic Timber and SEACOR Marine (SMHI) in the fourth quarter. SMHI was a 0.2% position after being split from SEACOR (one of the six earlier sales). SMHI provides transportation to oil rigs. We sold this small holding as oil prices rose. We owned Deltic Timber with acreage in Arkansas and Louisiana for three years. During that time we became more heavily engaged with management regarding capital allocation options as timber prices moved up but the stock failed to follow. Potlach’s buyout offer at a fair price ultimately helped drive our 57% gain.

Outlook

The Fund’s last two years’ 31% cumulative return substantially beat our absolute goal of real double-digit returns but did not meet our longer term objective of outperforming the index. We believe we can continue to provide solid absolute results that also beat the benchmark over the long run. Our 2017 relative shortfall versus the inflated index was primarily due to the combination of two decisions to avoid risk of loss: Small-Cap held between 20-30% cash throughout the year, which accounted for approximately 50% of the relative shortfall versus the index; and, we did not own more of a narrow, pricey part of the market, namely Healthcare and some IT, that far outperformed most stocks. Our notable act of commission that hurt results was a case of a single declining division at Kodak obscuring the value of a quality growing segment as well as
other valuable assets that management and the board are focused on monetizing.

We are confident we can outperform over the next 5+ years. First, as was true in 2017, what we own will produce our returns going forward, and the Fund’s portfolio primarily contains strong businesses with growing values selling for a P/V in the low 70s% — a striking contrast to what we believe is an overvalued Russell 2000 increasingly driven by momentum in a narrower group of companies. We expect our differentiation from the index (Active Share of 98%) 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 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 securities.

It is our strong view that after a nine year bull run and at high historic multiples, the market 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.” 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.

See following page for important disclosures.
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund's investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

**RISKS**

The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

“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.

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

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

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 December 31, 2017, the top ten holdings for the Longleaf Partners Small-Cap Fund: ViaSat, 7.4%; OCI, 7.3%; CenturyLink, 6.5%; Graham Holdings, 6.3%; Mattel, 5.3%; Hopewell Holdings, 5.1%; CNX Resources, 4.8%; Neiman Marcus, 4.7%; Liberty Media Formula One, 4.7%; Park Hotels, 4.7%. Fund holdings are subject to change and holding discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

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

Longleaf Partners Small-Cap Fund gained 2.08% in the third quarter versus the Russell 2000 Index's 5.67% return. Not owning the index's biggest performers and a high cash position were the primary reasons for the Fund's shortfall rather than declines at portfolio holdings. Among the Fund's stronger performers, the common thread was corporate actions aimed at building and gaining recognition for value per share.

We exited two investments - Scripps and Everest Re - that reached our appraisal over the last three months. We also trimmed Wynn Resorts, the Fund's best performer YTD. We initiated a new position (still undisclosed) late in the quarter and added to three other holdings.

The Fund's 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. 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, 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.

Almost all of the difference between Fund and index returns occurred in September when the Russell 2000 rose over 6% as optimism over the prospect of corporate tax cuts fueled a small cap rally. A similar surge occurred in late 2016 following the election. Both times, the Small-Cap Fund rose well above inflation plus 10%, but not as much as the index. Those two brief periods accounted for essentially all of the Fund’s relative shortfall in the last year. Because the global scope of most larger companies leads to lower tax rates than smaller U.S. based firms pay, smaller caps are assumed to be a bigger beneficiary of a tax cut. Within the Fund’s portfolio, a number of our companies already enjoy a tax rate below 35% because of offshore profits (Wynn, OCI, Formula One, and Actuant) and net operating losses (Level 3, Kodak, CONSOL, and Viasat), or they are real estate firms for whom this debate is less meaningful (Hopewell, Park, and Deltic). As we model the impact of a tax cut on smaller businesses beyond what we own, the size of any benefit is much less than the index's jump. Most smaller companies have weaker competitive moats, and we believe the money saved in taxes would likely to be spent fighting for share. Customers of these companies would be the beneficiaries with lower prices or better services, but shareholders would not necessarily see profits increase in line with the tax decrease.

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 Small-Cap Fund is currently more attractively positioned than the Russell 2000, which sells well above average historic multiples and at a record high level. Health Care and Financials, two areas whose future outlooks are generally difficult to assess, constitute one-third of the index and were two of its main return drivers in the quarter. Because of our higher hurdle for companies in these sectors and our belief that they currently trade at elevated valuations, the Fund has no exposure to Health Care or Financials (we sold our only position in the quarter). Because of the Fund's flexibility to own companies outside of the index such as foreign domiciled businesses and REITs, a large portion of the Fund's holdings, including two of the top three performance drivers in the quarter, are not part of the inflated Russell 2000 Index. 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%, +0.92%) the owner of leading cable channels including HGT, 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. When we first purchased Scripps in 2011, a brief ratings drop and international investments obscured the sustained profitability of Scripps's unique content. Over our holding period, Scripps added new viewers and grew advertising revenue, but industrywide pay TV subscribers declined more quickly than we anticipated. We consequently

Average Annual Total Returns (9/30/17): Since Inception (2/21/89): 11.05%, Ten Year: 7.57%, Five Year: 12.99%, One Year: 11.29%

Returns reflect reinvested capital gains 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 ratios for the Longleaf Partners Small-Cap 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.
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 capital and book a 135% gain in spite of the industry challenges that developed.

**Deltic Timber (+19%, +0.62)**, a natural resource company with timber assets, mills and development property in Arkansas and northern Louisiana, was another contributor. Southeastern amended our 13-D noting that Deltic had received at least one proposal from an interested acquirer and stating dissatisfaction with the company’s response as well as various actions of management and the Board. In response, the company acknowledged being approached by interested parties and said it is evaluating external and internal strategic alternatives. The stock market has recognized the merits of our engagement with management and the Board, and we are hopeful that the value of Deltic’s assets will be unlocked soon.

**CONSOL Energy (+13%, +0.60%)**, 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%, -0.84%)**, the global fiber and integrated communications network company, was the only notable detractor from the Fund’s return in the quarter. In anticipation of the close of CenturyLink’s (CTL) purchase of the company, we maintained an overweight 8% position which magnified the impact of the stock’s decline. Because we will receive approximately half of the transaction in cash, the combined company will become a more normal 4-5% 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 Changes**

During the quarter, sales exceeded purchases. In addition to selling Scripps, we exited Everest Re, the Bermuda-based reinsurer, when it reached our appraisal in late July – fortuitously before the season’s hurricanes struck. This investment gained over 180% over our 13 year holding period in spite of the Global Financial Crisis, a historically unprecedented decline in interest rates, and new competitors flooding the industry with capital. The resulting lower bond returns and softer pricing caused us to reduce our appraisal multiple on book value. In spite of the challenges, our partners, Chairman Joe Taranto and CEO Dom Addesso, used their operating and capital allocation expertise to consistently grow book value with intelligent underwriting and opportunisticly reduce the share count by over 25%.

We trimmed Wynn Resorts to keep it a more normal weight after being the strongest performer by far year-to-date, up 74%, and gaining 61% over the last 18 months. Wynn was 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.

We added to several of our most discounted companies, including Park Hotels, Neiman Marcus bonds, and ViaSat. 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 Longleaf Partners Small-Cap Fund to earn strong absolute returns that we believe can outperform the index over the long term as it has for most of the Fund’s 28 year history. The companies we currently own offer additional attractive upside given their P/V in the mid-70%s and 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 can 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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

“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.

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

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

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.

REIT is a real estate investment trust.

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.

The Global Financial Crisis (GFC) is a reference to the financial crisis of 2007-2008.

As of September 30, 2017, the top ten holdings for the Longleaf Partners Small-Cap Fund: Wynn, 5.1%; Formula One, 4.9%; OCI, 5.8%; CONSOL, 4.4%; Level 3, 8.1%; SEACOR, 0.3%. 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 Small-Cap Fund gained 0.98% in the second quarter. While a positive return, it trailed both our absolute return goal of inflation plus 10% and the Russell 2000 Index’s 2.46%. These results caused the Fund’s year-to-date (YTD) performance to fall barely below the index at 4.95% versus 4.99%. Most holdings grew their value, some that the market realized and some it did not.

Holding cash in a rising market held back the Fund's relative returns, but 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 sentiment turns. Our energy exposure was also a detractor. The main reason for the Fund’s relative underperformance, however, was errors of omission from areas that drove the index but we see as overvalued. Information Technology and Health Care were by far the largest contributors to the index performance both this quarter and YTD, comprising the majority of the benchmark’s return for the two periods and these sectors also accounted for the majority of the Fund’s relative underperformance. The excesses of the later stages of a bull market often can be seen most in the more speculative parts of the market, and we feel that the vast majority of small cap companies in these two sectors, which make up over 30% of the Russell 2000, are exhibiting dangerous signs of overvaluation. As evidence, the Information Technology sector of the Russell 2000 is trading at a Price/Earnings (PE) multiple of 22, and Health Care is trading at 25.

One of the improvements that we have made to our process in recent years is being slower to part with longer 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 Level 3, Wynn Resorts and Formula One, to grow their values in ways that do not necessarily fit easily into a spreadsheet.

We began buying one new investment in the quarter and added to two of our existing holdings. We sold one company and trimmed three 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%, +1.03%), 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.

OCI (+14%; +0.75%), the global nitrogen fertilizer and methanol producer, contributed positively to results in the quarter. Improved prices and volumes for related commodities led to greatly increased cash flow year-over-year. The company’s Iowa fertilizer plant began operating in April, which showed the market that this formerly non-earning asset is now about to produce significant earnings. OCI also made progress bringing its new methanol plant (“Natgasoline”) closer to its fourth quarter completion date. Late in the quarter, OCI’s stock price responded positively to rumors of private equity interest in the company. We are confident that our proven, aligned partner, Chairman Nassef Sawiris, will navigate any strategic outcome in a way that maximizes shareholder value.

OCI Communications (+14%, +0.29%), 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

Average Annual Total Returns (6/30/17): Since Inception (2/21/89): 11.08%, Ten Year: 7.56%, Five Year: 13.63%, One Year: 14.78%

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 ratios for the Longleaf Partners Small-Cap 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.
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%; -0.55%), 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 DeIuliis and Chairman Will Thorndike remain focused on delivering the unrecognized value within CONSOL, and 2017 likely will be a pivotal year for the company.

Portfolio Changes
We added one new company in the quarter that we have chosen not to disclose because we are still building our position. During the quarter, SEACOR Holdings, the provider of marine transportation services, split into two companies – SEACOR Holdings and SEACOR Marine Holdings. We sold SEACOR Holdings, since it traded at our value post-spin. We still held SEACOR Marine Holdings at quarter end, since it traded at a large discount to our value. Our relatively short SEACOR history thus far illustrates the importance of the margin of safety. In spite of reducing our appraisal after being wrong on how much lower oil and agriculture prices would impact operations, we have avoided a loss because of the deep discount we initially paid. SEACOR also highlights another improvement in our process over the last five years — we now have much higher hurdles to clear before adding to a position if the value is declining, even if the discount looks compelling. SEACOR remained a small holding over the last year because we did not add to it as the case and our appraisal changed.

Outlook
The Fund’s P/V ratio is higher than usual in the mid-70s%, as is our cash level at 28%. 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.

See following page for important disclosures.
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund's investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

**RISKS**

The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

"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.

As of June 30, 2017, the holdings discussed represented the following percentages of the Longleaf Partners Small-Cap Fund: Wynn, 5.1%; Formula One, 4.9%; OCI, 5.8%; CONSOL, 4.4%; Level 3, 8.1%; SEACOR, 0.3%. 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 Small-Cap Fund Commentary

Longleaf Partners Small-Cap Fund gained 3.93% in the first quarter and outperformed the Russell 2000 Index’s 2.47%. Our absolute return surpassed our annual absolute goal of inflation plus 10%, continuing the strong performance from 2016. We exceeded the market’s return thanks to strong performance from key holdings and pullbacks from some of the “Trump rally” highfliers that we did not own.

Companies with substantial non-earning assets (NEAs) were particularly rewarding in the quarter. Wynn Resorts, Graham Holdings, and OCI all have or had a number of assets that were not reflected in a simple earnings per share (EPS) calculation, and they also are run by owners who are willing to think long-term. One of the largest contributors over the last 12 months — Formula One Group (formerly Liberty Media Group) — started off as an NEA-heavy company before its great acquisition of Formula One turned non-earning cash into what will be a strong free cash flow generation business.

We did not buy any new securities and only added to two existing investments in the quarter. We trimmed five positions and exited another three. 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**

<table>
<thead>
<tr>
<th>(1Q portfolio return; 1Q Fund contribution)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Wynn Resorts</strong> (+33%, +1.78%), 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.</td>
</tr>
</tbody>
</table>

**Graham Holdings** (+17%; +0.95%), the media, education, and services company, was another contributor in the quarter. The Kaplan International segment reported relatively good results for the first time since 2015 and showed signs of having bottomed out as cost cuts should kick in this year. Graham’s TV segment continued to deliver industry-leading results, and the market began to anticipate TV consolidation opportunities under a less regulatory administration. We applaud CEO Tim O’Shaughnessy for buying back a meaningful amount of stock at discounted prices last year, and we are excited about his ability to go on offense with Graham’s formidable balance sheet.

**Formula One Group** (+9%; +0.59%), the media and entertainment company controlled by Liberty Media Corporation and formerly named Liberty Media Group, contributed positively in the company’s first quarter as the owner of the global car racing business, Formula One (F1). While there was only one race late in the quarter, our management partners were hard at work making positive changes from day one of their 100% ownership of F1. F1 CEO Chase Carey significantly upgraded his team, adding racing legend Ross Brawn and former ESPN executive Sean Bratches to work on the sport’s competitiveness and revenue maximization, respectively. The company also refinanced high cost debt to a lower rate and longer term. Formula One still owns a 34% stake in Live Nation, which reported a somewhat disappointing quarter but remains on track to grow nicely going forward.

Although several of our investments slightly declined in the quarter, none significantly detracted from the Fund’s return.

**Portfolio Changes**

We sold Triangle Petroleum, Tribune Media, and Rayonier in the quarter. We exited Triangle, an oil and gas company, and recognized a loss when we were unwilling to put further capital into the business because of a lack of confidence in several qualitative aspects of the investment case after we had gotten to know the company better. Our second time owning media company Tribune was not nearly as gratifying as our first successful investment in the company’s bonds as it came out of bankruptcy. This time, our value declined due to disappointing results at the TV division, a weak spectrum auction, and a lack of value growth from other assets. Our
small positive return amid these disappointments speaks to the margin of safety in our initial purchase. We also sold timber REIT Rayonier late in the quarter after the company issued equity at a price that reinforced our assessment that the stock was at or near fair value. Over the three years we held the stock, a challenging timber environment hindered value growth, and while the discount we paid plus the dividend helped preserve our capital, our 12% total return was less than we anticipated.

**Outlook**
Our P/V ratio is higher than usual in the mid-70s%. We also are holding a 26% 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.

*See following page for important disclosures.*
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund's investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

**RISKS**

The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

Earnings per share (EPS) is the portion of a company's net income allocated to each share of common stock.

“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.

REIT is a real estate investment trust.

As of March 31, 2017, the holdings discussed represented the following percentages of the Longleaf Partners Small-Cap Fund: Wynn, 6.4%; Graham Holdings, 6.2%; OCI, 5.1%; Formula One, 7.2%; Triangle Petroleum, 0%; Tribune Media, 0%; Rayonier, 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 Small-Cap Fund delivered a substantial return of 20.48% in 2016, following a 3.88% gain in the fourth quarter. The Fund far outpaced the Russell 2000 Index throughout the year until the November presidential election sent the index soaring over 13%, catching up with the Small-Cap Fund to deliver 8.83% in the fourth quarter and 21.3% for the year. Our 2016 risk adjusted absolute and relative returns were impressive given that our cash balance averaged 23% throughout the year. The Fund's longer-term results have materially outpaced the index.

Results at our companies drove the Fund’s return, with a large part of our success coming at the hands of our corporate partners’ moves to build shareholder value. Four holdings, including DreamWorks Animation, Chemtura, Liberty Media, and Level 3 Communications, were involved in attractive mergers or acquisitions. A number of other companies sold or bought assets to focus more heavily on their core businesses. Even at OCI, our primary detractor in 2016, the company was in the process of being acquired before the U.S. government removed tax inversion benefits. The year highlighted the importance of value additive capital allocation by our CEOs and boards. In large measure because of our capable management partners, we believe the Fund will continue to benefit from not only their operating skills, but their abilities to successfully integrate merged businesses and make value accretive capital decisions. The competitive strength of our businesses and our collaborative engagement with our partners make us confident in the Fund’s future returns.

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

**DreamWorks Animation** (+55%, 5.06%), the film studio and multimedia company, was the Fund’s largest contributor for the year. We sold the position in the second quarter after Comcast announced an all cash acquisition for $41 per share. We started buying DreamWorks in the third quarter of 2014 at $19 per share following disappointing new movie releases. Our appraisal hinged on the valuable film library and DreamWorks’ growing success in TV and web content, as well as licensing. We partnered with a strong board led by Chairman Mellody Hobson and owner-operator CEO Jeffrey Katzenberg, who built the company’s brands, developed a presence in China, managed costs, and ultimately monetized the company at full value with a 104% return for the Fund during our two year holding period.

**CONSOL Energy** (+13%; +3.55%), 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 Thornndike, 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 earnings before interest, taxes, depreciation, and amortization (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.

**Liberty Media Corp.** (+79%; +3.36%), a holding company for a broad range of entertainment businesses, was an additional large contributor to the Fund’s return in 2016 and rose 11% in the fourth quarter. We initiated the position in the second quarter when “old Liberty Media” spun out three tracking stocks, including Liberty Media Corp. (LMCK). LMCK’s main asset immediately post-spin was 34% of Live Nation Entertainment, the largest ticketing and live entertainment company in the world. Live Nation reported solid results throughout the year. Shortly after our purchase of Liberty Media, the company announced its acquisition of a controlling interest in Formula One Group, which is now LMCK’s most important asset. Formula One adds to LMCK’s properties a global, live sports brand with over 400 million unique viewers, and its worldwide races generate long-term contracted revenue from broadcasting, event fees, and advertising. A key part of the acquisition was the appointment of Chase Carey as Formula One Group Chairman. Southeastern successfully partnered with Carey previously, and we are thrilled to partner with him again, as his experience as one of the smartest

---

**Average Annual Total Returns (12/31/16): Since Inception (2/21/89): 11.09%, Ten Year: 8.15%, Five Year: 15.35%, One Year: 20.48%**

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 ratios for the Longleaf Partners Small-Cap 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.
people in sports media directly relates to the Formula One opportunity. Upon the anticipated first quarter 2017 closing of the acquisition, Liberty Media Corp. will be renamed Formula One Group. Our past investments with Chairman John Malone and CEO Greg Maffei have been rewarding, and we expect this opportunity to partner with these superior capital allocators to continue to benefit the Fund.

**Wynn Resorts** (+27%, +1.67%), 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.

**Scripps Networks** (+31%, +1.51%), the media company whose three main brands are HGT V, 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 HGT V 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%, +0.39%), a global fiber and integrated communications network company was the primary contributor to the Fund’s fourth quarter return with a 22% gain. The stock rose with the announcement of a merger with CenturyLink, Inc., equating to $66.50 per Level 3 share, a 4.2% 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.

**OCI** (-28%, -0.69%), a global fertilizer and chemical producer, was the largest detractor in the Fund for the year, even after a rebound of 18% in the fourth quarter. The two main pressures on the share price were weakness in nitrogen fertilizer prices and the cancellation of the CF Industries merger as a result of the U.S. government crackdown on tax inversions. Despite depressed fertilizer prices, nitrogen remains an essential part of global food production, and global demand is growing by around 2%, which will help deplete the current excess supply by 2018. Given the high cost and long lead time of building a new plant, it is unlikely that new capacity will be built in the medium term. OCI owns the newest and most efficient nitrogen fertilizer plants in the industry, with its large, new Iowa plant now producing. Its Texas Greenfield methanol plant comes online in late 2017. OCI recently initiated a cost savings plan over $100 million, $65 million of which is executed, and the company has completed the majority of its large capital expenditures. We expect significant earnings production in the coming two years, and CEO Nassief Sawiris and his team are working diligently to grow value per share. In early December, the company announced a 25% premium offer to acquire all publicly held shares of OCI Partners in exchange for OCI shares. The acquisition should allow for operating synergies between methanol assets and incremental free cash flow with a positive impact on the combined balance sheet in 2017.

**Annual Portfolio Changes**

When their prices reached our appraisals following announcements of being acquired, we exited two holdings during the year—**DreamWorks** in the second quarter and **Chemtura** in the third. We also sold our long-held investment in **Vail Resorts** in the third quarter when the stock reached our appraisal, generating a return of over 300% over our holding period. We trimmed a number of the Fund’s holdings that became overweight and as their price-to-values (P/V) rose. Our sales added to our cash position, which remained above 20% for most of the year because we found a limited number of new opportunities. The four new qualifiers we did buy—**Liberty Media**, **SEACOR**, **Sonic**, and **Eastman Kodak**—were positive performers, particularly Liberty. Kodak was initiated in the fourth quarter with the negotiation and subsequent purchase of convertible preferred stock (Preferred) of Kodak. This new security issued by the company at our suggestion is an example of the benefits of our engaged, collaborative approach with boards and management teams. The proceeds from our investment will allow the company to refinance high cost debt and unlock encumbered cash. Most importantly, it will allow CEO Jeff Clarke and his team increased financial flexibility
to highlight the value of a unique set of printing, imaging, and materials science technology assets. The Preferred provides an attractive risk/reward opportunity. It has an annual cash dividend of 5.5%, is convertible into shares of common stock at $17.40 per share (a substantial discount to our appraisal), and allows us to nominate directors to the board.

Outlook
The Fund's (P/V) in the mid-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 19% cash position.

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 Liberty Media, which benefitted from merger and acquisition activity in 2016, 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 expenditure investment programs over the last few years that should begin to generate returns in 2017 and beyond. These include ViaSat’s new satellites, Wynn’s newly opened Palace in Macau, Hopewell’s Centre II project, and OCI’s new fertilizer and methanol plants. 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.

See following page for important disclosures.
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund’s investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS

The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

EBIT is a company’s earnings before interest and taxes.

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

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

As of December 31, 2016, the holdings discussed represented the following percentages of the Longleaf Partners Small-Cap Fund: Liberty Media, 6.9%; Level 3, 8.1%; OCI, 4.8%; CONSOL, 5.7%; Wynn; 5.4%; Scripps, 4.8%; SEACOR, 1.6%; Sonic, 3.0%; Eastman Kodak, 5.1%. The following stocks discussed are not held in the Fund: DirecTV and News Corp. 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 Small-Cap Fund gained a strong absolute 15.97% return in the first nine months of 2016 after a 5.28% rise in the third quarter. By contrast, the Russell 2000 Index was up 11.46% year-to-date (YTD) and 9.05% over the last three months. Almost all of the Fund’s investments were positive contributors in the third quarter, but the large cash position dampened relative results in a quarter that comprised most of the index’s YTD return. The Fund’s longer term results, which include various periods with cash over 15%, outperformed the benchmark consistently.

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. Transactions were an important driver of the Fund’s results during the quarter. Our partners at Liberty Media struck an attractive deal to bring the Formula One brand into its stable of entertainment assets. The board and management at Chemtura found a buyer who would pay a fair price for the whole company. On a smaller scale, the team at CONSOL Energy continued to sell coal assets that were more valuable to buyers than to CONSOL.

We have ongoing conversations with all of our management partners about ways they might take advantage of the environment to build value per share. The rewarding transactions in the recent quarter exemplify the benefit of partnering with capable managements and boards who focus on long-term value for shareholders. We believe our aligned partners across our competitively advantaged holdings will continue to deliver outsized returns over time.

Contributors/Detractors
(3Q portfolio return: 3Q Fund contribution)
**Liberty Media Corporation** (+15%; +0.7%), a holding company with interests in a broad range of entertainment businesses, was the largest contributor to the Fund’s return, and we trimmed shares to adjust the position weight. The biggest news was Liberty Media’s acquisition of a controlling interest in Formula One Group, which adds a global live sports brand with over 400 million unique viewers to Liberty Media’s properties. Formula One’s worldwide race schedule generates long-term contract revenue from broadcasting, event fees, and advertising. A key part of the acquisition was the appointment of Chase Carey as Formula One Group Chairman.

Carey successfully led Southeastern’s great investment in DirecTV and also has a strong history in sports-related businesses from his time at News Corp. Prior to the Formula One announcement, the largest component of our Liberty Media appraisal was Live Nation Entertainment, which is 34% owned by Liberty Media and is the largest ticketing and live entertainment company in the world. In the quarter, Live Nation reported double-digit yearly growth in ticket sales, driven partly by pricing power at Live Nation’s Ticketmaster brand. We believe Chairman John Malone and CEO Greg Maffei are among the best in the industry at capital allocation and driving value recognition for shareholders.

Also a top contributor, **CONSOL Energy** (+19%; +1.0%), the natural gas and Appalachian coal company, added to the Fund’s return. CEO Nick Deluivils and the board, led by Chairman Will Thorne, 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 (FCF) 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 CNNX. Sales of other companies’ exploration and production assets in Appalachia highlighted the value of CONSOL’s assets.

**Chemtura** (+24%; 0.7%), an industrial specialty chemical company, helped performance late in the quarter when the company announced it is being acquired for $33.50 per share, a 19% premium to the previous closing price. This price was in line with our appraisal, and we sold our stake after owning it for two years and making 52% on the investment. Our investment case centered around partnering with a strong board and CEO Craig Rogerson, who was executing a plan to sell non-core assets, strengthen the balance sheet, return cash to shareholders through repurchases, and ultimately drive value recognition. We are thankful to our management partners at Chemtura for diligently working for the benefit of shareholders.

**Hopewell Holdings** (+15%; +0.7%), a Hong Kong-listed property company, reported impressive results, with rental...
revenue up 10% and rental earnings before interest and taxes (EBIT) up 16% year-over-year. Additionally, 67% owned subsidiary Hopewell Highway increased its dividend by 55%. Hopewell has net cash on its balance sheet. The firm exemplifies a central theme we see across Asian conglomerates - the transition from first generation founders to their western educated heirs. Managing Director Thomas Wu, son of founder Gordon Wu, received his undergraduate and MBA degrees in the U.S. and has demonstrated a keen understanding of capital markets and returning capital to shareholders. The company has repurchased shares at discounted prices and has latent dividend power that will show up in the coming years.

**Level 3 Communications** (-10%; -0.7%), the global fiber and integrated communications network company, was the primary detractor in the 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 earnings before interest, taxes, depreciation and amortization (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**

During the quarter, we initiated one new position. In addition to our sale of Chemtura discussed above, we exited Vail Resorts, the largest owner of ski resorts in the world, as the stock reached our estimate of fair value. We initiated the position almost six years ago at $38 per share. Although a cyclical business, we were attracted to Vail’s impossible-to-replicate properties, history of pricing power, solid balance sheet, and margin of safety in its non-earning assets. Our final sales in the quarter were at over $150 per share. When considering our additions and trims to the position over time, our total gain while we owned the stock was over 300%. CEO Rob Katz proved to be an all-star partner at building value. He attracted more customers to Vail’s resorts through loyalty programs and seasonal passes and increased prices at twice the rate of inflation. He also made accretive acquisitions, with the biggest being the Park City Mountain Resort in Utah that Vail then connected with its Canyons Resort. The company sold most of its saleable real estate and exited some non-core businesses in the lodging segment. Katz strengthened Vail’s financial position and operating cash flow and productively returned capital to shareholders through increased dividends and share buybacks when the stock was discounted.

**Outlook**

The stock market’s rise continued to make finding new qualifying opportunities difficult, and with our strong returns, we have sold or trimmed a number of businesses that became fully valued or overweight during the year. Because of our strong returns that drove successful portfolio sales, we anticipate a capital gain distribution that will be higher than normal. We strive to be as tax-efficient as possible, but adhere to our discipline of selling businesses when no margin of safety remains in its price. Estimates for the distribution amount will change over the next six weeks and will be updated on our website between now and the record date, November 15. As of September 30, the estimated distribution was approximately 16% of net asset value, with 97% long-term.

We have generated high absolute and relative returns YTD even though our cash throughout the year has stayed above 20%, ending the quarter at 27%. We have found a few new qualifiers in spite of what we see as a fairly-to-over valued market. Several names are on deck, and we will use our available liquidity as we identify compelling investments. Even with the strong performance, the portfolio remains attractive with a price-to-value (P/V) in the low-70s%. We believe we have competitive businesses that will grow their values and management teams who will further enhance values per share over time.

See following page for important disclosures.
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund's investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS

The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

EBIT is a company's 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.

"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.

As of September 30, 2016, the holdings discussed represented the following percentages of the Longleaf Partners Small-Cap Fund: Liberty Media, 6.0%; CONSOL, 5.8%; Hopewell Holdings, 4.8%; Level 3, 6.4%. The following stocks discussed are not held in the Fund: DirecTV and News Corp. 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 Small-Cap Fund Commentary

Longleaf Partners Small-Cap Fund significantly outperformed the Russell 2000 Index in the first half of 2016, rising 10.15% versus the index’s 2.22%. In the second quarter, the Fund rose 5.32% versus the index’s 3.79%. The Fund’s largest holding, DreamWorks Animation, was acquired, making it the primary driver of our solid second quarter results. CONSOL Energy also made significant progress.

The turmoil around the United Kingdom’s decision to leave the European Union should have a minimal impact on the companies we own in the Small-Cap Fund. While several industrial companies such as Actuant, Chemtura, and OCI have approximately one third of their sales in Europe, most of our other companies have less than 10% of sales in Europe and the U.K. OCI is the only European-domiciled company in the portfolio, but its fertilizer production is dollar-based, and by the end of the year, its new Iowa plant should be open, reducing the proportion of cash flow coming from the Netherlands.

The second quarter illustrated the benefits of Southeastern’s distinct approach—intelligent, concentrated, engaged, long-term, partnership investing. We held a very concentrated 9% position in DreamWorks, not only because of the quality of the company’s brands and assets, but also because our engagement with CEO Jeffrey Katzenberg and Chairman Mellody Hobson made us extremely confident that they would wisely represent shareholders’ long-term interests.

Intelligent, long-term investing also was relevant in the fearful environment that developed in the last week of the quarter. With our long time horizon, we hope the short-term reaction to Brexit provides opportunities to buy strong companies with growing intrinsic values at deep discounts based on conservative appraisals of free cash flow and assets.

Contributors/Detractors
(2Q return; 2Q Fund contribution)
As noted above, DreamWorks (+60%; +5.0%), the film studio and multimedia company, was the Fund’s largest holding and drove much of the return in the quarter, when Comcast announced an all cash acquisition for $31 per share. As our discipline dictates, we sold our stake when the price rose to our appraisal. DreamWorks was the kind of opportunity Southeastern hopes to find—a company with high quality, stable assets but volatile earnings being mispriced in a period when the market is rewarding companies with more predictable earnings and high dividend yields. We started buying DreamWorks in the third quarter of 2014 at $19 following disappointing new movie releases. Our appraisal hinged on the valuable film library and DreamWorks’ growing success in TV and web content as well as licensing. We partnered with a strong board and owner-operator CEO, who built the company’s brands, developed a presence in China, managed costs, and ultimately monetized the company at full value.

CONSOL Energy (+43%; +1.5%), 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 Thornridge 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.

The Fund’s primary detractor in the second quarter was OCI (-29%; -1.0%), a global fertilizer and chemical producer. The two main pressures over the last three months were weakness in urea commodity prices (a key nitrogen fertilizer) and uncertainty around the CF Industries merger. Despite attractive strategic rationale for the combination of CF Industries and OCI, the increased crackdown on tax inversions in the U.S. made the deal untenable. OCI’s European domicile further pressured the stock in the last week of the quarter, even though the Brexit vote should not impact fertilizer demand and could create some currency translation benefits to OCI. Positively, nitrogen fertilizer demand increased globally, helping to deplete excess supply. OCI’s plants have an advantage by being located near low-cost natural gas, a primary feedstock in fertilizer. Our investment case incorporates demand for nitrogen fertilizer continuing to grow at a couple of percent annually and supply tightening,

Average Annual Total Returns (06/30/16): Since Inception (2/21/89): 10.94%, Ten Year: 9.02%, Five Year: 10.82%, One Year: -1.10%

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. 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 ratios for the Longleaf Partners Small-Cap Fund at 12/31/15 is 0.91%. The Fund’s expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.5% of average annual net assets.
and beyond 2016, no major additional plant capacity will be added for at least five years. Despite the current decline in nitrogen fertilizer prices, the company is generating significant free cash flow. CEO Nassef Sawiris and his team are working to grow value per share and are exhibiting a disciplined approach to monetizing assets at prices that reflect longer term intrinsic values.

**Portfolio Changes**
With ample cash, especially following the sale of DreamWorks and trimming two other stronger performers, we bought two new companies and added to OCI. **Liberty Media Corporation** owns interests in a broad range of media businesses. Most important is the company’s 34% ownership of Live Nation Entertainment, Inc., the leading ticketing and live entertainment company in the world. Liberty Media’s other minority investments include Time Warner Cable and Viacom shares and an interest in the Liberty Braves Group. We purchased the shares after the company’s predecessor effectively split itself into three tracking stocks, and “new” Liberty Media emerged at a discount. We also bought **SEACOR Holdings**. The company’s three primary operating segments include Offshore Marine Services, which transports people and supplies to and from offshore drilling rigs; Inland River Services, which operates barges, towboats, machine shops and dry docks on U.S. rivers; and Shipping Services, which operates tankers and harbor tugs. The company also owns various interests, both controlling and non-controlling, in businesses ranging from corn processing to emergency preparedness services. SEACOR sells at a large discount to our appraisal following the decline in energy and agricultural prices which have negatively impacted utilization rates and revenues.

**Outlook**
The Small-Cap Fund sells for an attractive price-to-value ratio in the low-70s%. We own companies whose leaders are building long-term value and pursuing ways to drive prices closer to intrinsic worth. While cash has risen to 25% following our sale of DreamWorks, we believe we will 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.

*See following page for important disclosures.*
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund’s investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS

The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

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

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 Small-Cap Fund: CONSOL, 5.1%; Actuant, 3.6%; Chemtura, 2.8%; OCI, 4.1%; Undisclosed, 0.2%; Liberty Media, 4.4%. 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 Small-Cap Fund Commentary

Longleaf Partners Small-Cap Fund advanced a robust 4.60% in the first quarter, far exceeding the Russell 2000 Index's -1.52% decline. For the one-year and longer periods, the Fund's performance also surpassed the index. 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. Not only were our absolute returns well beyond our goal of inflation plus 10%, but our relative results also benefitted from our lack of exposure to healthcare, which was among the top performing index sectors in 2015 but was the Russell 2000'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 -15.9% at its February 11 low point but then rallied over 17% by the end of March, a 3300 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 four of our more undervalued investments and trim several positions as they became overweight or 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%; +2.0%), 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.

**ViaSat** (+20%; +1.1%), an integrated satellite company, reported a substantial 7% increase in average revenue per user (ARPU) year-over-year. Customer churn declined with the company’s focus on higher value, stable subscribers. Additionally, news reports that American Airlines would reexamine its in-flight Wi-Fi contract with ViaSat’s competitor, Gogo, implied that ViaSat could win the new contract given its superior service quality. CEO Mark Dankberg is a large owner who has invested wisely in expanding ViaSat’s capacity and product lines. The company plans to launch a revolutionary new satellite broadband constellation (ViaSat-3) in 2019 that has the potential to further ViaSat’s lead in the industry. Although ViaSat-3 is not fully reflected in our appraisal, it offers significant longer-term upside to our value and the share price.

**CONSOL Energy** (+43%; +1.1%), the Appalachian natural gas and coal company that was our top detractor 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/OCF 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 Thorsdike, 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.

**Scripps Networks** (+19%; +1.0%), the media company that owns cable channels, including HGTV, 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 simplified its asset mix, purchasing the remaining 35% of The Travel Channel that it did not own and selling its 7.25% stake in Fox Sports South & Southeast.

OCI (-21%; -0.9%), a global fertilizer and chemical producer, was the primary detractor from the Fund’s strong return. The stock fell early in the quarter, in line with a decline in the underlying urea commodity price which recovered somewhat by quarter-end. Global excess supply should diminish as nitrogen fertilizer demand grows approximately 2% per year while no additional plant capacity is scheduled for at least five years out. Uncertainty around OCI’s planned sale of its U.S. and European assets to CF Industries also weighed on the stock. A major hurdle to the deal was removed in mid-March, when OCI announced that Consolidated Energy Limited would jointly invest in the methanol plant, Natgasoline, which would fall outside of the scope of the assets going to CF. OCI is trading at a steep discount to our appraisal and even more cheaply assuming the CF deal closes in the second quarter of 2016 as planned.

Portfolio Changes
While we had no new investments to report, we added to four of our more undervalued businesses that were smaller positions. In addition to trimming a number of overweight and positive performers, including Wynn and Scripps, we completed the sale of Orascom Construction, which OCI spun out in 2015.

Outlook
We believe the strong absolute and relative returns we posted in the first quarter should be indicative of our expectations going forward. 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 low-70s% 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 21% 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 longer term strategic alternatives that can build material value.

See following page for important disclosures.
Before investing in any Longleaf Partners Fund, you should carefully consider the Fund’s investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit longleafpartners.com. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS

The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

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.

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.

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 Small-Cap Fund: Wynn Resorts, 6.1%; ViaSat, 6.5%; CONSOL, 3.6%; Scripps Networks, 5.0%, OCI, 3.3%; Orascom, 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 Small-Cap Fund Commentary

The Fund’s six energy-related holdings in 2015 combined to account for the Fund’s negative return and relative underperformance of the year and dampened the otherwise strong absolute and relative performance in the fourth quarter. Although our oil and gas price assumptions have been wrong, we believe that CONSOL Energy could rapidly rebound with major asset sales and, along with Triangle Petroleum, will benefit when commodity prices correct as supply and demand eventually rebalance. At both companies, our management partners are taking action, including cutting costs, increasing financial flexibility, and selling assets to ensure the companies can withstand the difficult commodity environment. These two companies trade at a substantial discount to our appraisal and, we believe, offer greater potential upside than the index. However, the short-term performance masked the positive progress across the majority of our businesses in the year.

