January 24, 2020

Longleaf Partners Shareholder Letter

4Q19

Each of our four Funds produced returns in 2019 that materially exceeded our absolute return goal of inflation plus 10%, but each Fund lagged its respective benchmark Index. In our 2018 annual letter, we made three primary observations: First, we noted that 2018 results did not reflect the progress in our portfolios, which we believed laid the foundation to deliver strong absolute returns in 2019. We started 2019 with price-to-values (P/Vs) at historically compelling levels in the high 50s-to-low 60s% and all Funds nearly fully invested. Second, we had several companies that were large detractors in 2018, which we felt were overly discounted with

	1 Year	4Q
Partners Fund	14.81%	9.05%
S&P 500 Index	31.49	9.07
Small-Cap Fund	19.65	9.32
Russell 2000 Index	25.53	9.94
International Fund	20.00	11.80
MSCI EAFE Index	22.01	8.17
Global Fund	20.38	9.84
MSCI World Index	27.67	8.56

Past performance does not guarantee future results.

Average Annual Total Returns (12/31/19) Partners Fund: Since Inception (4/8/87): 9.70%, Ten Year: 7.03%, Five Year: 1.29%, One Year: 14.81%. Small-Cap Fund: Since Inception (2/21/89): 10.67%, Ten Year: 11.98%, Five Year: 6.65%, One Year: 19.65%. International Fund: Since Inception (10/26/98): 7.67%, Ten Year: 5.56%, Five Year: 7.43%, One Year: 20.00%. Global Fund: Since Inception (12/27/12): 6.92%, Ten Year: na, Five Year: 5.78%, One Year: 20.38%. 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. The prospectus expense ratio before waivers for the Partners Fund is 0.97%. Effective August 12, 2019, Southeastern has contractually committed to limit operating expenses (excluding interest, taxes, brokerage commissions and extraordinary expenses) to 0.79% of average net assets per year. This agreement is in effect through at least April 30, 2021 and may not be terminated before that date without Board approval. The total expense ratio for the Small-Cap Fund is 0.92%. The total expense ratio for the Longleaf Partners International Fund is 1.19% (gross) and 1.15% (net). The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.15% of average annual net assets. The total expense ratio for the Global Fund is 1.33% (gross) and 1.20% (net). The expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.20% of average annual net assets. These agreements are in effect through at least May 1, 2020 and may not be terminated before that date without Board approval.

strong qualitative drivers and management-led actions that we believed could result in significant outperformance in 2019. Third, we felt the relative return opportunity was compelling, as our portfolios were positioned in areas that were out of favor, rather than the US, large cap, momentum, defensive and/or dividend stocks that led markets for almost a decade.

2019 was a year of exceptionally strong performance for listed equities across almost every geography, even as certain markets were more volatile than others. We would generally expect to outperform coming off near-historic level discounts for our portfolios at the start of the year. However, the market headwinds we wrote about in 2018 (and in many prior letters over the last decade) persisted in 2019, exacerbated by some stock-specific challenges. Our relative returns were impacted as Growth broadly continued its dominance over Value for most of the year, US markets outperformed non-US markets, larger-cap companies outperformed small cap, investors continued to chase yield as interest rates declined and Asian holdings were stressed by the US-China trade war and Hong Kong conflict.

As concentrated, bottom-up business appraisers, we focus on how the companies we own are performing. In 2019, most of our portfolio investments delivered solid double-digit returns. As we predicted, the top contributor to performance for all four Longleaf Partners Funds was among the larger detractors in 2018. We believe we will be sharing similar positive news next year about 2019's detractors.

The Last Decade

2019 marked the end of a tough decade for active, concentrated, value investing. While 2010 saw value – and Southeastern in particular – post a strong year as an extension of 2009's comeback from a dismal 2007 and 2008, the winning investment approach over the rest of the decade could be summarized as, "Buy only US stocks, the bigger/steadier/growthier your strategy, the better". Or simply, "Buy big quality at any price."

The current top 20 companies in the S&P 500 by market cap (excluding Amazon's high price to earnings (P/E) both then and now) have a weighted average next twelve months P/E of just over 26x vs. just over 16x at the start of 2014. Today's market multiples are on after-tax margins that are near peak levels. Most of the companies we own today are comprised of single or low double-digit multiples on margins that can grow meaningfully, even without the benefit of a growing economy. The rest of our portfolio holdings are better-appreciated stocks trading at mid to high teens multiples on mid-cycle margins, which can lead to solid returns as the market leaders did in 2014. It is, however, much harder to compound over the long run when your starting point is a sub-4% implied discount rate on high margins at companies that have already grown to hundreds of billions in market cap. We were too cautious assessing many big companies over the last ten years. Bigger has been better, and our relative results suffered.

