Small-Cap Strategy Commentary

3Q20

Southeastern Asset Management

For Institutional Investors Only

			Annualized Total Return				
	Qtr (%)	Ytd (%)	1 Year (%)	3 Year (%)	5 Year (%)	10 Year (%)	Since Inception (%)
Small-Cap Strategy (Gross)	25.83	-3.84	6.65	3.14	8.11	12.06	8.78
Small-Cap Strategy (Net)	25.55	-4.47	5.69	2.17	7.07	10.95	7.71
Russell 2000	4.93	-8.69	0.39	1.77	8.00	9.85	6.29
Russell 2000 Value	2.56	-21.54	-14.88	-5.13	4.11	7.09	3.74

*Since Inception 12/31/2006

The Small-Cap Strategy added 25.55% in the third quarter, far surpassing the Russell 2000's 4.93% return for the period. Almost every company in the portfolio produced positive returns in the quarter, with several companies reporting double-digit returns, driven by stronger-than-expected results. Kodak was by far the largest contributor, accounting for three-quarters of the positive absolute returns and almost 90% of the relative outperformance in the quarter. The Strategy has not only beaten the primary index, it is ahead of the Russell 2000 Value Index on a trailing 1, 3, 5, and 10-year basis. We are highly confident in the Strategy today and believe we have significant upside potential from here.

Performance Review: Update on Kodak

We have fielded multiple calls and emails on Kodak since the news first broke on July 28, 2020 about the company receiving a potential $765 million loan under the Defense Production Act to produce ingredients used in a variety of key generic medicines.

The Portfolio Characteristics

Price-to-Value	High-50s%
# of Holdings	15
% of Cash	36.9%
The Portfolio Yield	1.8%

When we first invested in Kodak in 2016, one of the most compelling but hardest to value parts of our case was the strategic upside in the Eastman Business Park (EBP) in Rochester, NY. This facility encompasses over 1200 acres and millions of square feet of buildings. But the vast majority of it was lying dormant at the time of our investment. One of the many good things about the news of the loan was that it could rejuvenate this asset in a win/win for both Kodak and the United States. The loan would not be a gift, but rather an investment that achieves a good return for both parties by bridging the EBP from an underutilized asset to a productive facility that can handle much more than just the drug ingredients contract initially announced.

It was discouraging that after the news of the potential loan broke, Kodak and CEO Jim Continenza had to endure multiple headlines alleging various improprieties, while the company was unable to publicly defend itself in the midst of a review of the events of the last few months by well-respected law firm Akin Gump. When Akin Gump's 88-page report finding no illegal behavior by Kodak management came out, there was less coverage, but the good news is that the facts appear to speak for themselves. Importantly, through release of this report, our view is that Jim Continenza and the Kodak board of directors were able to clear the air as it relates to his options granted this year and to potential insider trading. We will continue to monitor any developments regarding these issues.

It is not clear whether the government loan will still go through at this point, but Kodak has confirmed that commercial parties were interested in doing business with the company in this drug ingredients field before the government loan came into view, thus showing that there are multiple paths with and without a government loan to value realization here. Jim Continenza has been working hard to grow value per share since he became CEO of the company last year. Jim has dramatically cut costs, simplified the business and sharpened its focus. We are confident that he will continue to explore a broader array of strategic options for Kodak's other assets, like its digital printing business, its brand licensing stream and its under-monetized materials science patents from a position of strength.

We were not able to share details with you on our active trading in the midst of the extreme share price volatility, given regulatory restrictions and the sensitivity of the situation. We can now share more of those details and how we managed the position through the news cycle.

We exited our small common stock position the day the deal was announced and then worked with the company to convert our convertible bonds to common shares over the course of the next several days. As noted in Kodak's 8K filed on August 3rd, we received just under 30 million shares of common stock and $5.6 million in accumulated interest in cash upon conversion. We subsequently sold all of the converted shares to take advantage of the price appreciation and reduce an outsized position, as reported in our Schedule 13G filed on September 10th. Today, we still retain ownership in the preferreds, which represent 11% of the portfolio as of quarter end.