A top contributor to the Fund, film studio DreamWorks Animation gained 16% for the year after a substantial 48% rise in the fourth quarter—an example of how quickly payoff patterns can move. The company had a box office success with the late March release of the movie Home, which continued to do well in home video and streaming. In December, DreamWorks announced a co-production deal with DHX Media, demonstrating that the company’s efforts to develop television content has progressed into recurring revenues. The New Media segment, which contains AwesomenessTV, had impressive revenue growth and margins. License renewals helped drive strong revenue and earnings growth in the consumer division. CEO Jeffrey Katzenberg’s push in renewals helped drive strong revenue and earnings growth. In Las Vegas, Boston, and Macau, was up 15% but down 34% since we first added the position earlier in the year. Our exposure via options represented approximately one-third of the returns. 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.

Average Annual Total Returns (12/31/15): Since Inception (2/21/89): 10.76%, Ten Year: 8.32%, Five Year: 11.53%, One Year: -6.05%

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 ratios for the Longleaf Partners Small-Cap Fund is 0.91%. The Funds’ expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.5% of average annual net assets.
Vail Resorts, the largest owner of ski resorts in the world, gained 23% in the fourth quarter and 44% for the year, making it the Fund’s top contributor in 2015. So far in the 2015/2016 U.S. ski season, the company has posted strong pass sales (+13%), with price increases of 6% and higher units. With Vail’s strong financial position and positive operating cash flow (OCF), CEO Rob Katz reaffirmed the company’s plan to continue to return capital to shareholders via an increased dividend and share buybacks. The board recently authorized an additional 1.5 million shares for repurchase (roughly 4% of shares outstanding). Our appraisal of the company grew in the quarter and over the year.

In the first quarter, amidst the market selloff of energy companies, we purchased HollyFrontier, the independent petroleum refiner that owns and operates five U.S. refineries. The company owns plants in superior locations that allow for above-average margins. Additionally, management has a history of productive capital allocation. As a refiner, HollyFrontier benefits from the decline in energy prices which lead to more miles driven and increased demand for gasoline. During the year, CEO Mike Jennings bought in undervalued shares and focused on projects with master limited partnership (MLP) potential to cater to investors’ thirst for yield. This strategy, plus takeover speculation, helped the stock rise to our appraisal. HollyFrontier appreciated 55%, was among the year’s largest contributors to performance, and was sold in the third quarter.

A large detractor to the Fund’s performance in the fourth quarter, media and education company Graham Holdings’ 16% decline took its 2015 return to -11%. The stock price was impacted by broader weakness in the media industry and for-profit education where the regulatory and economic environment continued to be challenging. In the quarter, Graham Holdings’ Kaplan business reported worse U.S. student trends, and margins and revenue growth declined. However, the continuing education business (Pace) had solid growth, and Kaplan International met expectations even with tough currency headwinds. Importantly, U.S. for-profit education is now less than 10% of our Graham appraisal value. The television division had a good quarter. The company also announced in November that current President Tim O’Shaughnessy would take over as CEO from Don Graham, who will remain as Chairman. Graham and O’Shaughnessy have grown value per share through wise capital allocation, such as the spin-off of Cable One mid-year and the more recent sale of the most challenged parts of Kaplan. Our sum-of-the parts appraisal (TV, Kaplan’s International and U.S. education segments, Social Code, other businesses, pension, and net cash) is well above the stock price, which trades at a single-digit multiple of free cash flow.

As noted, 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 OCF estimates amidst declining coal and gas prices. Management is adjusting to lower commodity prices and adopting 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 alone 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 mitigation. Multiple directors purchased shares in the fourth quarter.

Another detractor for the year, media company Scripps Networks, which owns cable channels including HGTV, The Food Network, DIY, Cooking, and the Travel Channel, declined to -25% in 2015 despite rising nearly 17% in the fourth quarter. Scripps fell sharply in the third quarter along with the rest of the media industry after Disney acknowledged ongoing challenges in the pay TV landscape, and many peers followed with disappointing ratings. Scripps, unlike most of its media peers, creates and owns valuable content that attracts a specific loyal, upscale audience. For this, Scripps channels receive an advertising premium versus other, less differentiated channels. Scripps also is underpaid by distributors for the ratings points it provides. The final difference versus peers is that Scripps is much earlier in its international expansion plans. The company’s much larger free cash flow than reported earnings makes industry price-to-earnings (P/E) ratio comparisons somewhat meaningless.

We took advantage of discounted segments in the market and bought eight new businesses during the year, four of which were energy related and bought in the first half. As our outlook for energy and these individual companies evolved in the second half, we sold three of them, along with California Resources, which we bought in late 2014. Of these investments three were profitable and approached our
appraisals in spite of the sector’s weakness, and one grew less compelling as commodity prices declined further. In the last quarter we exited **Empire State Realty Trust**, which owns the Empire State Building as well as other properties in the New York metropolitan area. After making 44% in our two-plus year holding period, the price approached our appraised value. We are grateful to our partner, CEO Tony Malkin, and wish him continued success. We also made one new purchase in the quarter. Amid the fallout in distressed debt markets in the fourth quarter, we initiated a position in **Neiman Marcus** bonds. We previously successfully invested in this luxury retailer’s stock before the company went private. Since then the company has continued to prudently grow its limited store footprint and has expanded its online presence to an industry leading level. We know CEO Karen Katz and the leadership team and are optimistic in their ability to grow OCF and value going forward.

Although 2015 performance was disappointing, we believe the Small-Cap Fund is well positioned for a prospective strong rebound. The Fund’s price-to-value (P/V) ratio trades in the high-60s%. The three largest detractors are highly discounted, selling for less than 40% of our appraisals, and the four largest positions, which were among top contributors for the year, remain discounted with solid value growth prospects. Beyond 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. Cash in the portfolio provides liquidity for attractive new opportunities that might arise as a result of market uncertainty. 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 appreciate your continued partnership, and we are confident that your patience and ours should be rewarded with strong future performance.

*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 Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

**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.

**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.

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

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

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

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.

**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 Small-Cap Fund: CONSOL, 2.6%; Dreamworks, 9.4%; Level 3, 11.0%; Wynn Resorts, 0.6%(6.0% adjusted for close of options and purchase of underlying stock); Vail Resorts, 5.8%; Graham Holdings, 5.4%; Triangle, 1.2%; Scripps Networks, 5.0%, Neiman Marcus, 1.0%. 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.
Sharp energy price declines resulted in our energy holdings becoming further depressed. 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. China macro fears impacted companies with Asian exposure. The media industry broadly declined after several large businesses reported declining U.S. ad revenues in August, sparking fears over the long-term health of the television business. Stock price declines were not reflective of changes to underlying business appraisals. We continue to see a high level of value-additive corporate activity across the entire portfolio, at both top contributors and those businesses that declined the most in the quarter.

Integrated satellite company ViaSat was the largest positive contributor in the quarter, up 7%. While the company had a slight decline in Exede broadband subscribers, average revenue per user (ARPU) was up 7% year-over-year and churn was also down. ViaSat captured good margin performance at its government and satellite services segments. The government segment posted its best growth performance in two years, along with a healthy order book and a 22% increase in backlog. ViaSat still plans the launch of its next generation ViaSat-2 satellite in 2016, which will further improve the company’s ability to deliver superior broadband technology across a larger customer base.

HollyFrontier, the independent petroleum refiner that owns and operates five refineries throughout the Mid-Continent, Southwest and Rocky Mountain regions, rose 14% in the quarter prior to our selling the stock as it approached our appraisal. As a refiner, HollyFrontier benefitted from lower feedstock cost and more miles driven from increased demand for gasoline. CEO Mike Jennings bought in undervalued shares and focused on projects with master limited partnership (MLP) potential amidst the market’s thirst for yield. This strategy helped the stock price rise to intrinsic value, as HollyFrontier appreciated 55% over our short holding period.

One of the noted energy holdings, CONSOL Energy, the Fund’s largest performance detractor, 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 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.

Film studio DreamWorks Animation was down 34% in the quarter. A change in accounting for DreamPlace sales, currency impacts, and slower-than-expected merchandise licensing agreements cut in half revenue guidance for its developing Consumer Products division. We believe merchandise licensing will gain traction over time and deliver more recurring revenues, offering significant upside to our DreamWorks appraisal. DreamWorks’ other core businesses performed well. The strong results of the feature film Home highlights the company’s creative talent in generating engaging content that will build the film library. In addition, newer growth initiatives in the Television segment continued to ramp strongly, and the New Media segment, which contains AwesomenessTV, doubled revenues with strong gross margins.

Wynn Resorts, the luxury gaming and hotel company with properties in the United States and Macau, was also down in the third quarter, by 46%. 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.

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 purchased Tribune Media and one other holding during the quarter. We previously invested profitably in Tribune via its distressed bonds when the company went through bankruptcy. After completing the spin-off of its publishing business last year, Tribune is now a diverse mix of television and digital properties spanning news, entertainment, and sports. The company owns or operates 42 broadcast stations, representing the country’s largest combined independent station group. Additionally, Tribune’s spectrum ownership is uniquely valuable given its concentration in large, coastal cities. Management’s capital allocation discipline has been demonstrated by repurchasing undervalued shares and selling off non-core assets at compelling prices.

We sold several of the Fund’s investments in the quarter, including our position in Cable ONE after Graham Holdings spun it out at the beginning of the quarter. The stock sold for our estimate of fair value. We applaud Graham Holdings’ CEO Don Graham for his ongoing efforts to build and recognize value for shareholders.

Northern Oil & Gas, HollyFrontier, Diamond Offshore and California Resources are energy companies that we purchased in the Fund in late 2014 and early 2015 amidst the sharp decline in oil and gas prices. During the quarter, we selectively sold these companies. Northern Oil & Gas and HollyFrontier both proved profitable investments for the Fund as they approached our appraisals. With further energy price declines and some changes in our investment cases, our appraisals of Diamond Offshore and California Resources fell, and we sold the stocks as our risk-reward potential became less attractive. We consolidated our energy exposure into CONSOL and an increased stake in Triangle Petroleum.

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 half 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 65 cents on the dollar. 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 managements’ 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, a most valuable independently owned animated film library in DreamWorks, the premier collection of mountain resort properties in Vail Resorts, the world’s best casino developer and operator in Wynn, and the best U.S. cable channel company with HGTB and Food Network (via Scripps Networks). These companies are among those that offer a combination of competitive advantages, 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. As representative examples, Graham has sold or spun numerous assets, with valuable television stations, Kaplan, and a cash-rich balance sheet remaining; OCI is merging most of its assets into CF Industries; and Tribune sold its newspapers and has numerous remaining assets, including television stations, spectrum, and real estate, that management can monetize. This group comprises about 30% 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 57% 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 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 around 5% 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 Small-Cap Fund has meaningful attractive upside. 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.

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 Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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

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.

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 Small-Cap Fund: Level 3, 9.8%; Graham Holdings, 6.6%; Dreamworks, 6.5%; ViaStat, 5.9%; Vail Resorts, 5.0%; Wynn Resorts, 4.7%; Scripps Networks, 4.5%, OCI, 4.5%; Tribune Media, 3.8%; CONSOL, 3.3%. 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 Small-Cap Fund lost 1.27% in the quarter, trailing the Russell 2000 Index’s 0.42% return. Year-to-date the Fund returned 4.64% versus the index’s 4.75%. Over longer periods, the Fund’s performance surpassed the index. For the last three and five years, Longleaf Small-Cap far exceeded our annual absolute return goal of inflation plus 10%, as it did for the last 20 years.

In the second quarter, the majority of our companies made positive business progress, as our management partners took smart actions to drive value growth. Although most investments were positive performers in the quarter, much of our partners’ value-building efforts at the businesses we own is not being fully reflected in the fund’s returns. 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. Our 15.5% net cash position and underweighting to the index’s top performing sector, healthcare, also weighed on relative returns.

Film studio DreamWorks Animation was the largest positive contributor in the quarter, up 9%. The company had a box office success with the late March release of the movie *Home*. The company’s AwesomenessTV gained traction, as did CEO Jeffrey Katzenberg’s push in the Chinese film distribution market via the 45% Oriental DreamWorks JV, which has the potential for meaningful upside. DreamWorks’ efforts to develop television content also progressed well. We support Jeffrey Katzenberg and his team 100%. The market has focused on some of DreamWorks’ new movie misfires in recent years, but Katzenberg’s long-term value creation record is incredible. A major hidden weapon and important part of our calculus is the presence of Mellody Hobson as Chairman. We feel very fortunate to partner with this pair, and to own these incredible assets.

Another strong performer, Vail Resorts, the largest owner of ski resorts in the world, gained 6% in the second quarter. While visitors were down slightly due to historically poor snow in California, lift ticket pricing rose 15%. CEO Rob Katz purchased the Perisher ski resort in Australia at an attractive price. The acquisition supports Vail’s strategy to attract more customers to its resorts through loyalty programs and seasonal passes, and early indications are encouraging. The company is also pushing ahead with its plans to link Park City Mountain Resort and The Canyons in Utah.

Bermuda-based reinsurance company Everest Re added 5% in the second quarter. The company reported strong quarterly results, with earnings per share and return on equity (ROE) above consensus, and bought back shares at a 3% annualized rate. CEO Dom Addesso has a track record of executing well in a challenging environment. He is focused on growing the primary insurance business, which reported a significantly improved combined ratio.

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 going forward. Any bounce back in commodity prices will be additional upside. At CONSOL Energy, which was the largest performance detractor in the quarter, falling 22%, lower commodity prices have served as a catalyst to sharpen management’s focus on how best to optimize the returns on their valuable assets. In the quarter, the company reported operating cash flow (OCF) above Wall Street expectations and repurchased deeply discounted 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. Over the last few years, prior to and since we bought Small-Cap’s position, our discussions with management have been productive and contributed to adding board members, monetizing assets, and separating disparate segments. In the recent quarter, 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 value accretive monetization opportunities where proceeds can be reinvested in higher return alternatives, including CONSOL’s undervalued shares.

We bought one new position and did not exit any investments. 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. Over the next few years, revenues across the six Macau operators should improve 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. 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. In the U.S., with a prime location on the Strip, the company’s Wynn and Encore casinos are among the most profitable in Vegas. Steve Wynn has been a successful owner-operator who has made money for shareholders over a long period and has positioned the company to weather the Macau downturn while having a pipeline of casinos for future growth.

We believe the Small-Cap Fund is well positioned to meet our absolute goal and deliver strong relative performance. The price-to-value ratio (P/V) is in the mid-70s%. The U.S. small cap market has no margin of safety, with mergers, acquisitions, initial public offerings, and share buybacks near 2007 peak levels and at multiples well above our appraisals. Our net 15.5% cash provides dry powder to act quickly as new names qualify. 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 with our management partners to varying degrees and believe their near-term steps to close the gap in price will reward us.

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 Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

Return on equity (ROE) is a measure of profitability that calculates how many dollars of profit a company generates with each dollar of shareholders' equity.

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

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 June 30, 2015, the holdings discussed represented the following percentages of the Longleaf Partners Small-Cap Fund: DreamWorks, 8.2%; Vail Resorts, 5.6%; Everest Re, 5.9%; CONSOL Energy, 4.9%; Wynn Resorts, 3.7%. Fund holdings are subject to change and holding discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

Funds distributed by ALPS Distributors, Inc.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund rose 5.98% in the first quarter, outpacing the 4.32% that the Russell 2000 Index delivered. Our strong gain kept 1 and 5-year results well above both our absolute goal of inflation plus 10% and the index. For the longer term periods shown below, the Small-Cap Fund has compounded at double-digit annual rates and consistently outperformed the benchmark.

Cumulative 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>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>1654.43%</td>
<td>1418.66%</td>
<td>1092.16%</td>
<td>452.43%</td>
<td>171.85%</td>
<td>114.63%</td>
<td>13.35%</td>
<td>5.98%</td>
</tr>
<tr>
<td>(Inception 2/21/89)</td>
<td>1063.83</td>
<td>991.62</td>
<td>527.64</td>
<td>183.40</td>
<td>132.80</td>
<td>97.37</td>
<td>8.21</td>
<td>4.32</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>9.86</td>
<td>10.03%</td>
<td>9.62</td>
<td>7.19</td>
<td>8.82</td>
<td>14.57</td>
<td>8.21</td>
<td></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>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>11.60%</td>
<td>11.50%</td>
<td>13.19%</td>
<td>12.07%</td>
<td>10.52%</td>
<td>16.50%</td>
<td>13.35%</td>
<td></td>
</tr>
<tr>
<td>(Inception 2/21/89)</td>
<td>9.86</td>
<td>10.03%</td>
<td>9.62</td>
<td>7.19</td>
<td>8.82</td>
<td>14.57</td>
<td>8.21</td>
<td></td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>9.86</td>
<td>10.03%</td>
<td>9.62</td>
<td>7.19</td>
<td>8.82</td>
<td>14.57</td>
<td>8.21</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 Small-Cap 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 our businesses had solid operating performance, coupled with value-accrative actions taken by our management partners. The majority of names were positive performers, with double-digit returns at many. The Fund outperformed the index in spite of our high cash position, as corporate activity across many holdings drove strong excess returns. We put some cash to work, adding four new positions in the quarter.

Media and education company Graham Holdings was the top contributor in the quarter, up 22%, with all divisions performing well. Kaplan Higher Education’s margins improved, and Kaplan Test Prep had strong revenue growth. CEO Don Graham grew value per share and worked to get value recognized. In February, the company announced the sale of 38 unprofitable Kaplan college campuses to Education Corporation of America (ECA) in an all-stock transaction that will give Kaplan a preferred equity interest in ECA. Cable One’s operating income and margins grew, and its spin-off will happen this summer. Late in 2014 we purchased California Resources (CRC), the largest producer of oil and gas in the state of California. CRC gained 38% in the first quarter with the company’s decision to cut its capex budget by 80% and its indication that year-over-year production would be flat given CRC’s low decline rate. News that CRC’s lenders amended covenants in light of the weak commodity pricing environment was also a positive development.
Fiber and networking company Level 3 Communications appreciated 9% after another strong quarter of margin and 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 primary detractor from performance in the quarter was CONSOL Energy, 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 Deluliis expressed his agreement with a significant share repurchase announcement.

In the quarter we added four companies, all in the beaten down energy sector, and did not exit any positions. HollyFrontier Corporation (HFC), one of the largest independent refiners in the U.S., operating in advantaged markets in the Rocky Mountain, Southwest, and Mid-Continent regions, gained 28% following our purchase. The sharp advance largely coincided with the widening Brent-WTI price spread that had reached parity early in 2015. HFC owns a 39% interest in Holly Energy Partners MLP (HEP), which has a large percentage of revenues tied to long-term contracts with minimum payment obligations for volume/or revenue commitments. CEO Michael Jennings has a strong track record of capital allocation and returning cash to shareholders, and currently has financial flexibility with net cash on the balance sheet. Triangle Petroleum (TPLM) is a Bakken-focused exploration and production company with internally developed oil services (RockPile) and a joint-ventured pipeline business (Caliber). TPLM’s integrated strategy provides a cost advantage in North Dakota where there is little infrastructure. Management is showing discipline in a challenged environment by announcing a 71% cut in capex without an offsetting huge reduction in production and reducing vendor costs by 10-20%. Northern Oil & Gas (NOG) is an exploration and production company with operations in the Bakken and Three Forks formations within the Williston Basin. The company utilizes a non-operating strategy, partnering with a diversified group of partners with acreage spread across the Bakken play. NOG reviews multiple well proposals and strives to allocate capital to only the best projects. Management rejected the majority of proposals as energy prices declined. NOG cut its capex budget for FY 2015 while maintaining production levels, and reported fourth quarter production and earnings above the market’s expectations, causing the stock to gain 46% after we began buying. We are partnered alongside renowned investor Robert Rowling. Additionally, we bought offshore drilling rig operator Diamond Offshore (DO) after the company announced a cut in its special dividend to further fortify its balance sheet and preserve cash for opportunities that might arise from financially distressed competitors. Under the guidance of parent Loews, a longstanding Partners Fund holding, DO has a history of discounted equipment purchases during weak drilling cycles. Loews capitalized on DO’s undervaluation by purchasing an additional 1.6 million shares over the last four months.

We believe the portfolio is well positioned for the long term. The price-to-value (P/V) ratio is in the high-70s%. We believe we own high quality businesses with greater FCF yields and stronger future growth potential than the Russell 2000 Index. Our 22% cash position provides dry powder to act quickly as new names qualify. Our aligned management partners are taking actions to drive strong value growth.

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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invest in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

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.

As of March 31, 2015, the holdings discussed represented the following percentages of the Longleaf Small-Cap Fund: Graham Holdings, 9.6%; California Resources, 4.3%; Level 3, 9.7%; CONSOL Energy, 5.1%; Holly Frontier 2.9%; Northern Oil and Gas, 0.4%; Diamond Offshore Drilling, 0.7%. Fund holdings are subject to change and holding discussions are not recommendations to buy or sell any security. **Current and future holdings are subject to risk.**

**Funds distributed by ALPS Distributors, Inc.**
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund returned 12.49% in 2014 and far surpassed the Russell 2000 Index’s 4.89% rise. Strong returns in a number of stocks drove the outperformance. In the fourth quarter, the Fund added 3.82% and lagged the Index’s 9.73% advance due in part to our sizeable cash position. Over longer term periods shown below, the Fund’s performance consistently surpassed the Index. For the last one and five years, Longleaf Small-Cap also exceeded our annual absolute return goal of inflation plus 10%, as it did for the last 20 years.

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>Small-Cap Fund</td>
<td>(Inception 2/21/89)</td>
<td>1555.39%</td>
<td>1262.34%</td>
<td>1061.72%</td>
<td>395.44%</td>
<td>162.10%</td>
<td>124.66%</td>
<td>12.49%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td></td>
<td>1015.68</td>
<td>922.99</td>
<td>529.46</td>
<td>190.92</td>
<td>111.26</td>
<td>105.95</td>
<td>4.89%</td>
</tr>
</tbody>
</table>

Average Annual 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>12.49%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>(Inception 2/21/89)</td>
<td>11.47%</td>
<td>11.01%</td>
<td>13.05%</td>
<td>11.26%</td>
<td>10.11%</td>
<td>17.57%</td>
<td>15.55</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td></td>
<td>9.78</td>
<td>9.75%</td>
<td>9.63%</td>
<td>7.38</td>
<td>7.77</td>
<td>15.55</td>
<td>4.89</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, 2014 and 2013 total expense ratios for the Small-Cap Fund are 0.91%. The expense ratios are subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.

The merged positions of fiber and networking companies Level 3 Communications and tw telecom gained 49% and led the Fund’s performance for the year, after adding 8% in the fourth quarter. Level 3 provides critical infrastructure that connects businesses and consumers to the internet, allowing them to move data, video and voice. The company’s cash-and-stock acquisition of tw telecom closed in the fourth quarter, and the two names combined into the Fund’s largest single holding. By merging the two companies, Level 3 significantly expanded its network reach in metropolitan markets and gained 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 significantly below our appraisal of its operating networks and non-earning dark fiber and conduit assets.

Cement producer Texas Industries (TXI) gained 35% before we sold it at the start of the third quarter following Martin Marietta’s all-stock acquisition of the company. In spite of the financial crisis and worst recession in our lifetime, we doubled our money in the eight years we owned TXI.

Media and education company Graham Holdings (the renamed Washington Post) gained 32% for the year after a 24% rise in the fourth quarter. In November the company announced that it would
Weaker small-cap stock prices enabled us to add seven new positions.

spin off its Cable ONE subsidiary. This move, combined with sales of other assets and the tax-free exchange of a Miami television station for undervalued company shares earlier in the year, illustrates how owner-operators can grow value per share through smart capital allocation. On the operating side, the Kaplan business was steady throughout the year. Graham Holdings continued its legacy of capable, aligned leadership with the addition of its new president, Tim O’Shaughnessy, in the recent quarter.

Vail Resorts, owner of U.S. ski resorts, added 24% for the year and 6% in the quarter. Ski pass sales and pricing were strong throughout the year. The company’s acquisition of Park City Mountain Resort in Utah, when connected with Vail’s Canyons Resort, will create the largest ski resort in the country. Vail’s move into Utah has created significant value for shareholders already, and further upside remains.

Empire State Realty Trust (ESRT), the NY metropolitan office REIT (Real Estate Investment Trust), was up 17% for the year after an 18% gain in the fourth quarter. ESRT grew attendance and pricing at the observatory in the Empire State Building and leased various Manhattan office properties at higher rents.

Integrated satellite company ViaSat, which we bought in the summer, added 14% in the fourth quarter. The company delivers fast, secure-communications, internet, and network access to consumers in virtually any U.S. location and also has a stable government business. ViaSat recently reported better-than-expected growth in its Exede residential broadband subscribers and a strong backlog in its government segment.

The Fund had three main detractors in the year, two of which overlapped with the detractors in the fourth quarter. California Resources Group (CRC), the oil and gas company that we purchased in the recent quarter, declined 18%. CRC was recently spun out of Occidental Petroleum and is the largest operator of oil and gas in the state of California. CRC has quality assets, plus a strong management team and board. We believe the low decline nature of its production will allow the company to survive the oil and gas price downturn better than other levered peers.

Rayonier’s 9% decline in the fourth quarter took its 2014 return to -2%. The company reported that it had overcut its Pacific Northwest timber over the last 10 years. To compensate, Rayonier will reduce its harvest, lowering the dividend from $1.20 to $1 per share. This disappointing news decreased our appraisal, but we believe this is a one-time adjustment that does not alter the quality of the company’s various timber assets. New CEO Dave Nunes addressed the overcutting quickly, and the company is significantly discounted in our view.

Global fertilizer and chemical producer OCI fell 22% for the year, but gained 13% in the fourth quarter after positive news on various fronts. Egyptian natural gas shortages that had negatively impacted OCI’s plant utilization rates stabilized; the company won an Egyptian tax case related to the 2007 sale of its cement unit; and the EPA issued its final construction permit for the greenfield Beaumont, Texas plant that will be the largest methanol facility in the U.S. and is scheduled to begin production in 2016. CEO Nassef Sawiris’ decision in the third quarter to spin out the legacy construction business should help the market properly value OCI as a pure-play nitrogen company. Sawiris opportunistically bought shares personally throughout the year to take advantage of the price discount.

Film studio DreamWorks Animation, which we bought in the third quarter, initially made large gains after reports of acquisition talks with Japanese company Softbank. Following no deal announcement and a weak release of Penguins of Madagascar, DreamWorks pulled back 17% in the fourth quarter, but was up 15% over our holding period in the year. The company owns a valuable movie library and has attractive opportunity in TV, web content, and licensing.

Weaker small-cap stock prices enabled us to add seven new positions, primarily in the second half of the year. The decline in energy prices in the fourth quarter provided an opportunity to initiate positions including CONSOL Energy, California Resources and Diamond Offshore Drilling (DO) at
deep discounts to their long-term asset values. DO quickly rose 34%, and we sold it because we had only been able to purchase a small stake within our price limit. In the fourth quarter we also bought industrial specialty chemical company Chemtura. Earlier in the year we purchased our aforementioned ViaSat and DreamWorks stakes as well as Deltic Timber.

We sold nine holdings during the year as prices approached our appraisal values, including Wendy’s, Martin Marietta, and Legg Mason in the first quarter and TXI and DineEquity in the third quarter. In addition to DO, we sold Canadian based Fairfax Financial in the fourth quarter following its 16% stock appreciation in the year. We first purchased Fairfax in April 2000, and it returned 11% annualized over our holding period. CEO Prem Watsa steered the company through challenges in the early 2000s and improved insurance operations over time. He also regularly grew book value, with particularly strong investment returns in the Global Financial Crisis of 2008/2009 when he made substantial gains on credit default swaps. We also exited two small positions that were spun out of existing holdings – Rayonier Advanced Materials and Hopewell Highway.

The Fund began 2014 with 35% cash, but our new positions reduced cash to 23%. They also helped improve the price-to-value ratio (P/V) to the mid-70s%. Our on-deck list of prospective names improved, but finding deeply discounted names that qualify remains difficult. As we did in 2014 and have done previously when qualifiers were elusive, we will remain patient and disciplined but act decisively when opportunities come our way.

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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

As of December 31, 2014, the holdings discussed represented the following percentages of the Longleaf Small-Cap Fund: Level 3, 14.0%, Graham Holdings, 8.4%, Vail Resorts, 4.8%, Empire State Realty, 4.0%, ViaSat, 4.9%, Rayonier, 4.9%, OCI, 5.3%, Dreamworks, 4.8%, CONSOL Energy, 4.3%, Chemtura, 2.3%, Deltic Timber, 0.4%. 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.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund was down 0.8% in the quarter. The Fund performed well ahead of the Russell 2000’s 7.4% decline due to strong returns in several stocks and our sizeable cash position. Year-to-date (YTD), the Fund returned 8.4%, versus the Index’s loss of 4.4%. Over each longer-term period shown below, the Fund also surpassed the Index. Over the recent one and five years, Longleaf Small-Cap exceeded our absolute return goal of inflation plus 10%, as it did for the last 20 years.

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>Small-Cap Fund</td>
<td>1494.45%</td>
<td>1215.31%</td>
<td>993.98%</td>
<td>375.30%</td>
<td>180.86%</td>
<td>132.40%</td>
<td>14.47%</td>
<td>8.35%</td>
<td>-0.82%</td>
</tr>
<tr>
<td>(Inception 2/21/89)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>916.77</td>
<td>786.37</td>
<td>463.04</td>
<td>214.03</td>
<td>119.66</td>
<td>94.96</td>
<td>3.93</td>
<td>-4.41</td>
<td>-7.36</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>Small-Cap Fund</td>
<td>11.42%</td>
<td>10.86%</td>
<td>12.71%</td>
<td>10.95%</td>
<td>10.88%</td>
<td>18.37%</td>
<td>14.47%</td>
</tr>
<tr>
<td>(Inception 2/21/89)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></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 December 31, 2013 total expense ratio for the Small-Cap 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.

Film studio DreamWorks Animation was the largest positive contributor in the quarter and among the largest YTD. We purchased the company in the third quarter when the stock sold at a discount following disappointing new releases. These short-term results provided the opportunity to own the valuable movie library and participate in DreamWorks’ moves into TV and web content as well as licensing. We partnered with a strong board and owner-operator CEO Jeffrey Katzenberg. The holding gained 38% following reports that Japanese telecom/internet/media company Softbank was in discussions to acquire DreamWorks. While the deal was not completed, the discussions highlighted the value of the company’s assets.

Vail Resorts also contributed positively in the quarter and YTD, up 13% and 17% respectively. Vail announced that it acquired Park City Mountain Resort in Utah, which when connected with Vail’s Canyons Resort, will create the largest ski resort in the country. The acquisition increased our appraisal of Vail, and the stock price jumped on the news. Vail also reported strong ski pass sales and pricing for the coming ski season.
Fiber and networking company Level 3 Communications’ 4% gain in the quarter took the 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. Even after its gain, the stock sells for a deep discount to our appraisal and is an overweight position. Following the second quarter announcement that Level 3 is buying tw telecom, the two stocks have traded similarly. Tw telecom rose 3% in the quarter and was up 37% YTD.

Cement producer Texas Industries (TXI) remained the largest contributor for the year. Martin Marietta’s all-stock deal to acquire TXI closed at the beginning of the third quarter. We sold the position as discussed in our report last quarter.

Global fertilizer and chemical producer OCI declined 21% in the third quarter and 31% for the year, making it the largest performance detractor for both periods. Natural gas is the primary component in nitrogen fertilizer production, and during the quarter, gas supply interruptions impacted OCI’s two Egyptian plants, weighing on the short term stock price. Management anticipates that plant utilization will improve over the next year with several factors increasing gas supply: Egypt has begun to import liquid natural gas for the power sector, the cement industry is switching from natural gas to petroleum coke, and the major producers have begun to return to Egypt to ramp up exploration in the wake of a more stabilized government. We assume a continued low utilization rate of 50% in our appraisal, but even at this rate, the plants are cash flow positive. OCI’s other plants around the world are operating at or near full capacity and benefiting from low cost gas and higher prices for Ammonia and Urea, two primary outputs. The long-term case for OCI remains compelling as the company is a low cost industry leader in nitrogen fertilizer, essential for world food production. In the next 12-18 months the company will have higher production and lower capex with the opening of a greenfield plant in Iowa and the completion of the Beaumont, Texas extension. The company is also building the largest methanol plant in the country in Texas. CEO Nassef Sawiris has built and monetized substantial value historically; specifically, he has added enormous value for our partners in the Small-Cap Fund through his work at Texas Industries. Most recently, he announced that in early 2015 OCI will separate the fertilizer and construction businesses to remove the conglomerate discount in the stock price.

An increase in interest rates in September negatively impacted the price of both our timber and real estate holding, Rayonier, and Empire State Realty Trust (ESRT), the NY metropolitan office and retail Real Estate Investment Trust (REIT). Rayonier declined 10% in the quarter. The company lowered 2014 guidance for its forest resources business due to weak Chinese demand that is likely to lower prices for Rayonier’s Washington state and New Zealand timber. ESRT lost 8% in the quarter. Our appraisal, however, grew, as leasing at ESRT’s Manhattan office properties was on track and the Empire State Building’s observatory attendance remained strong.

Lower prices for small-cap stocks helped us identify a few more opportunities. We initiated two positions, including DreamWorks mentioned above, and added to several holdings. We sold Texas Industries and DineEquity (DIN), the IHOP/Applebee’s franchisor, when each stock reached our appraisal. The Fund had held DIN since 1996 and made 821% or 13% annualized in the investment. CEO Julia Stewart successfully re-built the IHOP brand, but the purchase of Applebee’s was ill-timed. DIN made it through the financial crisis and recession after the stock reached a low of $5.44. Ultimately, Stewart succeeded in the plan to sell company-owned units and convert Applebee’s to a 99% franchise fee model while delivering on cost reductions and paying down debt. When the stock price rose to our $80 appraisal, we made our final sales. Our investment in DIN illustrates just how much stock prices and values can diverge, particularly in periods of broad fear. Our in-depth knowledge of the assets and our engaged work with management gave us the confidence to be patient through the short-term pressures that made us look wrong, and ultimately allowed us to realize a meaningful gain.

The price-to-value ratio has become more attractive in the mid-70s%.
With our purchases, net cash dropped from our post-TXI sale high of 47% to 36% over the last three months. Although we have found a few qualifiers, stock prices for small-cap names remain elevated and make it challenging to find companies that meet our deep discount requirement. Following sales of higher valued companies and recent new buys, the price-to-value ratio (P/V) has become more attractive in the mid-70s%. We have liquidity to take advantage of additional opportunities that come our way through either stock-specific situations or general market volatility. We will continue to be patient and adhere to our investment discipline.

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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invest in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

As of September 30, 2014, the holdings discussed represented the following percentages of the Longleaf Small-Cap Fund: Vail, 4.9%, Level3, 9.1%, Texas Industries, 0.0%, Martin Marietta, 0.0%, OCI, 4.8%, Rayonier, 5.5%, Empire State Realty, 4.2%, DineEquity, 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.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund gained 3.9% in the quarter, outpacing the Russell 2000’s 2.1%. Year-to-date (YTD) the Fund returned 9.2%, versus the Index’s 3.2%. Over longer periods shown below, the Fund’s performance surpassed the Index as well. For the last one and five years, Longleaf Small-Cap far exceeded our annual absolute return goal of inflation plus 10%, as it did for the last 20 years.

Cumulative Returns at June 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>2Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>1507.60%</td>
<td>1343.31%</td>
<td>1096.77%</td>
<td>352.57%</td>
<td>177.67%</td>
<td>190.50%</td>
<td>24.00%</td>
<td>9.24%</td>
<td>3.87%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>997.54</td>
<td>921.21</td>
<td>550.00</td>
<td>217.54</td>
<td>130.34</td>
<td>151.03</td>
<td>23.64</td>
<td>3.19</td>
<td>2.05</td>
</tr>
</tbody>
</table>

Average Annual Returns at June 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>Small-Cap Fund</td>
<td>11.58%</td>
<td>11.27%</td>
<td>13.21%</td>
<td>10.59%</td>
<td>10.75%</td>
<td>23.77%</td>
<td>24.00%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>9.91</td>
<td>9.74%</td>
<td>9.81</td>
<td>8.01</td>
<td>8.70</td>
<td>20.21</td>
<td>23.64</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 0.91%. The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.50% of average annual net assets.

The Fund had good absolute and relative performance in the quarter and YTD despite having over 30% cash. Merger activity, combined with solid operating results at several core holdings, drove results. Fiber and networking company Level 3 Communications announced a deal to acquire tw telecom, which gained 29% in the quarter and 32% for the first half of the year. Level 3 returned 12% and 32% over the same periods. The deal benefits both companies as tw telecom shareholders collect a fair price for the company’s valuable assets and, through the Level 3 equity they will receive, will participate in the upside of the combined company. 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 Level 3 CEO, Jeff Storey and his team have delivered solid revenue growth, margin improvement, and higher cash flow.

Vail Resorts had a strong end to the ski season in Colorado and Tahoe, and the stock added 11% in the quarter. Ski pass sales and pricing (up 6% so far) already are going well for the next ski season. Vail also had a pickup in condo sales. The market reacted favorably to a court decision regarding their lease in Park City. Also in the quarter, Empire State Realty Trust (ESRT), the New York metropolitan office and retail REIT, gained 10%. ESRT delivered strong FFO (funds from operations) and good leasing news on New York City properties.
The Fund’s largest holding, cement producer Texas Industries (TXI), gained 34% YTD. Martin Marietta’s all-stock deal to acquire TXI closed at the end of the quarter, and we subsequently sold the position at our appraisal. In spite of the financial crisis and worst recession in our lifetime, we doubled our money in the eight years we owned TXI, a high quality but cyclical business. Many things that helped make this investment successful are applicable to Southeastern’s approach more broadly.

- “Recycled” names tend to do well. We also more than doubled our money in TXI from 2001-2005, and because we knew the company, industry, and management well, our case had a strong foundation when we bought the stock again in the second half of 2006.

- A five year time horizon can give clarity and conviction through short-term uncertainty. The slow economic recovery after the financial crisis made the timing of a rebound in U.S. construction and infrastructure uncertain through 2011. Given the healthier Texas economy and TXI’s new plant coming on line, we felt certain that over five years, volumes and prices would be higher, even though we were not sure of the path. Sentiment turned quickly, and in 2012 and 2013 TXI was the largest contributor to Small-Cap’s return, gaining 66% and 35%, respectively.

