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As of March 31, 2020 CenturyLink represented 11.0%, CNX Resources represented 4.7%, Liberty Media Formula One represented 6.3%, Empire State Realty Trust represented 3.0%, PotlatchDeltic represented 6.1%, and Mattel represented 6.6% of the Longleaf Partners Small-Cap Fund.

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| Gwin Myerberg: | 00:06 | Hello and welcome to The Price-to-Value Podcast with Southeastern Asset Management, where our Global Investment Team discusses the topics that are most top of mind for our clients from a Business, People, Price point of view. We at Southeastern are long-term, concentrated, engaged value investors, and we seek to own high-quality businesses, run by capable people at a discounted price-to-intrinsic value (or P/V). |
| Gwin Myerberg: | 00:28 | I'm Gwin Myerberg, Global Head of Client Relations and Communications, and I'm joined today by the three portfolio managers for the Longleaf Partners Small-Cap Fund, Mason Hawkins, Staley Cates and Ross Glotzbach.   |
| Gwin Myerberg: | 00:40 | Ross, I'll start with you. We've just announced that we are reopening the Small-Cap Fund, which has been closed since August 1997. Can you start us out by talking about why we've made the decision to reopen today?   |

Ross Glotzbach: 00:53 The simple answer is that it will help our existing clients upgrade the portfolio. We have existing companies that we already own, that we want to own more of. We have companies that are new to the portfolio that we have been buying and want to buy more of. And then we have attractive ones on deck that we'd also like to buy.

Ross Glotzbach: 01:13 We also think it's important that we're not opening at a time when we've had extremely strong absolute and relative returns. You could potentially get some performance chasing at that time. We want to find people who want to come to us when it's the best time for their own capital, and our own capital, and we've been adding ourselves here. That's it in a nutshell.

Gwin Myerberg: 01:38 Thanks Ross. That's really helpful. Many today are saying that now is a time to tiptoe or move slowly in versus just running into the market. Have you thought about that? Do you feel like we're too early in investing the cash, or how do you think about that timing?

Mason Hawkins: 01:55 This is Mason. I think it's a very straightforward answer for us. Ben Graham talked at length about the importance of pricing and not timing. By that, he meant pricing securities versus their value. An addendum to pricing securities versus their value is the importance of businesses' qualitative factors, in terms of their future ability to compete to generate not only current free cash flow, but growing streams of free cash flow.

Mason Hawkins: 02:30 So in Longleaf Partners Small-Cap Fund, we have, almost in every case, companies when we price them versus their intrinsic values, are extremely discounted, and as we think about the future, we know that the coronavirus will have ended in a certain period of time. No one knows for sure when this pandemic will end, but we do know business will get back to normal at some point, and that our investees will produce significant profits and free cash flow at that point. That future may be a year away; it may be a year and a half away. But we can say with great conviction, as has been the case in other bear markets, when the psychological turn occurs, we will get paid fairly for our holdings. The risk/rewards are skewed usually in the favor

of these holdings that we have on The Longleaf Partners Small-Cap Fund.

- Mason Hawkins: 03:34 I might add, any new cash would go not only into existing holdings but some, as Ross indicated, some that are on our list of potential investments, where we think the characteristics of those qualifiers are compelling.
- Gwin Myerberg: 03:49 Staley, how would you compare the opportunity set today to prior periods for the Small-Cap Fund? Is there any other time that you think the opportunity set has been this attractive?
- Staley Cates: 04:02 Starting in price-to-value terms, which we talk about a lot, this would really only have parallels to the dotcom days and then coming out of the Global Financial Crisis (GFC). What's every bit as important that is talked about less explicitly would be the qualitative and the quality of those companies. We say all the time that, especially because our money is in these names, we have to have great quality as defined by organic growth and higher returns and a lot of free cash. But it can't be visible quality, where you have to pay 30 times earnings. We're finding more of those that do check the quality box than in those other two times.
- Staley Cates: 04:40 We also would say that we don't have to squint at all on balance sheets while finding that quality, whereas some candidates had more leverage in GFC as a function of systemic debt at the time. It checks all the qualitative boxes better while it's like those other two [time periods] on values.
- Gwin Myerberg: 05:00 In the letter that came out recently we talked about that the target AUM [assets under management], or capacity level, is to get the fund to \$2.5 billion. Ross, can you talk about how you identified that as the target, and how you think about capacity?
- Ross Glotzbach: 05:17 We think our target market cap range is probably in the one to four billion size. There could be some above, some below, but that's the range in the middle. We also think about building this portfolio with 20 names, and then we also consider the 5% average ownership of each of these

names. When you do the math on that, it gets you to the \$2.5 billion.