Our investment in Kodak has been mostly done as a lender first with equity upside second because of what we viewed to be a much wider than usual range of outcomes at this company. We chose to live with less near-term liquidity in exchange for this downside protection, coupled with large potential upside. We understood that this could lead to more short-term volatility in the stock price given the small market cap at the time we invested, but we can't say that we expected a range of $2 to $60 in two days and now $9 two months later. We will always view volatility like this as a gift from Mr. Market, as Ben Graham and Warren Buffett would say. We have also long focused on being approximately right instead of precisely wrong in our appraisals. We have been monitoring the situation and updating our view in real time, and the range of the Kodak value per share today is both higher and wider than it was three months ago. It is likely that the replacement cost of EBP today is an extremely large number. This value needs to be added to Kodak's other assets that we thought were worth at least $500-750 million, including cash. We can see a path to meaningfully positive free cash flow (FCF) at Kodak over the next few years that can be worth at least a mid-high teens market multiple. With the conversion of our bonds into equity, our preferred investment is now an even higher quality credit, and when the time is right, we will explore various ways to monetize or modify this investment before it matures next year. In the meantime, this investment provides dividends and solid value as a safe credit.

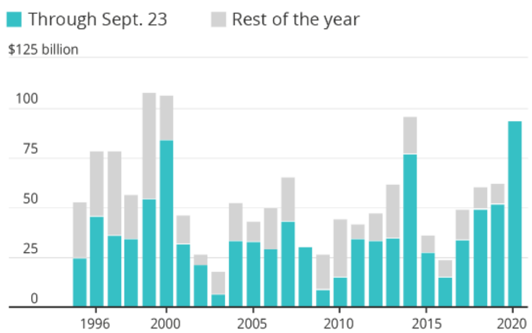
Market Review

Last quarter, we wrote about the two different categories of bear markets we have seen seven times over the last 50+ years – those that were started by an external macro shock (from which value has historically bounced back better than the market after a period of initial underperformance) and those that were started by the popping of a speculative stock market bubble. Over the last three months, we began to see early signs of both our style of investing bouncing back and the speculative bubble popping, or at least letting some air out. While we will highlight strong stock-specific results at the companies we own later, we saw some promising signs that momentum will not drive markets forever. While our previous letter focused more on the quantitative signs of market excess, we thought it might be helpful in this letter to highlight some other, more qualitative reasons things could soon turn our way.

The first sign of market excess to discuss has been the dramatic rise in initial public offerings (IPOs), as the market has continued to first thaw from and then quickly overheat after the initial COVID shock. After seeing sentiment measures reach Global Financial Crisis (GFC)-levels in March, it is pretty amazing to consider that 1999-2000's IPO issuance record is now within reach only six months later, as shown in chart 1 below.

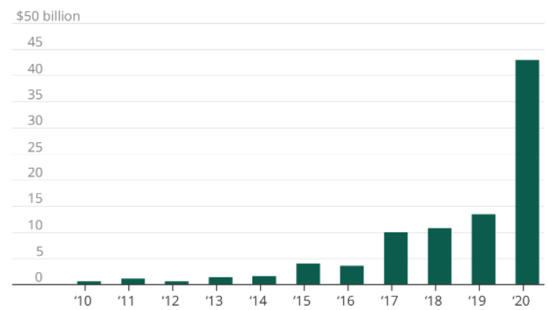
The September 4th MarketWatch headline christening 2020 as "The Year of the SPAC" (special purpose acquisition corporation) is arguably an even starker sign of excess, with the highest issuance of SPACs on record, by a lot, as shown in chart 2 below.

Chart 1:
Money Raised by US-listed IPOs



Source: Driebusch, C. (2020, September 25). IPO Market Parties Like It's 1999. *Wall Street Journal.* Retrieved from wsj.com; Dealogic

Chart 2:
Money Raised in Blank-Check Company IPOs, Annually



Source: Wursthorn, M. (2020, September 30). Blank-Check Companies Get the ETF Treatment. *Wall Street Journal.* Retrieved from wsj.com; Dealogic

In a way, this signifies an even frothier market than the kind of IPO boom that has typically been associated with traditional market peaks. At least with IPOs you know what you are buying, even if it is at a high multiple and is being sold by someone who knows a lot more about it than you do. Essentially "blank-check companies," SPACs represent shares in a company that has no operations. SPACs are a total leap of faith that markets are only open to when things feel the best, but a big leap off a high peak can lead to a painful splat. The Year of the SPAC was taken to an even greater extreme with the launch of the first SPAC ETF on October 1st. In our view, this unholy union is a sign of peak market mania.