- Overweighting positions at opportune times can pay off handsomely. In the 2010-2011 timeframe, we doubled down on our investment when TXI had 1) competitive advantages including its location in a state that was rebounding, new capacity, and a sound balance sheet, 2) management and a board committed to getting shareholder value recognized, 3) a major shareholder with industry expertise in the form of 23% owner Nassef Sawiris, and 4) a price that was a fraction of both the company’s replacement value and comparable sales ($/ ton) of other U.S. cement plants.

- Our size can be an advantage. We owned 9% of the company in 2009. To help protect our interests, we successfully suggested one board member whom we knew would represent shareholders. We did the same thing with additional directors after we increased our ownership to over 20% of the company in 2011.

Our four decades of experience, long time horizon, willingness to heavily concentrate at opportune points, friendly engagement with management, and network of industry contacts were all instrumental parts of our successful outcome at TXI. These strengths are equally relevant to all of our holdings.

Global fertilizer and chemical producer OCI, the only performance detractor in the quarter, fell almost 14%, causing the stock to also be among the few YTD decliners. The company announced that no dividend would be paid on 2013 earnings due to pre-funding $1 billion in capital investment for 2014. We view substituting growth capital expenditure for the dividend as a solid capital allocation move by CEO Nassef Sawiris (the same partner we had at TXI), who has generated attractive returns over time through greenfield expansions and financial investments. In addition to eliminating the dividend, several short-term pressures impacted the stock. OCI’s Algerian fertilizer plant, Sorfert, had shipments delayed in 2013 after the Algerian government required new export license agreements. As of April 2014, the plant had returned to 100% utilization, and management expects this utilization to continue for the rest of the year. The company also reported weak utilization at its Egyptian plants due to gas curtailments, which we already accounted for in our appraisal.

For the YTD, media company Scripps Networks was the other main detractor, down 6%. The stock sold off in January when rumored acquisition talks with Discovery Communications did not materialize. The company’s operations performed well, however, and the stock recovered 7% in the second quarter. U.S. advertising grew 9%, comparing favorably to peers. Management repurchased discounted shares at an 8% annualized pace.
Stock prices continued to run up, especially impacted by real or anticipated merger and acquisition activity. As a result, we are still finding almost no companies that meet our discount requirement. In spite of the elevated market level, we began buying one new qualifier in the quarter. We added to OCI given its price decline and stable appraisal value. Hopewell’s intrinsic value grew ahead of its price, allowing us to increase our position. We also added to timber and real estate company Rayonier before it spun off its performance fibers business, Rayonier Advanced Materials, which we sold. These transactions brought cash down to 41% at quarter-end, but the subsequent sale of our remaining shares of Texas Industries took cash to 47% while improving the Fund’s price-to-value ratio (P/V) to the high-70s%.

As the Fund’s largest owners, we prefer not to hold this much cash. We are less comfortable, however, compromising our investment discipline for the sake of being fully invested. We are diligently searching for qualifiers around the world. We should continue to find new opportunities in stock-specific situations and with more market volatility, but finding enough new holdings to put all the cash to work could take some time without the help of an overall market pullback. In whatever way new purchases emerge, they will drive down both the cash and P/V. We will continue to search for opportunities that meet our criteria but maintain our longstanding discipline.

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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invest in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V (“price to value”) is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

As of 6/30/14, the top 10 holdings in Longleaf Partners Small-Cap Fund - Level 3 (8.6%), Graham Holdings (6.9%), OCI (5.9%), Texas Industries (5.7%), Everest Re (5.3%), tw telecom (4.9%), Empire State Realty Trust (4.6%), Vail Resorts (4.3%), Hopewell (4.3%), Scripps Networks (3.7%). 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.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund gained 5.2% in the quarter, outpacing the Russell 2000’s 1.1%. Our high cash hampered relative results over the last twelve months, but over longer term periods, the Fund’s performance surpassed that of the Index.

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>Small-Cap Fund (Inception 2/21/89)</td>
<td>1447.76%</td>
<td>1010.05%</td>
<td>395.99%</td>
<td>177.02%</td>
<td>239.49%</td>
<td>22.41%</td>
<td>5.18%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>975.52</td>
<td>512.04</td>
<td>259.56</td>
<td>126.78</td>
<td>196.88</td>
<td>24.90</td>
<td>1.12</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>Small-Cap Fund (Inception 2/21/89)</td>
<td>11.53%</td>
<td>12.79%</td>
<td>11.27%</td>
<td>10.73%</td>
<td>27.69%</td>
<td>22.41%</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 Small-Cap Fund 0.92%. 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.

Small-Cap’s largest holding, cement producer Texas Industries (TXI), drove much of the Fund’s return in the quarter, gaining 30% after Martin Marietta (the #2 U.S. producer of construction aggregates) announced an all-stock deal to acquire TXI. The shares of both companies rose on the announcement, and we sold our small stake in Martin Marietta to manage our combined exposure. The deal is expected to close in the second quarter.

Level 3 Communications appreciated 18% in the quarter. 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.

Fairfax Financial, the property/casualty insurer, was up 11% in the quarter. Andy Barnard has successfully managed the insurance operations with solid underwriting and integration of acquisitions done in years past. A low number of catastrophes also helped recent results. CEO Prem Watsa’s investment returns have been held back by high cash and equity hedges over the last year, but he is off to a good start this quarter.

Graham Holdings (the renamed Washington Post) gained 7%. CEO Donald Graham continued to grow the company’s value per share. In the quarter, he reached an agreement to exchange a combination of a Miami-based television station, Berkshire shares currently held by Graham Holdings, and cash for approximately 1.6 million shares of Graham Holdings stock currently owned by Berkshire Hathaway. Graham Holdings gets the benefit of both repurchasing its undervalued shares and selling the station tax-efficiently. Management also continued to make progress in turning around the Kaplan education business.

Media company Scripps Networks was the primary detractor in the quarter, down 12%. The stock sold off in January after rumored talks about a deal with Discovery did not materialize. Our appraisal grew, however, with stronger-than-expected 2014 guidance and additional undervalued share repurchases. The company’s high quality assets (including HGTV, DIY Network, Food Network, Cooking Channel, and the Travel Channel) are attractively priced whether the company remains independent or becomes part of a larger content provider.

Vail Resorts, owner of U.S. ski resorts, was down 7% in the quarter. Vail downgraded earnings guidance for the year largely due to the drought at its three Lake Tahoe-area resorts. Conversely, the company reported impressive visitor increases at its Colorado locations. Our appraisal of the company grew during the quarter.
The continued run up in stock prices led to more sales and trims than purchases in the Fund. We did not find any new businesses that met our requisite discount to appraisal. We exited three positions: Legg Mason, Wendy’s, and aforementioned Martin Marietta. In the fourteen months that we owned asset manager Legg Mason, the stock returned 81%. The company grew assets under management with strong market appreciation and experienced improved flows, while management repurchased significant amount of stock when it was discounted. We bought Wendy’s in 2006, and our return was 45%. After the disappointing combination with Arby’s ended, the company hired Emil Brolick who successfully worked with franchisees in introducing menu innovations and revitalizing stores. He also sold company-owned stores, freeing up capital and improving free cash flow.

Following these sales, the Fund’s cash position was 37% at quarter-end. The P/V (price-to-value ratio) was in the mid-80s%. The cash level remains higher than we prefer, but as when we previously have had few new opportunities, we will continue to exercise patience and discipline until we find qualifying companies.

We are pleased to announce that effective with the May 1 Prospectus of Longleaf Partners Funds, senior analyst Ross Glotzbach will join Mason and Staley as a co-manager on Longleaf Partners Small-Cap Fund. Ross celebrates his tenth anniversary at Southeastern this year and has become an increasingly valuable member of the research team. Becoming co-portfolio manager of Small-Cap will not change Ross’ daily focus on finding and following investments, but this new role acknowledges his immense collective contribution, particularly to Small-Cap’s strong returns over the last few years.
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 Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. An index cannot be invested in directly.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern’s appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

As of 3/31/14, the top 10 holdings in Longleaf Partners Small-Cap Fund - Texas Industries (15.6%), Level 3 (7.9%), Graham Holdings (7.0%), Everest Re (5.2%), Empire State Realty Trust (4.3%), Vail Resorts (4.0%), tw telecom (3.9%), Fairfax (3.7%), Scripps Networks (3.6%), Hopewell (3.6%). 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 Rafferty Capital Markets, LLC. As of May 1, 2014, Funds distributed by ALPS Distributors, Inc.
Longleaf Partners Small-Cap Fund delivered strong absolute performance for the fourth quarter and the year, advancing 5.7% and 30.5%, respectively, and far surpassing our absolute annual goal of inflation plus 10%. In spite of the solid absolute results, our higher-than-normal cash level caused the Fund to lag the Russell 2000 Index, which returned 8.7% for the fourth quarter and 38.8% for the year. The Fund consistently outperformed the Index for all longer time periods and almost doubled our absolute goal 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>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>1371.59%</td>
<td>970.43%</td>
<td>358.26%</td>
<td>167.41%</td>
<td>198.20%</td>
<td>30.45%</td>
<td>5.65%</td>
</tr>
<tr>
<td>(Inception 2/21/89)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>963.63</td>
<td>489.14</td>
<td>236.29</td>
<td>138.31</td>
<td>149.69</td>
<td>38.82</td>
<td>8.72</td>
</tr>
</tbody>
</table>

See page 12 for additional performance information.

Texas Industries (TXI) led the Fund’s performance for the year with the combination of its 35% gain and overweight position. This cement producer posted improved results as the economy in Texas gained steam, driving higher volumes and prices. The company opened its new Hunter 2 plant, which also helped drive higher revenues. TXI will have additional Texas capacity available in 2014 and has upside when California demand turns.

Graham Holdings (the renamed Washington Post) gained 82% for the year after a 9% rise in the fourth quarter. The company sold The Washington Post at a premium to our appraisal in the third quarter, demonstrating the Graham family’s commitment to shareholder value and highlighting the company’s remaining education and media assets. Cost cutting at the Kaplan Higher Education unit and price increases at Cable One improved profitability throughout the year. In the fourth quarter, the company announced the sale of its headquarters building at an attractive price.

Wendy’s made substantial gains during the year, appreciating 91%. The company sold company owned stores, freeing up capital and cash flow. Additionally, management successfully introduced menu innovations and began to see the results from store revitalizations. As the stock rose closer to our appraisal, we scaled back the position.

Level 3 Communications was the largest contributor in the fourth quarter, adding 24% and boosting 2013 gains to 43%. 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.

Global asset manager Legg Mason gained 31% in the fourth quarter and 71% for the year. The company experienced improved flows and grew assets under management with strong market appreciation. Legg Mason also repurchased a significant amount of stock during the year.

We bought Empire State Realty Trust in the fourth quarter, and it soon became a large contributor, rising 18%. The company has a strong portfolio of office buildings located primarily in Manhattan, with the Empire State Building being its flagship property. The building is one of several properties that are poised to increase occupancy and rents over the next several years. CEO Tony Malkin and
his family are significant owners with a focus on building value per share.

We began buying Nuance Communications, a voice and imaging software company, in the fourth quarter but sold our small position after the company reported disappointing quarterly results with lower revenue and margins than we had anticipated. The name's 15% decline made it the primary detractor in the quarter and one of only two holdings that were down in the year. Oil and gas exploration company Quicksilver, which we sold in the third quarter, was the other detractor in 2013. Uncertainty regarding how and at what price Quicksilver would monetize its non-cash-flowing assets altered our view of the company's potential.

During 2013, the strong run up in stock prices led to more sales and trims in the Fund than buys. We bought five new positions and sold nine holdings. We initiated a position in Hopewell Holdings and OCI N.V. in the third quarter, and, as discussed earlier, we bought Empire State Realty Trust and Nuance in the fourth quarter as well as Rayonier. Most sales were a result of stock prices approaching our appraisal values, including Willis and Potlatch in the first quarter, Lamar Advertising and Madison Square Garden in the second quarter, and Saks, Service Corp., and Tribune in the third quarter.

The combination of transactions resulted in a 35% cash level at year-end. As large Fund owners, we would prefer to be more fully invested, but we will not compromise our deep discount criteria. 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, we anticipate converting the low-returning cash reserves into higher return opportunities as we identify companies that meet our criteria. In the interim, we own strong businesses with capable management partners who are building value per share. With a P/V in the mid-80s%, the portfolio trades at a discount to our conservative appraisals.

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 inflation plus 10% goal over the long term.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund had a strong 7.4% gain for the third quarter, but due to the Fund’s high cash level, it lagged the Russell 2000 Index, which returned 10.2%. Year-to-date (YTD), the Fund advanced 23.5%, far outpacing our annual absolute return goal of inflation plus 10% but falling below the Index due to the drag that cash imposed on return. Small-Cap exceeded our absolute goal over the most recent one, three, and five year periods. Results for periods of three years and longer were consistently above the Index. We believe that the Fund can continue to generate long-term outperformance over the Index, but we caution investors that the Fund’s robust absolute return of the last three years—averaging 20% per year—is not likely to continue for the next three years.

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>Small-Cap Fund (Inception 2/21/89)</td>
<td>1292.94%</td>
<td>972.76%</td>
<td>396.50%</td>
<td>189.95%</td>
<td>102.63%</td>
<td>27.82%</td>
<td>23.48%</td>
<td>7.44%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>878.31</td>
<td>455.92</td>
<td>259.77</td>
<td>151.03</td>
<td>69.68</td>
<td>30.06</td>
<td>27.69</td>
<td>10.21</td>
</tr>
</tbody>
</table>

See page 14 for additional performance information.

Wendy’s returned 47% in the quarter and 85% YTD, making it a top contributor to performance for both periods. Operations continued to benefit from new management’s menu innovation and store revitalization program. The company also announced a plan to sell more company-owned stores to drive higher returns on capital, improve the quality and predictability of earnings, and increase shareholder returns. The Washington Post Company, a diversified education and media company, was another strong performer in both the third quarter and YTD. The investment returned 26% and 67% in the respective periods.

In the quarter, management sold the flagship Washington Post newspaper for a price that was higher than our appraisal. In addition, cost-cutting at Kaplan Education and price increases at Cable One improved margins and profitability throughout the year. As owner-operators, the Graham family has built value per share over the long-term, and the stock has begun to reflect their work. Level 3 contributed meaningfully in the third quarter, gaining 26%. 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. Even with the meaningful recent gains, the stock remains among our most discounted. The Fund’s largest holding, cement producer Texas Industries, remained the top contributor for YTD with a 30% gain. A robust economy in Texas has resulted in volume and pricing increases.

Although the run up in the market has made it hard to find qualifying ideas, we were able to initiate two positions late in the quarter, OCI and Hopewell. Both are based outside of the U.S., where we generally are finding more opportunities.

We sold four positions. Oil and gas exploration company Quicksilver was the Fund’s largest detractor from YTD performance, declining 32%. As we noted in previous commentary, several challenges weighed on the company’s share price, including low natural gas prices and the company’s inability to refinance all of its debt. Uncertainty regarding how and at what price Quicksilver will monetize its non-cash-flowing assets changed our view of the company’s prospects, and we sold the stock. We sold Saks on the news that Canadian retailer Hudson’s Bay would buy the company for $16 per share. We
bought Saks in 2011 for an average cost of $9 and trimmed the position as it grew. Our return in the equity was 85%, while the convertible bonds we owned returned 54%. We sold Service Corp, the country’s largest funeral home services company, a long-term holding since 2005. CEO Tom Ryan and his team grew value through excellent operations, especially amidst difficult headwinds of lower mortality rates and changing preferences for lower revenue cremations over burials. The planned acquisition of Stewart pushed the stock price to our appraisal. We made 172% on the investment during the eight years that we owned it. We also sold media company Tribune, whose bank debt we bought a year ago before the company emerged from bankruptcy and our ownership was converted to cash and equity. As the company announced a well-received acquisition and a plan to spin off its publishing operations, the stock quickly approached our appraisal, generating over 75% during our short holding period.

Market strength, particularly among smaller companies, has meant that numerous stocks have moved closer to our appraisals, causing more portfolio sales than normal and a larger challenge to find businesses that meet our discount criteria. As a result, the Fund’s P/V finished the third quarter in the low-80s%, and the cash level stood at 45%. We remain confident that we will identify and add new companies that meet our criteria over time. We will be patient, however, and adhere to our proven discipline, which has guided us successfully for nearly 40 years. With the Fund’s high cash level and slim opportunity set, our partners should note that if they have current capital needs, it would seem a good time to take money out of the Small-Cap Fund to the extent that doing so does not create a tax liability.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund produced a gain of 2.5% for the second quarter but lagged its benchmark, the Russell 2000 Index, which returned 3.1%. Year-to-date (YTD), the Fund returned 14.9%, versus the Index’s 15.9%. The Fund outperformed the Russell 2000 for all longer time periods.

Cumulative Returns at June 30, 2013

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>20 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>One Year</th>
<th>YTD</th>
<th>2Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap (Inception 2/21/89)</td>
<td>1196.45%</td>
<td>921.41%</td>
<td>181.90%</td>
<td>66.25%</td>
<td>24.88%</td>
<td>14.92%</td>
<td>2.53%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>787.68</td>
<td>448.53</td>
<td>148.45</td>
<td>52.25</td>
<td>24.21</td>
<td>15.86</td>
<td>3.08</td>
</tr>
</tbody>
</table>

See page 16 for additional performance information.

Saks, which we purchased in the market decline in 2011, gained 19% for the second quarter and 30% for the first half of the year, making it the largest contributor in the quarter and the second largest YTD. Although the luxury retailer’s high-end shoppers are sensitive to large stock market downswings, they are less vulnerable to the challenges of high unemployment and slower economic growth that affect most consumers. During the second quarter, Saks’ price rose sharply on news that the company had hired Goldman Sachs to explore strategic alternatives, including a sale of the company. In addition, investment in store renovation and the online retail business began to show positive results.

The Fund’s largest holding, Texas Industries, continued to add meaningfully to performance and is the largest contributor YTD with its 28% gain. The Dallas-based cement and aggregates company has had large volume growth and improved pricing in Texas, with demand exceeding capacity in some local markets. As we mentioned in the first quarter, the company is bringing additional capacity on line to capture the incremental demand and has additional upside potential when a recovery in California generates additional earnings.

The Fund’s position in Quicksilver declined 19% for the second quarter and 33% for the first six months of the year, making it the largest detractor for both periods. The oil and gas exploration company had positive news that it closed on an agreement to sell 25% of its Barnett Shale assets to Tokyo Gas at a price that is in line with our appraisal. Several challenges, however, weighed on the stock, including failing to refinance all of the company’s debt and persistently weak natural gas liquids prices.

We sold two positions. Madison Square Garden’s share price approached our appraisal, helping to make it a large contributor year-to-date. We made 114% on the investment during the two years that we held it. The company’s multi-year arena renovation has been successful, and the increased value of the television rights for the Knicks and Rangers became clearer.

We also sold Lamar Advertising as it reached our appraisal. We bought Lamar in 2011 at an average cost of $26, trimmed the position as it grew, and fully sold it in the second quarter at an average price of $48 per share. Lamar’s strong outdoor advertising positions in its markets helped revenue growth as the economy recovered. Management’s effective cost control and decision to explore converting to a REIT also caused the stock’s move to value.

Strength in the small capitalization segment of the market over the past several quarters has resulted in a dearth of on-deck companies that meet our discount requirements. Consequently, the Fund’s P/V finished the second quarter in the mid-80s%. Following portfolio sales and trims, cash climbed to 40%, reminiscent of levels reached briefly in 2005 and 1997, and caused the Fund’s relative underperformance in the quarter.

To the extent that our investment partners have spending or rebalancing needs, we believe this an opportune time to use the Small-Cap Fund as a...
source of funds. We are confident that over time we will identify businesses that meet our criteria, either through general market volatility or individual company opportunities. In the meantime, our management partners are taking action to build corporate values and gain value recognition.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund produced absolute returns far above our absolute annual return goal of inflation plus 10% in the first quarter and over the last year, rising 12.1% and 25.4% respectively. Over the long-term, the Fund has also outperformed the Russell 2000 Index, including more than doubling the cumulative returns of the benchmark over the 15 and 20 year periods. Since the financial crisis in 2008, and the Fund’s low point in March of 2009, Small-Cap has gained 250.8% versus the Index’s 193.3%.

Cumulative Returns at March 31, 2013

<table>
<thead>
<tr>
<th></th>
<th>Since Inception 2/21/89</th>
<th>20 Year</th>
<th>15 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>Since 3/9/09</th>
<th>One Year</th>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>1164.43%</td>
<td>932.34%</td>
<td>294.83%</td>
<td>247.80%</td>
<td>62.61%</td>
<td>250.77%</td>
<td>25.40%</td>
<td>12.08%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>761.12</td>
<td>443.78</td>
<td>141.09</td>
<td>197.48</td>
<td>48.55</td>
<td>193.25</td>
<td>16.30</td>
<td>12.39</td>
</tr>
</tbody>
</table>

See page 12 for additional performance information.

Almost all of the names in the portfolio rose during the quarter, and a number of stocks gained over 20%. Texas Industries, the Fund’s largest position, added 24%, and our appraisal also grew. Cement pricing has been strong in the company’s primary market of Texas, and demand is beginning to grow with infrastructure spending as well as residential construction after several years of low capacity utilization. The company is working to bring its new cement plant to full capacity to help meet demand and has additional upside when a California recovery generates earnings from that plant. Madison Square Garden returned 30% over the last three months, and its strong momentum over the last year caused its price to approach our appraisal. We started selling the position late in the quarter and completed our exit in early April. As the major renovation of the arena nears completion on time and within budget, the company is raising ticket prices successfully. Meanwhile, television rights for the Knicks and Rangers have become increasingly valuable. Lamar, the billboard advertising company, gained 25% as results exceeded expectations, and guidance improved. The conversion to a REIT remains on track. Washington Post added 22% with encouraging margin development at its Kaplan Higher Education business and revenue growth at Kaplan International. The company has announced the sale of several smaller assets and reportedly is interested in selling its headquarters building.

Legg Mason was up 26% following the appointment of new CEO Joe Sullivan, as well as strong share repurchase activity. Three of the Fund’s holdings declined in the quarter. Level(3) fell 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. Our other fiber network holding, tw telecom, also invested in growth during the quarter, preventing margins from growing. The stock was down 1%. Our investment in Quicksilver, the oil and gas exploration and production company, declined 17%. Canada denied Transcanada’s application.
to build a second pipeline connecting to the Horn River basin, leaving Quicksilver with only one route for its production but giving the company more flexibility with its capital allocation. The company lowered its reserve numbers based on the previous twelve month gas price average of less than $3/mcf. Given more recent higher gas prices, this accounting adjustment should correct itself in the future. On the last day of the quarter, the company announced that Tokyo Gas is buying 25% of its Barnett Shale assets at a price in line with our appraisal for this play.

During the quarter stock prices rose faster than our appraisals grew, resulting in a number of position trims, as well as two full sales in addition to Madison Square Garden mentioned above. Potlatch, the timber company, approached our appraisal as the housing recovery helped drive up lumber prices. Willis, the insurance broker, also moved toward our appraisal.

The overall strength in smaller cap stocks over the last year has left few names on-deck near our requisite discount. Consequently, cash rose to 27% of the portfolio, and the Fund’s P/V reached the low-80%. These levels are reminiscent of when we closed the Fund in 1997, and in the 15+ years since, the Fund has delivered solid cumulative returns over twice the Index. We remain confident that we will find additional qualifiers in time, whether through general market volatility or individual company disappointments. In the interim, we believe that the 18 companies we own will grow their values. Rising interest rates would offer further upside to a number of holdings, and several companies could have near-term catalysts for value recognition.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund delivered strong absolute and relative results both for the year and the fourth quarter. The Fund far surpassed our annual goal of inflation plus 10%, gaining 23.0% in 2012 versus the Russell 2000’s 16.4%, and advanced 3.5% over the last three months of year compared to 1.9% for the Index. Over the four years since the 2008 financial crisis, the Fund has more than doubled, returning 128.6%. Over longer term periods, the Fund has also delivered strong results.

Cumulative Returns at December 31, 2012

<table>
<thead>
<tr>
<th></th>
<th>Since Inception</th>
<th>Ten Year</th>
<th>Four Year</th>
<th>One Year</th>
<th>4Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund (Inception 2/21/89)</td>
<td>1028.10%</td>
<td>194.89%</td>
<td>128.60%</td>
<td>22.96%</td>
<td>3.52%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>666.18</td>
<td>152.79</td>
<td>79.86</td>
<td>16.35</td>
<td>1.85</td>
</tr>
</tbody>
</table>

See page 12 for additional performance information.

Throughout the year, most names contributed positively to returns, especially those stocks that suffered the most when macro fears about U.S. default and a double-dip recession caused stocks to tumble in the third quarter of 2011. Texas Industries (TXI), which remains the Fund’s largest holding, drove a substantial portion of results, rising 25% in the fourth quarter and 66% for the year. With U.S. housing beginning to recover, Barron’s succinctly described the case for Texas Industries. “With strongholds in Texas and California, the two largest cement markets in the country, [TXI] has been cutting costs and improving cash flow by modernizing plants and adding capacity. At the same time, cement volumes have started to rise and prices have firmed, particularly in Texas.” (“Building on Housing’s Rousing Rebound” October 22, 2012)

The article also cited the company’s undervaluation based on both recent cement plant sales and replacement cost. Martin Marietta, the aggregates company, also benefitted from the same positive industry trends, rising 14% in the quarter and 27% in the year. Both companies serve as examples of the importance of anchoring our investments to conservative appraisals rather than market sentiment, and the benefits of a long time horizon. We did not know when infrastructure, housing, and commercial building investment would turn, but we felt confident that over five years, our companies’ unit sales and pricing would improve. That long-term view paid off handsomely over the next twelve months.

Numerous other investments had a strong quarter and year. DineEquity, which added 20% over the last three months and 59% in the year, completed its long-term plan to convert to a franchise fee model at Applebee’s. As management sold the last block of stores and reduced debt, the price rose, and we trimmed our position. Over the year, Madison Square Garden gained 55% with 10% coming in the fourth quarter. We scaled the position. The company’s multi-year arena renovation continued on time and in budget, and the completed sections achieved higher ticket prices. Higher affiliate fees both at MSG and other major market teams have supported the value of the Knicks. The entertainment division increased events through the year and purchased the LA Forum to expand its venues. After a 5% rise in the fourth quarter, Lamar gained 42% in 2012, and we trimmed our stake. In the most recent quarter, this billboard company announced a small acquisition at an attractive price and reported revenues and operating cash flow that exceeded guidance. More importantly, the company continued to reduce debt and lower interest cost throughout the year, and the plan to convert to a REIT is progressing. The other major contributor to 2012 return was Dillard’s, which we sold in the second quarter when it approached our appraisal.
Of the names that declined in the portfolio during the quarter or year, only Quicksilver had a meaningful impact, losing 27% over the last three months and 53% in 2012. Low natural gas prices hampered this oil and gas exploration and production company’s plan to raise capital through joint ventures in its Horn River, Barnett, and west Texas assets and through an MLP listing. Production declined in the fourth quarter. CEO Glenn Darden is an owner-operator who is focused on building value for his shareholder partners in spite of a challenging environment.

We bought three new names during the year: Leucadia, Tribune via its debt, and Legg Mason in the fourth quarter. Legg Mason has multiple strong brands including small cap specialist Royce and bond manager Western Asset, for which we paid less than ten times adjusted free cash flow. We began purchasing the stock when the CEO stepped down, knowing that the search for a replacement is being led by large shareholder Trian Partners, and the new leader should be able to meaningfully raise margins closer to industry average. Over the last three months we added to several positions, including Saks (via equity and convertible bonds), Wendy’s, Everest Re, and Fairfax. Earlier in the year we sold Dillard’s, Olympus, and Markel, and in the fourth quarter, we eliminated Leucadia after a brief holding period. The company merged with Jeffries Group, increasing the importance of investment banking to its value and reducing the influence of the management team with whom we originally partnered. In addition to previously mentioned trims of the Fund’s strongest performers, we also scaled our positions in Service Corp, tw telecom, and Potlatch.

The Fund’s strong 2012 performance combined with shaving some of our positions left the P/V in the low-70%s and cash at 10.5%. We believe that the companies we own will continue to grow their values through both solid operations and astute capital allocation. We have ample liquidity to buy several new qualifying opportunities when we find them to further enhance our return upside. We will continue to be patient and follow our proven discipline that has guided us for almost four decades.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund added 5.0% in the third quarter, bringing the Fund’s year-to-date (YTD) return to a substantial 18.8%. Over the last three months, the Fund delivered a slightly lower gain than the Russell 2000 Index’s 5.3%, but for the YTD, the Fund outperformed the benchmark’s 14.2% rise by over 450 basis points. Over the last one and three years, Longleaf Small-Cap has compounded at higher than our absolute annual goal of inflation plus 10%. While the financial crisis of 2008 muted the Fund’s longer term absolute results, the Fund has consistently outperformed the benchmark.

Cumulative Returns at September 30, 2012

<table>
<thead>
<tr>
<th></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>Small-Cap Fund</td>
<td>981.69%</td>
<td>290.21%</td>
<td>208.68%</td>
<td>12.62%</td>
<td>58.84%</td>
<td>29.61%</td>
<td>18.79%</td>
<td>4.97%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>469.34%</td>
<td>124.02%</td>
<td>163.47%</td>
<td>11.57%</td>
<td>44.24%</td>
<td>31.91%</td>
<td>14.23%</td>
<td>5.25%</td>
</tr>
</tbody>
</table>

See page 16 for additional performance information.

During the quarter, most names appreciated. Lamar Advertising, up 30%, had the largest impact on Fund performance and was also among the top YTD contributors. Not only did billboard ad results come in slightly ahead of guidance, but our management partners announced their intent to explore a REIT structure as a way to return capital to owners and promote value recognition. We trimmed the position as the P/V rose. DineEquity added 25% in the quarter as the sale of 65 Applebee’s completed management’s move to a 99% franchise model for its Applebee’s and IHOP restaurants. Eliminating its owned stores for sale enabled a restructuring plan to reduce expenses.

Various holdings gained over 30% YTD, driving the Fund’s strong results. In addition to Lamar, cement producer Texas Industries (TXI) rebounded after being penalized in the macroeconomic market decline a year ago. In addition to an improved general outlook for U.S. housing and infrastructure spending, TXI’s primary market, Texas, has experienced a faster economic rebound. Higher cement pricing and lower costs added to results. The company’s new plant expansion should be fully operational by spring 2013 to absorb the growing demand. Given the stock’s deep discount of a year ago, it remains significantly undervalued and is the Fund’s largest holding. At Madison Square Garden, all three segments grew revenues. The media group enjoyed higher affiliate fees. In sports, the post-season success of the Knicks and Rangers plus the partially completed arena renovation enabled higher ticket prices. The entertainment division put on more events and announced the purchase of the LA Forum to provide another venue for its productions. Although we scaled back the stock, it remains among the Fund’s top holdings. We also trimmed tw telecom, the fiber network company, which has gained 35% YTD. Margins and EBITDA continued to grow at a strong pace. Although we sold retailer Dillard’s early in the year, the stock’s appreciation was a primary contributor to the Fund’s 2012 results.

Few names declined in the quarter or YTD. Only Quicksilver had a noteworthy negative impact on Fund returns, losing 25% over the last three months and 39% this year. Low natural gas prices have been the primary challenge. As cash flow from operations fell below capex, the company cut unprofitable drilling. Less drilling has negatively impacted near term production but is the right thing to do for the long term. Weak NGL and gas prices also delayed QuickSilver’s MLP offering. Management renegotiated some of the company’s debt covenants, announced an AMI with Shell in Colorado, and introduced the possibility of selling Barnett reserves at the right price. QuickSilver continues to work on closing joint ventures in West Texas and the Horn River basin in British Columbia. During the quarter we added to our position via the bonds, which were selling at a significant discount to value.

In addition to a number of trims, we sold Markel. We added a partial position in the senior bank debt of Tribune, which will emerge soon from four years in bankruptcy. The debt was trading at a large discount to the value of the assets that will make up the new company – television stations, the WGN cable network, equity stakes in several companies such as the Food Network and CareerBuilder.com, various newspapers including the LA Times and Chicago Tribune, real estate assets, and cash.
The primary debt holders are proven investors who will control the board and select a new CEO. We base our appraisal on each segment’s cash flow, but many of the assets are worth even more to potential acquirers.

Given the market’s strength, we are finding few opportunities. We will invest the Fund’s 11% cash when we identify companies that meet our “Business, People, Price” criteria. The P/V is in the low-70%, slightly above the long-term average. Our on-deck list of new investments is thinner than we would like. Our companies’ solid operating results in a weak economy are a testament to the competitive strengths of our businesses and the skills of our management partners. We believe values can continue to build without an economic boost, but a stronger recovery would provide substantial upside.
Longleaf Partners Small-Cap Fund significantly outperformed the Russell 2000 Index, gaining 3.0% in the quarter and 13.2% for the year-to-date versus the benchmark’s -3.5% and 8.5% respectively. While the broader market headwinds over the last five years have challenged our absolute goal of inflation plus 10%, the Fund’s longer term returns shown below have surpassed those of the benchmark.

**Cumulative Returns at June 30, 2012**

<table>
<thead>
<tr>
<th></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>Small-Cap Fund</td>
<td>896.49%</td>
<td>146.13%</td>
<td>9.47%</td>
<td>87.60%</td>
<td>1.28%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>456.50</td>
<td>96.75</td>
<td>2.73</td>
<td>63.46</td>
<td>-2.08</td>
</tr>
</tbody>
</table>

See page 16 for additional performance information.

A number of holdings helped second quarter results and have led to the strong YTD return. The Fund’s largest position, Texas Industries, the cement and aggregates company that operates in Texas and California, added 11% in the quarter and is up 27% this year. Demand in Texas increased over last year even though the U.S. economy remains in a slump, but more importantly, the company is beginning to see stronger pricing. As its new central Texas plant comes on line this fall, the company will begin seeing revenue benefits from significant long-term capital investment. In spite of the stock’s strength, the company sells for a steep discount to our appraisal as many investors wait for increased infrastructure spending and a U.S. economic recovery to be more visible. tw telecom, which provides fiber communications networks to businesses, added 16% in the quarter and has gained 32% YTD. Margins were strong and EBITDA grew year-over-year at 8.5%, and at a higher annualized rate in the quarter. We trimmed the position to maintain a more normal portfolio weight. Vail Resorts, the owner of ski resorts in Colorado and Nevada, added 16% over the last three months to generate a 19% return in 2012. In spite of the warmest winter in memory, revenues held up reasonably well even though visits declined. In another indicator of the company’s pricing power, season pass sales for next winter are up significantly over last year. Scripps Networks, which owns cable channels including the Food Network, HGTV, and the Travel Channel, reported double-digit revenue growth in the quarter and beat expectations for its main brands. Management also took advantage of the discounted price to repurchase shares at a 14% annualized rate. We trimmed the over-sized position. Madison Square Garden added 9% over the last three months, and is among the top performers for the year with a 31% gain. During the quarter, only a handful of names declined. Lamar, the billboard advertising company, lost 12%. With the company’s migration to more digital boards in the aftermath of 2008, quarterly results have become more difficult to predict. The company conservatively estimated 3% growth for the second quarter versus the 4% delivered in the previous quarter. Additionally, a major competitor, Clear Channel, gave disappointing near term guidance. We view quarterly guidance as noise that has little to do with long-term value, and we encourage most of our investees to avoid providing such short-term guesses. Lamar remains significantly undervalued. Level(3) fell 14% in the quarter, but is up 30% in 2012. While our appraisal remained intact, short-term currency weakness impacted the stock as Brazilian and European revenues are a larger part of the business post the Global Crossing merger. Additionally, the market over penalized the Netflix announcement that they will begin using more caching and therefore less Level(3) bandwidth to send movies. The revenues Level(3) will lose from Netflix are a small percentage of Level(3)’s sales and were at a lower margin such that the profit
impact will be minimal. With the price weakness we added to our position. Quicksilver gained 8% in the quarter but was the largest detractor to the Fund’s YTD results with the stock down 19%. While the market remains skeptical that the company will monetize some of its assets amid depressed natural gas prices, recent comparable deals in Texas and British Columbia make our appraisal of Quicksilver’s assets look too conservative. We believe the Darden family will successfully pursue value recognition, and we added to our stake. Wendy’s declined 5% in the quarter and has negatively impacted 2012 results with the stock down 11%. The company delivered revenues and operating cash flow below expectations primarily due to an unsuccessful roll out of the “W” cheeseburger. Longer term, the company is implementing major changes to move to a more premium brand over the next five years. Emil Brolick’s track record at YUM gives us confidence that this migration will be successful.

We sold Dillard’s which we bought in 2007 for an average price of $20.70/share, and the stock proceeded to fall to $3 during the financial crisis. Through our almost five years of ownership, our management partners and large stock owners, Bill and Alex Dillard, proved to be excellent operators and capital allocators. They continually outperformed peers by managing costs, controlling inventory, closing nonperforming stores, and delivering better margins. They also sold a number of stores at attractive prices and used much of the proceeds plus the growing cash coupon to repurchase shares cheaply. Over the course of our holding, they bought in 40% of the company. As Dillard’s gained 41% this year and rose above $70, we sold our position near our appraisal. We owe credit for the stock’s more than three-fold gain to the Dillards and board members including Brad Martin, who recently agreed to join the Chesapeake board. During the quarter we added Leucadia, which lets us partner with a proven management team overseeing an undervalued set of assets.

The Fund sells for an attractive P/V in the high-60%, around the long-term average. Given the sales in the quarter, we have liquidity to purchase the next qualifying investment. Our companies are well positioned within their industries and have the ability to materially grow their prospective values. We have capable, vested partners, and our ongoing conversations include discussions of the capital allocation choices that will best build value per share.
**Small-Cap Fund Management Discussion**

*Longleaf Partners Small-Cap Fund gained 9.91% in the quarter, far outpacing our absolute return goal but falling short of the Russell 2000's 12.44%, which benefitted from meaningful exposure to information technology and leveraged financials not owned by the Fund. Over most longer term periods, the Fund's record surpassed that of the Index.*

**Cumulative Returns at March 31, 2012**

<table>
<thead>
<tr>
<th>Fund</th>
<th>20 Year</th>
<th>Ten Year</th>
<th>Five Year</th>
<th>Three Year</th>
<th>One Year</th>
<th>1Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>799.43%</td>
<td>128.25%</td>
<td>9.74%</td>
<td>121.17%</td>
<td>2.02%</td>
<td>9.91%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>437.07</td>
<td>86.81</td>
<td>11.12</td>
<td>104.37</td>
<td>(0.18)</td>
<td>12.44</td>
</tr>
<tr>
<td>Inflation + 10%</td>
<td>959.75</td>
<td>225.50</td>
<td>78.12</td>
<td>42.61</td>
<td>12.63</td>
<td>na</td>
</tr>
</tbody>
</table>

See page 16 for additional performance information.