- Ross Glotzbach: 05:42 We were also pretty close to \$2.5 billion at the start of this year when you factor in the cash, that's been at an elevated level of the portfolio for a while. That's how we got to the \$2.5 billion. A key thing that could make this a little different than some other openings is that we're not asking for a specific absolute amount in dollars to be added. If markets go higher and our AUM goes up over \$2.5 billion, then we'll close. We have a track record of doing what's right for existing shareholders, and that's what we're going to do here.
- Mason Hawkins: 06:17 I think it's fair to say that this is the most compelling opportunity we've seen in 23 years, and the fund has been closed for that duration. We would certainly not open the fund today if we didn't think we can improve it for the existing shareholders, as well as those that have expressed an interest in putting money in Longleaf Partners Small-Cap.
- Gwin Myerberg: 06:43 We've talked a lot about the opportunity set that we're seeing. Can you each talk in a little bit more detail about a few of the companies in the portfolio that we're most excited about, and why?
- Staley Cates: 06:55 In a lot of prior calls and letters, we have talked in detail about CenturyLink and CNX Resources, and they remain large positions that we love, but we thought we'd focus more on some of the names we've talked less about. There will be a lot more detail on both of those and on all of our positions in the quarterly letter. The one that I would start with because it's an incredible trade off in short-term pandemic disaster, but long-term, very bright future, would be Formula 1, which is part of the Liberty Media family.
- Staley Cates: 07:25 We do our Business, People, Price matrix: for business, this is a beloved sports circuit that is like owning the entire NBA or NFL, in the form of Formula 1. It has half a billion fans worldwide. It does not have nearly as much traction in the US as it does globally, but that's one of the to-do list things on the list of the very good management team here.

- Staley Cates: 07:52 As everyone knows, races have been either suspended or cancelled. All sports have suffered this immediate "trauma." It's interesting that, first off long-term, we have no clue when this pandemic goes away and when live sports are back. We would submit that this could be one of the first ones back, whether it's because the athletes are not sweating each other face-to-face. The pit crews have masks already. There's probably a way to work with that. This could be a fanless sport, in better ways than a lot of other sports. Tellingly, Formula 1 is still saying they are going to have a shortened season but still have a season. Whether that works or not, whether they are the first back or not, we just think that highlights that long term, this is an asset that is not going away. And it's dominant. And it's a true franchise. And it's just going to grow.
- Staley Cates: 08:44 This segues into the people part. I mentioned Liberty Media; our overall control and ownership is John Malone and Greg Maffei at Liberty Media, the CEO and the day-to-day operator is Chase Carey, whom our Longleaf holders will remember from doing an incredible job at DirectTV. We could not be in better hands on both capital allocation and management of the asset. While this is a long-term fix in terms of what Chase Carey inherited, the short-term metrics have already been good in terms of growing sponsorships, improving the quality of the product, negotiating with the teams and a lot of things that haven't yet shown up in the EBITDA, but we very much believe that they will.
- Staley Cates: 09:26 Lastly on price, I should have mentioned that another asset that they have is a big stake in Live Nation, even though they don't control the operations of that daily. Live Nation has, of course, suffered with all live events, even though they dominate because of their roster of both venues and artists. That is a similar dynamic of total freeze in the short term, but a dominant position that will come back at some point in the long term.
- Staley Cates: 10:03 When we total all these pieces up, the Live Nation part is publicly traded, and that's a meaningful part of the market cap of Formula 1. Then you impute the value of the pure Formula 1 asset, and we're in that at imputed costs less than what Liberty Media paid a few years ago, even though

they've improved it and will continue to do so. One other way to look at the value is that before this storm started, we thought that they were on pace to do about \$2.50 of free cash flow per share, which was growing, which was without a lot of the long-term fixes from Chase Carey and his team.