We have also seen a sharp increase in retail stock trading forming part of the zeitgeist, which is yet another sign of a market top. In recent history, we had the great bitcoin Thanksgiving of 2017 (bitcoin trades today at $10,504 vs. its high of $19,783 in December 2017). Similarly, right before the GFC, there was a mania for building and flipping houses (housing starts even in the strong year of 2020 are still on track to be in the 1.5 million range vs. a peak of over 2 million pre-GFC). But, we have to go back to 1999-2000 to see a retail frenzy for certain stocks at similar levels we are seeing today.

Putting a sad 2020 twist on the old "shoeshine boy test", one of us recently lost someone close to us but was unable to attend the small funeral service due to COVID restrictions and family obligations. While texting with the family member who was able to attend, she reported back not on the details of the service, but rather on all of the questions about options trading and an electric vehicle stock from the guests in attendance! For contrarians like us, this brought some glimmers of hope to a long day in a long year.

Contribution to Return

3Q Top Five

Company Name	Total Return (%)	Contribution to Return (%)
Eastman Kodak	121	20.16
Mattel	21	1.35
Realogy	27	0.97
Graham Holdings	18	0.93
PotlatchDeltic	11	0.81

3Q Bottom Five

Company Name	Total Return (%)	Contribution to Return (%)
Empire State Realty	-13	-0.65
Everest Re	0	-0.02
Summit Materials	12	0.03
GCI Liberty	2	0.06
Lumen	3	0.07

As discussed above, Kodak was the largest contributor to performance in the quarter.

Mattel, the classic toy company, was another strong contributor in the quarter. Although this year's revenues will be down due to global lockdowns shutting stores, the company is on track to increase its annual earnings before interest, taxes, depreciation and amortization (EBITDA) with higher gross margins and the successful execution of its outsourced manufacturing strategy. Barbie delivered another excellent performance, gaining seven points of US doll market share in the second quarter, while growing its revenues as competitors shrunk. Mattel also released a new Barbie special on Netflix in September, part of a promising long-term push into intellectual property licensing. American Girl, a brand that has struggled for years, doubled its digital sales during the quarter as well. With higher profitability, shoppers returning to stores and a strong new digital media presence behind its biggest brands, CEO Ynon Kreiz's strategy is beginning to pay off.

Realogy, the residential brokerage franchisor, was another strong contributor. Although quarterly numbers in both the Franchise and Owned Brokers businesses appeared anemic due to April's nearly frozen market, home sales picked up by the end of the second quarter and have surged in the third. The company amended its credit covenants to allow for another year of higher leverage ratios on depressed trailing annual EBITDA until its sales normalize. Realogy's Title business also cashed in on the refinance boom and doubled its EBITDA contribution during the quarter. CEO Ryan Schneider deserves credit for not panicking in the worst moments in March and April, and the company is poised to de-lever rapidly in today's healthy homes sales market.

Graham Holdings, the media, education and manufacturing conglomerate also contributed to positive returns. With small businesses slashing marketing expenses, Graham's quarterly TV revenues fell 17% excluding the election-year growth in political advertising. However, the TV revenues bottomed in April and have since shown marked improvement. In Education, Kaplan International constant-currency revenues decreased 9% due to the freeze in international travel and campus closures, but this result was better than feared and the segment's margins held up well. Kaplan Higher Education, a joint venture with Purdue, grew strongly, as did the company's wood treating and podcasting subsidiaries. CEO Tim O'Shaughnessy took advantage of a highly discounted price by repurchasing at a 7% annualized pace and announced in September the board's new repurchase authorization of up to 500,000 shares.

Empire State Realty Trust (ESRT) was the only detractor of note in the quarter. New York City is just beginning to emerge from COVID, so its office buildings remain only about 10% full, and the Empire State Building Observatory – while outperforming other observatories in the area by a significant margin – is still well off its 2019 levels due to a dramatic fall-off in tourist traffic. It will take time for the company to rebound to full strength, but a dire scenario is already priced in, and our value in the mid-teens per share assumes a slow ramp back. The good news is that ESRT has a best in class balance sheet, and our great CEO partner Tony Malkin is poised to go on offense in a market that is ripe with opportunities.