Dillard’s, which was the Fund’s top contributor last year, gained 41% in the first quarter. The company reported solid fourth quarter results relative to peers, holding gross margins flat and creating expectations for a stronger 2012. Management continued a strong buyback pace. 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.

Several other stocks continued to recover from their lows in the third quarter of 2011. Lamar, up 18% in the quarter, started the year with an oversubscribed debt offering that reduced its interest expense and extended maturities. Our appraisal grew following the company’s solid results in the fourth quarter and management’s confidence in expanding digital boards as quickly as possible. Madison Square Garden gained 19% and grew its value. Encouraging results included profits from the Radio City Christmas Spectacular and lower expenses for the media segment given the NBA’s delayed season plus lower programming costs at Fuse. The prices recently paid for the Dodgers and local TV deals for several large market teams such as the Lakers indicate the importance of local television rights, especially to large market teams such as the Knicks and the Rangers. An improved general economic outlook combined with higher year-over-year sales at Texas Industries drove the stock up 14% in the quarter. The completion of its central Texas cement plant this fall will enable the company to generate additional revenues and free up cash flow.

A few stocks negatively impacted performance in the first quarter. Quicksilver fell 25% and has weighed on Small-Cap’s results since natural gas prices began their steep decline in the fourth quarter. The company reported slightly lower production and year-end reserves than expected. The month-long delay in the 10k filing created doubts which have been dismissed upon the April filing. The delay pushed back the company’s planned MLP offering that will monetize part of their Barnett asset and retire debt for Quicksilver. Meanwhile, the Darden family, who has built value for owners over the long run, reported good news on Quicksilver’s Colorado oil play and began discussions to enter into JVs for assets in Canada and West Texas. The market remains skeptical that any of the above events will occur. The insurance industry suffered from lower investment yields and the second worst year in history for insured catastrophes. Fairfax lost 4% as catastrophes in the fourth quarter hurt underwriting results. Book value also declined reflecting dual investment challenges of being 100% hedged in a rising stock market and having several weak underlying investments. The first quarter of 2012 will likely suffer from the same dynamic. In spite of these recent challenges, Prem Watsa remains one of the most skilled long-term investors we know, and we are partnering with him at an attractive P/V of less than 70%. Willis, the insurance broker, fell 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. Wendy’s retreated 6% as the company indicated that it would spend its cash flow on store remodels over the next 3-5 years to upgrade its competitive position. The company also downplayed near-term expectations of the breakfast rollout and international expansion.

The Fund’s investment lineup remained the same during the quarter as no new names were added and none were eliminated. Six of the seven holdings we trimmed, including Dillard’s and Lamar, reflected a re-weighting after price appreciation over the last six months drove P/Vs higher. We began selling Olympus and completed the sale in April. Subsequent to our Annual Report, in which we assessed this investment mistake as well as company developments, we worked to identify and propose independent board candidates who would protect the value of the medical business and instill western corporate governance standards. We decided to sell in March when the announcement of the new president and board nominees indicated that shareholder interests would not necessarily be the primary focus once new leadership was elected in April. The “independent” directors were weighted toward creditors with the Chairman being affiliated with Olympus’ largest creditor. Holding onto Olympus to pursue our interests after the initial fraud revelations proved a good short-term decision, as our average sale price was over 300% higher than the ¥424 low in November 2011. Over our full holding period this investment made a small positive return for which we paid a large opportunity cost. The Fund ended the quarter at an attractive overall P/V in the mid-60%s and with enough cash to purchase the next opportunity that qualifies.
Longleaf Partners Small-Cap Fund finished the fourth quarter up 9.1% to deliver a positive return of 1.8% for the year. Although the Russell 2000 Index rose more in the quarter, 15.5%, it ended the year down 4.2%. The Fund has produced excess returns over multiple periods and strong absolute results in the three years since the unprecedented 2008 market decline.

Cumulative Returns at December 31, 2011

<table>
<thead>
<tr>
<th></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>Small-Cap Fund</td>
<td>754.61%</td>
<td>130.85%</td>
<td>7.21%</td>
<td>85.91%</td>
<td>1.79%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>413.44</td>
<td>72.76</td>
<td>0.75</td>
<td>54.59</td>
<td>(4.18)</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 18 for additional performance information.

Four of the Fund’s five largest holdings drove much of the quarter’s return. Lamar gained 61% as the company reported an increase in revenues for both its digital and traditional billboards. The numbers indicated that digital is not cannibalizing conventional boards, and that real estate and hotels, historically among the largest advertisers, are eroding more slowly and are replaceable. Following good quarterly results and the end of the NBA lockout, Madison Square Garden (MSG) rose 26%. The recent sale of Toronto-based Maple Leaf Sports and Entertainment, which also owns an NBA team, NHL team, and arena, implies that our appraisal of MSG is well below its transaction value. Among the top contributors for 2011, tw telecom added 17% in the fourth quarter. Management continued to execute on its plan to expand the network footprint at very high marginal rates of return. Another top performer for the year, Service Corp, also rose 17% in the last quarter. Revenues in the funeral and cemetery segments grew with pre-need sales doing particularly well. Management is doing a good job of offsetting low death rates and a challenging economic environment by focusing on higher-yielding packages, finding alternative distribution channels, offering tiered services, and repurchasing undervalued shares. The other top contributor in 2011, Dillards, increased a modest 3% in the quarter but 19% for the year. Results in the first half fueled the gain. Since the recession, management has built value through fine-tuned operations and high-return capital allocation including buying in shares during the third quarter’s price decline at a 22% annualized pace.

Few stocks declined in the fourth quarter, and most values were stable or grew. The exception was Olympus which fell 58%, putting it among the worst performers for the year. The revelation that the company had been hiding investment losses for over a decade indicated an initial mistake we made in assessing management. With the appointment of Michael Woodford as CEO, we believed we had upgraded to the right partner. We were stunned when he uncovered the massive fraud. Since the first report of wrongdoing in October, the three executives most involved have resigned, the independent committee’s audit report has provided transparency, the Tokyo Stock Exchange has determined not to delist the stock, and an extraordinary general meeting has been called for April to replace much of management and the board. Our intense due diligence since learning of the fraud indicates that the investment case and underlying value of the globally dominant medical business are intact. We are pursuing various avenues to ensure that the medical division value and our rights as owners are protected. We strive to learn from mistakes and improve our process. Assessing management is the most challenging part of our analysis. Humans are more difficult to predict than businesses or financials. Owning good companies at deep discounts helps dampen the impact when we make an error. In the case of Olympus, although our ultimate return will be lower than
we hoped, the large margin of safety in our purchase price should help minimize a loss even after the unforgivable fraud. We have already recouped 85% of our original investment when considering booked gains and dividends, and the current price is approximately half of our reduced appraisal. The quality of the medical business is unchanged in spite of bad partners.

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 by 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. Quicksilver fell 11% in the fourth quarter and has been among the Fund’s largest detractors since we purchased this energy company in the third quarter. In addition to the slide in natural gas prices to below $3/mcf with warm weather and oversupply, the company reported slightly lower than expected production and reduced production guidance for 2012. In spite of the environment, management has built value in various ways including successful exploration and finding joint venture partners. The primary challenge to the Fund’s 2011 return came from Texas Industries (TXI) which fell 32%. Continued slow commercial and residential construction demand and delays on a federal transportation bill for infrastructure spending have prolonged the cement industry’s recovery. TXI did not rise during the fourth quarter like most cement producers because the company announced that it was suspending its dividend due to the uncertain timing of a construction recovery. The intrinsic value of TXI’s assets is dramatically higher than the stock price, and the company is positioned to produce significant earnings when cement and aggregates demand returns.

Early in the quarter we took advantage of low prices to fill out our positions in stocks bought earlier in the year. We completed our sale of FICO, the credit score and decision management systems company. Following the steep decline in credit card offerings in 2008, we lowered our appraisal of the company since credit scores related to issuing cards were a meaningful part of profits. Management met the challenge of low volumes by radical cost cutting and share repurchases at deeply discounted levels. We began scaling the holding following the stock’s 35% rise in the first quarter. We completed our exit in the second half of 2011 and reinvested the proceeds into what we believe are far more attractive opportunities.

We end the year with positive performance and a P/V in the low-60%s, much more attractive than the high-60%s level that began the year. The P/V improvement came from replacing more fully-priced names with a handful of qualifying opportunities at large discounts and from value growth. Many appraisals grew at double-digit rates. Our management partners not only proved their abilities as operators, but also made solid capital allocation choices from repurchasing discounted shares to making attractive acquisitions to selling assets at fair prices. We believe that the opportunity for value growth is better today than a year ago. The portfolio sells well below our long-term average P/V, making the Fund a compelling investment.
Small-Cap Fund Management Discussion

In spite of the third quarter decline, Longleaf Partners Small-Cap Fund outperformed the Russell 2000 Index in both the last three months and for the year-to-date. For the two periods, Small-Cap’s returns were (18.0)% and (6.7)%, while the Index was (21.9)% and (17.0)%, respectively. More importantly, the Fund has meaningfully beaten the Index over longer time periods.

Cumulative Returns at September 30, 2011

<table>
<thead>
<tr>
<th>Fund</th>
<th>Inception</th>
<th>20 Year</th>
<th>Ten Year</th>
<th>One Year</th>
<th>YTD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>740.8%</td>
<td>696.4%</td>
<td>124.5%</td>
<td>5.0%</td>
<td>(6.7)%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>470.3</td>
<td>370.1</td>
<td>81.2</td>
<td>(3.5)</td>
<td>(17.0)</td>
</tr>
<tr>
<td>Inflation + 10%</td>
<td>1437.5</td>
<td>963.6</td>
<td>223.1</td>
<td>13.9</td>
<td>na</td>
</tr>
</tbody>
</table>

See page 16 for additional performance information.

Three holdings impacted performance most significantly in the quarter — Level(3), Texas Industries, and Lamar Advertising. 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 increase the value of the company.

Third quarter returns for Texas Industries (TXI), our largest holding, and Lamar made these two stocks the biggest detractors from the Fund’s year-to-date results. TXI’s 24% fall over the last three months took the stock down 30% for 2011. This cement and aggregates company with assets primarily in Texas and California faces challenging demand given low visibility on a transportation bill for much-needed infrastructure improvements as well as depressed housing and non-residential construction. While shipment declines may be prolonged, pricing has begun to rise — a testament to the competitive strength of the business. The company’s solid balance sheet provides the ability to wait out the low demand cycle. While replacement value is not a relevant appraisal metric in some industries, the cost to replace cement plants and aggregates is a meaningful analysis. At TXI, replacement value of its assets is over twice the current stock price.

Lamar’s price weakness (down 38% in the quarter and 57% since we bought the stock in May) also relates to lower economic expectations that will present a challenge to raising billboard advertising rates in the short run. The company reported slightly weaker than expected second quarter earnings and lowered third quarter guidance. Lamar has an attractive long-term outlook given its billboard locations and local restrictions against new signage in spite of short-term factors that are hurting Lamar’s locally-focused advertiser base more than that of other media companies. Over time, migrating to digital billboard technology should lower cost and lure in new advertisers that do not find traditional boards attractive. The stock trades at a single-digit multiple of free cash flow, which is much higher than reported earnings, and for less than half of our appraisal, which incorporates low growth assumptions. We were able to add to the stock during the quarter as did some of the Reilly family who controls the company.

With the Small-Cap Fund’s cash balance at the outset of the quarter plus sales proceeds, we increased our stake in five holdings including TXI and Lamar, and we bought three new names. Quicksilver Resources is an oil and gas company with its two main producing assets in the Texas-based Barnett shale and Horseshoe Canyon in Canada. The stock became discounted after the
company reported disappointing second quarter earnings and capital spending plans for 2011. Quicksilver’s decision to outspend its organic cash flow, which is depressed by weak natural gas prices, will enable the company to keep long-term drilling rights in valuable acreage. The market also gives the company little credit for significantly valuable, yet currently non-earning, assets such as its Horn River and Sandwash lease acreage. The Darden family has an excellent track record, and we applaud their recent decision to create an MLP for the mature Barnett assets.

We also bought Scripps Networks which owns two of the stronger brands in cable television, with 100% ownership of HGTV and 69% of The Food Network. Recent ratings weakness and worries about the company’s outsized reliance on advertising versus other cable networks have given us a chance to buy. The company’s much larger free cash flow than reported earnings makes unhelpful the common valuation method of comparing P/E (price-to-earnings) ratios among industry peers, especially since most of Scripps’ peers have inferior businesses. Management and the Scripps family have track records of rewarding shareholders including stepping up stock buybacks at today’s attractive prices.

The stock market decline enabled us to buy luxury retailer Saks whose high-end shoppers are sensitive to large market downswings but less exposed to the more challenging problems of high unemployment and slow economic growth faced by most consumers. The company has a unique mix of assets including the owned New York City flagship store which represents approximately 20% of sales and is a square block of premium real estate. Saks’ rapidly growing direct business has higher margins with no store overhead. The company also has 60 Off 5th outlet stores and 46 total Saks store locations where its luxury brands face little threat from new entrants without established premium reputations.

We sold two companies in the quarter. Expedia, the only positive contributor, was among the strongest performers this year. The company’s strong free cash flow and bookings combined with its plan to spin out Trip Advisor helped drive the stock close to appraisal, and we sold the position. Ruddick, the owner of Harris Teeter grocery stores, approached fair value after many years of steady, excellent results. We are grateful to the management team for building value for Small-Cap Fund shareholders. One of the Fund’s top performers year-to-date, Dillard’s, pulled back in the quarter. We maintain a full position in the stock after scaling back the position earlier in the year.

We wrote in last quarter’s letter about the positive outlook at Olympus with Michael Woodford as the new President and CEO. The stock rose upon his appointment. We were shocked by Woodford’s dismissal in October amid his allegations about corporate governance. We take seriously his accusations and are working diligently to get a comprehensive response from the board. While the stock price is down meaningfully, none of the allegations have yet changed the value of the underlying medical business at Olympus, but they obviously have destroyed the integrity of the entire board save Mr. Woodford. We are evaluating all options and will act accordingly depending upon the board’s response.

Value growth, the move into more discounted names, and the recent price declines have combined to make the Fund’s P/V extremely attractive in the mid-50% range.
Small-Cap Fund Management Discussion

Longleaf Partners Small-Cap Fund returned 3.7% over the last three months while the Russell 2000 Index lost 1.6%. For the year-to-date the Fund has more than doubled the benchmark, earning 13.7% versus 6.2%. Small-Cap’s one year 40.3% gain not only exceeded the Index, but outperformed our absolute annual goal of inflation plus 10% by over three times.

Cumulative Returns at June 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>Small-Cap Fund</td>
<td>925.0%</td>
<td>910.7%</td>
<td>148.3%</td>
<td>40.3%</td>
<td>13.7%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>629.9</td>
<td>550.9</td>
<td>83.7</td>
<td>37.4</td>
<td>6.2</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1395.5</td>
<td>967.5</td>
<td>222.1</td>
<td>13.7</td>
<td>na</td>
</tr>
</tbody>
</table>

See page 14 for additional performance information.

The Fund’s solid gain in the quarter and for the year was primarily attributable to two holdings. Level(3)’s 66% rise in the quarter took the stock’s first half return to 148%. The company announced the acquisition of Global Crossing. 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 25% of the company. We added a minimal stake in Global Crossing just after the Level(3) announcement.

Dillard’s returned 30% in the quarter continuing its streak as one of the Fund’s top performers for each of the last two years. The company reported positive sales comparisons and an increase in margins. Management bought in just under 12% of outstanding shares. Even following its multiyear rally, the stock still trades for less than 8X free cash flow.

Expedia, a new position this year, gained 28% in the quarter and has appreciated 40% since our purchase. The company had strong revenue growth across the board — in airline sales, hotel bookings, and at TripAdvisor. Management confirmed guidance for the year and anticipates the TripAdvisor spin will occur this fall. The company also repurchased shares over the last three months. We trimmed tw telecom, the Fund’s largest position, to manage the position size after the stock returned 7% in the quarter and 20% year-to-date. The company retired shares and reported strong revenue growth across all product and service offerings. Olympus, which rose 20%, in the last three months, had several positive developments. Michael Woodford became the first non-Japanese president and immediately highlighted the importance of the medical and life sciences businesses where we attribute all of the company’s value. He also sees substantial opportunity for reducing bureaucracy and costs — upside to our appraisal. The company’s repurchase of 1.5% of its discounted shares was welcome news. Service Corp. returned 43% year-to-date. Management of this funeral services business continues to build value through solid operating results, successful acquisition integration, and substantial buybacks.

The two cement and aggregates producers, Texas Industries and Martin Marietta, created the largest headwind to performance both in the quarter and for the year-to-date. The slow U.S. construction recovery is weighing on volumes. 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. These companies sell far below both replacement value
and prices recently paid for similar assets. During the quarter we added to our stake in Texas Industries.

We sold two names that approached full value and one, Sealed Air, which announced the acquisition of Diversey. We exited the stock because management diluted shareholders by issuing 15% of shares at a discount; the price paid was higher than our appraisal of Diversey; and the CEO’s justification was unrelated to maximizing value per share. In spite of our mistake in assessing management, the margin of safety in the price we paid relative to appraisal helped us earn over 19% on our Sealed Air investment over the 18 months we owned the company. We sold Worthington as the stock approached our appraisal in early spring. We also sold Pioneer Natural Resources. 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 around $12 to over $100.

We purchased two new qualifiers late in the quarter, Lamar Advertising and Madison Square Garden. Lamar, a billboard company, has seen the markets where the company dominates — local businesses in mid-sized cities — recover more slowly than national billboard advertising. Over time the company’s growth rate should increase with economic recovery and conversion to digital billboards. Lamar’s real estate provides a valuable advantage as new billboards in prime locations are difficult to build. Management has significant stock ownership and a history of increasing value for shareholders.

Cash reserves grew to 11% as we sold and trimmed more than we purchased. As price cooperates, we hope to fill out several positions. The P/V is in the high-60%s, the long-term average. We expect our companies to continue to build shareholder value at a strong pace. The P/V, the value build, and the liquidity to buy new 60-cent dollars equate to attractive return opportunity.

The P/V, the value build, and the liquidity to buy new 60-cent dollars equate to attractive return opportunity.
Management Discussion

Longleaf Partners Small-Cap Fund’s 9.7% return over the last three months far outpaced the Russell 200 Index which was up 7.9%. The Fund has also meaningfully exceeded our annual absolute goal of inflation plus 10% over the last year. The Fund has delivered substantial cumulative returns over the benchmark for 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>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>888.3%</td>
<td>875.2%</td>
<td>161.3%</td>
<td>20.9%</td>
<td>9.7%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>641.8</td>
<td>551.1</td>
<td>113.3</td>
<td>25.8</td>
<td>7.9</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1346.7</td>
<td>965.1</td>
<td>222.2</td>
<td>12.8</td>
<td>na</td>
</tr>
</tbody>
</table>

See page 12 for additional performance information.

A number of stocks in the portfolio rose double-digits. FICO added 35% as management at this credit scoring and decision management systems provider announced sizable cost cuts that boosted earnings guidance as much as 25%. FICO’s large free cash flow coupon has gone primarily to share repurchases, growing value per share. Service Corp., the largest funeral services company in the US, also gained 35%. The company’s yield on sold services rose even as volume remained weak. Management’s successful integration of acquisitions has contributed to earnings growth, and total free cash flow is far above reported net earnings. 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. tw telecom experienced business improvements similar to those seen at Level(3) as the order backlog began to be installed and produce revenues. Pioneer Natural Resources rose 17% following its well-timed sale of Tunisian assets and the rise in oil prices.

Few names lost ground. Fairfax declined 6% following fourth quarter earnings and the recent natural disasters which will affect the company’s reinsurance unit. The company has conservatively hedged around 90% of its equity portfolio. Unrealized losses from the hedge positions flowed through reported earnings, but the corresponding unrealized gains in equities did not. Vail pulled back 6% as result comparisons failed to measure up to a robust year earlier period.

We scaled back several overweight names that have seen substantial appreciation over the last year including Dillard’s, FICO, and Pioneer. We added Expedia, the travel services company, to the portfolio.

The price-to-value ratio (P/V) is in the low-70%s reflecting the Fund’s price appreciation. Value growth has begun to accelerate, and sales proceeds have resulted in a 7% cash position that we will deploy when we identify the next qualifying name. The on-deck list has become somewhat sparse following the market rally over the last year, particularly in smaller cap names. We will wait patiently for market volatility, macro events, and/or corporate disappointments to pressure the prices of valuable franchises with capable management partners.
2010 ended on a strong note with the Fund gaining 12.6% in the fourth quarter and delivering 22.3% for the year. These results far surpassed our goal of inflation plus 10% even though they were below the Russell 2000 Index. Over the long term shareholders have earned returns well above those of the benchmark.

<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>Small-Cap Fund</td>
<td>801.3%</td>
<td>960.5%</td>
<td>433.3%</td>
<td>139.2%</td>
<td>22.3%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>587.2</td>
<td>682.5</td>
<td>201.8</td>
<td>84.8</td>
<td>26.9</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1284.9</td>
<td>954.3</td>
<td>477.7</td>
<td>220.0</td>
<td>11.5</td>
</tr>
</tbody>
</table>

See page 20 for additional performance information.

Three holdings made meaningful progress and comprised over half of the Fund’s return thanks in large part to strong corporate leaders. Dillard’s rose 61% over the last three months and more than doubled over the year, making it the Fund’s largest holding at the end of December in spite of several scale backs during the year. Management cut expenses and controlled inventories well through the recession. In the last year margins have increased, and revenues have begun to grow. The company continued to sell stores at attractive prices and used those proceeds as well as the company’s free cash flow to buy in almost 20% of shares in the last year. Since year-end, Dillard’s announced a plan to create a REIT for its large real estate holdings as another way to unlock value for shareholders.

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%.

DineEquity doubled in the year. The company refinanced its debt, swapping 2012 maturities for notes due in 2017 and 2018 at a slightly better rate. In addition, more Applebee’s stores were sold to franchisees, taking the mix to approximately 300 store-owned and 1500 franchisee-owned locations. These proceeds along with the $130 million in free cash flow went to paying down the debt that DineEquity took on when it purchased Applebee’s. On the operating front management delivered on its plans for
growth and profitability, with particular improvement at Applebee’s. The company maintained number one market share in both the family dining (IHOP) and casual dining (Applebee’s) categories.

In the fourth quarter renewed optimism regarding the U.S. economy and Congressional change helped our materials related holdings, Texas Industries and Martin Marietta, which rose 46% and 20% respectively in the quarter. This rally put Texas Industries among the top contributors for the year as well. Martin Marietta was a new purchase earlier in the summer when fears of delayed recovery took most construction-related suppliers’ stock prices down. Each of these companies has irreplaceable aggregates in locations that should see growing demand from infrastructure as well as other building over time. Because they have been so discounted, the stocks remain far below their intrinsic worth even after the recent rise.

The Fund had only one meaningful detractor from performance in the year. 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.

As market prices fluctuated throughout the year, we opportunistically scaled back names that were overweighted and added to others when they became more severely discounted. During the year we purchased three new companies. We discussed our Sealed Air purchase in the first quarter report and covered Martin Marietta in the June letter. We bought Vail Resorts in the fourth quarter. We have owned Vail previously and since that time management has increased the company’s value per share. The company has several developments that currently are being sold and will benefit earnings in the near term. Their recent acquisition of Northstar-at-Tahoe is already reaping synergies with nearby Heavenly by growing season pass sales for both mountains. Since our purchase in October, the stock is up almost 40%.
We have several on-deck names that meet our qualitative criteria but lack enough discount in price. The P/V for the Fund is in the high-60%s, in line with the long-term average. We believe that our conservative appraisals will increase at double digit rates even without a strong economic recovery. We own valuable dominant businesses that are growing, and we have management and board partners who are committed to value recognition. We are confident this will prove to be a rewarding combination for our fellow shareholders.
Longleaf Partners Small-Cap Fund rose 9.6% in the third quarter and is up 8.7% for the year, surpassing our absolute return goal of inflation plus 10%. The Russell 2000 delivered 11.3% in the quarter and 9.1% thus far in 2010. Over longer time periods the Fund has outperformed the benchmark.

<table>
<thead>
<tr>
<th>Cumulative Returns at September 30, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-21-89 IPO</td>
</tr>
<tr>
<td>Small-Cap Fund . . . .</td>
</tr>
<tr>
<td>Russell 2000 Index . . .</td>
</tr>
<tr>
<td>Inflation plus 10% . . .</td>
</tr>
</tbody>
</table>

See page 14 for additional performance information.

During the quarter we trimmed two of our largest holdings, tw telecom and Pioneer Natural Resources, following significant price increases. We added to several of our most discounted names and filled out the Martin Marietta Materials position that we initiated in the second quarter. We have several names “on deck” and have acquired one new holding since quarter-end.

Most stocks in the portfolio rose over the last three months. DineEquity(DIN) was the most substantial contributor to return, gaining 61% in the quarter and 85% for the year-to-date. The company made progress in moving Applebee’s to a franchise model by announcing the sale of some restaurants. More importantly, the company successfully refinanced its debt, pushing maturities out meaningfully and putting the company on solid footing. Although comp sales declined slightly at IHOP and were down 2.7% at Applebee’s, these numbers were better than the market expected. The company’s substantial free cash flow coupled with store sales is enabling DIN to reduce its debt. tw telecom, the Fund’s largest position, gained 11% in the quarter as Larissa Herda and her team grew the customer base and delivered better-than-expected services revenue in all segments of its fiber network business.

Both Pioneer Natural Resources and Dillard’s rose over the last three months, and these two stocks have been among the top contributors in 2010, appreciating 35% and 29% respectively. 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. Dillard’s is benefitting from the company’s reduced cost structure and inventory management. Margins are growing. Management’s focus on selling stores at good prices and aggressively repurchasing discounted stock has led to meaningful value growth.
Level 3 declined 14% in the quarter and has been the primary detractor from performance this year. The company 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.

The Fund remains attractively priced in the low-60%s P/V range. Even more compelling is the quality of the competitively entrenched businesses we own. Values have begun to grow following a number of reductions in 2008-2009, and organic growth should further increase values going forward. Additionally our corporate partners have substantial free cash flow and/or cheap available capital to pursue various capital allocation options including share repurchases, merger and acquisition activity, and/or strategic sales. Our taxable shareholders not only have the portfolio upside, but also have the tax benefit of loss carry forwards equivalent to 7% of NAV.
Longleaf Partners Small-Cap Fund fell 10.6% in the second quarter. Year-to-date the Fund’s return is (0.8)%. The Russell 2000 Index lost 9.9% and 2.0% over the same periods. These results are below our annual absolute goal of inflation plus 10%. The Fund’s relative results over all longer term periods have been superior.

Two names delivered positive returns in the quarter. 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. Potlatch gained 3% in the quarter and is up 15% for the year. Interestingly, because investors have flooded private timber funds with capital, private timber trades for a much higher multiple than publicly traded timber. Potlatch has taken advantage of this price disparity by selling non-core land to help support the company’s dividend until demand and pricing recover from these depressed levels. Dillard’s remains among the top contributors to Fund performance in 2010 despite the stock’s decline in the second quarter when concerns about consumer spending hurt all retailers. The company’s margin improvement and free cash flow beat estimates. Additionally, repurchases this year have equated to shrinking shares at a 25% annualized rate.

Most stocks in the portfolio lost ground in the last three months. Four holdings fell over 20%. DineEquity reported earnings slightly lower than expectations. Renewed fears of a general economic decline impacted the stock even as our appraisal grew due to substantial free cash flow generation and debt reduction. Although the stock lost 29% in the quarter, it has appreciated 15% this year. 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.

Olympus was flat in the first quarter and fell 25% over the last three months. Management reaffirmed their belief that the medical business will grow organically.

Cumulative Returns at June 30, 2010

<table>
<thead>
<tr>
<th>Fund</th>
<th>Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>630.8%</td>
<td>539.8%</td>
<td>380.1%</td>
<td>115.5%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>431.2</td>
<td>380.0</td>
<td>161.9</td>
<td>34.4</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1215.9</td>
<td>976.8</td>
<td>478.0</td>
<td>220.9</td>
</tr>
</tbody>
</table>

See page 14 for additional performance information.
8-9% per year over the next five years. The price, however, reacted to the company’s short-term foreign exchange assumptions. 25% of revenues are euro based. The euro-yen exchange rate, which has gone from 132 at the start of the year to 108 at the end of the second quarter, reflects extremes in both yen strength and euro weakness.

Worthington lost 25% in the second quarter and is flat for the year. While the market is probably concerned about the company’s perceived cyclicality, the stock’s retreat is somewhat of a mystery because Worthington beat estimates and showed improved results in all of its segments. Results have been in line with our appraisal assumptions. The company has been wisely allocating capital and also has a meaningful opportunity to increase value per share via repurchases at this price level.

During the quarter we trimmed several names that have appreciated meaningfully including Pioneer, Potlatch, and Dillard’s. We added one new name, Martin Marietta Materials. The company’s valuable aggregate assets are significantly discounted due to the construction industry’s dramatic decline over the last three years. Demand for aggregates has recovered more slowly than expected because the stimulus package remains largely unspent, and Congress has not prioritized a highway bill. Over time both of these issues will reverse. With high barriers to entry due to transportation costs, location-specific supply, and no true substitutes, the company has increased prices through this depressed period.

With a P/V in the mid-50%s, the Fund’s discount to intrinsic worth is far below the long-term average. We believe this wide margin of safety combined with the high caliber of the businesses we own and the people running them implies substantial compounding opportunity. Although we have no plans to re-open the Fund, we believe it is an attractive point for long-term shareholders to add to their investment. Taxable investors also receive a tax loss carry forward of approximately 9% of NAV.
Longleaf Partners Small-Cap Fund rose 10.9% in the first quarter, outperforming the Russell 2000 Index's 8.9% 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>Cumulative Returns at March 31, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inception</td>
</tr>
<tr>
<td>Small-Cap Fund</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
</tr>
</tbody>
</table>

Please see page 14 for additional performance information.

Most names in the portfolio rose over the last three months, and several that had done well in 2009 continued their rally. Following a 372% return last year, Dillard’s gained 28% in the first quarter after reporting both strong free cash flow and margins to finish 2009. During the first quarter of 2010, the top-line began to show signs of stabilizing and even growing, and the company should deliver very strong free cash flow again in 2010. DineEquity is seeing the results of its Applebee’s turnaround effort after cutting labor costs and other operational changes. The company has no debt due for three years and has been purchasing its obligations at double-digit discounts to par. Once credit becomes more available, management will pursue its plan to sell owned stores to franchisees. The stock rose over 60% over the last three months after a gain of 110% in 2009. Pioneer Natural Resources, another large contributor, gained 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. FICO rose 19% in the quarter with anticipation of increased credit card offerings that will grow demand for FICO scores. The company’s entrenched market share dominance in both credit scoring and fraud detection provides a competitive edge. FICO has over $200 million in excess cash. Management has taken advantage of the discounted stock price by aggressively repurchasing shares at double-digit annualized rates. Worthington reported better earnings than expected as steel demand began to recover and the company’s efforts to improve margins showed results. The stock gained 33% in the quarter.

A few portfolio holdings declined slightly over the last three months, though our appraisals of each were stable or grew. Everest Re, the reinsurer, declined 5%. The company increased claims reserves slightly and announced that the Chilean earthquake and European wind storms would collectively cost approximately one quarter of
earnings. As long-term owners we applaud management’s focus on building value. Over the last year they made significant share repurchases at big discounts, underwrote profitably, increased gross premiums at a double-digit rate, and grew book value almost 30%. Texas Industries lost 2% as this cement company with assets concentrated in Texas and California reported declines in tons shipped and pricing versus a year ago. Additionally, stimulus funding may not impact the industry’s revenues this year as has been anticipated. The short-term challenges are reflected in both our appraisal and the stock price, and over the long term the company will benefit as economic growth and the resulting construction return. Fairfax pulled back 4%. Earnings were as expected, and the company issued modest equity as part of its Zenith acquisition. We believe that this purchase will be a long-term benefit for the company. While issuing undervalued shares is not our preference, when netted against Fairfax’s buybacks in the fourth quarter, the issuance was minimal and helped the company maintain stable ratings while making a solid acquisition.

During the quarter we sold First American and Discovery when each approached our appraisal, earning 50% and over 110% respectively over our holding periods. We were able to buy First American (the second time we have owned it) as the housing bubble imploded, hurting the title industry. Management announced a plan to split the title insurer from the data company, which helped close the gap between price and value once the housing market became more stable. Discovery continued to impress throughout the recession, improving programming and attracting ad revenues. We are grateful to David Zaslav and his team for their commitment to building value and ultimately getting it recognized. We purchased one new name during the quarter, Sealed Air, which is a packaging company serving the meat industry, industrial customers, and other specialized needs. The company has competitive advantages in its FDA approvals and integration of equipment into customers’ manufacturing. Management consists of owner-operators with a proven history of returning capital to shareholders. The company's costs have declined. Expected growth in the specialty and food solutions segments as well as in emerging markets should result in strong value growth at Sealed Air.

We believe the Small-Cap Fund is positioned for continued good performance over the next several years. The P/V is in the low-60%s, and the businesses we own have competitive advantages and/or valuable assets with capable management partners stewarding them. We have enough liquidity to buy an additional position and have one on-deck name that we would like to purchase. We thank you for your patience when things appeared dismal a year ago. We are glad that the Fund’s return over the last twelve months has begun to reward your support.
Longleaf Partners Small-Cap Fund rose 49.3% in 2009, recording the best absolute and relative performance in the Fund’s twenty year history. The Russell 2000 gained 27.2%. The Fund ended with a strong fourth quarter, rising 7.4% versus 3.9% for the Index. Small-Cap’s longer term returns also have meaningfully exceeded the benchmark.

<table>
<thead>
<tr>
<th>Cumulative Returns at December 31, 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inception</td>
</tr>
<tr>
<td>Small-Cap Fund</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
</tr>
</tbody>
</table>

Please see page 18 for additional performance information.

Three of the top five holdings were the largest gainers in the fourth quarter as well as for the year. Dillard’s, up 31% for the quarter and 365% over twelve months, surprised investors with its deep cost cutting and substantial free cash flow generation. In spite of the tremendous appreciation, the stock remains the most discounted in the portfolio even if the company is only worth its depressed real estate assets. 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. A 28% return in the last three months helped tw telecom double for the year. This provider of internet connectivity to small and mid-sized companies successfully grew revenues and margins throughout the recession while furthering its first mover advantage in various markets by adding new customers. Discovery Communications almost doubled in 2009. Revenues held up well versus cable TV channel competitors given the company’s programming improvements and subscription fees. Management successfully drove down costs and found new ways to revamp weaker channels.

The only stock that declined in the year was Ruddick, down 7%, which owns the Harris Teeter grocery chain. The supermarket industry in general, and premium stores in particular, suffered from weak stock prices in 2009 as many shoppers turned to discount alternatives. Management showed a disciplined approach by protecting market share and continued the successful expansion into the Washington, DC area. In the fourth quarter Texas Industries fell 16%. Business conditions remain terrible for the short term, but longer term the value of their Texas cement, concrete, and aggregates assets is dramatically higher than the stock price. We have a 13D filed on
the company to enable us to have frank discussions with management and the board regarding ways to improve the company’s value and get it recognized. Most recently, the board added three new independent directors, eliminated staggered board terms, and agreed to terminate the company’s poison pill in 2012.

In the first half of the year we bought First American, the title insurer and information provider, which we previously owned. We also added to several of the Fund’s most discounted names early in the year. More recently we have added to Wendy’s/Arby’s and FICO at attractive prices. We sold Del Monte Foods in June and in the second half scaled back several positions that had appreciated meaningfully and become overweight. The Fund’s lower-than-average turnover in the year reflects the quality of the businesses we own and how significantly they were undervalued, particularly at the outset of 2009. Numerous companies qualified, but we believe few were as attractive as those we already owned.

Because the Fund started the year at a P/V in the mid-30%s, the portfolio remains below the long-term average of the low-60%s even after the strong price rally. Given our limited trading, there is little cash in the portfolio. The quantitative appeal of the Fund is matched by significant qualitative strength both in the competitive positions of our businesses and in the management teams that run them. Not only is this an attractive opportunity for existing owners to add to their stakes in the Fund, but for those who are taxable, the NAV contains tax loss carryforwards that will offset a meaningful amount of future realized gains. We believe the portfolio can generate better than average returns over the next five years.
Longleaf Partners Small-Cap Fund had the second best quarter in the Fund’s 20-year history, gaining 24.0%. The Russell 2000 Index added 19.3%. For the year-to-date the Fund has risen 39.0% versus 22.4% for the benchmark. The Fund’s results far exceed our absolute annual goal of inflation plus 10%. As shown below, our partners have been rewarded for their investment over the long term as well.

<table>
<thead>
<tr>
<th>Fund</th>
<th>20 Year</th>
<th>15 Year</th>
<th>10 Year</th>
<th>5 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>466.0%</td>
<td>370.7%</td>
<td>104.5%</td>
<td>20.9%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>354.6</td>
<td>188.8</td>
<td>61.1</td>
<td>12.7</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1006.6</td>
<td>484.2</td>
<td>226.2</td>
<td>81.1</td>
</tr>
</tbody>
</table>

Please see page 14 for additional performance information.

Most of the stocks in the portfolio rose in the quarter. Fairfax, which is the Fund’s largest position, gained 48% as this insurer benefitted from strong equity and tax-free bond returns. The company also offered to acquire the publicly traded minority interest of Odyssey Re at an attractive price, financed by new FFH shares. This value-neutral transaction will enhance Fairfax’s financial flexibility by allowing management to upstream excess cash from this key subsidiary to the holding company, thereby giving Prem Watsa and his capable team more investment discretion. Fair Isaac appreciated 39% in the quarter. The company has generated meaningful free cash flow throughout the last year, and although revenues declined, operating income margins grew. Management reported an increase in the top line over last quarter in both their credit scoring and software businesses.