- Staley Cates: 10:33 Whether we value the assets on what we really think Formula 1 is worth versus its cost, plus add the Live Nation, or whether we put a free cash flow multiple on that \$2.50, our appraisal would be something around \$50 a share. The stock's gotten as low as low-\$20s. Accompanying for the damage from the storm, we would say what looked something like roughly a \$50 appraisal going into all this would still be something in the \$40s. It checks our price box.
- Staley Cates: 11:05 Between some recent financing they've done as well as the overall Liberty Media parent presence, we have no liquidity or balance sheet worries. It's a full position accordingly, and we'd like to own more if we could.
- Gwin Myerberg: 11:20 Ross, is there a company that you would highlight as one you're excited about?
- Ross Glotzbach: 11:26 I'd like to talk about one that is new in the portfolio this quarter, although we do have a history with it and have owned it before, and that's Empire State Realty Trust. So, Business, People, Price on that one. The business: their key asset is that they own the Empire State Building. This is trophy real estate, but it is very much in the eye of the storm, for two reasons. First, New York, as we all know, is really going through the virus hard right now. That is an issue. This is a resilient city. It has been through many things before, but it doesn't make it less painful at the moment.
- Ross Glotzbach: 12:04 Then, particular to this building, the Observatory is a key tourist attraction. It has had toll road-like Consumer Price Index (CPI) plus pricing as far back as we have numbers. It's been resilient through lots of other downturns, if you look at its time after the Global Financial Crisis when other observatories have opened. It's just kept on marching up.

It's closed right now, for good reasons. But it will eventually reopen.

Ross Glotzbach: 12:32 We also point to a strong lease book with long-term leases with high-quality tenants, throughout the office part of both the Empire State Building and the other buildings that ESRT owns. This gets to the people. Tony Malkin and his team did a great job preparing for this storm. They have an industry-best balance sheet. They raised debt last month at a low single-digit interest rate, and they can use that capital to go on offense. We're very interested to see what that offense turns into. They also have a not-too-high dividend pay-out ratio. They were never catering to the yield chasers. They're focused on building value per share.

Ross Glotzbach: 13:16 This is trophy real estate that, before the crisis, we thought was worth \$20 or more a share. Now it's hard to see how it spreads out to less than mid-teens. We also think this is a very reasonable multiple of look through long-term free cash flow per share.

Gwin Myerberg: 13:37 Mason, is there a company that you would point out as well?

Mason Hawkins: 13:39 Well, we haven't talked much about PotlatchDeltic in our recent ownership history. As many of you know, PotlatchDeltic is in the timber business. It's an industry that we have had more long-term experience with than any other. We have known these assets that PotlatchDeltic has in our current ownership of PotlatchDeltic, as well as our prior ownership at Deltic Timber, which we owned twice before this occasion, because as many of you also know PotlatchDeltic owns Deltic at this point.

Mason Hawkins: 14:17 Timber is an asset that grows its value and its pricing uninterruptedly, over time. It grows its volume because trees increase in diameter and height. It, secondly, grows its realizations. As you move from pulpwood to tip and saw to saw logs, those prices escalate. In essence, over time, you're producing more units at higher prices, and much higher margins. Those combinations are very desirable, from Southeastern's standpoint.

Mason Hawkins: 14:57 So underlying this investment called PotlatchDeltic, we have growing prices, growing volumes, and higher margins. On top of that, we have a management team led by Mike Covey that has been a stellar capital allocator throughout his history. He's been an exemplary steward of our underlying assets, in terms of real estate acreage, and in terms of the forest that he oversees.