The Portfolio Activity

Summary of Trade Activity

New Purchases	Full Exits
Liberty Braves Group	GCI Liberty
Everest Re	ViaSat
Summit Materials	

We exited GCI Liberty in July for an 84% return over two years of ownership. Charter Communications, the cable company that is GCI Liberty's largest holding, grew its value consistently with improved EBITDA and FCF, and Charter's share price roughly doubled in the last two years. GCI's Alaskan cable business faced a seemingly endless series of unforeseen challenges but navigated them well. Once again, CEO Greg Maffei and Chairman John Malone proved to be exemplary partners. We also exited our position in satellite communications company ViaSat, which was a small performance detractor but a longer-term opportunity cost given its six-year holding period. Over the course of our holding, ViaSat shrunk its subscriber churn and raised prices, as we had originally believed they would. Its government business consistently grew revenues and profits very well, and ViaSat Inflight signed up over 2000 airplanes. But the company will not produce positive FCF for several more years due to the ongoing investment demands of its next-gen satellites. Threats from new entrants have emerged from the likes of Amazon that are difficult for us to quantify. We have also disagreed with management on certain items over our holding period. There is a wide range of outcomes from here for the business, but we felt we could deploy the capital elsewhere with less downside risk.

We initiated three new investments in the quarter. Liberty Braves, a sports, media & real estate company, is an opportunity to invest with excellent management partners John Malone and Greg Maffei again. The company encompasses the Atlanta Braves baseball team, its new stadium and a surrounding mixed-use real estate development. We had the opportunity to purchase this collection of strong assets at a significant discount due to the COVID disruption to the Major League Baseball (MLB) season. The majority of our appraisal value is the Atlanta Braves baseball organization. The Braves team and properties have grown revenues and profitability for years, with baseball revenues nearly doubling between 2014 and 2019 to $476m. The recent acquisition of the Mets by Steve Cohen at a price substantially above our value for the entire Braves baseball and real estate portfolio shows a continuing appetite for trophy sports acquisitions. We anticipate Liberty controlling shareholders, John Malone and Greg Maffei will continue to compound value, while closing the price-to-value (P/V) gap to get shareholders paid.

Everest Re, the Bermuda-based reinsurance company. The historically unprecedented decline in interest rates and uncertainty in markets presented us with the opportunity to own this high-quality business again. Everest Re is a "recycled" company that we have owned before and know well. In spite of the challenging and uncertain times, we expect Chairman Joe Taranto will again display strong operating discipline and take advantage of a potentially hardening property and casualty (P&C) insurance market, while making smart capital allocation decisions.

Summit Materials, the cement and aggregates company, is a "recycle" for Southeastern that we have owned before, within an industry that we know very well. Summit has irreplaceable assets with pricing power in aggregates and cement. US 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. As the US cement and aggregates industry consolidates, new CEO Anne Noonan will have numerous strategic options to close the stock's P/V gap.

Outlook

After another quarter of strong market returns, we were excited to see increased volatility and share prices pulling back a bit in the last month, when we were able to start putting some of our cash to work again. Our research team has been busy, and our on-deck list of potential new investments grew substantially in the last three months. We have over five ideas that are fully vetted and being closely watched across a variety of industries. These companies range from branded apparel to diversified infrastructure to diversified industrials to financial services to media/entertainment. They have all been discounted for idiosyncratic reasons. With more market volatility, we expect we will be able to put more cash to work into at least some of these businesses at good prices.