Another top holding, tw telecom, added 31% in the last three months and is also one of the top contributors for the year. This provider of internet connectivity to small and mid-sized enterprises has grown revenues and margins in spite of the bad economy. Dillard’s rose over 50% in the quarter and has been the largest contributor to year-to-date return with a 260% gain. While the recession has caused the top line to suffer in line with other retailers, management has done an impressive job controlling inventory and cutting costs. The company’s real estate assets alone are worth considerably more than the stock price. Pioneer Natural Resources, up 42% in the quarter and 125% year-to-date, has benefitted from rising oil prices and adding new independent directors.

Discovery, which rose 27% in the quarter, has been among the best 2009 contributors, gaining almost 100% this year. Revenues have held up well in a brutal advertising environment thanks to a large percentage of subscription fees and management’s programming successes. The company has cut costs and entered agreements with brands such as Hasbro and Oprah Winfrey to convert lagging channels into new ones.
Only two names detracted from performance over the last three months. DineEquity raised guidance, but the market focused on overall lower demand in casual dining and the company’s shelf registration for up to $200 million in new securities. Even in this challenging eat-at-home environment, the stock has more than doubled this year. 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.

We made relatively few changes to the portfolio, though we trimmed overweight Discovery and Fairfax positions after their substantial gains. The Fund is trading at a P/V in the mid-50%s, far below the historic average. We have witnessed impressive work by many of our management partners throughout the stressed economic climate of the last year. Whether slashing costs, retiring debt and equity at steep discounts, selling assets at attractive prices, or taking advantage of weaker rivals, managements have been fending off the forces of economic decline and positioning our companies to be stronger in the aftermath. The quality of our management partners and the businesses we own combined with the steep discounts in their stock prices make us thrilled to be long-term owners of Longleaf Partners Small-Cap Fund.
Longleaf Partners Small-Cap Fund had the second best quarter in its 20 year history, adding 21.4%. The Russell 2000 Index rose 20.7%. These results brought year-to-date returns to 12.1% for the Fund and 2.6% for the Index. While this performance pushed the Fund’s return nicely ahead of our annual absolute return goal of inflation plus 10%, we must post similar quarters to regain 2008’s loss.

Most of the stocks in the portfolio rose during the quarter. Several made up a large portion of the Fund’s return. DineEquity has had the biggest impact for both the quarter and the year-to-date after an over 160% gain. The company’s better-than-expected results removed Wall Street’s concerns about tripping debt covenants. In addition better credit availability improved the prospects for selling more company-owned Applebee’s stores. Service Corp rose almost 60% from its severely depressed level at the end of the first quarter. The company reported substantial free cash flow despite a bizarrely low death rate. Pioneer rallied over 50% as the price of oil rose, and we worked with the company to install three new directors. Pioneer has solid operations and terrific assets, but is in great need of better capital allocation; hence our choices of directors. Dillard’s gained an additional 60+% over its strong rebound in the first quarter. The company has managed expenses successfully through the recession and reported positive free cash flow in spite of negative same-store sales. 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. Because of the extreme discounts placed on the prices of these stocks at the outset of 2009, each company still sells for less than half of our appraisal.

Discovery Communications, which rose in the first quarter, continued to rally and remained among the top contributors for the year. The company announced a joint venture with Hasbro to convert the Discovery Kids channel to one that focuses on the toy company’s brands. At the end of March the Small-Cap Fund held two different classes of the stock. During the second quarter Class A sold at a meaningful premium

<table>
<thead>
<tr>
<th>Cumulative Returns through June 30, 2009</th>
<th>Inception</th>
<th>20 Year</th>
<th>15 Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>453.4%</td>
<td>396.9%</td>
<td>312.0%</td>
<td>55.8%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>337.2</td>
<td>306.8</td>
<td>158.9</td>
<td>26.5</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1085.7</td>
<td>1012.6</td>
<td>488.8</td>
<td>229.0</td>
</tr>
</tbody>
</table>

Please see page 12 for additional performance information.
to Class C, and we took advantage of the discount by swapping all of the Fund’s Class A shares into C shares.

Wendy’s/Arby’s declined. Arby’s, which represents less than a quarter of our value for the company, again reported disappointing results. In addition, because the company has provided limited detail on its operations, Wall Street penalizes the stock. Our appraisal assumes more conservative margins than are likely. Fairfax declined 4% in the quarter, but remains the largest detractor from year-to-date results given the size of the position and its negative first quarter. Our appraisal has grown, and we are as optimistic as we described three months ago about the company’s prospects given its investment and underwriting opportunities in conjunction with its capital strength. Furthermore, Fairfax announced that the SEC completed its investigation of the company without recommending any enforcement action, removing a cloud of investor concern.

During the quarter we sold Del Monte and purchased First American. Del Monte was the most fully priced stock in the Fund with the company reporting much stronger earnings than expected after successfully cutting costs and raising prices. We sold our previous First American position in early 2008. Since that time five members of the board as well as several top managers have been added, the company’s split into the title insurance business and data business is less than a year away, and First American’s competitive position has improved. The stock fell to our required discount in the quarter when the short-term spike in mortgage rates created uncertainty about title insurance’s rebound.

The Small-Cap Fund remains steeply discounted at a mid-40% P/V even after the second quarter’s strong return. Not only will appraisals grow materially when the economy improves, but the competitive strength of most holdings has increased in the downturn, raising the potential for faster-than-normal value growth that our appraisals do not reflect. As your managers and the largest shareholder group in the Fund, we are grateful for the patience and confidence that our investment partners have shown over the last year. While the recent quarter helped justify your support, we believe much more compounding remains ahead.
Longleaf Partners Small-Cap Fund declined 7.6% in the quarter, holding up better than the Russell 2000 Index, which was down 15.0%. Though negative returns are unacceptable, the Fund's results put it among the top performers in Morningstar's Small-Cap Value category. The dramatic decline over the last year has impacted the Fund's absolute returns over the longer term, even though the relative results have remained favorable. With a P/V below 40% at quarter-end, the Small-Cap Fund was positioned to recapture the last twelve months' market damage and again compound at inflation plus 10%.

<table>
<thead>
<tr>
<th>Cumulative Returns through March 31, 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 Year</td>
</tr>
<tr>
<td>Small-Cap Fund</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
</tr>
</tbody>
</table>

*Please see page 16 for additional performance information.*

In the first quarter the economic environment remained challenging, pressuring earnings at a number of our investees and preventing appraisal growth. However, two of the fourth quarter's worst performers, Dillard’s and Level 3, each rose over 30% in the first quarter. Dillard’s year-end free cash flow totaled more than half of the company’s market cap, and the company’s cash holdings were four times its debt maturities over the next two years. Although we expect 2009 store results to be worse than 2008, the stock sells for less than 20% of the company’s liquidation value based on recent sales of lower quality retail real estate comparables. Level 3’s dramatic price movements described in Longleaf’s Annual Report continued through the first quarter in spite of a stable business value. At one point the stock soared to twice the 12/31 price, and then traded 15% below it. At the end of March, the stock had gained 31% over the three months. Given the steady operational results, Level 3’s stock offers a good example of how manic “Mr. Market” can be. Discovery rose over 10% as its various channels attracted more viewers and David Zaslav’s team continued to improve operations. While U.S. ad revenues, which account for 30% of total revenues, will decline in 2009, contractual affiliate fees will grow.

Fairfax, the Fund’s largest holding and best performer in 2008, pulled back 15% in the first quarter, making it the biggest detractor from results. Fairfax declined after reporting somewhat weaker than expected fourth quarter insurance and investment results. The company has never been as strongly capitalized and is well-positioned to benefit from current investment and underwriting opportunities. Volatility in quarterly results is a price worth paying for the superior long-term investment returns that Prem Watsa and his team have delivered to Fairfax shareholders. Service Corp fell...
30% as the stock market’s decline hurt pre-need funeral trust assets’ performance, and the recession made new pre-need sales more challenging. These two challenges should abate in late 2009. This leading funeral services provider has demonstrated pricing power as well as excellent cost control, and demand is certain to grow in the long term. The stock currently trades at an approximate 20% yield on depressed free cash earnings. Texas Industries also declined as residential construction stayed in the ditch and commercial construction weakened. While the company expects margin pressure and limited pricing increases in 2009, infrastructure spending, which is half of TXI’s business, should increase nicely beginning in 2010 with the government’s economic stimulus. The stock trades at a seemingly reasonable EBITDA multiple. A deeper review, however, reveals not only that EBITDA in Texas is severely depressed, but the California operation, on which the company has spent over half its current stock price, is at roughly breakeven.

During the first quarter we had opportunities in early January and late March to scale back several stocks that had held up well. We sold Clearwater, the company that Potlatch spun out last year. We added to several of the portfolio’s most undervalued names including Potlatch, Service Corp, and Olympus. We did not buy any new holdings, but several on-deck names are compelling.

The Small-Cap Fund sold for less than 40% of appraised value at quarter-end. We own companies that have staying power through the recession due to their financial and/or business strength. Many will gain advantage over weaker competitors. For example, the capital positions of Fairfax and Everest Re should enable each to attract more policies while other underwriters struggle with weaker balance sheets. Kaplan (the most valuable component of our Washington Post appraisal) has the opportunity to grow its student population as laid off workers look for new job skills. tw telecom is growing profitably and taking share in its niche of providing the last mile of telecom services to buildings and campuses. FICO scores, which have dominant market share and brand credibility, will have greater importance with mortgage refinancing and when lenders start lending again. These names illustrate a common theme within the portfolio. We believe not only that the gap will close between the steeply discounted prices of what we own and the companies’ values, but that values will grow significantly over the next several years.
Small-Cap Fund
MANAGEMENT DISCUSSION

In the fourth quarter Longleaf Partners Small-Cap Fund fell 28.2% versus the Russell 2000’s 26.1% decline. The Fund ended the year down 43.9%, while the Russell 2000’s return was (33.8)%. The year’s significant decline pushed the Fund’s long-term returns below our absolute goal of inflation plus 10%. In spite of 2008’s relative results, the Fund has outperformed the benchmark over longer periods. We believe that the Small-Cap Fund has never been better positioned to deliver absolute returns that surpass our goal over both the short and long-term.

<table>
<thead>
<tr>
<th>Cumulative Returns</th>
<th>Inception</th>
<th>15 Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>393.5%</td>
<td>259.0%</td>
<td>53.7%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>326.0</td>
<td>136.0</td>
<td>34.7</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1002.0</td>
<td>482.9</td>
<td>225.3</td>
</tr>
</tbody>
</table>

Please see page 28 for additional performance information.

Of the few names that rose during the year, Fairfax had the largest impact. The company’s book value rose between 30-40% as Prem Watsa’s investments in credit default swaps, equity hedges, and long-term government bonds posted big returns. When prices were severely discounted, Fairfax bought in the minority interest in Northbridge, bought its own shares, and had Odyssey Re repurchase its shares. In addition, the company’s underwriting results were solid. During the year we swapped shares of Odyssey Re for its more liquid parent, when Fairfax briefly became cheaper. The stock rose 38% in 2008, but the value grew by 50%, making Fairfax’s P/V 60% today. The company is the Fund’s largest holding.

A handful of names accounted for a large portion of 2008’s negative results. In the fourth quarter Pioneer Natural Resources, Level 3, and Dillard’s declined steeply and became among the year’s worst performers. Pioneer was an overweight position entering the last quarter, when the stock fell almost 70%. 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 to achieve value recognition.

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 raised $400 million by issuing 2013 notes with a 15% coupon, convertible at $1.80 per share to buy over half of its debt maturing in the next two years at significant discounts. Level 3 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.

Dillard’s owns most of its stores. Its real estate assets sell for a small fraction of the per square foot prices of comparable transactions over the last year. Although demand for retail space has declined, the company’s many superior locations help to insulate it. The operating business also faces recessionary challenges, and our appraisal assumes Dillard’s loses money in 2009. The reconstituted board is pushing management to reduce costs, close underperforming stores, and improve governance. Management has responded to the price decline of over 70% by retiring shares at the corporate level and buying more personally.

Because the Washington Post began the year as the Fund’s largest holding, its 50% decline made it the largest detractor in the year. Newspapers are an increasingly competitive business given the proliferation of internet and television access, and a recession presents additional challenges. This explains part of the stock’s decline. Even after assigning the newspaper a value of zero, the investment case is compelling. The Kaplan education business, which has grown through the recession, and the cable business are the most valuable parts of the company. While the decline in private student loan availability has impacted many proprietary education businesses, these loans affect less than 10% of Kaplan’s student population. Post’s management has repurchased shares throughout the year, and the stock sells for roughly 40% of our conservative appraisal.

Service Corp. International, the funeral services company, fell over 60% in 2008 because of disappointing earnings related to their trust investments having a poor year and a decline in pre-need cemetery sales. While these two items hurt this particular year’s results, in the long term they are not among the most important drivers of the business. SCI sells for less than 5X after-tax free cash flow. The company is using its cash coupon to buy in shares and take advantage of weaker competitors.

Throughout the year we looked for opportunities to upgrade the portfolio as new ideas were abundant and the highest quality names that we owned became more discounted. In January we sold First American below full value, locking in gains to reinvest into less leveraged businesses. We received additional shares of Willis when the company bought Hilb Rogal, a smaller and less efficient insurance broker. We sold
Office Depot, previously discussed in our Third Quarter Report. Throughout the second half we liquidated the Fund’s position in IDT, which was a mistake, and added to higher quality businesses with better partners.

While we added to several existing holdings, we also redeployed capital into two new names in the third quarter, tw telecom and Saks. In October, shortly after purchasing Saks, the collapse of the economy and consumer credit lowered our appraisal. More specifically, it became apparent that high end retail plus a large exposure to Manhattan would be a challenge. With the numerous compelling opportunities becoming available, we quickly traded Saks for businesses with higher value growth prospects.

Price volatility enabled productive trading activity as we scaled back names that spiked and added to many that hit lows. The price drama illustrates: (1) the stability of values compared to stock prices; (2) the turmoil surrounding companies with financial leverage; and (3) how much a few days can impact returns. For example, our Level 3 appraisal was relatively stable. If one watched stock price to determine value, whiplash would be a problem. The table below shows various trading highs and lows reached over the last year even as the company’s cash flow grew.

<table>
<thead>
<tr>
<th>Date</th>
<th>Level 3 Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/07</td>
<td>$3.04</td>
</tr>
<tr>
<td>3/17/08</td>
<td>$1.68</td>
</tr>
<tr>
<td>6/5/08</td>
<td>$4.48</td>
</tr>
<tr>
<td>10/23/08</td>
<td>$0.60</td>
</tr>
<tr>
<td>11/4/08</td>
<td>$1.46</td>
</tr>
<tr>
<td>12/24/08</td>
<td>$0.57</td>
</tr>
<tr>
<td>12/31/08</td>
<td>$0.70</td>
</tr>
<tr>
<td>1/9/09</td>
<td>$1.65</td>
</tr>
</tbody>
</table>

At DineEquity our appraisal moved little during the year, but the price fell as much as 85% from January to the trading low on October 27. The next day the stock rose over 200% during the day, and, in less than a month, was down again over 60%. Three weeks later, on December 5, the trading price had risen almost 150% from the November 21st low. For the year overall, the stock declined 68%, severely over discounting the impact that the recession would have on results. The real values of Level 3 and DineEquity, no matter how one arrives at those values, did not change this much.

In Southeastern’s thirty-three years our portfolios have never traded this cheaply, and individual companies below 50% of value have not stayed there long. We feel confident that returns over the next several years will more than make up for the losses in 2008, and that our partners in the Small-Cap Fund will be rewarded for their patience and support. Our confidence is based on numerous factors:

- At a P/V in the mid-30%s, the Fund is the cheapest in its history and far below the long-term average in the high-60%s.
While our appraisals assume that the economy in 2009 is worse than 2008, over half of what we own is not significantly impacted by lower consumer spending including commercial insurers and internet transport companies. Some businesses such as the Washington Post’s Kaplan and Wendy’s/Arby’s add customers in a recession.

Most, if not all, of the companies we own should generate free cash flow coupons that should increase their intrinsic values even in this recessionary environment.

Most of our corporate partners own significant amounts of their own stock and have the same incentives for value recognition that we have.

When credit becomes available, several of the companies in the portfolio are prime candidates for buy-outs.

We hope that you share our enthusiasm and confidence. We encourage you to take advantage of this unique opportunity to add to the Small-Cap Fund when it sells for a huge discount and has the added benefit of tax loss carryforwards to offset a good deal of future gains.
Longleaf Partners Small-Cap Fund declined 11.9% in the third quarter versus a 1.1% drop in the Russell 2000 Index. These results brought the Small-Cap Fund’s year-to-date results to (21.9)% and the Index’s to (10.4)%). Clearly the recent results have been disappointing and have weighed on our absolute return goal of inflation plus 10%. We believe, however, that coming out of this bear market the Fund is well positioned to make up recent losses and post absolute returns in line with our expectations. The Fund’s long-term results remain meaningfully above the Index, even considering the third quarter differential.

<table>
<thead>
<tr>
<th></th>
<th>Cumulative Returns at September 30, 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Since Inception</td>
</tr>
<tr>
<td>Small-Cap Fund</td>
<td>587.5%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>476.6</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>1017.7</td>
</tr>
</tbody>
</table>

Please see postscript on page 6 regarding recent volatility and page 18 for additional performance information.

Over the last three months several stocks in the portfolio rose, but none as dramatically as Fairfax which gained 25% and is now the Fund’s largest holding. CEO Prem Watsa’s investment acumen has always been an important part of our case. He correctly bought CDS (credit default swap) contracts when credit spreads were ridiculously narrow, and has profited immensely as credit markets have collapsed and taken spreads to the opposite extreme. The company’s stated book value has grown 52% over the last year, and Fairfax has been the largest positive contributor to 2008 Fund performance. During the quarter we exchanged the Fund’s small stake in Odyssey Re, which is controlled by Fairfax, for additional Fairfax shares. Given Fairfax’s relative stock price weakness at that time, we were able not only to improve our portfolio P/V but also to move our economic interest to the controlling holding company level.

Pioneer Natural Resources has also contributed positively to the Fund’s year-to-date return in spite of the fact that it had the most negative impact over the last three months, declining 33% with falling energy prices. Our appraisal, which already assumed lower energy prices, remained intact. 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.

We sold Office Depot in July, but not early enough to avoid losses in the quarter. We purchased the company late in 2007 with a correct view that the economy would slow,
but with an incorrect view that Office Depot’s results would hold up as they did in the last recession, particularly as they were able to take advantage of smaller, weaker independents. The current slowdown, however, has hit the company much more severely. Because of its large Florida footprint where the real estate decline has been most pronounced, the impact has been even greater on Office Depot than Staples, its largest competitor. Unfortunately, management assumed the same limited damage that we did and was ill-prepared to weather the storm. As lower sales and margins caused us to reassess our case, we sold the position at a loss and used the proceeds to purchase more attractively priced companies with better business quality. This mistake has been the largest drag on 2008 performance.

With few liquidity options available, the market has penalized all companies with meaningful debt levels. DineEquity fell 55% in the quarter. IHOP (the company’s previous name) purchased Applebee’s restaurants using debt financing with the view that the company would adopt IHOP’s successful franchise model by selling Applebee’s stores to franchisees. While the model remains valid and franchisees have expressed enthusiasm over the opportunity to grow their stores, their financing sources to make these purchases have shrunk. Until credit markets loosen, DineEquity will be saddled with some of the debt from its acquisition and unable to convert as quickly to the more profitable franchise fee business.

Texas Industries also negatively impacted the quarter’s return, making it among the Fund’s larger detractors for the year. In this weaker economy residential construction has declined along with some commercial building. Our appraisal came down slightly to reflect slower sales through 2009, but the company should produce a substantial cash coupon even in recession. The company sells for less than half of our conservative appraisal. Other meaningful drivers of performance for the year-to-date had most of their impact in earlier quarters, whether Hilb Rogal and Hobbs and Potlatch to the positive, or Washington Post, Service Corp., and IDT to the negative.

Throughout the quarter we scaled back some names and added to others as we found opportunities to improve the quality and the undervaluation in the portfolio. We also purchased two new holdings, Saks, which Southeastern has previously owned, and tw telecom, an IP backbone network provider.

While the Small-Cap Fund’s recent performance has been dismal, we remain enthusiastic as both the managers and the largest shareholder group in the Fund. Because most of our partners have been investors for so long, they know that there have been previous periods where the Small-Cap Fund has significantly underperformed its benchmark Index. Our concentrated portfolio built without regard to index sector weightings has produced superior results over the long-run, albeit in uneven
increments. We believe that this time will be no different, though it doesn’t make current results feel any better. Each company has been impacted differently by the economic environment and tighter credit, but on average, our appraisals are slightly down for the year. Flat values do not meet our goal of 10+% annual appraisal growth, but holding up in today’s environment implies that most of the Fund’s businesses are well capitalized with substantial cash flow and good operators. In addition, at least half of the Fund’s companies have been taking advantage of these discounted prices to repurchase shares, thereby increasing value per share as well as the Fund’s percentage ownership. The P/V at the end of the quarter was in the high-40%s, and in the first few weeks of October has gone to below 40%, a historic low.

Some have asked us if this down period will enable the Fund to re-open. Thanks in large part to the great partners we have, the Small-Cap Fund has had roughly flat net flows over the last year. While performance has taken the absolute level of assets down, we fully expect to get those and more back from performance. We therefore will continue to limit the size of the Fund to existing investment relationships.
Longleaf Partners Small-Cap Fund rose 0.3% in the second quarter, slightly short of the Russell 2000 Index’s 0.6% gain. The Fund is down 11.4% for the year-to-date while the Index has fallen 9.4%. The Fund’s more impressive long-term returns are shown below.

<table>
<thead>
<tr>
<th>Cumulative Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Inception</strong></td>
</tr>
<tr>
<td><strong>15 year</strong></td>
</tr>
<tr>
<td><strong>10 year</strong></td>
</tr>
<tr>
<td><strong>5 year</strong></td>
</tr>
<tr>
<td>Small-Cap Fund</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
</tr>
</tbody>
</table>

Please see page 16 for additional performance information.

Over the last three months Pioneer Natural Resources appreciated 59% as energy prices reached record highs. After two strong quarters, Pioneer has been the biggest performance contributor for the year-to-date, and as a result, the company is the Fund’s largest holding. Interestingly, because Pioneer began the year at a steep discount and subsequently reported large potential reserve additions, the stock still sells way below intrinsic worth even if oil declines to half of its recent price.

During the quarter we sold one position, the insurance broker Hilb Rogal, when Willis announced the purchase of the company for a fair price (taking into account undervalued Willis shares to fund half of the transaction.) As Willis holders, the slight dilution should be offset by significant cost synergies, a stronger North American footprint and sales culture, and increased leverage with underwriters. Hilb was one of the largest contributors to second quarter performance, and we used some of the proceeds from the sale to fill out the previously underweighted position in Willis.

Level 3, among the worst performing stocks through March, rallied 39% in the second quarter. The stock was extremely volatile even though the company did not report any significant news. Our appraisal grew.

Two stocks, Dillard’s and Del Monte, hurt performance the most in the quarter. Following a decline earlier in the year, Dillard’s is also among the largest detractors in 2008. The weak economy has hurt retail stocks, and Dillard’s has not been immune. Our appraisal is underpinned by the value of the company’s real estate, which is selling in the stock market for less than $20 per square foot versus a recent comparable transaction of $120 per square foot. We are pleased to have new board members involved who are focused on securing the value of the company’s assets for its owners.

At Del Monte raw material and transportation cost increases have hurt earnings. The company expects costs to continue to rise and has budgeted higher marketing expenses to implement a price increase and introduce new products. Our lowered
appraisal reflects reduced margins, but the price is far below what the valuable food brands and pet products are worth.

In addition to Dillard’s, the largest detractors from year-to-date returns have been Washington Post, IDT, and Fair Isaac. The same credit and recession fears that plagued the Post’s stock in the first quarter continued through the second. Less than 10% of the company’s higher education students receive private loans, and only a small portion of the company’s operating income is tied to newspaper advertising. The stock sells for approximately half of our appraisal. IDT has been a mistake; we misjudged the core business and the management.

We added to the Fund’s position in Fair Isaac, and the company’s leaders have continued to shrink shares and buy stock personally. The terrible credit markets have reduced the use of FICO scoring as financial institutions have significantly cut back solicitations for credit cards as well as other types of financing. Fair Isaac’s other product lines have also suffered from the decreased activity of their financial institution customers. The competitive strength of FICO’s brand remains intact, and in this most challenging and depressed environment the company should generate $2.50/share of free cash flow versus a stock price under $21.

Because opportunities to add to Fair Isaac, Willis, Markel, and Service Corp. were so compelling, proceeds from sales and trims went to these existing names. The on-deck list, however, is growing in size and attractiveness. We are carefully considering tradeoffs for higher business quality and/or improved partners. The Fund’s P/V is mid-50%s, a rare occurrence and far below the long-term average. We do not know how long these discounts will remain, but believe that the Fund is extremely well positioned to produce good returns for our long-term partners.

As recently as a year ago, many small caps traded for prices close to their private market values. Now, the stock market prices many of these companies dramatically below levels at which they would trade in a transaction because of the difficulty for all buyers in securing debt financing. But the long-term discounted cash flow values of these companies is intact, and, at some point when financing returns, these companies will be the first ones to change hands at prices far higher than today’s.
Longleaf Partners Small-Cap Fund declined 11.6% compared to a 9.9% drop in the Russell 2000 Index. The Fund’s longer term results are shown below.

<table>
<thead>
<tr>
<th>Cumulative Returns</th>
<th>15 years</th>
<th>10 years</th>
<th>5 years</th>
<th>1 year</th>
<th>1st Qtr</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>534.8%</td>
<td>142.8%</td>
<td>113.9%</td>
<td>(15.4)%</td>
<td>(11.6)%</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>499.6</td>
<td>233.4</td>
<td>84.2</td>
<td>14.0</td>
<td>3.3</td>
</tr>
<tr>
<td>Russell 2000</td>
<td>266.1</td>
<td>62.3</td>
<td>100.3</td>
<td>(13.0)%</td>
<td>(9.9)%</td>
</tr>
</tbody>
</table>

Please see page 16 for additional performance information.

We sold First American and scaled back several other names that had performed well in order to concentrate in the Fund’s highest quality and most steeply discounted holdings. We added to Fair Isaac, Markel, Wendy’s, and Worthington. While we have a number of qualified “on deck” names, none were more compelling than some of the companies we already own.

IHOP returned 31% in the quarter, partially bouncing back after its steep decline in late 2007. IHOP provides a good example of how stock prices are much more volatile than intrinsic values, and thus the market’s inefficiency in the short run. Six months ago IHOP sold for over $63 per share which was close to 80% of our appraisal. The price fell by over 40% in the fourth quarter of 2007, and we marked our appraisal down around 10% reflecting the slower pace at which the company would be able to sell Applebee’s stores to franchisees and pay down debt. Over the last three months, IHOP’s stock rose 31% to almost $48 versus an appraisal gain of 1% from the cash flow the business generates. Vast swings between price and value provide opportunities to take advantage of Mr. Market.

Fair Isaac, Service Corp., IDT, Level 3, and the Washington Post had the greatest negative impact on the Fund’s results in the quarter. Fair Isaac, which produces the widely used FICO score that helps lenders determine the risk profiles of borrowers, was impacted by the fear surrounding all companies involved in credit related activity in addition to company specific concerns. While lenders pulled fewer scores with the seizing of credit markets, we believe FICO scores will retain their critical role in underwriting. New management is pursuing a credible strategy to reinvigorate growth and has bought back significant stock at discounted prices using the company’s still prodigious cash flow and strong balance sheet. The stock fell by one-third, and we added to the Fund’s position at less than half of appraised value.

Service Corp.’s value rose slightly in the quarter while its price sank 28%. Although death rates have declined, this funeral services provider has successfully
integrated last year’s Alderwoods acquisition and has used its substantial free cash flow to repurchase discounted shares. Cash drains from IDT’s competitive long distance calling card business as well as concerns over where the company might deploy its significant cash helped drive the price down 54%. IDT trades for less than the sum of its cash and securities.

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.

Washington Post, the Fund’s largest holding, fell 16% due to fears of shrinking availability of private education loans and a recession’s impact on the media business. Very little of the company’s value is related to advertising revenues from media. The Kaplan education division comprises the largest part of our appraisal. The half of Kaplan that is related to test preparation services has no loan dependency. Of the higher education piece, less than 10% of Kaplan’s students are served by private loans. Washington Post sells for approximately half of our appraisal.

While the Fund will remain closed to contain asset size, we encourage our fellow shareholders to add to their investments in the Fund as we have. The composite P/V is in the high-50%s, its lowest level in over five years. Values are growing as share prices are declining, giving us an even larger margin of safety and upside return. Most of our management partners are owners and many are pursuing initiatives to increase value-per-share. The market’s current mispricing juxtaposed against the quality of what we own presents a unique opportunity.
After a fourth quarter decline of 9.1%, Longleaf Partners Small-Cap Fund ended the year up 2.8%. The fact that the Fund surpassed the Russell 2000 Index’s 1.6% decline is only slight consolation given our absolute return goal of inflation plus 10%. The long-term results of the Fund have been much more rewarding, and we believe that the prospects for meeting our absolute goal over the next five years are high.

<table>
<thead>
<tr>
<th>Cumulative Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 Years</td>
</tr>
<tr>
<td>Small-Cap Fund</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
</tr>
</tbody>
</table>

Please see page 16 for additional performance information.

In the fourth quarter we sold Trend Micro when it reached appraisal, and we scaled back several holdings that had become overweighted due to strong performance. The market volatility gave us ample opportunity to add to seven underweighted, steeply discounted companies and to buy one new name, First American. As a result of these portfolio changes as well as price declines, the P/V of the Fund dropped from the low-70%s to the low-60%s in only three months. Through mid-January of 2008 it has declined further to its lowest level in five years.

Not all prices suffered during the year, and sixteen companies positively contributed to 2007 performance. The largest gain by far came from Discovery which pulled back slightly in the fourth quarter but managed a 56% return for the last twelve months. Margins improved, EBITDA grew rapidly, and the company’s holding structure was finally simplified. Recently Advance/Newhouse announced that they will roll the last privately held stake of Discovery Communications into Discovery Holding Company, making it a fully public operating company. Because the company’s value grew 20% in 2007, the stock remains below our appraisal.

Fairfax was the Fund’s major positive contributor in the fourth quarter and also meaningfully added to 2007’s return. Not only were underwriting results solid, but the company’s investments did exceedingly well, particularly those that anticipated widening credit spreads. Prem Watsa ranks highly among the best investors we have known.

Service Corporation added to the Fund’s 2007 results. The integration of the Alderwoods acquisition and continuous improvements in operations created
higher free cash flow. Tom Ryan bought back discounted shares with that cash flow, thus further increasing value. Olympus’ 25% increase over the year also helped returns. The company’s dominant core medical business continued to grow and build value, and the camera business performed better than we expected.

Declines at Office Depot, IHOP and Level 3 in the fourth quarter made them the largest detractors from the year’s return. 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 flow 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.

Office Depot faced a number of short-term obstacles. A slowing U.S. economy has hurt retail sales in general, which account for 40% of Office Depot’s business. Small businesses have delayed purchases, particularly the larger furniture and technology investments that represent a bigger piece of Office Depot’s mix than their competitors’. The company also is more dominant in Florida and California, two markets that have been the worst hit. Although these issues are real, the fears are overdiscounted. The company is producing $2 of free cash flow even in this depressed environment, and CEO Steve Odland’s track record in cost cutting and expanding sales per square foot gives Office Depot meaningful long-term growth potential following this pullback.

Over the last three months credit markets dried up, slowing the process for IHOP to sell Applebee’s stores to franchisees in order to pay down debt from the acquisition. This caused IHOP to be one of the worst performers for the quarter and the year. Over the next five years IHOP should grow and realize cost improvements related to combining the two companies. During the year, our appraisal grew, and at today’s price the stock qualifies as a new buy. IDT, the other significant detractor for the year, rebounded in the fourth quarter. The company sells for less than the value of its cash, investments, NOLs and spectrum.

In addition to those companies previously discussed, Worthington was among the worst performers in the quarter, reversing its gains for the year over the last three months. While the economic and construction slowdown impacted the steel processing and metal framing businesses, the primary disappointment came from
the cylinder division which reverted from peak to more normal operating levels. The company’s joint ventures combined with our conservative appraisals on the other pieces make Worthington extremely attractive. We took advantage of the price decline to add to our stake.

We believe Longleaf Partners Small-Cap Fund is extremely well positioned for long-term future compounding. The collective quality of what we own and the partners running those businesses combined with the lower-than-average P/V make a compelling case for adding to the Fund. As Small-Cap owners and managers, our biggest challenge is choosing the best among a number of good choices with the Fund’s limited cash resources. This is a good problem to have.
Longleaf Partners Small-Cap Fund added 2.0% in the third quarter, bringing the year-to-date performance to 13.1%. Not only is the Fund ahead of our annual goal of inflation plus 10%, but these results are significantly higher than the Russell 2000 Index’s loss of 3.1% over the last three months and 3.2% return in 2007. More importantly, the cumulative returns below show that the Fund has maintained this outperformance over the long run.

<table>
<thead>
<tr>
<th>Cumulative Returns at September 30, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Small-Cap Fund . . . .</td>
</tr>
<tr>
<td>15 Years  10 Years  5 Years  1 Year</td>
</tr>
<tr>
<td>860.5%  246.5%  174.1%  23.6%</td>
</tr>
<tr>
<td>Year-to-Date  3rd Quarter</td>
</tr>
<tr>
<td>13.1%  2.0%</td>
</tr>
<tr>
<td>Inflation plus 10% . . . .</td>
</tr>
<tr>
<td>495.3  227.9  83.2  12.8  10.8  2.6</td>
</tr>
<tr>
<td>Russell 2000 Index . . .</td>
</tr>
<tr>
<td>410.3  100.8  136.1  12.3  3.2  (3.1)</td>
</tr>
</tbody>
</table>

Please see page 14 for additional performance information.

The most substantial contributor in the quarter (up 25%) and throughout the year (up 79%) has been Discovery Holdings. David Zaslav has improved results throughout the year, consistently increasing margins and growing EBITDA at high rates. There has also been progress in simplifying the holding company’s structure. We used this price strength to scale the company back to a normally sized position.

Fairfax, up over 27% in the quarter, also has added to the year’s solid return. The company benefited from a favorable hurricane season and a well-positioned investment portfolio that anticipated many of this summer’s negative credit events. The gains at Olympus, Texas Industries, and Service Corp. posted earlier in the year and discussed in previous quarterly letters have made these among the top contributors to 2007 returns.

The 20% pullback in Level 3 in the quarter caused this stock to be the biggest detractor from performance both for the year-to-date and the last three months. 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.

IDT remained a primary detractor from 2007 performance after it declined 20% in the third quarter. Although challenges to the calling card business have hurt profitability, the company sells for substantially less than the value of its non-earning assets including cash, securities, other investments, NOLs and spectrum.
In July we completed the sale of Pepsi Americas. After doubling since we purchased it, the stock reached our appraisal. The market volatility enabled us to add a meaningful amount to several positions including Washington Post, Worthington, and Fair Isaac. In addition we purchased a full position in Office Depot and began buying Dillard’s and Markel before prices rebounded.

The combination of portfolio changes and value growth at most of the Fund’s holdings helped move the price-to-value ratio from the high-70%s to the low-70%s even as prices appreciated. Cash levels declined from 14% to less than 5%. The “on-deck” list of stocks that are close to meeting our criteria remains robust. We believe that we will have the opportunity to further strengthen the Small-Cap Fund’s foundation and are glad to have some available liquidity.
Longleaf Partners Small-Cap Fund gained 3.2% in the second quarter, bringing year-to-date performance to 10.8%. Thus far in 2007 the Fund is significantly ahead of our annual goal of inflation plus 10% and the Russell 2000 Index. Results over the last twelve months have been spectacular, but are not likely sustainable. We believe the Fund’s longer term performance, which has exceeded our absolute return goal, is more indicative of what shareholders might expect over the next five years. The cumulative returns show that outpacing a real return of 10% leads to significant compounding over long periods.

<table>
<thead>
<tr>
<th>Cumulative Total Returns at June 30, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Small-Cap Fund  .  .  .  . .  .</td>
</tr>
<tr>
<td>Inflation plus 10%  .  .  .  .  .</td>
</tr>
<tr>
<td>Russell 2000 Index  .  .  .  .  .</td>
</tr>
</tbody>
</table>

Please see page 16 for additional performance information.

Most names in the portfolio have risen this year, but gains at Discovery and Olympus contributed significantly both in the second quarter and year-to-date. Discovery rose 20% over the last three months, and has appreciated over 40% in 2007. No specific news occurred in the quarter, but new management has intensified the company’s focus on its core programming strengths. Our appraisal has grown and the company still sells below fair value. Olympus has successfully turned around its camera business while reporting better than expected growth in its core medical equipment business. Texas Industries has also been a strong contributor to this year’s Small-Cap Fund results with much of its rise occurring in the first quarter. Business remains strong and multiples being paid in transactions for similar companies imply a higher private market value than the current price.

Fairfax fell 15% in the second quarter, probably as a result of general industry concerns over the performance of bond portfolios as interest rates rose. Our appraisal has risen this year due to Fairfax’s investment and operating successes. IDT continued the decline that began in the first quarter and is the only name that has meaningfully detracted from year-to-date Fund performance. While pricing in the long distance calling card business is fiercely competitive, the net cash position and smart, vested management team give us confidence in our appraisal, which is significantly above the current price.

We have found several interesting small-cap ideas, but only one met our price criteria in the quarter. We purchased the Washington Post, which Southeastern
has previously owned. We have confidence that partnering with Don Graham again will yield another successful outcome.

The Fund's price-to-value ratio remains in the high-70%s. The cash position will allow us to lower the P/V as we find opportunities that meet our qualitative and quantitative criteria.

Please see postscript on page 5 regarding recent volatility.
Longleaf Partners Small-Cap Fund had an outstanding quarter. The Fund’s 7.4% return significantly outpaced the Russell 2000 Index’s 2.0% gain as well as the annual absolute return goal of inflation plus 10%. Although every quarter in the Small-Cap Fund’s history has not been as robust as the first three months of 2007, the Fund has consistently outperformed the benchmark as well as the absolute bogey over longer term periods.

