March 24, 2020

COVID-19 FAQs

Southeastern Asset Management

Thank you to everyone who has already listened to the latest episode of the Price-to-Value Podcast, Global Volatility and Opportunity with Southeastern's Portfolio Managers. We recorded the podcast March 16-18th and posted it March 20th, but the situation has continued to develop rapidly over the last week. We have received many great questions from our clients and podcast listeners over the last several days/weeks, and we are sharing some of the most frequently asked questions (FAQs) with our current responses below.

Haven't things been getting worse in the last week? How has your outlook changed accordingly?

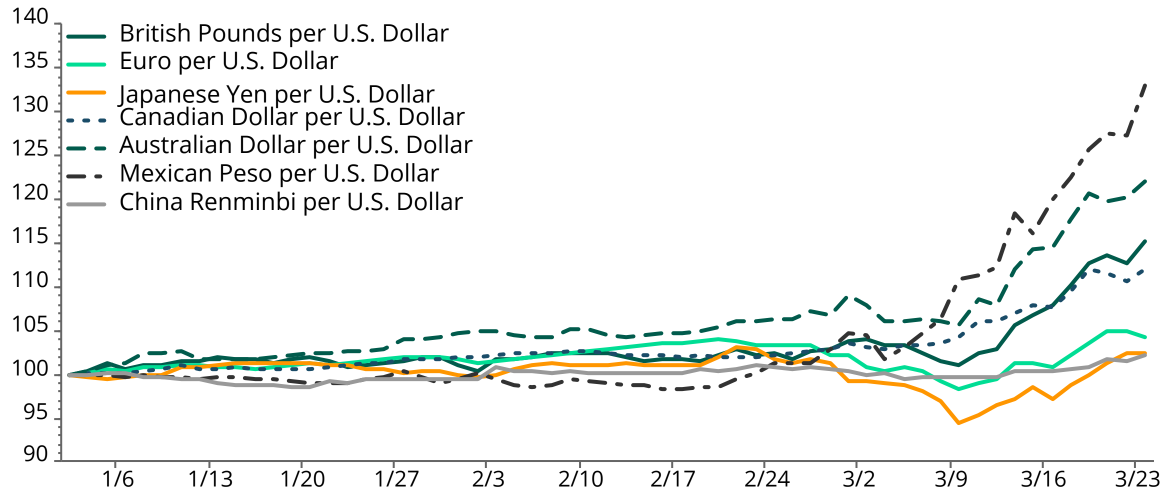
Yes, things have been getting worse around the world. Our direct, customer-facing companies are talking about unprecedented levels of slowdowns in customer activity in places where lockdowns already are in place or are expected to be imposed soon. Debt markets became more turbulent in the last week, as well. While our companies with publicly traded debt had a median yield to maturity (YTM) of 4% as of Monday, March 16th, by Friday, March 20th, this had increased to 5.5% - that is an incredibly large move for one week. We still feel that, for the vast majority of our companies, the individual debt levels are not concerning (while acknowledging that the risk-free rate is still lower now than it was in the Global Financial Crisis (GFC), so rates cannot be compared then to now on an apples-to-apples basis). But the risk level overall has increased, so we have stepped up stress testing of our portfolio companies, as we will discuss more below.

On the podcast, we referenced the strength of banks and liquidity of the financial system today relative to what we saw during GFC as a key current differentiator between the current environment vs. 2008. However, various measures of bank liquidity meaningfully worsened during the last week. We do not own banks, but this is systemically important. The long debt maturities of the most important banks worsened noticeably late in the week. And we are hearing of large bid-ask spreads in overnight funding mechanisms, which the Federal Reserve (Fed) is trying to address with its moves. There are more anecdotes on this topic about non-US banks, which might have contributed to recent dollar strength. To keep this in perspective, while these indicators are much worse than in "normal" times, they are not near the stress levels that occurred during the GFC.

We have seen some very wild currency moves over the last week, as the chart below shows. We feed these changes into our appraisals in real time as we make portfolio management decisions.