Mason Hawkins: 15:38 I would say that he has been very attuned to matching markets with merchandise. By that I mean if pulpwood prices go from \$3 a ton to \$20 a ton, he's been quick to say the net present value (NPV) of that inventory is very valuable today. And you would decide to cut instead of holding for a much longer period of time and realizing maybe higher prices but not net higher prices, after you discount those future revenues back to the present. So he has been a terrific steward, as I've said, of our acreage of our standing timber and volume. In addition to that, he's been a great seller of assets as well as buyer during his career. That would include selling some of his manufacturing capacity, which he got at a very fair price, having bought acreage when it was available for a cash price that was warranted.

Mason Hawkins: 16:42 Or, he's bought acreage via the stock market when he's repurchased share. Lastly, we would say that he bought Deltic Timber at a very fair price. On Business, People and Price, we think we have a terrific underlying long-term business. Number two, we believe that the price is very discounted, and our appraisal is \$50 a share, and the stock has been in the \$20s recently. Finally, we believe that the people that run this company and the board that supports that management, as good as it is, in that particular industry. Maybe as good as there is in many other industries.

Gwin Myerberg: 17:31 You've all talked about some of the companies we're really excited about. In the fund commentary and also in the COVID-19 FAQs that we've posted recently, we talked about three categories of companies, the smallest of which were those companies where we did expect to see more material near-term hit and potential long-term impairment. Staley, can you talk a bit about that bucket, how you think about those companies and what our outlook there is?

Staley Cates:	18:00	There'd be several things about that, but the first would be if the qualitative doesn't fit and/or there's a balance sheet problem and/or we have a much better opportunity both qualitatively and quantitatively, that we trade up some of those names we have sold despite a headline great P/V.
Staley Cates:	18:19	Others have gone down because they have true damage in the crisis, they have a true balance sheet problem, and we therefore didn't add to them. For a combination of reasons, that bucket is smaller than when we even first wrote about this. I would highlight two things about that. One is that in that bucket, for some of these companies we are being pretty harsh on the value markdowns because of where they are on P/ V and because they could make their way through this. Because they all have great leadership, even if they have some incredible external problems, some of those are going to fight their way out, and they may even find their way to the first bucket. And/or, because of that price-to-value, if they do survive this storm, they could be some of the best performers. It's not quite as simple as saying, "Why don't you just take that bucket to zero overnight?" even though it is smaller.
Ross Glotzbach:	19:12	I'd like to jump in and talk some about our history working our way through GFC, and '08, '09. I would encourage you to go look at our moves that we made then, and we bet on certain people, we didn't bet on others, and ultimately we used this as a chance to upgrade the portfolio. As Staley just said, we came out of that with a lot of category one and category two great companies with great, growing free cash flow that a lot would have grouped into that bucket three in the midst of the crisis, which was the exact worst time to give up on some of them.
Gwin Myerberg:	19:49	You both just talked about upgrades we're making. I know with companies that are very close on our on-deck list that we don't usually like to disclose those companies. Can you talk a little bit more broadly about some potential upgrades we're looking at or maybe where we're seeing opportunities? Whether in different sectors or different themes. Ross, I'll start with you.
Ross Glotzbach:	20:16	We touched on this a little bit in the letter, but certainly companies where there's a group-of-people effect, where

those businesses have stopped for now, we think there will be definite winners and losers, and they are not all created equal. We are not just rushing too hard into that category, but it's created some opportunities in companies that people thought were just A+ quality a month ago, and now nobody wants to touch them.

- Ross Glotzbach: 20:42 Well, the truth is somewhere in between. We're combing through those diligently, but we're also finding a pretty broad range of other interesting places to be looking. For example, there's industrials, that if you can pick your spots with the right partners, are quite interesting. Staley, do you want to talk about some of the ones that you've been working more on lately?
- Staley Cates: 21:07 As you said, the industrial production had been weak, even going into all the pandemic stuff. We had seen that in multiple ways, and we had candidates that were interesting. This has pushed some of those straight into our buy list. We've already bought some of those. We'd like to buy more. Also, some financials are interesting. We remain wary of things with heavily leveraged balance sheets and assets we can't ever fully understand contract-by-contract. The big financials, a lot of them are cutting dividends or have had to. All that financial damage has thrown out a few candidates that are more fee related, and they have great liquidity. That group has gotten more interesting than it was also.
- Staley Cates: 21:51 As you can tell from some of the examples, REITs have been hit pretty hard. We've talked about our best ideas on those already, but that's another group that we spent some time on.
- Gwin Myerberg: 22:03 We've talked a lot about the companies we own. Can we take it a little bit higher level? Staley, I'll start with you first because you've talked about this previously in the speech that you gave at Berkshire a couple of years ago. How has value investing fared this year during the recent market turmoil? Have you been surprised by that?
- Staley Cates: 22:27 I'll start and then anybody else weigh in if they want. On this, it is a perpetual question of value investing is meant to be more defensive, so it should hold its ground. What's

