April 16, 2018

Longleaf Partners Shareholder Letter

1Q18

In a tumultuous quarter for markets, we made positive progress identifying new qualifiers and putting some of our cash reserves to work. Benchmark indices fell, while the Longleaf Partners Funds delivered flat to negative returns. Around one-third or more of each Fund's holdings posted positive results, and cash reserves helped buffer market declines. The International and Global Funds outperformed their respective indices because of both the strong performance of our overweight position in EXOR and the absence of any large non-U.S. detractors. The Partners and Small-Cap Funds lagged their respective indices due to a lack of any major outperformers, as well as declines in a few stocks, including newer investments in the Partners Fund. Our limited investment in Information Technology stocks impacted relative returns across all Funds. Even after technology stocks lost steam in the last weeks of March, Info Tech was the largest contributor and one of only two positive sectors in the S&P 500 and MSCI World Indices, and one of only three positives in the MSCI EAFE and Russell 2000 Indices.

	One year	1Q
Partners Fund	8.27%	-2.61%
S&P 500 Index	13.99	-0.76
Small-Cap Fund	3.77	-1.05
Russell 2000 Index	11.79	-0.08
International Fund	14.18	0.00
MSCI EAFE Index	14.80	-1.53
Global Fund	14.75	-1.27
MSCI World Index	13.59	-1.28

Average Annual Total Returns (3/31/18) Partners Fund: Since Inception (4/8/87): 10.40%, Ten Year: 5.68%, Five Year: 6.49%, One Year: 8.27%. Small-Cap Fund: Since Inception (2/21/89): 10.88%, Ten Year: 10.02%, Five Year: 9.83%, One Year: 3.77%. International Fund: Since Inception (10/26/98): 7.78%, Ten Year: 2.61%, Five Year: 5.51%, One Year: 14.18%. Global Fund: Since Inception (12/27/12): 8.88%, Ten Year: na, Five Year: 8.52%, One Year: 14.75%. *Returns reflect reinvested capital gains and dividends but not the deduction of taxes an investor would pay on distributions or share redemptions. Performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by visiting longleafpartners.com. The total expense ratio for the Partners Fund is 0.95% and 0.91% for the Small-Cap Fund. These expense ratios are subject to fee waiver to the extent a fund's normal annual operating expenses exceed 1.50% of average annual net assets. At March 31, 2018 the total expense ratio for the International Fund was 1.33%. Effective April 1, 2018, the total gross expense ratio for the International Fund is 1.19% with a total net expense ratio of 1.15%. This expense ratio is subject to fee waiver to the extent the fund's normal annual operating expenses exceed the 1.15%. The total expense ratio for the Global Fund is 1.52%. This expense ratio is subject to fee waiver to the extent normal annual operating expenses exceed 1.65% of average annual net assets. Effective May 1, 2016, Southeastern agreed to voluntarily reduce the expense limit to 1.20%. This voluntary fee waiver for the Global Fund may be discontinued at any time.*

The quarter began where 2017 left off, as upward stock momentum continued through January. February, however, brought a much more volatile two months with stock swings so wide late in the quarter that we had to draft multiple iterations of this commentary. The threat of global trade wars in the face of U.S. tariffs, anticipation of where Brexit negotiations will lead, and renewed U.S. inflation that stoked global concerns around higher interest rates and a weaker U.S. dollar injected fear into markets and led to long overdue volatility.

Since September of last year, increased volatility enabled us to buy 11 new companies across the Funds, 5 in the last three months. We rarely have the luck of precisely capturing the lowest price for new purchases, and the majority of our newer names remain near or below our initial cost. Purchasing a company at the very bottom is difficult, especially when a stock has had a large decline from peak to trough in a somewhat short period - i.e., General Electric (GE) from $32 to under $13, Mattel from $48 to $13, Allergan from $340 to $145, Comcast from $43 to $33, Hikma from £27 to below £9, Vestas Wind Systems from 620kr to 365kr and Realogy from roughly $55 to $24. We believe that these new additions set the stage for strong future performance, as we averaged into our current positions and were not buying anywhere near the highs.

Over the last several years, as cash reserves built in the absence of qualifiers, some argued that the combination of Business/People/Price is impossible – that quality businesses do not get cheap, and therefore, that paying up for quality is the only way to go. The first quarter, however, proved otherwise, as we purchased growing, market leading businesses at attractive discounts, and some market favorites began to falter as the quarter went on. Our consistent approach sometimes requires patience and discipline but has delivered over Southeastern's 40+ year history. We believe that if we adhere to our three criteria, while always working to improve our execution as we learn from both successes and mistakes, we can build portfolios that focus on both preserving capital from permanent loss and delivering successful long-term returns.

Business

The Funds' current portfolios are populated with what we view as high quality companies whose durable competitive advantages should produce strong returns in the years to come. For example, the natural monopoly search businesses at Alphabet and Baidu, the difficult-to-replicate assets at Ferrovial, CenturyLink, Comcast and CK Asset Holdings, and the pricing power/consolidated industry structures at FedEx, LafargeHolcim, Vestas, CNH Industrial, Allergan, GE and United Technologies imply strong value growth prospects. It is important to remember that long-term quality is linked much more to organic growth and returns on capital over our multi-year holding periods than to quarter-to-quarter stock price stability. We are not afraid of value growth in a less than straight line at some of the above companies that might be viewed as more cyclical than others.