<table>
<thead>
<tr>
<th>Cumulative Returns</th>
<th>Inception</th>
<th>15 Year</th>
<th>10 Year</th>
<th>5 Year</th>
<th>3 Year</th>
<th>1 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-Cap Fund</td>
<td>818.8%</td>
<td>719.6%</td>
<td>289.3%</td>
<td>108.0%</td>
<td>64.5%</td>
<td>24.4%</td>
</tr>
<tr>
<td>Inflation plus 10%</td>
<td>816.0</td>
<td>494.7</td>
<td>225.5</td>
<td>82.7</td>
<td>44.7</td>
<td>12.8</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>566.3</td>
<td>383.3</td>
<td>164.9</td>
<td>68.1</td>
<td>40.5</td>
<td>5.9</td>
</tr>
</tbody>
</table>

Please see page 14 for additional performance information.

Most portfolio holdings contributed to the quarter’s results with a number of stocks rising over 10%. The top two performers were Discovery and Texas Industries. Discovery Holding Company bought Cox’s 25% ownership in Discovery Communications in exchange for cash and the Travel Channel, leaving only one remaining private holder of the Discovery-owned channels. The improved structure enhanced Wall Street’s view of the company. More importantly, viewership ratings have been strong in the first quarter. Texas Industries’ stock rose due in part to rock solid results, but also due to buy-outs at several cement and aggregates companies that traded at significantly higher multiples than those reflected in Texas Industries’ stock price.

IDT detracted from the Fund’s return, declining 13%. Fierce pricing competition among long distance calling card companies hurt margins. The company announced that it will use a large portion of its cash to pay a one-time special dividend.

During the quarter we sold two positions and began buying two, although thus far, prices have not enabled us to accumulate meaningful positions. In spite of our opposition to the sales price, Jacuzzi was bought by a private equity group. We sold Vail Resorts when the stock approached our appraisal.

The strong performance moved the price-to-value ratio (P/V) into the high-70%. While we have several names that are close to our buy price, a couple of holdings are approaching 90% of appraisal. Cash levels rose slightly to 16% of the portfolio. We like the businesses that the Fund owns and believe that most of their values will appreciate at double-digit rates. We would, however, welcome more volatility, particularly among smaller size companies so that we could fill out several positions and find a few new ones. We would also caution Small-Cap shareholders that the returns of the next three years are unlikely to be as high as the previous three, based on the higher prices of companies in this universe.
Longleaf Partners Small-Cap Fund rose 22.3% in 2006 following a 9.3% return in the fourth quarter. These results far outpaced our absolute goal of inflation plus 10% as well as the 18.4% return of the Russell 2000 Index for the year and the Index’s 8.9% performance over the last three months. Over the last decade the Fund has compounded at 14.5%, meaningfully ahead of our absolute goal and the Index.

With such significant compounding one would assume that the P/V for the Fund would have risen. Surprisingly, the P/V both began and ended the year in the low/mid-70%s. Three things account for this stability. First, we sold an unusually large number of businesses during the year as they approached our appraisals — Hollinger, Hasbro, Deltic Timber, and Saks in the first half, and Shaw, Molson Coors, U.S.I. Holdings and the Level 3 Bonds in the fourth quarter. Second, we purchased positions in 5 new names — Del Monte Foods, Fair Isaac, IDT, Texas Industries, and Wendy’s — and added to several holdings that sold at substantial discounts. Third, the values of most holdings rose, some at a meaningful rate. The average value growth across the portfolio was 10%. In spite of the strong return, the P/V is as attractive now as at the outset of 2006 and the Fund has almost 14% cash available to lower the P/V when we identify new opportunities.

Level 3 played the biggest part in the Fund’s 2006 results. The equity almost doubled and the bonds also rose. 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.

Shaw Communications rose over 35% and reached our appraisal. We mentioned in the Third Quarter Report our immense gratitude to Jim Shaw for his management acumen that has now rewarded shareholders for the second time in the Fund’s history.

Jacuzzi’s strong fourth quarter made it one of the Fund’s largest contributors in 2006. Apollo Management has made an offer to take the company private. We have filed a 13D stating our intent to vote against this $12.50 per share deal given our belief that the value is significantly higher and new management can build that value. Texas Industries, purchased in the third quarter, rose 24% over the last three months, and helped the Fund’s full year results as well. The other major contributor in the fourth quarter and for the year was Fairfax. The
company improved its capital position by selling a portion of its Odyssey Re subsidiary. This sale along with good 2006 underwriting and terrific long-term investing reversed Fairfax’s slide.

Only two names had any meaningful negative impact on Small-Cap’s return. Pioneer Natural Resources fell over 20%, 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 among the cheapest in the portfolio. Pepsi Americas also lost ground during the year because of relatively poor execution.

Small-Cap’s “on-deck” list is limited, but we have started to add a new name since year-end. The run in smaller stocks over the last few years has made finding companies that qualify more difficult. We will continue to be diligent as we look for the next building blocks for the Fund, and are glad to have available liquidity.
Longleaf Partners Small-Cap Fund rose 8.4% in the third quarter, bringing the year-to-date return to 12.0%. These results far exceeded the absolute annual goal of inflation plus 10% as well as the Russell 2000 Index’s 0.4% rise in the quarter and 8.7% gain for 2006.

The Fund’s largest position, Level 3, appreciated over 20% during the last three months. The combined equity and bond holdings have driven the majority of the Fund’s successful results this year. 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.

Most of the Fund’s positions have helped returns. In addition to Level 3, Shaw Communications has played an important role this year. The stock’s 38% increase brought the price close to our appraisal of the company. We trimmed the position, which was the largest holding at the quarter’s outset, to help fund more undervalued opportunities. Subsequent to quarter-end, we completed the sale of Shaw. Jim Shaw has been a wonderful partner to Southeastern and Longleaf twice in the firm’s history. We expect that he will continue to build value. Our investment discipline, however, dictates that we exit a position when no margin of safety remains between price and value. We hope to have the opportunity to partner with Jim Shaw again someday, and we are grateful to him.

The only holding that meaningfully detracted from performance in the quarter and for the year-to-date was Pioneer Natural Resources. Although this year’s 15% stock retreat mirrored energy price declines, lower energy prices have not impacted our appraisal of the company’s oil and gas assets because the appraisal is not predicated on high near-term prices.

By selling Shaw and some Level 3 bonds, we added to a number of existing holdings that sold at steep discounts, particularly early in the quarter. In addition, we began purchasing three new businesses. In previous years we have owned Texas Industries, the cement and aggregate company, and are pleased to have a full position in the company again. Price was less cooperative in our attempts to build positions in Del Monte and Fair Isaac.

Because the steep price appreciation in the quarter outpaced the value growth at most companies in the Fund, the price-to-value ratio (P/V) rose slightly from the high-60% to the low-70%, even with the transactions that replaced higher
P/V holdings with lower ones. In spite of the P/V increase, we believe that we have a solid foundation in place for successful long-term compounding given the quality of the businesses we own and the excellent management teams running them.
Longleaf Partners Small-Cap Fund held up better in the second quarter than the benchmark, falling 2.2% versus the 5.0% decline of the Russell 2000 Index. The Fund’s year-to-date return of 3.3% fell short of our absolute annual goal of inflation plus 10% and the Index’s 8.2% return.

Two companies have driven most of Small-Cap’s positive results in 2006. Although Level 3’s stock fell 14% in the second quarter, both the equity and the 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.

Shaw Communications’ price has also steadily increased this year, and the stock was the best performer during the second quarter. The company has experienced rapid growth in its voice-over-IP phone offering along with price increases and subscriber growth in basic cable and high-speed internet. Shaw’s value has increased with the substantial organic growth in its business.

Olympus and Jacuzzi, which had been among the largest contributors to performance in the first quarter, gave back some of those gains over the last three months. The recent price declines did not reflect a change in our long-term outlook for either company, and both stocks remained in positive territory for the year-to-date. After its dramatic decline in the first quarter, Fairfax remained the largest detractor from 2006 performance even though the value of the company has been stable and the ratings agencies affirmed the company’s ratings early in the second quarter.

More important than the Fund’s short-term price swings was the ongoing improvement to Small-Cap’s portfolio. Over the quarter new purchases helped cut cash levels in half, even as we sold Hasbro and the Fund’s minimal stakes in Saks and Hollinger. In each case we exchanged businesses selling at close to appraisal for companies with a larger margin of safety between price and value, and with values that are growing more rapidly. The primary new holding in the Fund was Wendy’s. We have taken a short swap position in Tim Hortons to lock in the price we receive for this high quality Canadian restaurant chain when Wendy’s spins it out in October. This position is, therefore, a hedge, and not a bearish stance on Tim Hortons.

As a result of new purchases and adding to several extremely discounted existing holdings, the P/V moved below 70% for the first time in three years. The trading desk is currently working on adding two additional names which would put the remaining cash to work. The Fund is almost fully invested in a core group of holdings with growing values and solid management teams.
Longleaf Partners Small-Cap Fund rose 5.6% in the first quarter, outpacing the annual goal of inflation plus 10%, but underperforming the Russell 2000's 13.9% return. Over the last five years the Fund has surpassed both our absolute goal and the index, compounding at 14.3% per year versus 12.6% for both inflation plus 10% and the Russell 2000.

The primary driver of the first quarter’s return was 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 were also up significantly. We are comfortable with the Fund’s overweighted position in Level 3 because the equity sells for a deep discount to a growing appraisal. The company’s improving fundamentals have not only increased Level 3’s value, but have also provided additional cushion and coverage to the convertible and non-convertible bonds.

A number of other stocks helped performance with Shaw, Jacuzzi and Olympus leading the way. Shaw reported strong results on all fronts and its value continued to build. At Jacuzzi, the non-residential division, Zurn, posted outstanding results and the company has taken steps to turn around its residential bath business. Olympus showed a significant improvement in the camera business due to cost cuts and a successful new SLR camera. While the growing and profitable medical equipment business generates 90% of earnings, the market remains focused on cameras.

Pioneer Natural Resources and Fairfax Financial hurt performance in the quarter. Pioneer fell 13% as oil and gas prices retreated and the company reported poor exploration results for 2005. The stock sells well below our appraisal, and for substantially less than comparable oil and gas companies due to the long life of its reserves. Fairfax delayed its annual report because of a restatement that auditors required at Odyssey Re, the reinsurance company that is 80% owned by Fairfax. The restatement related to the timing of when profits on certain finite reinsurance contracts from as long as ten years ago would be recognized. Odyssey filed its 10-K, and Fairfax released its annual report, after trading hours on March 31. Rating agencies have affirmed Fairfax’s ratings. None of this impacted our appraisal, which is substantially higher than the price.

We have completed the sale of Deltic Timber, which reached our appraisal. Investment opportunities that meet our qualitative criteria and are selling at a
steep discount to appraisal remain difficult to find. The small cap universe has had quite a run over the last three years, averaging 29.5% per year as measured by the Russell 2000, and the long rally has been somewhat broad-based. The result has been higher cash levels than we would like. At the end of the quarter the Small-Cap Fund held 12.5% in cash reserves.

A couple of companies are “on deck,” meaning they meet our qualitative criteria but are not quite cheap enough. We are hopeful that these ideas or others we find will enable us to convert the low-returning cash into investment opportunities. In addition, several new qualifying names would help move the Fund’s price-to-value ratio closer to historic averages from its current mid-70s level.
Longleaf Partners Small-Cap Fund finished the year up 10.8% following a solid fourth quarter gain of 4.4%. These results far outpaced the Russell 2000 Index’s return of 4.6% for 2005 and 1.1% over the last three months. Although the Fund did not quite reach inflation plus 10% for the year, double-digit compounding added to Small-Cap’s successful long-term record.

The portfolio made significant progress during 2005. We began the year with almost 30% cash. Thanks to finding a number of new investments for the first time in several years, cash fell to under 8%. We also had strong value growth at existing holdings working in our favor. The combination of new purchases and value growth helped lower the portfolio’s price-to-value ratio (P/V) from peak levels to the low-70%s. While still above the long-term average, the P/V improvement is noteworthy, especially given the double-digit performance.

Only four of the nine new names are full positions because prices rose beyond our required discount before we could buy as much stock as desired. Fortunately, two filled orders were Pioneer Natural Resources and Olympus. These two holdings helped drive the Fund’s results with each stock up over 30% since purchase. Not only did Pioneer’s stock appreciate but our appraisal also grew with rising energy prices and exceedingly productive capital allocation by management. Olympus’ high-growth medical business began to overshadow its unprofitable camera business. Olympus was one of the top performers in the fourth quarter as well as for the year.

Level 3’s results indicated improved pricing for its Internet Protocol and transport businesses, and the company announced its purchase of WilTel in the fourth quarter. This industry consolidation should generate substantial cost savings. The good news helped drive up Level 3’s stock and bonds, particularly in the fourth quarter. Small-Cap’s combined position had a meaningfully positive impact on 2005 results.

Only four holdings, Hollinger, Jacuzzi, Molson Coors, and Fairfax, lost ground over the year and none had a material impact on the Fund’s performance. Fairfax’s fourth quarter decline accompanied an industry-wide inquiry related to finite reinsurance, which Fairfax states it has accounted for appropriately.

We sold two names in 2005 – the remaining profitable stake in Texas Industries in the first quarter, and Neiman Marcus in the fourth. Neiman, which private investors bought for $100 per share, serves as a good example of how the combination of a great business and particularly capable management can escalate investment returns. We purchased Neiman in the mid-20s in late 1999 as the technology bubble overshadowed all non-tech stocks. Given the quality of
Neiman's brand and its superior sales per square foot, we believed that we were buying a 60-cent dollar with good prospects for value growth. Over the six year period, in spite of the dot-com bust and an economic recession, our appraisal of Neiman more than doubled. Not only did the initial gap between price and value close, but thanks to the operational talent of management, superior value growth helped accelerate our total return to over 300%. Neiman was the largest contributor to performance in 2005.

After three years of 22.3% average annual returns, the Small-Cap Fund portfolio is surprisingly attractive, particularly compared to a year ago. While the P/V is higher than the long-term average, it has improved by a meaningful amount. In addition the Fund has replaced its low returning cash reserves with high quality businesses that offer much greater opportunity. The next three years’ performance is unlikely to outpace the last three, but we do believe the Fund is well positioned to meet inflation plus 10% over the long run.
Small-Cap Fund - MANAGEMENT DISCUSSION
by Mason Hawkins, Staley Cates, and John Buford

Longleaf Partners Small-Cap Fund is up 6.1% in 2005 following its 1.5% rise in the third quarter. The Russell 2000 Index has gained 3.4% for the year-to-date after its 4.7% return over the last three months. While results have outpaced the Index year-to-date, we have not met our absolute annual goal of inflation plus 10% thus far this year.

Part of the year’s slow returns can be attributed to the Fund’s large cash reserves held throughout most of 2005. The Fund began the year with almost 30% cash. The good news is that in the third quarter cash fell to single digits for the first time in two years. The better news is that we have converted the low-returning cash into a number of extremely discounted investments with a much higher return potential. We began identifying new opportunities that qualified in the second quarter. During the third quarter we added to several of those and purchased one new stock, Discovery. We own a number of entertainment-related companies across all three Longleaf Funds. Discovery has some of the most attractive characteristics among content providers as its channels carry primarily high quality and lower cost programming that is easily portable across multiple geographies. Until July Discovery was privately held with 50% of its stock owned by Liberty Media, a holding in the Partners Fund. Liberty spun its portion out in a public offering that gave us the chance to own Discovery in the Small-Cap Fund.

One of the purchases in the second quarter, Pioneer Natural Resources, has made a quick impact on returns, leading the second quarter’s gains and thereby becoming one of the largest contributors for the year. The stock rose 31% in the last three months as the company benefited from rising energy prices and very productive capital allocation. The other driver of 2005 results has been Neiman Marcus, which was purchased by private buyers in early October, affecting both the Fund’s capital gains distribution and cash balance. We will continue to look for additional qualifying investments to redeploy the proceeds, but as always, will be disciplined and patient.

Two holdings, Level 3 and Molson Coors, have hampered returns for the year, although both appreciated during the third quarter. No significant changes have occurred in our appraisal of Molson Coors since the mark-down discussed in the Semi-Annual Report. In the case of Level 3, the first quarter’s decline in the stock, not the bonds, accounts for almost all of the year’s negative impact. Hints of firmer prices in Level 3’s IP and Transport businesses have begun to show in the most recent 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. In the third quarter Jacuzzi had the only major
negative impact on the Fund. The company’s president departed due to disappointing earnings driven by the Jacuzzi branded products. Rumors of a possible buyout had driven the stock up, but the upheaval delayed any “catalyst” that Wall Street anticipated, thus pushing the price down 25%. Short-term changes in sentiment create opportunity. Our appraisal of the company grew because the commercial side of the business, Zurn, had strong results. We took advantage of the new disparity between price and value and added to Small-Cap’s stake.

The purchases in the portfolio as well as growing values helped lower the price-to-value ratio to the low-70%. This is a meaningful decline since the start of the year, and coupled with the much lower cash balance, makes the prospect for future compounding brighter.
Longleaf Partners Small-Cap Fund returned 2.3% in the second quarter and was up 4.6% for the first half of 2005. By contrast the Russell 2000 added 4.3% over the last three months but remained in the red for the year-to-date, down 1.3%.

Neiman Marcus propelled the Fund’s positive results thus far this year as a private equity firm agreed to buy the company for $100 per share. The closing date is not yet firm, but if it occurs before October 31st, the Small-Cap’s already meaningful realized gains (currently over 10% of NAV) will increase by about a third. These gains are all long-term and are a result of some extremely successful investments. We will not have a final estimate of the gains distribution until late October, and we hope that the Neiman deal will close after October 31st. For those partners who are taxable, we thought this information would be of interest.

The Fund’s performance fell short of inflation plus 10% in the first half. Although Level 3 positively impacted returns in the second quarter, our investment, driven primarily by the equity piece, has hurt 2005 results. No significant news has occurred since last quarter, and our appraisal has not changed materially.

During the second quarter a number of holdings helped performance, led by PepsiAmericas, Fairfax and a new investment, Pioneer Natural Resources. Ongoing growth in revenue and operating cash flow helped drive PepsiAmericas’ stock. At Fairfax continued operating improvement and the recapitalization in which the Fund participated led to a critical ratings decision that will strengthen the competitiveness of Fairfax’s core insurance business. Pioneer Natural Resources has been a holding in the Partners Fund for quite some time, and as its value and price grew in early 2004 we scaled back the position in that Fund. During the quarter the price declined, providing a window to add this company to the Small-Cap Fund. The stock has appreciated since the mid-May purchase, but sells for well below our appraisal.

The only significant decline in the quarter came at Molson Coors when they surprised investors with the announcement of weak earnings at Carling in the U.K. Our appraisal fell by a single digit percentage but the stock dropped almost 20% in the quarter, making it one of the portfolio’s more discounted holdings.

The Fund’s cash position declined by almost half over the last three months to under 18% as a result of a number of new purchases. We added to several undervalued existing holdings and also bought new names including Pioneer Natural Resources, Willis, Service Corp., Olympus, and Hollinger. In most cases we acquired only partial positions for various reasons. For the year-to-date, with the exception of Service Corp and U.S.I. Holdings, each of the new holdings is
now or has been a position in one of the Longleaf Funds. Our familiarity with these businesses and the people running them makes us confident in our knowledge and understanding of each.

With cash down to the teens and an “on deck” list of new names for the first time in a while, we are pleased with the Fund’s progress. The price-to-value ratio has become more attractive in the mid-70%es, aided by the purchase of undervalued securities and value growth at our holdings.
Longleaf Partners Small-Cap Fund rose 2.2% while the Russell 2000 Index fell 5.3%. The Fund’s return in the quarter was lower than our annual goal of inflation plus 10%.

The 35% increase in Neiman Marcus’ stock was the primary contributor to Small-Cap’s positive performance. The company announced that it is exploring a possible sale, and the expectation is for a premium price based on strong results over the last few years. Both Shaw Communications and IHOP also helped the Fund’s return. Shaw continued to perform strongly in all areas, while IHOP maintained its successful transition to a less capital-intensive growth model.

Level 3 hurt Fund performance as the stock declined 39% and the bonds also fell, though not nearly as much. 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 its prospects over the next three to five years are compelling.

Fairfax fell 10% although our appraisal held steady. Most insurance companies suffered stock declines during the quarter. The softer market cycle relative to a few years ago means weaker pricing; asbestos reform looks less likely; and a scandal surrounding the largest player, AIG, has left a taint across the industry, particularly for insurers who use finite reinsurance. In Fairfax’s specific case, short sellers and certain sell-side analysts along with media outlets beholden to them continue to sling mud at the company.

The positive side of the insurance industry weakness is that it afforded us some opportunity. We added to our position in Odyssey Re during the quarter and bought a small amount of insurance broker U.S.I. Holdings. Purchases in the quarter did not offset sales. We scaled back several holdings that were approaching our appraisal, and we completed the sale of Texas Industries. We are grateful to Chairman Bob Rogers, CEO Mel Brekhus, and the rest of the TXI team for doing a great job operationally and for making the capital allocation moves that resulted in such a successful investment for Longleaf.

Coors completed its merger with Molson. The company continues to thrive under Leo Kiely’s leadership, and we believe that the new entity remains substantially undervalued. There is upside to be realized from cost savings in the combination and less risk due to major market positions in three geographies (Canada, UK, and US) instead of two.
Although the price-to-value ratio of the Fund fell a bit in the quarter to the mid-70%, Small-Cap’s cash balance rose to 32%. We are hopeful that we can continue to uncover new ideas and that we will be able to successfully execute our buy orders.
Longleaf Partners Small-Cap Fund delivered another year of successful compounding, rising 14.8% after an 11.3% fourth quarter return. While the results were behind the Russell 2000’s 18.3% for 2004 and 14.1% in the fourth quarter, the return exceeded our absolute goal of inflation plus 10%.

The higher-than-average 31% turnover of assets indicates a large amount of portfolio activity. We began 2004 with nineteen stocks and during the course of the year sold nine. Particularly rewarding was that all nine were profitable investments, including MONY and Hollinger which had disappointing managements. In the fourth quarter we liquidated three positions: Hilton, Forest City Enterprises, and NCR. Each of these investment experiences represented the successful implementation of our discipline. They had competitively entrenched businesses run by capable owner-operators. We bought them at a steep discount because of short-term challenges and/or misperceptions about their prospects. Because of their strong qualitative characteristics these companies grew their worths substantially over the time we held them. Our successful results derived from both the steeply discounted price we paid and the double-digit value growth achieved during our ownership period.

Not only did we sell many names, we added six new holdings during the year. We successfully built full positions in Coors, Hasbro, and Hilb, Rogal & Hobbs. Unfortunately the prices of the three companies we added in the fourth quarter moved above our buy limit quickly. In only one case, Everest Re, did we get more than a negligible position.

The Fund’s imbalance between sales and purchases pushed cash levels from 15% at the outset of the year to 29%. Low returns on cash hindered results somewhat, but the performance of the Fund’s securities drove Small-Cap’s successful numbers. Each of the largest contributors to Fund performance, including Texas Industries, NCR, Neiman Marcus, and Coors, rose over 35% during the year and delivered strong fourth quarter returns. The Level 3 bonds also added meaningfully to the 2004 numbers. Early in the year the bonds traded close to par and we scaled them back. In the second quarter they fell to enough of a discount that we added to the position. By year-end the bonds had rallied and the Fund benefited from both the price improvement and the large coupon we received throughout the year.

Unfortunately the success of our Level 3 bonds did not entirely make up for the decline in our equity position. After being one of the largest positive contributors to 2003 performance, Level 3 fell 40% in 2004 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 during the year.
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 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.

Delivering inflation plus 10% will be a challenge in 2005 if we cannot find a handful of qualifying new investments. Our high cash position is earning minimal returns, and several holdings are approaching full value. The Fund’s price-to-value ratio is below last year’s all-time high due to purchases and sales as well as value growth. The P/V, however, is still hovering in the high-70%ks.
Longleaf Partners Small-Cap Fund fell 2.0% in the third quarter versus a 2.9% decline in the Russell 2000 Index. Year-to-date the Fund is up 3.2% against 3.7% for the Russell 2000. Although the Fund’s return is positive for the year, we have thus far not met our annual goal of inflation plus 10%.

While the Fund’s recent return may not reflect progress, the portfolio had a number of positive changes during the quarter. We sold Genlyte and received proceeds from AXA’s acquisition of MONY. We added two new positions: Hasbro, the toy maker, and Hilb, Rogal & Hobbs, the insurance broker. We have previously owned both, and were excited that short-term market concerns allowed us to buy them again at substantial discounts to our appraisals.

During the quarter Texas Industries continued the rally that began in the second quarter, bolstered by strong steel pricing. The company rose 25% over the last three months and is up 39% for the year, making this holding the largest positive contributor to Small-Cap’s return for both periods.

Level 3’s stock fell 26% in the quarter, and the bonds also retreated. 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 stiF price competition. In our opinion the stock, which has had the largest negative impact on the Fund’s results this year, is the most undervalued in the portfolio.

The other stock that hurt both recent and year-to-date performance is Fairfax Financial Holdings. This insurance underwriter has made great progress turning around its troubled divisions over the last several years. Because of leverage at the holding company as well as a complex structure, Fairfax has been a target of short sellers. We believe that the company sells for a steep discount to its value, that most negative claims by analysts are unfounded, and that the company’s fundamentals will continue to improve.

The portfolio has made substantial progress this year.

• We have sold a number of fully priced businesses.
• We have bought three new, high quality names at significant discounts to appraisal.
• Values have grown at most holdings.

Finding a home for the 22% cash in the Fund should further reduce the price-to-value ratio, which today is in the low 70’s.
Longleaf Partners Small-Cap Fund had a solid second quarter. The Fund rose 3.6%, outperforming the 0.5% return of the Russell 2000 Index and meeting our annualized absolute goal of inflation plus 10%. For the first half of 2004 Small-Cap was up 5.2% and the Russell 2000 Index added 6.8%.

Coors, the only new addition to the portfolio this year, was the largest contributor to the Fund’s first half return, rising over 30% since we purchased the stock beginning in mid-January. Most of the return was generated in the first quarter as the company’s U.K. brands, Carling and Grolsch, performed well.

NCR reported strong results in its Teradata subsidiary that provides data warehousing and in its more traditional ATM business. Our appraisal of the company has grown at a high rate with the combination of successful cost cutting initiatives and rising revenues. The stock rose 13% in the second quarter and was up 28% year-to-date through June.

In the second quarter Hilton and Texas Industries were the other main contributors to results, erasing the negative return of each in the first quarter, and resulting in a positive impact to the Small-Cap Fund for the first half. At Hilton occupancy and room rates continued to rise as travel, particularly business travel, returned to vibrancy. Increased transportation costs helped Texas Industries’ cement business versus imports, but the main driver of the company’s strong results was higher pricing for the steel subsidiary.

Jacuzzi’s stock performance in the first six months was a mirror image of Hilton and Texas Industries. The company posted a solid first quarter but fell 14% in the second. Jacuzzi’s overall affect on Small-Cap’s first half return was positive. In the last three months, although revenue grew nicely, the company took several one-time charges related to the restructuring efforts by the new COO, Don Devine. Going forward Jacuzzi should benefit from these changes through improved operations. Our appraisal was unaffected.

Early in the year Level 3 reduced expectations in its managed modem business because of the decline in AOL’s dial-up traffic. Price competition continued to neutralize 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. The stock’s decline throughout the first half made Level 3 the Small-Cap Fund’s largest drag on performance. While the shares fell in both
quarters, our various bond holdings helped make up for some of the loss, and the combined position provided a positive return in the second quarter.

During the second quarter MONY’s management, using tens of millions of shareholders’ dollars to pay lawyers and proxy solicitors, won their vote to be acquired by AXA by a slim margin, with about 53% of the votes. Management’s heavy expenditures and a change in the record date carried the day, despite opposition from Institutional Shareholder Services and Glass Lewis and widespread outcry about the excessive management pay-out. This experience offers several lessons for our shareholders: 1) Southeastern will fight managements whom we deem to be destroying value or acting unethically (and Southeastern, not the Fund, paid for the MONY fight); 2) A research mistake in evaluating management on the front end may not result in a loss if we buy the undervalued security with enough margin of safety (we made money on the MONY investment.)

The price-to-value ratio of the Small-Cap Fund’s equities dropped from a near all-time high in the low 80’s in January, to the high 70’s at the outset of July. Sales of several fully priced holdings, primarily in the first quarter, helped generate the decline as did value growth at many of the companies that remained in the portfolio. Cash in the Fund rose from 15% to 25% over the six months. Several businesses with the qualitative characteristics we require have recently declined to approximately 60% of value. We are hopeful that prices will drop below our buy limits so that we may convert some our cash reserves into higher return opportunities.
Longleaf Partners Small-Cap Fund rose 1.5% during the first quarter and finished the twelve-month period up 53.7%. The Russell 2000 Index also compounded at a phenomenal rate, rising 6.3% over the last three months and 63.8% for the last year. That level of annual compounding will not be sustained over the long run. We remain the largest shareholders of the Small-Cap Fund because we believe that we will preserve capital and make a real return of inflation plus 10% over time.

The Small-Cap portfolio had a large amount of activity during the quarter. We sold Alleghany, Brascan, Hollinger, and Timberwest because all four reached our appraisal. We scaled back several positions as prices rose closer to value. We found one new investment, Coors, which rose 24% above cost, making it the largest contributor to the Fund’s performance. Short-term worries about Coors Light in the midst of the low-carb craze ignored the strength and growth opportunities of the Coors Light brand in the U.S. and Canada and the Carling and Grolsch brands in the U.K. In addition, CEO Leo Kiely is rolling out a low-carb alternative and significantly improving the operating efficiency and cash flow at the company.

Early in the quarter as the Level 3 bonds approached par and the stock rose, we trimmed both positions. In March when Level 3 lowered operating cash flow expectations for 2004, prices fell, hurting the Fund’s performance. 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. We took advantage of the price decline by buying more of the senior and convertible notes in late March. Although the earlier sales and lower prices reduced Small-Cap’s Level 3 combined position from 12.5% to 10.7% over the quarter, the company remains the Fund’s largest holding with the bonds now more heavily weighted than the equity.
MONY’s management continued to hit new lows with their behavior during the quarter. After management agreed to sell out to AXA for a very low multiple on book value and a very high severance package, shareholders from all directions (including Longleaf) voiced major opposition to the deal. Institutional Shareholder Services and Glass Lewis, the two major independent proxy advisory services, also came out against the deal, and a Delaware judge required MONY to amend its proxy materials to indicate that change in control payments to management were “considerably more lucrative than is normal.” MONY’s response to vocal shareholder opposition was to spend corporate assets suing shareholders (including Longleaf), and its response to the Delaware judge was to reduce management severance enough to fund a $0.10 increase in the $31 purchase price. A ten cent tweak of the purchase price means nothing when our value for the company, if properly managed, is north of $40 per share. To this end, we have recommended that Robert M. Devlin, ex-Chairman and CEO of American General, be installed as head of a new management team. In addition, in its revised proxy statement, MONY acknowledged that it would have had difficulty obtaining an affirmative vote from a majority of outstanding shares using the original record and meeting dates. In a move that was challenged (but upheld) in a Delaware court, MONY changed the record and meeting dates, thus allowing arbitrageurs with positions in a convertible debt instrument issued by AXA to fund the deal, to buy MONY shares and vote at the later meeting. Even though the MONY vote has shifted to an arb battle, Southeastern intends to continue to voice its opposition to the deal. Please see the SEC’s website at www.sec.gov under MONY’s corporate filings if you are interested in reading our letters and press releases opposing the deal.

Selling fully valued securities and purchasing heavily discounted investments helped lower the Small-Cap Fund’s price-to-value ratio from an all-time high of 85% to 79%. Cash reserves moved from 15% to almost 28%. We close the quarter not only with positive performance, but with a portfolio that contains less risk and, when we find a home for the cash, much more return opportunity.
Longleaf Partners Small-Cap Fund had an outstanding year with a 43.9% return - almost quadruple our absolute goal of inflation plus 10%. The fourth quarter added 14.6%. Those investors who focus on relative returns might be disappointed that the Small-Cap’s results were below the Russell 2000 Index’s 47.3% for the year. With our personal assets we focus on protecting capital and making adequate long-term results. Forty-plus percent returns far exceed the goal and we urge our partners to expect much more modest results in most years.

With the exception of Fleming, which we sold early in the year, every stock in the portfolio contributed positively to performance in 2003. Several companies, such as Catellus and Ralcorp, reached our appraisals and we sold them. We also sold Rogers Communications to build a position in what we believed was a better quality Canadian cable investment, Shaw. With rising prices we scaled back some positions to maintain diversification requirements and control weightings. While we added to some existing holdings when their prices qualified, we did not purchase any new companies in the Fund. U.S. Industries changed its name to Jacuzzi to better reflect one of its top brands, but our stake did not change. We exchanged our 9% convertible notes in Level 3 for equity.

The combined equity and bonds we hold at Level 3 made this our largest holding throughout the year. This investment also contributed the most to the Fund’s strong performance. 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. The 9.125% senior notes rose 42% and we scaled them back significantly. The stock remains undervalued compared to our appraisal.

Fairfax Financial’s stock increased 86% during 2003, making it the second largest contributor to the Small-Cap Fund’s results. Fairfax’s operational and investment performance exceeded the market’s expectations while the company strengthened its balance sheet by placing two attractive bond issues and successfully renegotiating its bank lines. Even after the tremendous price increase, Fairfax remains one of the more undervalued businesses in the portfolio.

As the economy improved and consumption resumed, luxury goods retailers benefited. These outside forces along with the operating capabilities of management helped Neiman Marcus’ stock rise 83% in the wake of enormous comp-store sales gains.

NCR did not have any significant news, but continued to report good results, especially in its data warehousing business, Teradata. The stock rose 63%.
Excellent results in a tough industry also helped Genlyte, the commercial lighting manufacturer, gain 87%.

Several businesses in the portfolio have received public attention recently. AXA has made a bid to purchase MONY for a price that we believe is far below corporate value. We are pursuing various avenues to protect our interests as shareholders.

Hollinger and its leader Conrad Black are facing issues related to alleged improper payments made by the company to Black and several others. While the information that has come out has created turmoil, the value of the company’s newspapers is increasing.

As one would expect after a 40+% year, the price-to-value ratio of the Small-Cap Fund’s holdings has risen from the high 50’s early in the year to the mid-80’s. Executing several sale orders would remove fully priced positions and help lower the P/V of the remaining group of equities. We also have 15% cash which we will use to purchase underpriced securities when we find them, thereby further lowering the price-to-value ratio. Our greatest challenge is finding new investments that qualify. We remain patient and diligent in our effort.
Longleaf Partners Small-Cap Fund posted a 4.5% gain in the third quarter and the Russell 2000 Index rose 9.1%. The Fund’s 25.6% year-to-date return is twice our annual goal of inflation plus 10%, although it is less than the Russell 2000’s 28.6% nine month return. As the Fund’s largest shareholder group, we are elated with Small-Cap’s recent results and caution our partners not to expect such high absolute numbers every year.

With the exception of three holdings, all of our investments added to the quarter’s solid gain. Several companies made a substantial positive impact on performance. NCR, Hilton, and Genlyte rose 24%, 27% and 28%, respectively. The substantial appreciation came more from improved sentiment rather than from any news or actual changes at the companies. Our appraisals remained essentially the same, and thus these three holdings sell for a smaller discount.

Although Level 3 has been the largest contributor by a wide margin to Small-Cap’s year-to-date performance, the stock declined 19% and the bonds we hold fell 6% 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.

Shaw fell almost 10%. No news accompanied this decline, and our appraisal held steady. We applaud CEO Jim Shaw, who has seized this price-to-value disparity by personally buying a significant amount of the non-voting shares.

MONY has been in the news along with comments your managers have made about the company’s recent agreement to be purchased by AXA for what we and other large shareholders believe is far below value. In this age of corporate governance scrutiny, it is difficult to believe management and the board could agree to a $31 per share bid without pursuing any type of auction. $31 is materially below the $43 per share GAAP book value that gives no credit for the distribution network or brand name. Furthermore, the closed block of insurance business is carried within GAAP book at a substantial negative number, despite the fact that the closed block generates profits. We believe shareholders have a number of options to get paid fairly for their investment. We are pursuing alternatives.
Small-Cap Fund - MANAGEMENT DISCUSSION
by Mason Hawkins, Staley Cates, and John Buford

We have scaled back several holdings as prices have risen closer to appraisals. We have not found new qualifying investments to redeploy the proceeds, and therefore both our cash and our price-to-value ratio have risen. We are focused on lowering the P/V ratio from its mid-70’s level by diligently looking for 60-cent or better dollars to buy.
Longleaf Partners Small-Cap Fund recorded the best quarter in its history, gaining 26.5%. The Russell 2000 had an impressive rally of 23.4%. For the six months ended June 30, 2003, the Fund returned 20.2% versus the Russell 2000’s 17.9%. The Fund’s results in the last three months are approximately double our absolute return goal for the entire year. We do not expect to continue to deliver quarterly numbers of this magnitude.

While almost all of the Fund’s holdings were up during the quarter, Level 3 Communications, our largest investment, continued to have the most impact on performance. In June we converted our 9% 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 prompted a rise in the senior notes we hold, and further improved the quality of the equity which we now own. Because our investments in both the bonds and the convertible notes of Level 3 have been extremely successful, the company remains the Fund’s largest holding.

Fairfax Financial’s stock rose almost 200% in the quarter as the company successfully addressed liquidity concerns. Fairfax renegotiated its bank lines of credit after floating a bond issue for its CFI subsidiary. The company combined its Canadian subsidiaries into a newly formed company, Northbridge, and sold approximately 25% in an IPO. The proceeds were used to strengthen the holding company. Fairfax also placed an adverse development reinsurance cover on a portion of its reserves related to its former TIG division. In addition to improving the company’s financial structure, Prem Watsa booked tremendous gains from his bond investments as long-term interest rates declined to new lows. In spite of its dramatic increase, the stock remains well below our appraisal of Fairfax’s intrinsic value and well below book value.

The Fund’s investment in Hollinger International has received much media attention recently. We are working with management to improve the voting structure. There has been a great deal of speculation regarding this effort, and we continue to work in good faith with Conrad Black to strike an agreement. Whatever the outcome of our effort, Hollinger has valuable operating businesses, and the board has responded to shareholder requests for increased accountability. In the last three months the stock rose 37%, but it remains far below the fair value of the company’s newspapers.