Major Currencies per US Dollar

1-Jan-2020 to 23-Mar-2020 (Price Indexed to 100)



Source: FactSet

Finally, there have just been a lot more "weird" moves in individual stocks lately. These may be a result of a key shareholder having to liquidate its position for non-fundamental reasons, or an investor making an emotional short-term decision to just "get out". Our experienced trading team is keeping an even keel, while managing our liquidity deftly, and we are doing our best to use these moves to our advantage.

Do you really own quality companies that can weather this storm? How are your appraisals being impacted?

We feel strongly that we own high-quality businesses with capable management teams that can adeptly navigate the current environment. We are running scenario analyses on all of our investments and on-deck companies, but it is hard to be precise in a situation like this, and excessive precision can create excessive confidence. This is not your average downturn (not that there is such a thing), where impacts are more uniform across industries. Actual long-term values are changing faster than we have ever seen, as near-term free cash flow (FCF) has evaporated or decreased dramatically for certain regions and businesses. That said, while stock prices are down on average

30-40% across our five strategies, our appraisal values have held up much better, relatively speaking.

We like the Warren Buffett quote: "When you build a bridge, you insist it can carry 30,000 pounds, but you only drive 10,000 pound trucks across it. And that same principle works in investing." We are not going to get it exactly right on the severity and length of the downturn, but we are going to focus on owning companies where our margin of safety is large enough to get across this bridge, our businesses are not permanently impaired and our partners will do the right thing. We believe owning the right companies at mid-single-digit multiples of FCF power matters more than a 100 basis point move in discount rates and that improving our portfolios during these difficult times will pay off if things continue to get worse and once glimpses of hope finally emerge.

We broadly group our investments into three categories:

1) Those where we expect minimal long-term impact and/or see the potential for the company to at least partially benefit from the current situation. We generally expect to see a small near-term value impact but significant long-term value growth potential from these businesses that can more than make up for today's pain. This category includes businesses like: Canadian-based insurance conglomerate Fairfax Financial, led by Prem Watsa who dramatically grew the value of the company during the GFC with his conservative investing prowess and now has a large amount of liquidity to put to work; CenturyLink, which is seeing increased demand for its fiber infrastructure as video-conferencing and streaming grow strongly around the world and end providers are running short on bandwidth; UK-listed Domino's Pizza Group, which is seeing elevated demand for pizza delivery for those in isolation; Alphabet, whose Search and YouTube businesses benefit from significantly higher demand in this environment, even as its travel and local advertising has taken a near-term hit; Mexican-based Becle, whose Cuervo tequila brands are benefitting from reduced costs in pesos, as over two-thirds of their revenue comes from outside of Mexico, among others.

2) Those that are likely to feel a larger near-term hit (a high-single to mid-teens digit percentage decrease), but where we feel highly confident over the long term. This situation describes a majority of our holdings. For example, German specialty chemical business Lanxess is well-positioned given its

outstanding balance sheet health, which CEO Matthias Zachert is using to execute an aggressive 10% share buyback program in the face of recent share price weakness. He also has a strong track record of accretive bolt-on M&A, and this environment is likely to create some compelling opportunities. Lanxess's more economically sensitive businesses, primarily auto which accounts for mid-teens % of revenue, will suffer in the current environment, but other business lines should prove more resilient. Classic toy company Mattel was just hitting its stride under the leadership of CEO Ynon Kreiz heading into 2020. Although the company is now facing bigger headwinds in the current environment, its supply chain is more flexible than ever, the company is producing positive FCF and is moving multiple non-earning assets through its content pipeline. It is also likely that parents around the world desperate to entertain their shut-in children will turn to ordering toys and programming online. The stock trades at 5x our estimate of earnings power, and the ability to monetize the intellectual property and brands like Barbie and Hot Wheels in movies, shows, and other forms of distribution should be deferred, not lost. We discussed Agnelli family holding company EXOR and Asian gaming company Melco International as further examples on the podcast, and we would encourage you to revisit those discussions. Melco in particular is an interesting example, as it is beginning to show initial positive signs of recovery from the extreme lows in late February. We discussed in detail two recent deals announced by EXOR. The current environment will make closing those deals at the initially announced prices more difficult, but our appraisal values are not predicated on the deals closing, and CEO John Elkann remains a great partner for navigating a time like this.

