

## ***Data and discussion as of June 30, 2022***

*Average annual total returns for the Lingleaf Partners Fund and its benchmark for the one, five, ten year and since inception (4/8/1987) periods ended 6/30/22 are as follows: Partners Fund: -15.90%, 2.94%, 6.33% and 9.41%; S&P 500: -10.62%, 11.31%, 12.96% and 9.92%.*

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](https://southeasternasset.com). The prospectus expense ratio before waivers is 1.00%. The Partners Fund's expense ratio is subject to a contractual fee waiver to the extent the Fund's normal operating expenses (excluding interest, taxes, brokerage commissions and extraordinary expenses) exceed 0.79% of average net assets per year. This agreement is in effect through at least April 30, 2023 and may not be terminated before that date without Board approval.

***Before investing in any Lingleaf 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 <https://southeasternasset.com/account-resources>. Please read the Prospectus and Summary Prospectus carefully before investing.***

## **RISKS**

The Lingleaf Partners Fund is 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 Fund generally invests 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 Fund may be more volatile than those of larger companies.

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.

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.

ESG considerations may affect the Fund's exposure to certain companies or industries and the Fund may forego certain investment opportunities. While we view ESG considerations

as having the potential to contribute to the Fund's long-term performance, there is no guarantee that such results will be achieved.

Please [click here](#) for definitions of certain terms used.

As of June 30, 2022, the top ten holdings for the Longleaf Partners Fund: Lumen, 11.7%; FedEx, 7.2%; Mattel, 6.7%; Liberty Broadband, 5.4%; IAC, 5.3%; General Electric, 5.1%; Fairfax Financial, 5%; Affiliated Managers Group, 5%; CK Hutchison, 4.9% and Warner Bros Discovery, 4.7%. Fund holdings are subject to change and holdings discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

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Gwin Myerberg:	00:09	Hello, and thank you for joining us for a Q2 2022 review with the portfolio managers of the Longleaf Partners Funds. I'm Gwin Myerberg, Global Head of Client Relations and Communications for Southeastern Asset Management. Today, you'll hear from the portfolio managers for the Partners Fund, Ross Glotzbach, who joined Southeastern in 2004, and is our CEO and Head of Research, and Staley Cates, who joined in 1986, is also our Vice-Chairman. Ross, could you start us off with your view on value investing, and as the markets pivot towards value style, what's your outlook for the strategy today, and how does this differ to prior periods in our 47-year history?
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Question:	As the market pivots towards value, what is your outlook for the strategy? How does this differ from prior periods in our 47-year history?
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Ross Glotzbach:	00:52	So one thing that we've been seeing broader in the market would be this kind of bifurcation, or whatever you want to call it, in value world that does explain some of the absolute and relative numbers over the last few months and maybe even a little bit longer in the last year or so. To one extreme of value world, you've had folks who did what could be called paying up for quality,
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and that worked very well for a long time. But it is definitely not working this year, and there has been some pretty extreme, permanent capital loss, we would argue, in that world. Now it's also led to some potential opportunities for us that we're looking at and we're checking out in great detail. We'll talk about some of those later. But just growth at all costs or stability and high ROCs at all costs, we don't think that's necessarily the way to go, especially in a more normal interest rate environment.

Ross Glotzbach: 01:56 Now, what has been working more over the last several months and parts of last year too, is the flavor of value that we would call more kind of value ETF, where you just want low multiples on current earnings and/or reasonable stability or dividend yield or book value multiples, whatever you want to call it. There are a few places where folks have been doing that to success recently. We would question that success long term. One would be some of the larger and less differentiated banks out there. Those can be hard ones for us to get there qualitatively on both business and people often. But when rates were going up, and maybe rates will still go up, that was a good place to be. But longer term, the yield curve is going to govern your spreads often, and therefore, your ROEs, and the yield curve is not looking as good as it once was at times earlier this year, last year.

Ross Glotzbach: 03:03 Big oil and gas, and this is more Exxons of the world than the CNX and Williamses of the world, they've just had their earnings go up a lot because of Russia and Ukraine. They are historically low multiple stocks. They should be low multiple stocks. They still look low because now we're capitalizing a \$100-something oil instead of \$60 oil. But again, a lot of that is already in those prices, and they're very hard to understand black boxes, again, often not great owners on the case. We like more targeted looks in those industries.