Continuing the theme of this letter, it feels like things are closer to coming our way, mostly because it felt for the first two months of this quarter that market sentiment had rarely been worse for bottom-up, value investors like us. It will be an interesting rest of the year for all of the reasons that we are all tired of hearing about. We can imagine a grid of outcomes with the best possible (but not the most likely) “cube” being [vaccine that works well and is rolled out smoothly and swiftly over the next 6-9 months] + [“normal” (we give some leeway with those quotes) US election] + [nothing else bad happening], but we are aware that there are a lot of other cubes in this grid. Of course there are always large outcome grids like this (that’s life), but it is rare to find so many consequential and sharply divergent paths compressed into so few months, and it feels like the market is pricing in a scenario much closer to the ideal cube for a lot of market sectors that have been seemingly priced for perfection for years now. Where the market is more doubtful, we feel that the vast majority of the pain has already been taken, including in some of our portfolio holdings, like Lumen (the recently renamed CenturyLink) and Empire State Realty Trust, to name a couple. We have maintained our cash discipline as the market melted up, meaning we have cash available to be a liquidity provider in the next market downdraft, and we will not be afraid to put it to work when investments qualify. For those reasons, we are confident our Strategy will work from here in a variety of outcomes and look forward to speaking with you again after year end. We hope you and your families remain safe and healthy.

See following page for important disclosures.

Southeastern Asset Management can be found in our ADV Part 2, available at www.adviserinfo.sec.gov. Statements regarding securities are not recommendations to buy or sell the securities discussed. The statements and opinions expressed are those of the author and are as of the date of this report. Holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients. Current and future holdings are subject to risk and past performance does not guarantee future results. Portfolio information is based on a sample account at September 30, 2020. Portfolio makeup and performance will vary on many factors, including client guidelines and market conditions.

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 strategy 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.

SOUTHEASTERN ASSET MANAGEMENT, INC.
INSTITUTIONAL U.S. SMALL-CAP EQUITY COMPOSITE
ANNUAL DISCLOSURE PRESENTATION

					Annual Performance Results Composite				
Year End	Total Firm Assets (USD) (millions)	Composite Assets (USD) (millions)	Number of Accounts	Russell 2000 (with dividends)	Gross	Net	Composite Dispersion	Composite 3-Yr Annualized EX-Post Standard Deviation	Benchmark 3-Yr Annualized EX-Post Standard Deviation
2019	12,481	34	<5	25.5%	19.0%	17.9%	na1	12.9%	15.7%
2018	13,881	29	<5	-11.0%	-6.3%	-7.2%	na1	11.4%	15.8%
2017	18,203	31	<5	14.7%	3.3%	2.2%	na1	10.7%	13.9%
2016	19,302	55	<5	21.3%	25.0%	23.7%	na1	10.8%	15.8%
2015	20,315	44	<5	-4.4%	-2.8%	-3.8%	na1	10.3%	14.0%
2014	30,542	46	<5	4.9%	13.7%	12.5%	na1	9.4%	13.1%
2013	34,914	50	<5	38.8%	32.9%	31.6%	na1	14.6%	16.5%
2012	31,752	38	<5	16.4%	27.5%	26.2%	na1	19.0%	20.2%
2011	31,485	35	<5	-4.2%	5.8%	4.8%	na1	25.6%	25.0%
2010	34,639	40	<5	26.9%	27.7%	26.4%	na1	29.6%	27.7%

na1 - Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

Institutional U.S. Small-Cap Equity Composite - Portfolios included in this composite normally contain 18-22 securities. Sector and industry weightings are a by-product of bottom-up investment decisions, and market capitalization ranges from over $1 billion up to sizes found within small-cap indices. Assets held in non-U.S. investments generally do not exceed 30% of portfolios. Cash is a by-product of a lack of investment opportunities that meet Southeastern's criteria. The benchmark used for comparison is the Russell 2000 with dividends. Southeastern Asset Management, Inc. ("Southeastern") claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Southeastern has been independently verified for the periods January 1, 2001 through December 31, 2019. The verification reports are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. Southeastern is an independent investment management firm that is not affiliated with any parent organization. Southeastern invests primarily in equities. Results are based on fully discretionary portfolios under management that are managed without regard to tax considerations. Past performance is not indicative of future results. A complete list of composite descriptions is available upon request. The U.S. dollar is the currency used to express performance. Returns are presented gross and net of management and performance fees and include the reinvestment of income. Dividends are recorded either gross or net of foreign withholding taxes based on the treatment of these taxes by the accounts' custodian. Net of fee performance is calculated using actual management and performance fees. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the portfolios in the composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. The investment management fee schedule is 1% on the first $25 million and then 0.75% on the balance. Actual investment advisory fees incurred by clients may vary. The Institutional U.S. Small-Cap Equity Composite was created July 1, 2011.