We did not add any new holdings to the Fund in the quarter. The price-to-value ratio has risen to 70%, slightly higher than the historic norm. We are not finding many new investments that qualify, but we are encouraged by the value growth at the companies that we own, and by the improved balance sheets at some of our larger holdings.
Longleaf Partners Small-Cap Fund was down 5.0% in the first quarter, slightly worse than the Russell 2000’s loss of 4.5%, but better than Value-Line’s 7.4% decline. The combination of lower prices of some of our stocks, increasing values, and a few portfolio changes has created a compelling price-to-value ratio of 59%. Although prices are far below intrinsic worth at all our holdings, we are pleased with the progress at most of our businesses and with the quality of the overall portfolio.

We sold Catellus during the quarter as it moved closer to our appraisal. Real estate stocks have done relatively well during the bear market, yet fundamentals at many properties have become worse. Nelson Rising and his team at Catellus have done a laudable job, especially in a region that has been hardest hit by the dot.com bust. Proceeds from Catellus enabled us to own more of other businesses with steeper discounts and higher value growth prospects.

We also sold our position in Rogers to create a full position in Shaw Communications. Both companies are well-run cable operators in Canada. Shaw, however, is more straightforward since Rogers has a hefty wireless telecom component. With the run-up in Rogers due to its wireless exposure, the Shaw price became much more compelling.

Our largest position by far is our stake in Level 3 via both the regular and the convertible bonds. Good news at the company most heavily impacted the Fund’s three-month performance. Level 3 purchased Genuity at a price that we believe to be immediately value accretive, adding high margin revenues over a uniquely low fixed cost communications system. The bonds rose over 21%, and the stock price, which we use to price the convertible position, increased 5.3%.

Because of the significant appreciation of both the bonds and the converts, the bonds now represent 14% of the portfolio and the convertible notes 8%. Some have asked why we are willing to commit so much of our own capital (as the Fund’s largest shareholders) to one business. We own a large position because Level 3 is qualified in each of our investment criteria — good business, good people, and good price, and because of the safety afforded us as lenders. If we found other equally or more compelling opportunities, or if we no longer believed Level 3 was as qualified, we would reduce or sell the position. We would rather hold cash than risk our capital, but when we find something that is superior in so many aspects, we are not afraid to own a large stake. To protect shareholders we refrain from discussing when we might convert to shares or at what point we will trim our position. We will manage this investment as we do all others — price-to-value ratios and the desire for protection of capital and adequate return will rule the day.
One of the most remarkable disconnects that we have ever seen in the capital markets has been the pricing of the various parts of Level 3’s capital structure. At one point last year, the bank debt of Level 3 sold at $.70 on the dollar. That price implied that the banks could not get repaid in full, and that neither the junior debt beneath the banks nor the common equity had any value. The $.70 bank debt pricing on roughly $1.1 billion in loans suggested $788 million in total enterprise value for Level 3’s assets. At the same time, the senior notes we owned in the Fund sold for $.46 on the dollar. To realize that value, the banks would first have to receive their full $1.1 billion. The total bank debt plus 46% of the senior notes’ face amount implied a total enterprise value of $2.8 billion. Lastly, the common stock sold for around $4 per share. The assumed dollar-for-dollar value for all debt plus an equity market cap of $1.8 billion equaled a total enterprise value of $8 billion. Efficient market subscribers cannot reconcile how lenders could say Level 3 was worth under $800 million while equity investors assigned an $8 billion value. This absurd price differential has tightened somewhat in the wake of the value-enhancing Genuity purchase. The bonds still trade at a substantial discount to par, and are especially attractive considering the huge cushion over par implied by the rising stock price. The stock is also discounted from our assessment of its intrinsic worth. We therefore remain comfortable owners of the converts.

We were less successful with our investment in Fleming which filed for Chapter 11 in the first quarter. Many of our shareholders have asked the same question we ponder in our effort always to improve — what went wrong? Our primary mistake was in our assessment of the people who, in spite of previous success at Fleming and elsewhere, allowed the business to run out of cash.

They failed to execute on their retail strategy by poorly operating the stores. As the numbers revealed bad results, management claimed to have secured buyers for the retail assets. This has not yet come to fruition. The failure of the retail business reduced our appraisal of the company significantly over the course of 2002. The price, however, was well below the remaining value for the wholesale business, and we therefore kept our stake.

Management misallocated capital by investing in infrastructure to serve Kmart exclusively while not securing the revenue and cost benefits anticipated from the agreement. They mismanaged supplier relationships and therefore working capital by most recently extending payment time so far that suppliers insisted on much stricter terms to provide goods. The company ran out of cash when the banks withdrew their support, just as management needed it. In spite of the mismanagement Fleming is still one of the two nationwide independent food
wholesalers in the country, and the bankruptcy filing shows over $12/share in net assets. We know that we will not recover our approximately $14 per share cost, nor are equity holders likely to receive the $12 in net assets. We are evaluating how we go forward, assessing the likelihood of some investment recovery versus the 0.1% of the Fund’s net assets involved.

The price of one other holding, Fairfax Financial, fell over 36% in the first three months. This share weakness did not reflect a decline in our appraisal of the company. To the contrary, this property and casualty insurer began to show dramatically improved underwriting results, reported significant investment gains which grew book value materially, and received affirmation of its ongoing insurance subsidiaries’ ratings by A.M. Best. Fairfax also announced an IPO of part of its valuable Canadian insurance subsidiaries, offering those subsidiaries increased flexibility while reducing leverage at the Fairfax holding company level.

Most stock price declines in the quarter were unrelated to the fundamentals at the companies we own. Examples of strong business results and poor stock price performance include NCR, where Teradata’s dominance continues to build, and Hollinger, where operating cash flows are growing, the balance sheet has been completely refinanced, and London newspaper price wars are abating.

We are confident in the current portfolio’s long-term opportunity and strength. In addition, taxable investors have the benefit of realized losses and unrealized depreciation going forward.
During the fourth quarter stock market rally we were hopeful that Small-Cap would end the year in positive territory. The Fund’s 3-month 8.4% gain was not enough, however, to overcome earlier declines. Longleaf Partners Small-Cap Fund ended 2002 down 3.7%, well above the (20.5)% return for the Russell 2000 Index, but far short of inflation plus 10%.

Market volatility allowed us to improve the portfolio in 2002. We sold our successful investments in Macerich and Thomas Industries when they reached our appraisals. In the first half of the year we scaled back Hilton and Ralcorp as their prices rose closer to fair value. These four companies were among the positive contributors to the year’s performance.

Proceeds from these sales helped fund several new positions between July and October. The Small-Cap Fund participated in the private placement of convertible Level 3 bonds. We purchased Shaw Communications and subsequent to year-end have a full position in this Canadian cable business which has the competitive characteristics and opportunities of its U.S. peers — 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.

We added NCR to the portfolio in the fourth quarter. While the company is best known for its cash register and automatic teller machine businesses, most of its value and all of its growth are in its data warehousing business, better known as Teradata. The product is one of only a few data warehouse solutions, has numerous competitive advantages, and the contribution margin from new sales is substantial. Lars Nyberg and his team are successfully building value by adding new customers, enhancing Teradata’s advantages, and improving NCR’s organization. Because many analysts fail to realize the importance of Teradata to the company, and those who do are fearful of lower technology spending in the short term, we got the opportunity to purchase this business at below half of our appraisal.

The performance of Small-Cap in 2002 primarily resulted from the impact of two holdings. The Fund gained over $100 million from Level 3’s senior notes combined with the convertible private placement. A portion of this return came from the attractive yield we receive. We also benefited from the rise in both the bonds and stock. Level 3 has the lowest cost structure in the industry and financial flexibility. Management has succeeded in both winning new customers and growing its existing blue chip accounts. The company has made a bid for Genuity, a bankrupt competitor. Level 3 is our largest position in the Fund.
Because our appraisal has grown over the last year, our combined stake still provides low risk and large return opportunity.

Although Fleming rose 32% in the fourth quarter, the stock fell a total of 64% over the course of the year. Most of the decline came in the third quarter when rampant short selling compounded the pressure on the stock brought by several pieces of bad news – weak wholesale results, a lower than expected price for its retail assets, and instability at Kmart, its largest customer. While Fleming’s contract with Kmart will not yield the originally planned level of benefits, the value of the company’s other supermarket and growing convenience store business remains stable.

Unlike the Fund’s negative return in 2002, the values of our businesses grew during the year. The value growth of existing holdings along with trading fully priced businesses for undervalued investments helped lower the Small-Cap Fund’s overall price-to-value ratio to 60%. As the largest shareholder group in the Fund, we are excited to have such an attractive P/V in combination with sound businesses and the managements that run them.
Longleaf Partners Small-Cap Fund lost 16.3% in the third quarter, with most of that loss occurring in September. The Russell 2000 small cap index fell 21.4% over the same period. In spite of recent results, the Wall Street Journal listed Small-Cap as one of the 50 best performers out of 1,057 mutual funds over the last ten years. The list includes sector funds, and if those are removed, Small-Cap is in the top 30 funds.

Over the last three months we strengthened the portfolio and have the foundation to build the next decade of performance. We sold Thomas Industries which reached our appraisal. Proceeds from the sale, the 10% cash reserves we held at June 30th, and net inflows during the quarter gave us the buying power to add substantially to our positions in Ruddick and Rogers Communications. We also participated in the Level 3 private placement discussed in the June 30 report.

Only two businesses, Level 3 and Macerich, contributed positively to the Fund’s return in the quarter. Our Level 3 bonds appreciated substantially as the company’s increased financial strength improved its ability to add revenues over its fixed cost structure via acquisitions of distressed competitors.

Although prices of our other businesses declined in the quarter, Fleming had the most significant impact as it dropped 72%. Fleming is by far the most controversial company we hold, with the largest short position in it that we have ever experienced as an owner. Whether the shorts end up being right or wrong, their actions are also unprecedented. Their influence in the press, their activism in spreading negative stories, and their personal attacks on Fleming executives represent a level of aggressiveness that is fairly unusual in normal markets. Fleming has real issues: weak current wholesale results, the divestiture of retail assets, and serious instability at its largest customer, Kmart. Against these problems, we continue to hold the stock because we believe 1) members of top management have been unfairly accused; 2) there are no present liquidity or covenant events that would tilt Fleming into insolvency, in spite of the shorts’ best efforts; and 3) the wholesale business remains well-positioned for the long haul and is dramatically undervalued.

As in the Partners Fund, new names in Small Cap come not only with low prices but also with high asset quality. At Rogers we have one of the two dominant cable systems in Canada, and with Ruddick we get the well-entrenched and well-regarded North Carolina grocery store brand, Harris Teeter. Both are run by largely vested owners who have done a good job of building value for shareholders over the years.
Our Level 3 position is in two forms. The first is what we believe to be an incredibly low-risk bond position that offers attractive equity return potential. The second form is the private placement done in July alongside the Partners Fund. While also having defensive characteristics, we view this commitment as more of an equity investment. As we have learned more about the company since buying the bonds over a year ago, we are more comfortable than ever with the assets, their low-cost stature even as competitors’ bankruptcies wipe away liabilities, and the exceptional management team.

The values of our businesses are sound and yet prices have declined. This dichotomy leaves us with a compelling price-to-value ratio in the mid-50’s. The compounding opportunity is the best we have seen in over two years, and we have meaningfully added to our stake.

Note: Included in this mailing is a supplement to the Prospectus regarding the investment policy of the Small-Cap Fund. The definition of “small-cap” is evolving. Today, at least three major indices track small-cap size ranges. To prevent Longleaf’s small-cap universe from being subject to the reconstitution of a single index, and to retain our ability to invest in companies widely accepted as small-cap, we will use the S&P Small-Cap 600 and the Wilshire Small-Cap 1750 in addition to the Russell 2000 to define the small-cap universe. We believe this updated definition of small-cap improves our opportunity and flexibility. There have been no other changes to the Fund’s investment policy.
Over the quarter Longleaf Partners Small-Cap Fund lost 4.5% versus the Russell 2000’s decline of 8.4% and Value Line’s 14.2% fall. Although we are not pleased with the quarter’s results, the Fund is close to meeting our absolute return goal of inflation plus 10% with a 6.1% year-to-date return.

The stocks at several businesses we own did well during the quarter. Both TimberWest and Deltic Timber posted solid numbers, helped by higher lumber prices. Ralcorp rose 15% in the quarter after reporting strong earnings. Genlyte continued to generate a tremendous amount of valuable free cash flow in the face of a challenging environment.

Three investments drove most of the Fund’s losses for the quarter. Fleming, Small-Cap’s largest holding, fell 19% over the last three months as fears lingered about the company’s reliance on Kmart. In reality, Fleming’s revenues from Kmart will grow this year, the relationship represents less than a quarter of Fleming’s sales, and is an even smaller percentage of profits. Fleming’s balance sheet is strong with no debt due until 2007. Non-Kmart business is growing, especially in non-traditional channels like convenience stores and “superstores.” Our appraisal is over twice today’s price, and Mark Hansen continues to steadily build value.

Texas Industries fell 23% in the quarter, mainly due to concerns about non-residential construction and short-term swings in structural steel prices. The company’s sizeable cash flow is being used to pay down debt, and the stock sells for close to half of our conservative appraisal.

Our previous investment in Level 3 bonds also declined as the telecom industry shakeout continued and negative stories about WorldCom and Qwest took center stage. We added to this position. After quarter-end the bonds rose over 58% with the company’s announcement of a $500 million private placement of convertible notes.

Longleaf Partners Small-Cap Fund purchased $70 million of this private placement together with Longleaf Partners Fund, Berkshire Hathaway, and Legg Mason. 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 elevate 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.”

We also bought a position in Rogers Communications, the largest Canadian cable operator. Rogers’ stock has suffered with the sell-off of cable companies. We have used low assumptions in our appraisal of the company’s subscriber base and of its other media and wireless businesses. Using this conservative approach, the company sells at half of its intrinsic worth.

Longleaf Partners Small-Cap Fund is well positioned. We are almost fully invested and are finding new opportunities. As we sell several fully priced stocks and buy much more discounted businesses, the price-to-value ratio will become even more attractive than its mid-sixties level today.
Longleaf Partners Small-Cap Fund gained 11.2% during the quarter, far surpassing our absolute annual return goal of inflation plus 10%, and outperforming the Russell 2000 Index which rose 4.0%. For the last one, five and ten years, Small-Cap has compounded your and our assets at a real rate of over 10% while handily beating the Russell 2000 Index. The Fund has also preserved capital by avoiding negative returns in every year over the last decade — an achievement that few funds, and especially small cap funds, can claim.

The most recent quarter’s results were driven by positive returns in almost all of our holdings. Fleming and Hilton, in particular, contributed to the Fund’s performance. Investors realized that K-Mart’s bankruptcy declaration would not substantially reduce Fleming’s revenues from its K-Mart relationship or the other 75% of Fleming’s business. We added to our position early in the year when the price was in the high teens. These additions combined with the stock’s 21% rebound in the first quarter made Fleming the largest position in the Small-Cap Fund at March 31.

Hilton continued its rally from its low after the terrorist attacks last September. The stock rose 31% during the first quarter and has gained 59% since we added to our position last fall. Travel has rebounded over the last six months and the outlook for both occupancy and supply growth is favorable. Although the price has risen dramatically over the last six months, Hilton sells for less than 80% of our conservative appraisal.

The portfolio’s holdings have not changed in 2002. We scaled back several positions that rose closer to intrinsic value, and we added to existing companies when their stocks traded below 60% of our appraisal. The Fund’s cash position of 8% will enable us to take advantage of new investment opportunities when we identify them, although they are somewhat elusive at this point.
Longleaf Partners Small-Cap Fund added 6.1% in the fourth quarter and completed the year up 5.5%. Although the Fund produced positive returns and outperformed the Russell 2000 in 2001, we are disappointed that we did not reach our absolute goal of inflation plus 10%. While a number of our stocks appreciated during the year, value declines at several holdings hindered our compounding progress.

Fleming was the largest contributor to Small-Cap’s performance by a wide margin. The stock rose 57% for the year in spite of a 37% decline in the fourth quarter. Mark Hansen and his team have strengthened this food distributor. As the exclusive food supplier to Kmart Super Centers, Fleming gained greater economies of scale and helped the Super Centers lower costs. Recent concerns about Kmart’s bankruptcy filing have hurt Fleming’s stock. Fleming, however, is involved primarily with Kmart’s Super Centers, which are growing and producing free cash flow. Whatever the reorganization outcome at Kmart, Fleming should be able to retain its position in providing the most economic distribution of grocery products both to the Super Centers and to many other varied retail formats. Furthermore, Fleming’s non-Kmart business is growing strongly. Fleming sells for roughly half of its value and is one of the most discounted stocks in the portfolio.

A number of equities in the portfolio gained over 20% during the year, reflecting business improvements and how discounted these stocks were at the outset of 2001. Texas Industries expanded both its cement and steel businesses, and steel pricing improved dramatically. Ralcorp strengthened its dominance in the private label food industry through several acquisitions. IHOP grew its restaurant locations and is considering improvements to its capital structure. We are encouraging management to exit the lending business, while leaving the successful IHOP operating model completely intact, and have amended our SEC ownership filing on IHOP to enable us to be more active in our discussions with management.

Several businesses in the portfolio were impaired during 2001. In the second quarter USG filed for bankruptcy to help protect itself from spiraling asbestos claims. The anticipated dilution of equity holders reduced our appraisal by over 50%. In addition, wallboard’s increased supply and lower demand have kept prices at depressed levels. USG’s price, which fell 75% during the year, remains below our assessment of value after adjusting for all the bad news. Management is working hard to protect shareholders, and the company retains a leading position in the wallboard, ceiling, and building supply distribution businesses, which will benefit when the economy improves.
U.S. Industries failed to refinance its balance sheet in a timely fashion, and the deepening recession hurt all of its segments. The stock fell 68% and our appraisal also dropped substantially. Lower cash flow forced the company to restructure some of its debt and sell assets at cheap prices. Management has made progress selling all non-core subsidiaries to reduce USI’s liabilities. We believe that including its prospective net debt, the value of U.S. Industries’ bath and plumbing business with the Zurn and Jacuzzi brands is multiples above the current stock price.

Fairfax Financial Holdings declined 28% during 2001 following a 19% drop in the fourth quarter. Like many insurers, the company increased reserves for losses related to unprofitable business written in 1999 and 2000 and for 9/11 claims. To cover the reserves Fairfax issued additional shares, thereby diluting existing owners and raising fears in the market about the company’s financial strength. While our value suffered, the stock fell much more dramatically, and the company sells for less than half of our appraisal. Prem Watsa has added value over the years with his investment skills, and he successfully took a portion of Odyssey Re, the reinsurance subsidiary, public last year. Fairfax has a large cash balance at the holding company, the industry is enjoying price increases, and with the exception of one division, the operating companies are writing new business at profitable levels.

Small-Cap’s portfolio changed fairly dramatically during the year as its 40% turnover ratio indicates. We sold three major positions that approached our appraisals – Gulf Canada and Wisconsin Central in the first half and Hilb Rogal in the fourth quarter. We also liquidated six smaller positions during the first three quarters. We spent part of the resulting cash from these sales in the fourth quarter as we added to a number of our most undervalued holdings including IHOP, Hilton, Macerich, TimberWest, and Deltic Timber. We also took a new position in Level 3 Communications corporate bonds, discussed in the third quarter report.

We enter 2002 with the portfolio more concentrated in our best ideas. We believe the fundamentals for good returns are in place.
Longleaf Partners Small-Cap Fund’s September decline accounted for essentially all of its -9.3% return for the quarter. The -20.8% quarterly return of the Russell 2000 Index is little consolation. The quarter erased the gains for the year and left year-to-date Fund performance at -0.6% versus the Russell 2000’s -15.4%. The Small-Cap Fund’s longer-term results, which appear on the following table, are more in line with our inflation plus 10% goal.

After September 11th, Wyndham, which had risen throughout the year, plummeted. A prolonged period of lower occupancy and REVPAR (revenue per available room) coupled with the company’s leverage caused us to significantly lower our value of the common shares. We began selling our position and subsequent to quarter end no longer own the stock.

Our best performing holding for the year by a wide margin has been Fleming. During the quarter as the price increased closer to appraisal, we scaled back our position. The stock later fell on profit taking, and the 17% decline in our largest holding detracted from the Fund’s third quarter return.

Fears of a longer and deeper recession hurt the prices of many media related companies including Hollinger, which owns several newspapers, including the London Telegraph and the Chicago Sun Times. Advertising revenues will be lower until the economy rebounds, but the company still generates valuable free cash flow, and Conrad Black has an outstanding record in building value. The stock’s 23% decrease in the quarter leaves the price at less than half our appraisal.

Several of our holdings posted positive returns in the quarter. PepsiAmericas, the Midwestern Pepsi bottler, rose 12%, benefiting from the strong brands and good results at Pepsi. Hilb Rogal & Hamilton, the insurance broker, appreciated beyond our appraisal with expectations of premium increases, and we began selling our position. We have completed the sale since the close of the quarter. Hilb Rogal provided Small-Cap shareholders with a phenomenal return over the course of our investment, and we are all immensely grateful to Andy Rogal and his team for their superb performance.

We also sold our small stake in Bay View as the price rose to our significantly reduced appraisal. We purchased two new positions in the Small-Cap Fund and added to several that we already owned. We bought Level 3 Communications bonds with a yield to maturity of over 30%. Level Three’s network is superior and the company is rare because its cash generation is dramatically higher than reported earnings. Our outstanding management partners, Chairman Walter Scott and CEO James Crowe, have a large cash reserve with which to finish the network and pay back our bonds. We prefer the risk-adjusted returns from the
bonds’ yield to maturity over the equity, since the equity bears some risk of dilutive financing in a few years.

We also acquired a position in Forest City Enterprises, a diversified real estate company that develops and manages unique properties across the U.S. The Ratner family has a tremendous record of growing value for shareholders at a rapid pace. Forest City has been one of the best performing long-term investments in the real estate universe, and Small-Cap got the opportunity to own the stock through a recent secondary offering.

While the Small-Cap Fund put some of its liquidity to work during the quarter, 19% of assets are still in cash. Although we have several new positions we are considering, the market’s recent decline seems to have had a greater impact on larger companies in our universe. We will add new companies to the portfolio when we find the combination of quality business, capable management, and substantial discount that we require. Meanwhile, the companies we own sell at an average 57% of our appraisals, presenting an attractive opportunity.

Our taxable investors should be aware that the higher than normal cash reserves resulted from sales throughout the year of successful investments. While some gains have been offset, the Funds’s current realized gains are roughly 8% of NAV and are all long-term. Any further losses or gains realized through October 31, 2001 will affect the capital gain distribution, which should take place during the second week of November.
For the year ended June 30 Longleaf Partners Small-Cap Fund is up 21.8% after adding 9.2% during the second quarter. In spite of the Russell 2000’s 14.4% gain in the quarter, this small-cap index is flat for the last year with a 0.7% return. We are pleased with Longleaf Small-Cap’s recent results, but caution our partners to temper their future expectations: 20+ annualized returns are not likely to be sustained over the next few years.

During the second quarter the Small-Cap Fund’s composition changed because of a combination of portfolio sales and individual stock returns. The Fund’s holdings decreased from 25 to 22. We sold our second largest holding, Gulf Canada. Conoco’s bid for the company confirmed our appraisal. We made a 70% return over the two-and-a-half years we owned the company. Although Tyco purchased Scott Technologies for less than our value, we gained 35% on our investment. We also sold Pediatrincess as its price reached our appraisal due to renewed faith in the doctors’ billing integrity and better controls which improved cash flow.

Fleming remains our largest holding although we scaled the position back as the stock rose 40% during the quarter. The company has tripled this year. Mark Hansen and his team continue to demonstrate the value that disciplined, motivated, vested management can bring to an otherwise challenging business.

Thomas Industries also contributed to the Small-Cap Fund’s successful quarter. This maker of pumps and compressors continues to do relatively well in a tough manufacturing environment.

The Fund’s three insurance companies increased during the quarter. Both MONY and Fairfax were helped by falling interest rates, while Fairfax benefited from the IPO of subsidiary Odyssey Re. Fairfax and Hilb, Rogal and Hamilton continued to experience stronger pricing in their insurance underwriting and brokerage businesses.

Two of Longleaf Partners Small-Cap Fund’s holdings lost substantial ground in the quarter. In our March report we discussed the value of USG “even in a worst-case scenario for the wallboard division.” That scenario materialized in June as the company filed for Chapter 11 and the stock fell over 70%. The asbestos liabilities of other companies that have been recently bankrupted increasingly saddled USG. The company previously had paid its share of claims, but lawyers in multiple states had begun filing against USG under joint and several liability. Bill Foote saw Chapter 11 as the only way to salvage value for equity holders before the company had to weaken its balance sheet to cover more legal bills and unwarranted claims. Bankruptcy will meaningfully dilute equity holders and our
appraisal has fallen accordingly. USG’s value, however, is still multiples of its price because Chapter 11 (1) consolidates all claims from individual somewhat plaintiff-oriented state courts into a single and more fair federal court; (2) relieves USG of any responsibility other than for its own product which is a minimal piece of the asbestos exposure claims; and (3) allows the company to quantify its total liability and then focus on continuing to make money from its successful wallboard, ceiling, and building parts distribution businesses.

U.S. Industries’ stock fell 30% during the quarter as the company’s cash flow was lower than expected and questions arose about USI’s ability to refinance its debt later this year. The building products and hardware businesses are suffering at a time when the company is faced with this large refinancing. We do not know how the attempted refinancing will be resolved, but asset values at just the Jacuzzi and Zurn divisions are materially greater than total company liabilities.

Our portfolio sales added to Small-Cap’s liquidity. Because we are having difficulty finding companies that qualify, the Fund’s cash position is 24.6%. These reserves will allow us to go on offense when we find new investment opportunities. New qualifying investments will also help lower the Fund’s price-to-value ratio, which has moved close to its historic average in the wake of increased prices and a few stagnant or lower values.
Longleaf Partners Small-Cap Fund posted a slight gain during the first quarter, up 0.4%. Over the last twelve months the Small-Cap Fund delivered both requirements of an investment — safety of principal and an adequate return — with a 19.1% one-year return. The small cap market, by contrast, as measured by the Russell 2000 was (6.5)% in the first three months of 2001 and (15.3)% over the last year.

Fleming added a substantial amount to the Fund’s performance in the first quarter. The stock rose 116% and ended March as the Fund’s largest holding. K-Mart selected Fleming to be its sole grocery distributor thereby increasing the company’s value and serving as a catalyst for investors to recognize the superior results that Mark Hansen and his team are delivering. The free cash flow generated by Fleming is worth substantially more than the current stock price.

Several holdings detracted from the Fund’s performance in the quarter. MONY Group fell 33% driven by stock market pessimism that anticipates a decline in MONY’s products such as annuities as well as worsening investment results. Despite this volatility in the income statement, MONY’s balance sheet value and brand name continue to underpin an appraisal far above today’s stock price. We used the lower price as an opportunity to add to our stake.

USG fell 32% during the quarter as fears increased over asbestos litigation as well as excess capacity and shrinking demand. We believe the company has adequate asbestos liability reserves and as the low cost producer in wallboard, USG is one of the few competitors able to make money in spite of lower pricing. Our appraisal is far above the current price and we are assuming a pessimistic outlook for both wallboard demand as well as litigation liability. We also believe that USG’s distribution and ceilings businesses provide significant corporate value even in a worst-case scenario for the wallboard division.

U.S. Industries dropped 27% when the company announced disappointing earnings due to operating challenges in the tool business and the company’s inability to sell its lighting business for a reasonable price. Management is focused on running these two businesses more efficiently and continuing to strengthen U.S. Industries’ dominance in bath and plumbing with the Jacuzzi and Zurn brands.

During the quarter we sold three of our holdings. Wisconsin Central is being purchased by Canadian National Rail and VICORP Restaurants is being sold to a management buyout group. In addition, we liquidated our very small position in The Carbide/Graphite Group.
We used the proceeds from these sales to add to some of our most undervalued companies and to purchase two new positions, Brascan Corporation and Texas Industries. Brascan is a holding company with majority ownership in several businesses: Brookfield, the owner of class A office space in supply-constrained North American markets; Great Lakes Power, an independent hydroelectric power producer; Trilon, a Canadian merchant bank and real estate brokerage firm; and Noranda, a large producer of zinc, nickel, and aluminum. Brascan’s management team owns a substantial amount of the stock and has taken advantage of the low price by aggressively buying shares. Texas Industries has a very valuable cement, aggregates, and concrete business with results masked by its more cyclical steel beam division. Bob Rogers, our management partner, has significant incentives tied to value recognition.

As market volatility continues we remain well positioned in the Small-Cap Fund. Our current holdings are selling for an average 57% of our appraisals and we are armed with a 10% cash position to purchase more of our existing holdings or to take advantage of new opportunities.
Longleaf Partners Small-Cap Fund rose 5.9% in the fourth quarter and posted a solid 12.8% return for the year. The Fund outperformed the Russell 2000 Index, which fell 6.9% in the quarter and declined 3.0% in 2000. The Small-Cap Fund’s positive performance came amidst a substantial market decline of many overvalued stocks. From the March 10th peak of the NASDAQ, Longleaf Partners Small-Cap Fund rose 25.3% while the Russell 2000 fell 19.4% and the NASDAQ shed 51.0%.

We had strong performance because most of our holdings appreciated; several had a substantial impact on our results. Gulf Canada, the Fund’s largest holding throughout the year, rose 50% in 2000 and was the largest contributor to performance. In spite of its appreciation, this Canadian oil and gas company remains well below our appraisal. The MONY Group finished the year as the Fund’s fifth largest position. During 2000 the company increased free cash flow and in the second half investors renewed their interest in financial services companies. The stock was up 69% in 2000. Pediatrix Medical rebounded dramatically from a low of $6.41 to end the year at $24.06. The stock rallied in the fourth quarter as several state investigations of billing practices ended favorably for this physician management firm specializing in neonatology. Pioneer Group rose 198% from its low in February before we sold the stock in May when Unicredito Italiano agreed to buy the investment management firm. Hilb, Rogal & Hamilton, an insurance brokerage firm specializing in small to mid-size commercial business, appreciated throughout the year as property/casualty rates turned up after a decade of weakness. The stock gained 41% last year. Catellus, the California real estate company, benefited from both development progress and increasing demand in its San Francisco and San Diego markets. The stock increased 37% during the year.

In the second quarter we began adding Fairfax Holdings to the portfolio at an average cost of $118. This Canadian-based insurance company is benefiting from industry pricing trends as well as CEO Prem Watsa’s skillful investment policies. The stock ended the year at $152, quickly adding to the Fund’s results. Fairfax is the third largest holding in the Small-Cap Fund and remains significantly below our estimate of intrinsic value.

While the majority of our holdings posted gains in 2000, four of our stocks meaningfully dampened results. The largest disappointment was Safety-Kleen, which we sold in the second quarter after the company disclosed accounting irregularities and its accounting firm withdrew its opinions on the audited financials. To date, very little information is available regarding what went wrong at the company. Clearly, however, the combined businesses of Safety-Kleen and
Laidlaw were worth a vastly lower number than either company’s pre-merger financials indicated.

In spite of management’s responsible stewardship, the price of U.S. Industries suffered in 2000. The stock fell 43% during the year amid fears of lower demand for building materials and foreign currency weakness. With the divestiture of its lighting company, management has focused the enterprise on its core Jacuzzi and commercial plumbing products businesses. U.S. Industries sells for 40% of our appraisal and we are confident in the quality of both the business and our management partners. Bay View suffered as its FMAC acquisition failed when the secondary market for mortgages dried up. The stock declined 56% during the year. Although the value of the company has deteriorated, the price of the stock is well below our adjusted appraisal. Management is committed to getting that value recognized. Wyndham made great operating progress at its hotels and strengthened its balance sheet during the year, but the stock declined. Wyndham is selling at an incredibly low price of approximately a quarter of our appraisal, while management continues to produce positive results.

Longleaf Partners Small-Cap Fund ended the year with five fewer holdings than at the outset of 2000. In addition to Pioneer Group, we sold Cousins Properties, Midas, Agribrands, and our remaining Romac shares when these stocks approached our appraisals. All five companies provided Fund shareholders with solid returns over the periods we owned them, and we are grateful for the work of our management partners at each. The affiliation with Cousins was especially rewarding over many years, and we hold that management team in the highest regard.

We also liquidated several investments that were less successful. We sold our stake in Carmike Cinemas in the first half when the company’s value declined because overbuilding began to negatively impact Carmike’s theaters. Although AMETEK and Perrigo had not reached appraisal, we sold these stocks to buy more compelling opportunities.

Our sales helped fund four new holdings including Fairfax. We added Hollinger to the Fund in the second quarter when the stock got incredibly cheap as fears of lower advertising and higher newsprint costs hurt the prices of many newspaper publishers. The stock is less than 50% of our appraisal, and Conrad Black is selling individual papers and using the proceeds to buy in his very undervalued shares. We are ecstatic to be partners with Mr. Black and to watch our value grow under his leadership. We are delighted to own Ralcorp Holdings again (it was spun out of Ralston, a previous Partners Fund holding). Ralcorp is a leader in
baked goods for the private label market and is chaired by Bill Stiritz, an all-star corporate partner. We anticipate that Mr. Stiritz will be as successful for us at Ralcorp as he was at Ralston and Agribands. We added USG in the third quarter when anticipated declines in housing starts, concerns of overcapacity, and fears of asbestos liability sent the stock well below its value. USG has a dominant, low-cost share of the wallboard industry, which has limited and rational competition. Our conservative appraisal assumes that demand and pricing slow. The company has limited exposure to asbestos claims – USG did not make asbestos, but used it in some of their joint compounds. The company has now quantified much of its liability. We are pleased to be partners with Bill Foote, USG’s CEO.

We enter 2001 enthusiastically as owners of the Small-Cap Fund. The cash in the portfolio is somewhat temporary, as the trading desk is adding to several existing holdings and buying one new company. The price-to-value ratio of the Fund is 60%, which is below the historic average and implies a good deal of upside potential.
Longleaf Partners Small-Cap Fund completed a second consecutive quarter of strong absolute and relative performance. The Fund rose 4.9% over the last three months while the Russell 2000 advanced 1.1% and the Value-Line appreciated 2.9%. Year-to-date the Small-Cap Fund is up 6.5% versus 4.2% for the Russell 2000 and –2.6% for the Value Line.

Several holdings contributed to our successful quarter. Gulf Canada, our largest position, continued its upward pace, advancing 12% in the quarter for a total return of 59% this year. The strength in oil and gas prices combined with an efficient cost structure have dramatically increased free cash flow at Gulf. The stock sells for approximately 60% of our conservative appraisal, even after we have reaped large gains.

Continued pricing strength in the commercial property/casualty insurance business increased profitability for Hilb, Rogal & Hamilton. The stock rose 20% during the quarter. The MONY Group produced substantial free cash flow and, coupled with renewed market interest in financial services, the stock climbed 18% over the last three months.

Genlyte rose 21% over the last three months. The company began to reap the benefits of 4-5% pricing increases earlier this year and made substantial progress assimilating its lighting business with Thomas Industries’ lighting division at Genlyte-Thomas LLC.

A few of our stocks declined in the quarter. At Wisconsin Central fuel prices hurt margins and growth in all three locations (North America, U.K., and New Zealand) slowed. New management at each rail is working to turn around results. The company remains attractive to larger railroads which are prohibited by the Surface Transportation Board from executing mergers until June 2001. We have filed a 13-D to enable us to have open conversations with management and other large shareholders to chart an optimal outcome. The company remains at 50% of appraisal.

U. S. Industries also dropped during the quarter amid fears of lower demand and foreign currency weakness. Highly competent owner operators are running USI. They compete by being the low-cost producer, cutting costs more quickly than prices. The company is now focused on its core plumbing and hardware businesses and will be distributing its lighting company to shareholders.

Wyndham did not enjoy the price appreciation that many lodging companies experienced in the third quarter. Although cash flow from operations increased, reported numbers were deflated due to asset sales. Management is strengthening the brand and the balance sheet. The company remains one of the most undervalued businesses we own at Southeastern.
During the quarter we sold our remaining stake in Perrigo. We used the proceeds as well as cash inflows to add two new holdings, Ralcorp and USG.

The Small-Cap Fund’s portfolio is well positioned with competitively entrenched businesses and a number of superb corporate partners. In aggregate the Fund sells for 55% of our appraisal. We are fully invested and have several new ideas ready for new cash. Our confidence emanates from our holdings. For those with access to this closed fund, Longleaf Partners Small-Cap Fund is a buy.
Longleaf Partners Small-Cap Fund rose 6.8% in the second quarter versus a 3.8% decline in the Russell 2000 Index and a 4.9% fall in the Value-Line Index. A combination of positive operating results and corporate management actions helped produce the Fund’s solid return.

Small-Cap’s largest position, Gulf Canada, provided a sizeable boost to performance as the stock rose 30% during the quarter. Higher oil and gas prices have increased the company’s cash flow, and management has successfully reduced Gulf’s debt. There have been numerous North American oil and gas company acquisitions this year at prices that reinforce our belief that our Gulf appraisal is conservative.

Pioneer Group also contributed to Small-Cap’s performance. We began discussing alternatives with management to get corporate value recognized at Pioneer’s $12.88 low this year. The board put the company up for sale. In May Unicredito Italiano agreed to buy Pioneer, and we liquidated our position at over $41, well above our appraisal.

Several other holdings added to the Fund’s positive results. Hilb Rogal & Hamilton rose 27% as its agencies benefited from substantial increases in property/casualty insurance rates. Wyndham’s stock appreciated 34% as the company demonstrated that its turnaround is under way. Pediatrix, a relatively small position, shot up 60% in the quarter when a state of Florida audit concluded with no fines and no charges of overbilling. Management at Bay View hired an investment banking firm to help explore all strategic options, and the stock rose 31% in the quarter. U.S. Industries announced the sale of its lighting business on the heels of divesting its Diversified Division. Management is aggressively purchasing shares at a large discount to our appraisal. Timberwest enjoyed an up quarter as the company reported higher operating cash flow due to increased volume and improved mix. The company also completed a major share repurchase. Catellus made progress: clearing all Fremont approvals, selling much of its residential development business, and capitalizing on increased demand and rents in both the San Francisco and San Diego markets.