3) Those where we believe we could see a more material near-term hit and a potential long-term impairment to appraisal. Again, it is difficult to know how long the current crisis will continue, but we could potentially see some material value declines (20% or greater) in this much smaller group of businesses. In some cases, these businesses are likely to prove to actually be a "category 1 or 2", as outlined above. However, our discipline dictates that we will not add to companies where our value has taken a permanent impairment until our values have stabilized and begun to grow again. If we believe that the long-term business case or competitive advantages of a business become impaired and/or that our management partners are not capable of taking action to grow the value, then we will look to exit a position.

> We hope that you can understand that we do not want to go into great detail on these holdings that are being actively reviewed, but please trust us that we are making these decisions with great care and without too much focus on a simple levered price-to-value (P/V) metric that could miss the broader picture.

We noted on the podcast that we have not been mindlessly adding to the broadly cheapest companies and instead have been adding to those businesses that improve the overall quality and future return potential of the portfolio. As the largest collective investor alongside our clients, we are keenly focused on taking every step necessary to ensure the highest quality and best positioning for future outperformance of each portfolio.

Have you seen significant insider purchases over the last month?

Yes, insiders at 20 of our companies have bought shares personally. We also are partnered with many other large insider owners who have been blacked out from buying more, but who we expect will add more personally once they are able to do so. Employees at Southeastern have been adding to all five strategies over the course of the last month, in what has collectively been the largest Southeastern employee insider buying (outside of seeding a new strategy) since the GFC. We are excited to see so many of our investment partners expressing their confidence and conviction in the same way that your partners here at Southeastern are today.

What new opportunities are you seeing, and what does your on-deck list look like today?

As we discussed on the podcast, we started the year with relatively high levels of cash, which we have used as dry powder to improve our portfolios. We recognize that it can be easy to fall prey to simply holding onto or doubling down on the companies that we already own and know in an uncertain environment, and we also recognize that we built our portfolios in a very different environment than today. We are therefore looking at each existing company and comparing it against opportunities to upgrade the quality and durability of the portfolio with any new additions. We have made at least one new addition across every strategy this year. Prosus, which we bought in Non-US and Global accounts and discussed in detail on the podcast, is a prime example of a company where we upgraded our portfolios in all ways with its addition. There are several additional examples that we are not yet ready to disclose as we are building the positions, but we will share more details as these are completed.

Looking ahead, we continue to find new opportunities across the globe. Our on-deck list of qualified new potential holdings has at least doubled for every strategy, with a double digit number of prospects for each portfolio. The price-to-value ratio (P/V) of our on-deck lists are less than 50%, down from the 60s-70s% range before this move over the last month. As discussed on the podcast, we remain most fully invested with the largest on-deck list in our non-US strategies, followed by US small cap and US large cap, given where valuations were at the start of the year.

The opportunities are not limited to a single industry or region, as selling has opened opportunities across a broad spectrum of companies. Some of the more interesting opportunities where we are looking closely include "groups of people" stocks, primarily in the travel and entertainment space, that are competitively advantaged to weather the storm; misunderstood companies where the market is applying a 2008 scenario even though the business has changed significantly since the GFC; and industries or businesses that are great long-term value growers but are subject to short-term volatility.