Multiple factors drove this "big quality at any price" trend. Interest rates have gone only one way (down), contributing to a lack of stock-specific volatility that would typically benefit bottom-up, fundamental value investors like Southeastern. Low interest rates also made the boring dividend stocks that would usually come our way in the later stages of a bull market overpriced as they became places to reach for yield. The two most influential and fastest-growing market strategies of the past decade have been as opposite in their core tenets as possible: passive, which charges low-to-no fees to own the market with daily liquidity, and private equity (PE), which charges high fees on highly-levered, illiquid capital. Since the global financial crisis, net flows into index funds and exchange-traded funds (ETFs) have totalled $4 trillion, while active funds have lost $148 billion. Passive is fundamentally a strategy that buys more of what has been outperforming, meaning big becomes even bigger. As more and more assets move towards indexing, the overuse of the strategy is likely to hinder its own future success. If an allocator did decide to invest in an active strategy in the last decade, it was likely that they invested in PE. Much like passive, PE was founded on valid principles – pay 6-8x EBITDA on depressed margins, use a reasonable amount of leverage, take a longer-term view to make tough improvements out of the public eye, then monetize at a higher price. But PE has benefitted in the last decade from rising exit multiples, and now the industry is forced to pay materially higher going-in multiples on peak margins with more leverage when interest rates are at all-time lows.

What We Own Today

Quality is critical to Southeastern, but we define it differently than the standard, backward-looking, stock momentum approach that has driven markets. In our bottom-up, fundamental approach, we define a high-quality business as one with a long-term growth tailwind , pricing power or gross profit royalties, network effect benefits, a lack of technological and/or regulatory risks and an ability to grow free cash flow (FCF) higher than revenue with a high incremental return on capital (ROC). High-quality partners are honorable people who think long-term instead of quarter to quarter, are preferably large owners of their stock relative to their net worth and are incentivized on ROC, FCF per share growth and/or total shareholder return. We find that the market tends to focus more on business rather than people quality, but our history has shown that good partners can achieve excess returns beyond what the business quality alone may suggest. This becomes even more evident in cases where we engage with companies to help drive superior outcomes.

Our 45-year history has taught us that the price paid for any investment matters greatly for future returns and risk reduction, and we believe the market is paying a very high price for big, "quality" businesses today, particularly within the US. We track a global master list of thousands of companies that we have assessed using our Business, People, Price criteria. Today, the 800-900 company US-subset of that list trades at a median P/V of 115% and the Non-US subset trades at closer to 100%. We quantify our view of the qualitative by assigning a score of 1 (worst) to 5 (best) for both business and people by analyzing the factors outlined above for each. Interestingly, the 5 (highest) quality score businesses in the US trade on average 10 P/V percentage points higher than the 4 quality score businesses, which are also trading 10 points higher than the 3s. We spend little time on the 2s and 1s. Although the 5s are rightfully worth the highest multiples (and we own some of these), it is hard for something that is both consensus-great today and already huge to stay 26x-PE-multiple-great for a 10 year+ period.

As long-term, concentrated, engaged value investors, we remain focused on identifying new opportunities with the potential to be our next successful long-term holding. We go down the list each day of quality companies we would love to own if market prices cooperate. The relatively low level of new purchases across our Funds in 2019 does not reflect the extensive work of the research team in what was a busy and productive year. In 2019, the team talked with well over 300 companies across the globe. This includes current investments, where we engage with our management partners to ensure we are on the right path for long-term value creation. Prospective investments include both successful prior holdings that have come back in range to be potential "recycled" investments and companies that are newer to us or within industries or regions where we are expanding our expertise and circle of competence, including smaller-cap US technology-related businesses and Japanese companies with value-focused owner-operators and/or independent board members at the helm. In addition to management teams and boards, we met with competitors, former employees, various industry experts and other like-minded, influential investors to help us understand these businesses and vet their management. Nor does our process end when we sell a company. The primary analyst completes a postmortem at the end of our holding period for every investment – whether positive or negative – reviewing our original thesis, devil's advocate work and lessons learned. These reports provide valuable insight that we apply in the future. The result of all this work has led to a global on-deck list that is more robust in recent years.

Company Update

2019 was a year of progress across our Firm, not just within our portfolios. As discussed in our 2018 annual letter, Ross Glotzbach became CEO at the start of the year, and it has been a seamless transition. Despite his CEO and Head of Research roles, Ross still considers "analyst" to be his most important responsibility and devotes 85%+ of his time to research. As part of our multi-year succession plan, Ross increased his ownership stake in the Firm, as did International Fund Portfolio Manager and fellow member of Southeastern's Executive Committee, Josh Shores, and other senior non-research department heads. Additionally, London-based Senior Analyst, John Woodman, was named a Principal in recognition of his contribution over the last several years.