Fleming announced the sale of its retail business except for Food 4 Less stores. The company has had success with large distribution customers such as Target and Kmart, and Fleming is reaping the benefits of the Internet by
providing distribution to a number of on-line grocers. In spite of this progress the stock declined.

During the quarter as more information surfaced, we concluded that Safety-Kleen had been permanently damaged, even though final details have not yet emerged. The tax implication of selling the position is that its short-term loss offsets the substantial short-term gain generated by our earlier sale of Romac.

Longleaf Partners Small-Cap Fund sells for below 55% of our appraisal. Companies priced this cheaply attract bargain hunters, and a number of our management partners are considering partial or full liquidations. For those investors who have access to the closed Small-Cap Fund, the portfolio has a unique mix of upside potential and tax attractiveness. We very recently added to our personal stakes in the Fund.
In the first quarter Longleaf Partners Small-Cap Fund fell 5.0% while the Russell 2000 fueled primarily by technology stocks, rose an impressive 7.1%. Most of our decline was caused by four of our holdings.

Our biggest single issue in the quarter was Safety-Kleen. The outside directors announced they were exploring accounting irregularities and suspended top company officers. It is a bizarre situation that seems far from being resolved. Safety-Kleen is the combination of the old Safety-Kleen business (which we previously owned) that distributes and collects cleaning solvents for small industrial users, and Laidlaw Environmental which deals in hazardous substances for large users. We literally do not know how to comment or even fully assess this situation yet since the company has not detailed the numbers or explained the problem nor have any of the suspended officers been terminated. We continue to monitor this closely and as soon as we have any information on which to base a decision, we will make one.

Bay View Capital’s stock has been weak in the wake of the FMAC acquisition. Time will tell whether FMAC will perform up to expectation or whether our value has been permanently diluted. Even assuming the latter, BVC’s intrinsic value is significantly higher than the stock price. BVC sells for less than book value, which reflects no credit for the company’s San Francisco deposit franchise.

Wyndham’s new management continues to upgrade the chain and report good core results. The stock suffers from the overall weakness of the lodging group. WYN, however, is effectively streamlining its business and focusing on its Wyndham properties. A new, sophisticated ownership group and board hired a new management team with very large ownership positions, thus aligning all of our interests. This new board and team originally sparked our interest in Wyndham, and the stock sells far below bids offered for the company during the restructuring process.

U.S. Industries declined over Wall Street’s general fears about building products investments. Our appraisal incorporates where we are in the construction cycle. Substantial insider buying and aggressive corporate repurchases confirm our assessment of the stock’s extreme undervaluation.

Our long-term optimism for the Small-Cap Fund is rooted in the specific building blocks in this portfolio. Whether partnering with Mark Hansen’s team, which has already made dramatic strides at Fleming, at less than 4X EBITDA, or with the Smiths’ team at Neiman-Marcus at just over half of revenues, our opportunities are better than they have been in years. As in the Partners Fund, 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 not only provide a return that more than compensates for the past year, but would also put us on a platform from which we have historically generated high long-term absolute returns.

Not surprisingly, the low prices and small capitalizations of our holdings have begun to attract a great deal of interest both from insiders and from outsiders. Many of our partners have taken advantage of these discounts by aggressively repurchasing their stocks. Several managers have sold assets or are exploring full liquidation to get shareholders paid. Merger and acquisition interest has risen. We have been approached by third parties to discuss purchasing our stakes as part of efforts to buy out several companies. To enable us to talk freely with all interested parties, we converted our 13G filings with the SEC on Catellus, Gulf Canada, Pioneer Group, VICORP, and Wisconsin Central to 13D’s. The recent activity gives us confidence that values will be realized and our wait in many cases will not be long.

Besides the enthusiasm for our current holdings, our buy list of new and future ideas is extensive. Partners who invest additional cash will allow us to purchase more compelling businesses and improve our future returns.
Longleaf Partners Small-Cap Fund ended 1999 up 4.1% after a flat (-0.4%) fourth quarter. While the average stock as measured by Value Line declined 1.4% during the year, the Russell 2000 Index finished the year up 21.3% following an amazing fourth quarter rally of 18.4% when technology and internet related stocks soared. (Please refer to the table on page 35 for specific contributions to the Fund’s 1999 performance.)

Each of our three largest positions going into 1999 appreciated substantially and was sold. Shaw Communications, the Canadian cable operator, reached our appraisal in the first quarter. Over the eighteen months we owned the company, the stock almost tripled. Orion Capital, Promus Hotels, and Pinkerton’s were acquired and significantly added to the Fund’s performance.

Several smaller holdings also appreciated during the year. Agribrands’ results improved as its overseas feed business rebounded with the recovering Asian economy. Hilb, Rogal and Hamilton continued to grow free cash flow both organically and through intelligent acquisitions. Gulf Canada, currently the Fund’s largest holding, rose during the year as oil and gas prices rebounded. This exploration and production company did not appreciate nearly as much as oil prices, however. With a strengthened balance sheet and unique energy assets, Gulf Canada remains at a large discount to its value. Timberwest, the Canadian timber company, had solid cash flows, and should benefit further from an improving Japanese economy.

We bought eleven new holdings during the year. Three, Romac International, First Health Group, and Neiman Marcus Group, quickly added to the Small-Cap Fund’s results. Romac, the largest single contributor to performance, is a job placement firm with both a traditional business filling full and part-time positions, and a new Internet placement venture, kforce.com. The stock fell as the market feared that the end of Y2K work would hurt revenues, and this decline allowed us to acquire a position. In a fascinating commentary on today’s stock market, Romac almost doubled in a two week period following an announcement that the company would change its name to kforce.com, inc. First Health rose to our appraisal, allowing us to sell our stake. We bought Neiman Marcus, the high-end retailer, in the fourth quarter, and it ended the year as our fourth largest holding. Although the stock rose shortly after our purchase, the market has not fully recognized the value in Neiman’s superior brands and rapidly growing customer base.

The good returns at many of our companies were tempered by price declines in some of our positions. Pediatrix Medical, a national physician practice manage-
A company that specializes in managing critical care units for babies and children, is under attack from short sellers over its billing rates to state governments. At Carmike Cinemas we underestimated the increase in new supply for rural movie theaters, and how that would impact Carmike’s revenues. U.S. Industries, currently our third largest holding, declined during the year to our cost. Management took advantage of the price weakness by selling assets and using the proceeds to repurchase shares. Bay View reported higher cash earnings in 1999, but the market was unsatisfied. Carbide/Graphite operated below capacity awaiting improved demand and pricing for both its needle coke and graphite electrode lines of business. Midas reported weak same-store sales, but the new management team made great progress in improving franchisee relations, building value through improved operations, and buying in stock. Wisconsin Central, currently the Fund’s second largest holding, took longer to turn around the U.K. rail it bought very cheaply from the government. The domestic rail continues as an industry leader, and the prospects for each of its rail operations remain compelling.

In 1999 we found numerous investment opportunities and used proceeds from sales to re-position the portfolio. We also sold our Japanese holdings as equally attractive qualifying domestic opportunities emerged. As we look down the list of holdings, we see tremendous upside. We own high quality businesses with good management partners, and our ownership stakes are very discounted. Collectively the Fund’s composite price-to-value ratio approaches 50%. Businesses that produce substantial free cash flow and have capable managements with the right incentives invariably reach full value when either the market changes its mind (Shaw), the business fundamentals improve (Agribrands and Timberwest), corporate acquirers see an opportunity (Orion, Promus, Pinkerton’s), management restructures the company (Romac), or management aggressively moves to repurchase shares (most of our holdings).
Longleaf Partners Small-Cap Fund is up 4.5% in 1999 after a 5.6% decline during the third quarter. Small-Cap continues to outperform the Russell 2000 Index. While we are disappointed in the short-term results, we are most sanguine about the Fund’s long-term opportunities.

During the quarter, price declines at several holdings accounted for much of the Fund’s loss. Wisconsin Central, the rail operator in the Midwestern U.S., the UK, Australia, and New Zealand, gave up earlier gains as Wall Street took a bearish view of transportation stocks in general, and rails specifically. Our appraisal of WCLX has remained steady. Wisconsin Central’s managers own a significant amount of the company, have been successful rail operators and have a track record of maximizing shareholder value. We took advantage of the recent weakness by adding to our stake.

Catellus has made excellent progress on its development of Mission Bay in San Francisco, and the company’s other properties have reported positive results. Nelson Rising and his team are some of the most capable real estate developers we have seen. These attributes carry no weight with investors who have fled from all businesses related to real estate.

Bay View, a leading San Francisco area thrift, has superb management, compelling future prospects, and sells at a huge discount to its value. Bay View’s purchase of Franchise Mortgage Acceptance Company will strengthen both the balance sheet and loan origination capability. The company’s deposit mix is stronger than it was a year ago. In the face of these attractive fundamentals, the market has sold off Bay View on fears of interest rate increases.

Three companies in the Small-Cap Fund had a significant positive impact on our performance this quarter. Royal & Son Alliance Insurance Group PLC announced its purchase of Orion Capital at a price close to our appraisal. Promus Hotel Corporation, the Fund’s largest position, is being bought by Hilton. This cash and stock transaction, given Hilton’s extreme undervaluation in the market, equals our value for Promus. Agribrands also rose substantially as its animal feed operations delivered improving profitability.

The portfolio changed slightly during the quarter. We sold two holdings. Vail Resorts, less than 0.5% of the portfolio, was liquidated after its price rose. We could not add to TrizecHahn which was less than a 2% position because of Canadian ownership limits. TrizecHahn became a big cap company after Horsham purchased Trizec several years ago. We sold our stake and used the proceeds to buy equally attractive, smaller companies which could be full positions.
The proceeds from these two sales plus those from Orion Capital enabled us to add to several of our most undervalued holdings, and to acquire stakes in three new businesses. The Fund has less than 10% of assets in cash, and the trading desk has orders in place for that. The prospects for the Small-Cap Fund are bright with the composite portfolio priced at about half of our appraisal. For the first time in years, we must select among numerous choices in deciding where to concentrate our resources.
During the second quarter, Longleaf Partners Small-Cap Fund continued its successful compounding record. The Fund rose 13.8% in the quarter, and Small-Cap posted a year-to-date return of 10.6% versus the Russell 2000 Index’s 9.3% return in 1999.

Most of the businesses in the portfolio appreciated during the quarter as the market’s overall performance broadened. Eight of our top ten holdings provided over 60% of the quarter’s return, led by gains at Gulf Canada and Wisconsin Central. Gulf Canada made great strides in strengthening its balance sheet and meaningfully cutting costs. In addition, rising oil prices moved the market’s sentiment. In spite of Gulf Canada’s appreciation, the company still sells for significantly less than its value based on its reserves and securities. Wisconsin Central is increasing its EW&S stake (the United Kingdom’s only cargo rail system) at a very attractive price, and is continuing to make improvements to its operations. WCLX’s traffic in its U.S. markets also grew. The management team owns over 15% of this company and will continue to use its expertise in building value through rail assets.

Our largest holding, Promus Hotels, fell during the quarter when the company announced slower than expected growth. Although expansion of the Doubletree brand will not be as fast as anticipated, the free cash flow generated by its other brands is growing in the mid-teens, and the company is selling significantly below the value of its core franchising business. In addition, management has aggressively repurchased shares. We also took advantage of the temporary stock decline by adding to our stake.

Our other major position that declined during the quarter was Midas. Although same-store sales were weak, the new management made great progress in improving franchisee relations.

We are continuing our effort to concentrate in our twenty best domestic businesses. The Fund has decreased its holdings to 30 stocks. We sold four companies that represented 3% of assets, including the last three Japanese securities in the Fund. Our only remaining foreign exposure consists of Canadian headquartered businesses in oil, real estate, and timber.

During the quarter we increased our stakes in several of our most undervalued businesses and added two new companies. Since the end of the quarter, we have begun buying an additional new holding. The trading desk has orders pending that will use the Fund’s remaining cash.
The second quarter’s small stock rally and the performance at the companies we own was gratifying. Even better, this appreciation did not dim the Fund’s future prospects. We continue to find a large number of qualifying businesses, the Fund is fully invested, and the price-to-value ratio remains below historic levels.
Those who track relative returns should continue to be pleased with the Small-Cap Fund’s results. During the first quarter of 1999 the Fund again outperformed the Russell 2000 Index. Small-Cap was down 2.8% while the Russell fell 5.4%. The Fund’s long-term relative returns are equally impressive.

As significant Small-Cap owners, however, we view absolute, after-tax, real return as the only appropriate measure of compounding. Our long-term partners have enjoyed successful results, but the recent quarter detracted from this record. Of our largest holdings, Promus and Midas rose and positively impacted the Fund. Price declines at Orion Capital, Perrigo, AMETEK, and U.S. Industries were predominantly responsible for Small-Cap’s negative first quarter return. Lower stock prices did not impact our appraisals. Each company that declined, consequently, has become more attractive and should materially contribute to the Fund’s future results.

Small-Cap’s composition changed during the first quarter as we continued to concentrate assets in our best domestic ideas. The Fund’s holdings dropped from 35 to 32 companies, and foreign businesses represent 13% of assets versus 27% at year-end. The most dramatic change to the portfolio was the sale of our largest holding, Shaw Communications, which was 11.7% of assets at year-end. We began buying Shaw, Canada’s leading cable system operator, at $10/share in the fourth quarter of 1997 when cable companies were generally out of favor. Shaw is extremely well operated, dominates its markets, and has the highest margins in the industry, a testament to the discipline, operating skills and vision of the vested management team. Shaw’s business is also growing rapidly due to Internet access, telephony, and new programming tiers. We sold our position at our appraisal of approximately $30/share. Shaw was the single largest contributor to the Fund’s first quarter return.

We also sold our stake in Pinkerton’s, which rose quickly when it was purchased by Securitas AB, a Swedish security company. Securitas paid $29/share versus our appraisal of $30, and an average cost of $16.58/share. In addition, we liquidated our holdings in Chiyoda, Dai-Tokyo, and Fuji, three Japanese non-life insurance companies we bought in late 1997 when undervalued domestic small companies were elusive. At year-end these three companies represented 1.6% of the Fund’s assets. We sold these Japanese businesses from Small-Cap because we had equally undervalued U.S. opportunities where we could acquire a position meaningful to the portfolio. Longleaf Partners International Fund’s introduction last Fall provides a vehicle for the foreign companies we want to own.
We used the proceeds from the above sales to add to a number of our most undervalued businesses. Wisconsin Central newly appears in our top ten holdings. This railroad company operates in the Midwest U.S. and owns monopoly rails in the United Kingdom, New Zealand, and Australia. The WCLX management team is the company’s largest shareholder, and has a proven history of successfully buying and operating privatized railroad assets. The largest non-U.S. rail asset is the U.K.-based EW&S line, which dominates freight transport in that country. Bringing this business to acceptable service and profitability standards has taken longer than anticipated by the market, hence the large discount to appraised value. Because we accumulated our position as the price was falling, our purchase of Wisconsin Central hurt the Fund’s first quarter return.

We have numerous investment opportunities in the Small-Cap Fund, and the trading desk has orders pending for the Fund’s remaining cash. We are not interested in growing the size of the Fund; it remains closed to new investors. Our existing partners should know, however, that Small-Cap’s very low price-to-value ratio implies a compelling return.
Longleaf Partners Small-Cap Fund completed another successful year with a 12.7% return in 1998 versus a decline in the Russell 2000 Index of 2.5%. Small-Cap gained 14.5% during the fourth quarter. The Fund’s return has consistently outpaced the index, but more importantly, our investment partners have compounded their capital at high rates. The average annual return for the last five years was 18.5%, and for the last three years was 23.9%. While we are optimistic about the Fund’s opportunity, we are skeptical that 20%+ returns will be the norm.

Success at several of our large holdings drove the year’s results. Shaw Communications, the Canadian cable operator, added $84 million to the Fund’s return. MediaOne Group, a U.S. based cable company provided another $40 million. The cable industry benefitted from growing cash flows and the recognition that their broadband capacity will experience increasing demand from telephony and Internet users.

Our new holding, Midas, also added significantly to our results. We purchased Midas in January after it was spun out from Whitman (a former Partners Fund holding). In a short period the management team has effectively paid down debt, improved relationships with franchisees, and cut costs.

After U.S. Industries used stock to purchase Zurn, the commercial plumbing products manufacturer we owned, we sold USI in the high $20’s based on our appraisal. When USI subsequently declined below $15 with the market’s recession fears, we took a new position.

Not all the Fund’s holdings were successful in 1998, and several negatively impacted our return. Gendis, the Canadian based holding company whose assets are largely related to the oil and gas industry, has suffered the most. The decline in oil prices has hurt Gendis’ assets including its interest in Pioneer Natural Resources (which the Partners Fund owns), the Alliance gas pipeline, and the oil company, Tundra. In addition, Wall Street has expressed concern over Gendis’ debt relative to cash flow. As a holding company, Gendis is rich in assets and poor in cash flow. The value of Gendis’ net assets, even at today’s depressed prices in oil and gas, are dramatically greater than its stock price. We have confidence in the management team’s ability to grow value and get it recognized.

Bay View also declined considerably in 1998. This San Francisco based savings and loan has one of the most impressive management teams in the industry. They have been challenged to replace their prepaying mortgages with higher earning assets. This short-term problem presents a long-term opportunity for Bay View to replace lower yielding mortgages with more profitable loans.
The Fund also has a temporary loss in our new position in The Carbide/Graphite Group which supplies graphite electrodes to the domestic electric arc steel industry for melting scrap. The recent steel dumping in the U.S. by overseas manufacturers desperate to lower inventories in the face of no Asian demand has hurt Carbide/Graphite’s customers. Once overseas manufacturers deplete their inventories, the company should see sales rise.

Gulf Canada Resources is an important new holding that also has been volatile since we began purchasing the stock. Gulf Canada is the Canadian oil and gas exploration and production business that remained after Gulf Oil sold the retail service station business to British Petroleum several years ago. The value of the company’s net oil and gas reserve, leasehold, and mineral acreage is multiples greater than the stock price, even in today’s depressed energy price environment.

The Small-Cap portfolio looks significantly different than it did a year ago. Turnover was higher than our historic average. We sold several businesses that were spun off from existing holdings. In addition, we sold Dart, Showboat, Zurn, and White River when they were bought out. We sold Vanguard Cellular and Corecomm as they approached our appraisals. We also liquidated some very small positions which we could not increase, and bought more attractive businesses where we could own a meaningful stake. Our level of concentration is now higher than it was a year ago—the top five holdings represent 36% of assets (they were 27% at 12/31/97). Because a number of attractive small cap companies became underpriced, we replaced the two large cap companies (MediaOne and FDX) we had bought in 1997 when small cap opportunities were elusive.

We used these proceeds as well as our cash reserves to buy several new holdings at compelling prices, especially in the third quarter. In addition to the new positions mentioned above, we added Promus Hotels to the Fund. As the lodging industry suffered terribly on Wall Street, those with premier brands and/or superior properties continued to grow earnings and cash flow. Promus offers the strength of several dominant brands that produce valuable management and franchise fees. The company has been an opportunistic repurchaser of shares.

As significant owners in the Small-Cap Fund we begin 1999 with one of the Fund’s most attractively priced portfolios since we began tracking the price-to-value ratio. Our businesses are strong and our management partners are excellent.
The composition of Longleaf Partners Small-Cap Fund changed dramatically over the last three months. We used the $340 million we had in cash at June 30 plus the proceeds from sales of five other companies to buy seven new businesses and add to a number of existing holdings. Cash reserves are now at their lowest level since we closed the Fund last summer, and our remaining liquidity is allocated to several companies that our trading desk is buying.

Longleaf Partners Small-Cap Fund is ranked one of the top performing small cap funds over the last one, three and five years by publications such as the Wall Street Journal, Kiplinger’s, Mutual Funds Magazine, and Investment News. The Fund’s long-term results have been rewarding. In the third quarter, however, Small-Cap declined 13.4% while the Russell 2000 lost 20.2%. Although our short and long-term relative returns are outstanding, relative performance does not compound capital.

Several companies helped the Fund’s performance during the third quarter. Both Midas, our second largest holding, and Media One which we sold, appreciated during the quarter. We also benefitted from our new position in Gulf Canada. Most other holdings were flat or down over the last three months. Companies whose declines most impacted the Fund such as BayView, newly acquired The Carbide/Graphite Group, and Shaw Communications each have strong competitive positions, solid free cash flows, great corporate partners at the helm, and are selling at below 40% of corporate worth. This temporary mispricing affords us the unique opportunity to buy more of these companies and others like them.

As significant owners we are very excited about the Fund’s long-term prospects based on the current price of the portfolio and its implications for future returns. Small-Cap is at an all time low price-to-value ratio of 48%.

Many of you have inquired about plans to open Small-Cap. While our investment opportunities finally do exceed our cash, the Fund will remain closed. Concentration allows companies to have a meaningful impact on performance and insures that we have a deep understanding of those businesses we own. If we equally weight twenty businesses in a $1.1 billion fund, each stake must be worth $55 million. Liquidity issues make us reluctant to own much more than 20% of any one company. The math implies that a company must have at least a $300 million market cap to be in our universe. While we can own companies in the range of the Russell 2000 (currently $5.9 million to $2.4 billion), we want to remain flexible to invest in more than the upper end of that spectrum. Limiting asset growth will benefit all existing partners.
Over the last quarter and throughout 1998, Longleaf Partners Small-Cap Fund has delivered strong absolute and relative performance. The Fund grew 1.2% during the second quarter versus a decline of 4.7% in the Russell 2000. Year-to-date the Small-Cap Fund is up 13.7% compared to the Russell 2000’s 4.9%. The Fund’s performance is more impressive given our high cash levels. At the end of June, Small-Cap had 27% of its portfolio in cash reserves.

Our investments in cable have propelled much of the year’s performance. Shaw Communications and MediaOne have dramatically impacted the Fund since we acquired these holdings less than a year ago. Each remains below our appraisal, and our confidence in their cash flows and managements continues to grow.

While we have found a few qualifying domestic stocks in 1998, the largest opportunity to buy significantly undervalued small cap businesses has been outside the U.S. We currently own four companies headquartered in Canada which represent 18% of Small-Cap’s assets. Another 9% of the portfolio is in fourteen Japanese positions. Our bottom-up process to find the best companies selling at the steepest discounts has led to our foreign holdings. We hedge the currency of businesses whose revenues or assets are tied to a single country. Small-Cap is limited to 30% foreign purchases; below that, we will continue to own the best investments we can find for our money and yours, wherever they are located.

We sold several companies which reached full value during the quarter including Dart Group, Corecomm, Grey Advertising, and Chicago Title (spun off from Alleghany). We have been unable to acquire significant stakes in our new holdings, and consequently the cash in the Fund rose from 20% in March to 27%. While the effort to find new investment opportunities has been painstaking, the attempt to purchase meaningful amounts of our qualifiers has been more so. Southeastern remains committed to our belief in concentrated portfolios — 43% of the portfolio is in our top ten holdings. We are not, however, rigidly wed to any formal portfolio construction. As long as each marginal investment is amply qualified, we would rather be owners than lenders. If we adhered to a dogmatic rule that required investing 4-5% of our assets in a company or none at all, we would miss a number of outstanding investments in companies we have found. We will take even the small stakes we are dealt if we are convinced that the business, people, and price stack up.

On a more optimistic note, we have identified three small cap U.S. companies that meet our criteria since quarter end. We hope the prices will remain stable so we can acquire meaningful stakes.
Small-Cap Fund - MANAGEMENT DISCUSSION

by Mason Hawkins and Staley Cates

Small-Cap completed an eventful and successful three months with a number of companies contributing to the first quarter’s 12.4% return. Four of our holdings were, or are in the process of being acquired: Showboat, Union Corp., White River, and Zurn. In addition, Vanguard Cellular sold a part of its subscriber base for a premium price. Alleghany announced the spin-off of its Chicago Title Insurance business. Corecomm, U S West Media Group, and Midas were also large contributors.

Our cash level has risen to 20%, and investment opportunities in the U.S. continue to elude us. We are, however, finding attractively priced businesses elsewhere. We own four Canadian companies, representing 18% of our assets. Shaw Communications, our largest holding, contributed a substantial amount to first quarter performance as cable television companies regained investor interest. Gendis and Timberwest, two other Canadian firms, remain among the most undervalued companies in the portfolio.

We have taken relatively small stakes in a number of Japanese companies, each selling at steeper discounts than U.S. stocks have seen since 1974. Many of these are available at less than their net cash or net/net working capital positions, with no recognition of their underlying business values. Even if these companies never produce another yen of revenue or profit (which they will), and even with the widely reported structural problems in the Japanese economy, these businesses could be liquidated or sold for significantly more than what we have paid. Collectively, our Japanese holdings are 5% of assets, and our currency exposure is hedged.

On a final note, some of you have asked when or if the Small-Cap Fund will reopen. It was closed because our cash levels exceeded our investment ideas. That situation remains the same today, and the Fund has surpassed $1.1 billion in assets. Even if volatility or a market correction present buying opportunities again, the Fund will most likely remain closed to new investors to maintain our small cap focus and our concentration strategy.
1997 was a banner year for Longleaf Partners Small-Cap Fund. The 1996 Annual Report stated that we “have had little difficulty finding qualifying investments for the Small-Cap Fund. As a result, the Fund remains fully invested . . .” We asked shareholders and prospective shareholders to send money to enable us to take advantage of the numerous opportunities to own high quality small cap companies run by wonderful managements and selling at significant discounts.

We greatly appreciate the many of you who responded to our request. The cash inflows received during the first half of 1997 helped us purchase a number of fantastic new businesses for the portfolio including the current seven largest holdings.

Unfortunately, the market’s pricing inefficiency was short-lived. By summer we were struggling to find new investment ideas and our cash levels were rising. In addition, we sold several companies which reached their full value. To avoid diluting the investments of existing shareholders, we closed Small-Cap to new investors on August 1. The Fund’s liquidity during the second half and its dramatic increase in size did not compromise performance. Small-Cap produced a 29.0% return in 1997, significantly outperforming the Russell 2000’s 22.4% gain.

Of the fourteen companies sold during the year, Healthsource was the most significant. It contributed $7.8 million of the Fund’s total $148 million gain during the year when CIGNA agreed to purchase the business in January. The thirteen other companies sold were relatively small positions in the portfolio either because they were spin-offs from other holdings or their prices rose before we could buy a meaningful stake. Their combined sales added $13 million to the Fund.

Our long-time holdings compounded nicely, contributing $99 million to 1997 performance. Catellus and Bay View both benefitted from the rapid economic recovery in California’s real estate market. Combined, they provided almost $23 million to the Fund’s return. Our corporate partners at the Fund’s three insurance related holdings each continued to make wise capital allocation and operating decisions which benefitted shareholders. Hilb, Rogal and Hamilton, Orion Capital, and Alleghany together contributed over $30 million to performance. White River provided almost $9 million to the portfolio, and Harvard Management announced its plan to buy the company in December.

Several of the businesses we bought during 1997 have already contributed substantially to our results. In aggregate, these new businesses added over $20 million to the portfolio. Most notably, Showboat added over $15 million to 1997 performance. The stock rose when Harrah’s announced its acquisition of
the company. US West Media Group became mispriced during the third quarter as cable companies 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 the industry’s regained stature enabled US West Media Group to provide over $14 million to the Fund’s gain. TimberWest diminished the portfolio’s return by $16 million as its price declined with the fall of the Asian markets. Lower Japanese demand will cause a decline in short-term revenues. However, the timber will continue to grow (literally) in value.

It is worth noting that since year end several holdings have been liquidated or soon will be. Showboat, Union Corp. and White River are each being acquired. These sales have returned the cash level in the Fund to approximately 21%. We will continue to look for qualifying businesses to own but will not compromise our criteria.

The table on the following page provides a more detailed accounting of contributions to performance in 1997.
Longleaf Partners Small-Cap Fund
MANAGEMENT’S DISCUSSION OF LLSC
for the year ended December 31, 1996

Longleaf Partners Small-Cap Fund (LLSC) produced a 30.6% total return in 1996. The Fund remained fully invested. As several holdings reached full value and were sold, we found a number of attractively priced investment opportunities in which to redeploy the cash.

Eight companies were sold during the year, contributing to the Fund’s performance. Helene Curtis provided 11.9% of the gain for the Fund as the company was sold to Unilever early in the year.

Several of our long-time holdings contributed substantially to 1996 performance. The market began to realize White River's value as the company took public its operating business, CCC Information Services, and the holdings of White River thus became easier to evaluate. White River contributed over $5.6 million to Small-Cap’s performance. American Safety Razor provided 11.1% of the Fund’s return as improved earnings got rewarded. Cousins Properties appreciated as it moved its asset base to more income producing properties yielding higher FFO (funds from operations), a measure which greatly interests Wall Street. As a result, the company added over $3 million to Small-Cap’s performance. Rhodes diminished portfolio return by $1.4 million when a 30% shareholder forced the company’s sale to Heilig-Meyers at a point when Rhodes’ profits were temporarily depressed. The transaction closed in January of 1997.

During the year the Fund added twelve new companies to the portfolio, and several contributed to LLSC’s returns. Our position in Trizec benefitted greatly when Horsham announced, it was buying the remaining half of Trizec that it did not already own. The new company, TrizecHahn, become one of the world's largest and most strongly capitalized real estate companies, which was applauded by Wall Street and added $6.2 million of profit to Small-Cap’s performance.

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 30.64% total return for 1996.

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Contribution of Total in 1996</th>
<th>Contribution in 1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>Realized Gains:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Helene Curtis Industries, Inc.</td>
<td>11.9%</td>
<td>$ 5,594,782</td>
</tr>
<tr>
<td>Craig Corporation</td>
<td>2.0</td>
<td>939,218</td>
</tr>
<tr>
<td>All others, net</td>
<td>0.2</td>
<td>80,919</td>
</tr>
<tr>
<td>Total Realized Gains</td>
<td>14.1</td>
<td>6,614,919</td>
</tr>
<tr>
<td>Increase in unrealized appreciation:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>From securities held at December 31, 1995:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>White River Corporation</td>
<td>12.1</td>
<td>5,679,948</td>
</tr>
<tr>
<td>American Safety Razor Company</td>
<td>11.1</td>
<td>5,206,875</td>
</tr>
<tr>
<td>Cousins Properties Incorporated</td>
<td>6.4</td>
<td>3,031,875</td>
</tr>
<tr>
<td>United Asset Management Corporation</td>
<td>5.4</td>
<td>2,536,420</td>
</tr>
<tr>
<td>Franklin Electric Co., Inc.</td>
<td>5.1</td>
<td>2,382,355</td>
</tr>
<tr>
<td>Pinkerton's, Inc.</td>
<td>4.4</td>
<td>2,093,325</td>
</tr>
<tr>
<td>Duff &amp; Phelps Credit Rating Co.</td>
<td>4.1</td>
<td>1,953,900</td>
</tr>
<tr>
<td>The Union Corporation</td>
<td>2.8</td>
<td>1,312,500</td>
</tr>
<tr>
<td>Grey Advertising Inc.</td>
<td>2.4</td>
<td>1,114,060</td>
</tr>
<tr>
<td>VICORP Restaurants, Inc.</td>
<td>2.2</td>
<td>1,015,000</td>
</tr>
<tr>
<td>Rhodes, Inc.</td>
<td>(3.0)</td>
<td>(1,416,633)</td>
</tr>
<tr>
<td>All others, net</td>
<td>0.7</td>
<td>337,640</td>
</tr>
<tr>
<td>Total Increase in Unrealized Appreciation</td>
<td>53.7</td>
<td>25,247,265</td>
</tr>
<tr>
<td>From new holdings in 1996:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TrizecHahn Corporation</td>
<td>13.3</td>
<td>6,247,743</td>
</tr>
<tr>
<td>Bay View Capital Corporation</td>
<td>5.5</td>
<td>2,606,462</td>
</tr>
<tr>
<td>Zurn Industries, Inc.</td>
<td>4.5</td>
<td>2,131,482</td>
</tr>
<tr>
<td>Orion Capital Corporation</td>
<td>4.2</td>
<td>1,996,022</td>
</tr>
<tr>
<td>AMETEK, Inc.</td>
<td>3.7</td>
<td>1,755,802</td>
</tr>
<tr>
<td>Healthsource, Inc.</td>
<td>2.2</td>
<td>1,021,702</td>
</tr>
<tr>
<td>Vanguard Cellular Systems, Inc. - Class A</td>
<td>(2.0)</td>
<td>(957,025)</td>
</tr>
<tr>
<td>The Pioneer Group, Inc.</td>
<td>(2.3)</td>
<td>(1,075,626)</td>
</tr>
<tr>
<td>All others, net</td>
<td>2.5</td>
<td>1,158,341</td>
</tr>
<tr>
<td>Total From new holdings in 1996</td>
<td>31.6</td>
<td>14,884,903</td>
</tr>
</tbody>
</table>

Net realized and unrealized gain on investments | 99.4 | $46,747,087 |
Net investment income | 0.6 | 305,763 |

Net increase in net assets resulting from operations | 100.0% | $47,052,850 |
Longleaf Partners Small-Cap Fund (LLSC) produced an 18.6% total return for shareholders in 1995 without exposure to technology stocks which are difficult for us to value. Southeastern believes that the portfolio’s current holdings are financially sound, well managed, good businesses and are positioned for substantial growth over the next five years.

In 1995 the Fund liquidated two financial services companies as their prices approached our appraisals with the market’s renewed interest in this sector. Legg Mason, the regional brokerage firm provided almost 10% of the year’s gains. The mutual fund company, Pioneer Group, contributed an additional 6.8% of 1995’s return. The sale of Arden Group, a California grocery operator, realized $1.2 million in gains for LLSC. The stock rose in recognition of the company’s improved profitability.

The Fund also benefitted from tax deferred unrealized gains of companies that remain in the portfolio. Meredith Corp., with its publishing business and television stations, contributed over $3.8 million to 1995 performance as advertising revenues and circulation grew. Longtime holding Alleghany continued to add to LLSC’s value, providing $1.6 million in 1995. The company benefitted substantially as its large holding in Santa Fe Paciﬁc railroad was merged with Burlington Northern. The Fund’s largest holding, White River Corporation, rose in price as investors focused on the company’s automobile claims settlement services and proﬁtable stake in Northwest Airlines. This provided $1.5 million to LLSC. Union Corp. added $1.4 million to the portfolio’s value as proﬁts grew from the company’s accounts receivable and debt collection management services.

Of LLSC’s new holdings, Thomas Industries which makes lighting products, compressors and vacuum pumps, contributed 5.1% of the year’s gains with the acceleration of its revenues and earnings. Another new holding, American Safety Razor, declined over the year, reducing gains by $1.9 million. Although the company failed to match Wall Street’s elevated expectations, Southeastern believes that this maker of razors and other bladed instruments as well as bar soaps has a much higher intrinsic worth than its year end price.

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 18.61% total return for 1995.

<table>
<thead>
<tr>
<th>Contribution in 1995</th>
<th>Percentage of Total Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legg Mason, Inc.</td>
<td>$ 2,100,417</td>
</tr>
<tr>
<td>The Pioneer Group, Inc.</td>
<td>1,449,546</td>
</tr>
<tr>
<td>Arden Group, Inc. – Class A</td>
<td>1,221,259</td>
</tr>
<tr>
<td>National Education Corporation</td>
<td>772,981</td>
</tr>
<tr>
<td>Meredith Corporation</td>
<td>554,169</td>
</tr>
<tr>
<td>Duff &amp; Phelps Corporation</td>
<td>547,329</td>
</tr>
<tr>
<td>Phoenix Duff &amp; Phelps Corporation Convertible Preferred A</td>
<td>(477,340)</td>
</tr>
<tr>
<td>All others, net</td>
<td>501,991</td>
</tr>
<tr>
<td></td>
<td><strong>6,670,352</strong></td>
</tr>
</tbody>
</table>

Increase in unrealized appreciation (depreciation):

From securities held at December 31, 1994:

<table>
<thead>
<tr>
<th>Contribution in 1995</th>
<th>Percentage of Total Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meredith Corporation</td>
<td>3,853,278</td>
</tr>
<tr>
<td>Alleghany Corporation</td>
<td>1,614,430</td>
</tr>
<tr>
<td>White River Corporation</td>
<td>1,512,275</td>
</tr>
<tr>
<td>The Union Corporation</td>
<td>1,425,000</td>
</tr>
<tr>
<td>Duff &amp; Phelps Credit Rating Co.</td>
<td>1,092,579</td>
</tr>
<tr>
<td>Chartwell Reinsurance Company</td>
<td>1,033,801</td>
</tr>
<tr>
<td>Grey Advertising Inc.</td>
<td>1,029,980</td>
</tr>
<tr>
<td>Plenum Publishing Corporation</td>
<td>1,017,500</td>
</tr>
<tr>
<td>Cousins Properties Incorporated</td>
<td>1,008,144</td>
</tr>
<tr>
<td>Delchamps, Inc.</td>
<td>615,000</td>
</tr>
<tr>
<td>Ralcorp Holdings, Inc.</td>
<td>565,762</td>
</tr>
<tr>
<td>Phoenix Duff &amp; Phelps Corporation</td>
<td>563,928</td>
</tr>
<tr>
<td>VICORP Restaurants, Inc.</td>
<td>(2,320,000)</td>
</tr>
<tr>
<td>All others, net</td>
<td>128,271</td>
</tr>
<tr>
<td></td>
<td><strong>13,139,948</strong></td>
</tr>
</tbody>
</table>

From new holdings in 1995:

<table>
<thead>
<tr>
<th>Contribution in 1995</th>
<th>Percentage of Total Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thomas Industries Inc.</td>
<td>1,077,450</td>
</tr>
<tr>
<td>Markel Corporation</td>
<td>615,797</td>
</tr>
<tr>
<td>Franklin Electric Co., Inc.</td>
<td>430,374</td>
</tr>
<tr>
<td>Rhodes, Inc.</td>
<td>(694,709)</td>
</tr>
<tr>
<td>American Safety Razor Company</td>
<td>(1,909,604)</td>
</tr>
<tr>
<td>All others, net</td>
<td>953,782</td>
</tr>
<tr>
<td></td>
<td><strong>473,090</strong></td>
</tr>
</tbody>
</table>

Net realized and unrealized gain on investments ........................................... $20,283,390 95.2%
Net investment income ......................................................................................... $ 1,025,608 4.8%
Net increase in net assets resulting from operations ............................................ $21,308,998 100.0%