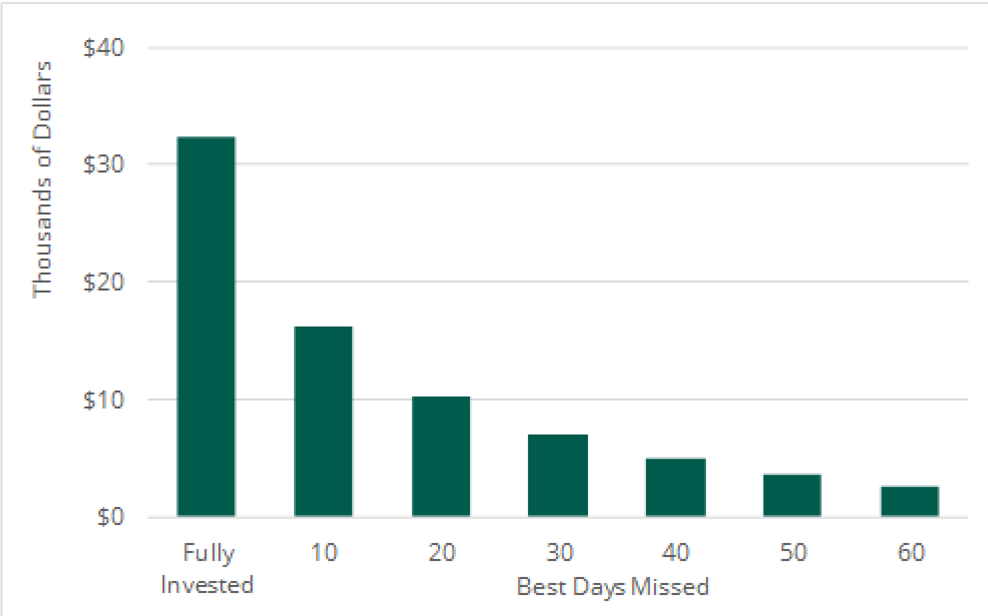
We are avoiding undifferentiated companies with over-leveraged balance sheets no matter how statistically cheap they are, such as balance-sheet-heavy financials, oil (which we do not consider high enough quality, despite the large price drop), airlines, etc. We still believe that many consumer branded goods, utilities and healthcare companies remain broadly fair-to-overpriced, given their perceived defensiveness.

Why shouldn’t I just take my money/tax loss now and get back into the market when things settle down?

As referenced on the podcast and shown on the chart below, studies show that missing even a handful of the biggest market recovery days, which can happen quite swiftly, can dramatically impair your long-term performance. It is extremely difficult to call a bottom. Though it can feel bad to do so, it is better to be invested through the pain in great businesses with management teams that will navigate the companies through to future strength.

Missing The Best Days of the Market

Growth of $10,000 in the S&P 500 From 1/1/2000 to 12/31/2019



We feel it is fitting to end with another quote from Warren Buffett, who we regret we will not be able to see in person at the Berkshire Hathaway annual meeting this year: "The future is never clear; you pay a very high price in the stock market for a cheery consensus. Uncertainty actually is the friend of the buyer of long-term values."

We thank you for your continued partnership and for a constructive and dynamic dialogue in this uncertain environment. We will endeavor to communicate as candidly and transparently as possible and will continue to keep you updated in real time as best we can. We hope above all else that this letter finds our clients and readers safe, healthy and practicing responsible social distancing measures.

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 southeasternasset.com/account-resources. Please read the Prospectus and Summary Prospectus carefully before investing.

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.

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 values could fluctuate more than if a greater number of securities were held. Mid-cap stocks, held particularly in the Partners Fund, may be more volatile than those of larger companies. Smaller company stocks, held particularly in the Small-Cap Fund, may be more volatile than those of larger companies. Particularly for the International Fund and Global Fund, 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.

As of December 31, 2019, holdings for the Longleaf Partners Fund - CenturyLink, Inc. 10.3%, Alphabet 3.9%, Mattel 7.5%; holdings for the Longleaf Partners Small Cap Fund – CenturyLink, Inc. 9.3%, Mattel, Inc. 6.1%; holdings for the Longleaf Partners International Fund – Fairfax 4.1%, Domino's Pizza Group 7.3%, Becle 4.8%, LANXESS 5.7%, EXOR 9.6%, Melco International 7.2%, Prosus 2.5% (at March 15, 2020); holdings for the Longleaf Partners Global Fund – CenturyLink 9.0%, Alphabet 3.7%, EXOR 9.0%, Melco International 7.2%, Prosus 4.0% (at March 15, 2020).

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.

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

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.