We deepened the research team bench by hiring two new junior analysts in 2019. Taieun Moon joined our Singapore office in the first quarter, and Alicia Cardale joined our London office in the second quarter. Both have hit the ground running and complement our global research efforts with their diverse experience and expertise.

International Fund celebrated its 20th anniversary with solid absolute and strong relative long-term returns. It has benefitted from the positive broadening and deepening of our global research capabilities, with two-thirds of our 15-person research team now focusing outside the US and eight of the 15 holding passports from six different countries. Our Asia Pacific presence has exceeded our expectations by leading to deeper expertise and a greater understanding of cultural nuances within the region, an expanded network, greater portfolio management perspective across the team and more investment ideas for our International and Global Funds.

Finally, we have taken steps to enhance our communications with our clients in the past year. We recently redesigned our website at www.southeasternasset.com to enable better access to portfolio information and communication from your portfolio managers. We also launched The Price-to-Value Podcast in 2018. In 2019, we hosted a series of conversations with our management partners, including Prem Watsa, Will Thorndike, Fred Smith and Lawrence Ho, which we hope gives insight into how these top-notch leaders think. We are grateful to those of you who shared ideas for future podcast topics and welcome you to send any feedback to podcast@seasset.com. We look forward to sharing new episodes with you in 2020 and will continue to strive to provide best in class communications and service for our clients.

Outlook

While a narrow band of high-quality companies have ruled the markets lately, we were heartened by the strong results in the fourth quarter across all our Funds. We expect to report more good news in 2020. We believe the intrinsic values of our companies will grow, their managements will act honorably and allocate capital intelligently and the market will recognise these critical investment attributes, thus delivering excess returns. Please know that as Southeastern's largest client, our capital and careers are aligned with these convictions. We thank you for your long-term support and patience, which we believe will soon be rewarded.

See following pages 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 Funds are subject to stock market risk, meaning stocks in the Funds may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Funds generally invest in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Mid-cap stocks held may be more volatile than those of larger companies. With respect to the Small-Cap Fund, smaller company stocks may be more volatile with less financial resources than those of larger companies. With respect to the International and Global Funds, investing in non-U.S. securities may entail risk due to non-US economic and political developments, exposure to non-US currencies, and different accounting and financial standards. These risks may be higher when investing in emerging markets.

Information in this letter regarding market or economic trends, or the factors influencing historical or future performance, reflects the opinions of management as of the date of this report. These statements should not be relied upon for any other purpose. Past performance is no guarantee of future results, and there is no guarantee that the market forecasts discussed will be realized. There is no assurance the investment process discussed will consistently lead to successful investing. There is no assurance the Fund objectives will be met.

The S&P 500 Index is an index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. An index cannot be invested in directly.

The 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.

MSCI EAFE Index (Europe, Australasia, Far East) is a broad based, unmanaged equity market index designed to measure the equity market performance of 22 developed markets, excluding the US & Canada. An index cannot be invested in directly.

MSCI World Index is a broad-based, unmanaged equity market index designed to measure the equity market performance of 24 developed markets, including the United States. 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. For example, a ratio of 60% would indicate a stock price at 60% of Southeastern's appraisal. 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.

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

Return on capital (ROC) is a calculation used to assess a company's efficiency at allocating the capital under its control to profitable investments.

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

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

As of December 31, 2019, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 10.3%; GE, 8.1%; CK Hutchison, 7.8%; Mattel, 7.5%; FedEx, 6.3%; CNH Industrial, 6.0%; CNX Resources, 4.9%; Fairfax Financial, 4.9%; Affiliated Managers Group, 4.6%; Comcast, 4.5%. Longleaf Partners Small-Cap Fund: Kodak, 9.4%; CenturyLink, 9.3%; Graham Holdings, 6.5%; Mattel, 6.1%; Lazard, 5.3%; PotlatchDeltic, 5.1%; CNX Resources, 4.9%; Realogy Holdings, 4.8%; GCI Liberty, 4.7%; Actuant, 4.6%. Longleaf Partners International Fund: EXOR, 9.6%; Domino's, 7.3%; Melco, 7.2%; CK Hutchison, 6.0%; LANXESS, 5.7%; C&C Group, 5.4%; MinebeaMitsumi, 5.2%; Lazard, 4.9%; LafargeHolcim, 4.9%; Becle 4.8%. Longleaf Partners Global Fund: EXOR, 9.0%; CenturyLink, 9.0%; Melco, 7.2%; GE, 7.1%; CK Hutchison, 6.0%; FedEx, 5.4%; CNX Resources, 4.9%.; Fairfax Financial, 4.5%; MinebeaMitsumi, 4.4%; LafargeHolcim, 4.2%. Fund holdings are subject to change and holding discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

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