The other major component of a strong company, financial flexibility, impacts how the company can respond to adversity and opportunistically build long-term value per share. Most of the Funds' investees have conservative leverage such that management can consider a wide range of capital allocation options to compound value beyond what operations will organically produce. The value of this ability to go on offense can be further magnified by short-term volatility. Capital allocation leads to the importance of people.

People

People determine much of our outcome but are the hardest aspect of a company to assess. Properly aligned partners with a shareholder mind set and record of compounding value provide upside to our return opportunity and a higher degree of confidence in our prospective returns. We call upon our 40+ year cumulative network of contacts to help us better understand the history, character, decision-making, priorities and personalities of the CEOs and board leaders at our companies. Additionally, we have become even more engaged with our management partners to ensure we share similar views of the pursuit of value per share growth and to bring resources where we can add value. In a number of cases, our global network has produced qualified board members who bring substantial expertise and assistance.

The Funds have an unusually long list of heavily aligned leaders who have meaningful capital to allocate and a demonstrated commitment to building shareholder value. These include Prem Watsa at Fairfax, John Elkann at EXOR, Victor Li and Canning Fok at CK Hutchison and CK Asset, Brian Roberts and Steve Burke at Comcast and Fred Smith at FedEx. We also were thrilled to see Jeff Storey named CEO of CenturyLink ahead of schedule during the quarter. Not only do we have partners who can grow value per share, but many have demonstrated a willingness to proactively take measures to close meaningful gaps between their stock price and intrinsic value per share. CONSOL Energy's management and board split its gas and coal assets; Baidu held an initial public offering (IPO) of the iQiyi streaming platform; GE's new CEO has targeted sales of $20B in non-core assets; Millicom's leaders have sold most of the company's African assets; and Ferrovial's owner-operators have historically monetized pieces of London's Heathrow airport and the Toronto 407 toll road at prices well above what the stock price implied. We also have leaders in place who are repurchasing deeply discounted shares or are authorized to do so and understand that this could offer a low risk/high return option for compounding value per share. Just as our partners must be disciplined in what price they will pay for their stock, our entry price matters.

Price

Buying discounted securities is the foundation of Benjamin Graham's value investing approach. Paying less than the intrinsic worth of a business should help mitigate permanent capital loss in the event that the business faces unanticipated challenges. To vastly oversimplify, given our conservative assumptions and an 8-10% normal discount rate, most of our appraisals are in the neighborhood of 15-20X free cash flow (FCF) after adjusting for non-earning assets. We generally will enter at a low double-digit multiple. The discount is a critical piece, but not the only thing that shapes our outcome – cheap is not enough without the requisite business and people criteria discussed above.

Determining a single appraisal number is false precision but a worthwhile discipline. The value of a business is really a range based on the probabilities of differing outcomes, and the exercise of calculating an appraisal helps clarify the biggest value drivers. If a stock declines, assessing any differences in these drivers is as important as the deeper discount in deciding whether to buy more. Similarly, before selling a core holding that is approaching our appraisal, we reassess the range of outcomes to try to insure our conservatism is not short changing our long-term compounding opportunity.

Summary

The Funds today provide an attractive discount, selling for at or below 70% of the aggregate appraisal values of our holdings. This price to value (P/V) is around the historic average from which Southeastern has delivered solid long-term returns. We believe the discount is understated and the Funds more compelling than average, given our expected level of value growth from both organic FCF and anticipated accretive capital allocation by our high quality partners.

We welcome the long-awaited market volatility that enabled us to buy several new companies without compromising our Business/People/Price criteria and to enlarge our on-deck list of prospective qualifiers. While broad stock pullbacks can be a short-term performance headwind, they often offer an opportunity to build the foundation for stronger future compounding. Our long-term investment outcomes will be reliant on management teams' actions and company-specific events. Periods of market volatility have generally provided attractive entry points for our clients, and as the largest investors across the Funds, your partners at Southeastern are hoping for a little more market turmoil to position the portfolios for even better long term return potential.

See following page for important disclosures.

Past performance does not guarantee future results.

***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 Fund 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 by the Funds 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.

The statements and opinions expressed are those of the author and are as of the date of this report.

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. 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. 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. 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. 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.

As of March 31, 2018, the top ten holdings for the Longleaf Partners Fund: CenturyLink, 8.5%; CK Hutchinson, 7.2%; LafargeHolcim, 6.6%; FedEx, 5.8%; Allergan, 5.8%; CNX Resources, 5.4%; Park Hotels, 5.1%; Fairfax, 4.9%; United Technologies, 4.8%; Mattel, 4.7%. 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%; Eastman Kodak, 4.6%. Longleaf Partners International Fund: EXOR, 8.3%; LafargeHolcim, 7.2%; Hikma Pharmaceuticals, 6.6%; CK Hutchison, 6.3%; Fairfax, 5.9%; OCI, 5.7%; CK Asset, 5.2%; Ferrovial, 4.6%; Great Eagle, 4.6%; Melco, 4.5%. Longleaf Partners Global Fund: CenturyLink, 7.7%; EXOR, 7.3%; Allergan, 5.6%; FedEx, 5.6%; Fairfax, 5.3%; LafargeHolcim, 5.2%; CK Hutchison, 5.1%; Ferroival, 4.8%; Comcast, 4.6%; General Electric, 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.

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