the deal with the relative performance? I would say that we're certainly disappointed, as we've written and talked about, and any of these numbers, whether absolute or relative, we are obviously not pleased with.

Staley Cates: 22:49 I'd also say we're not quite surprised. Because if you do look back at other crashes, and this is a crash, not just a bear market, there's the old maxim about "in a crash, correlations go to one." Truly by different measures here of correlation, they have been up over 0.9 literally for I think either five or six weeks. The whole dynamics we've talked about on what has driven the outperformance of growth over value, who knows whether that's more free money or indexing or a combo, or whatever.

Staley Cates: 23:22 It doesn't really matter, whatever that dynamic has been as we entered this has not been yet corrected by this. In other words, the same groups that lead are still leading. The range of returns is pretty tight. The correlations are high. If you look back at other crashes, that's not that inconsistent. Where we won was coming out of them, not necessarily somehow miraculously holding ground during the actual crash. That makes intuitive sense just because when people are panic selling, they don't decide that's the time to reweigh, "is this value stock actually over discounted? Maybe I should look at it." They just sell and they get liquidity, and that sifting process happens later as you come out. That's been our history, and that's been the history of overall value. That's why we are sheepish and embarrassed about the returns to date. But that's also why we're optimistic enough to be opening this fund.

Ross Glotzbach: 24:21 It also gets to what we own here, which many of these specific companies, when we look back on them five years from now, will be thought of as growth stocks. A company like Mattel that had a lot of its own issues to work through over the last few years, has now made it through those. Years from now we'll be looking at all the content they've created with their library and their much-improved cost base, and it will be growing strongly. Similarly, at something like a ViaSat, which is again a relatively steady set of businesses here because the lion's share of the value is in the government segment, and then the residential

segment. This is a company with strong growth in free cash flow per share to come in a variety of environments.

- Ross Glotzbach: 25:09 As we look to just parts of some of our companies, you can look at the fiber part of CenturyLink, that is a growth company, and we see a peer for that like a Cogent trading at a high-teens multiple of EBITDA, even today, as the market looks through to the demand for fiber created by all the staying at home and streaming and video conferencing.
- Gwin Myerberg: 25:31 My last question would be, do you think that today is a market where active managers can differentiate themselves from passive investing or ETFs, which we all know have dominated equity markets for the last decade? Ross, I'll start with you, on whether you think that's the case and why?
- Ross Glotzbach: 25:54 Yes, definitely. It gets back to what we own and the ability to construct a portfolio at a single-digit multiple of free cash flow per share, and have a high level of confidence that that free cash flow per share is going to grow because these businesses will be stronger in the future. Our partners on these management teams will do great things with this free cash flow per share. This versus just an index that is a mishmash of companies that have single-digit multiples and should be single-digit multiples or much higher multiples and they're hitting the law of large numbers or they're about to face more competition.
- Ross Glotzbach: 26:33 It's just now more than ever, in the wake of this correlation to one, when taking the time to build a portfolio from the bottom up will be rewarded in the years to come, which is why we are excited to open this fund. To get to put additional money to work from great partners, who want to join us right now.
- Gwin Myerberg: 26:55 Thank you to Mason, Staley and Ross for taking the time, and many thanks to all of our listeners for tuning in to the Price-to-Value Podcast with Southeastern Asset Management. We hope that you're all keeping well and healthy, and we look forward to being in touch with our next episode. As always, if you have any questions or

would like to share topics you would like to see us cover in future episodes, please email us at [podcast@SEasset.com](mailto:podcast@SEasset.com).



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