Ross Glotzbach: 03:41 Then consumer staples, which we do think that is often a very good business, often some good partners as well, but it's a different dynamic than it was in '99, 2000 when

we got to own companies like this, or 10 years ago we were doing more of that as well. These companies have just become more bond proxies, where they trade at a high multiple because of this perceived stability or perceived dividend growth, and we would grant that they are often more stable and their dividends probably should go up from here, but on a DCF that doesn't make them worth high teens or 20 times what could be some peakish earnings as this industry doesn't grow as much as it used to. So, we'll get to own more of these in the future and we can find places where we get unique shots at them, but that's been something that's done better in the market, and we haven't owned much of it.

Ross Glotzbach: 04:35

Where we have found value instead, so far, unsatisfyingly, in certain cases, from an absolute return basis, is in complexity and companies that are misunderstood, but extremely high quality on both the business, the industry dynamics, and the people running them. And what we were originally getting to pay 10 times free cash flow power for often has gone down to 8 to 6 to 7 times. That only makes it more attractive. And we just went through this few month period where people kind of got punched in the face by the stock market, and now as our partners who are in positions to be on offense are shifting even more into offense mode because they're not happy with their stock prices either. That's when you start seeing idiosyncratic winners coming down the pipe for reasons that are within their control.

Ross Glotzbach: 05:33

And that's what we see more of happening as this year goes on and as the next few years goes on, and it becomes more of an environment where money isn't free and you have to make your own moves to get paid, and we've got the right people, the right businesses to thrive in that world.

Question:

What drove returns in the quarter, and why do we own so many economically sensitive businesses heading into a recession?

Staley Cates:	05:54	Well, we can certainly understand on the surface why the common thread in our detractors looks like just an overexposure to economic sensitivity, but as normal, if you drill down into this, it's really about the feature of each company that really overcomes that general theme. And that's probably best shown if we go through these detractors name by name. But starting with FedEx, which would be kind of the classic economic barometer and therefore, not that surprising that it does poorly when Mr. Market's anticipating a recession. But this one is very interesting on several things within the company that are going to go our way regardless of macroeconomic situations. So, starting with the Express business, that's the airplanes, that's the intercontinental, that's the most economically sensitive and politically vulnerable and all of that. Well, there are two different things in that business that are helping out right now, one because of the recession.
Staley Cates:	06:52	Ironically, as the recession cuts back on discretionary travel, that cuts back on underbelly capacity that the airlines have, which is really FedEx's biggest competitor on international air freight. So that supply destruction goes on while there's also the demand destruction and it's a meaningful offset that Mr. Market may not realize. And then the second one has to do with TNT. They acquired that many years ago, the synergies are finally now coming through as advertised, and they just quantified those numbers as hundreds of millions of dollars of savings. They did that at their investor day last week. And we'll see that in this coming fiscal year, that is costs, that is synergy putting together two networks that's under their control regardless of the economic situation.
Staley Cates:	07:41	Then in the US, the biggest surprise to them in the pandemic was this explosion of e-commerce volume. And of course, that's good to get unit growth of 30% type numbers, but that had a big margin headwind with it because that growth was in B2C versus their traditional B2B strength. And B2C gross margins, if you will, are much lower than B2B margins because of the route density. There are just way fewer packages per

stop on the consumer than in the business. So that mix margin headwind, they were not ready for. And you see that really hurting ground margins, even while those Ground revenues went through the roof in the pandemic.

Staley Cates: 08:20 The second related issue was they were not ready for that kind of growth, so they had to lay out a lot of growth CapEx to expand the system and capacity and at their ground hubs and infrastructure. And understandably that also put the hurt on short-term margins because if you open a new hub that takes a minute to get profitable. Well, they're now getting past both of those issues. So overall the revenue gain, even though still driven by B2C in a recession, that is still going to look like revenue growth and that will drop to the bottom line, and some of these growth investments are also subsiding, all to mean that in their investor day, they talked about very big margin gain targets at ground, and we believe they will get most or all of that.

Staley Cates: 09:08 It seems like Mr. Market doesn't believe it because it's still at a PE of 10. But looking at other votes, if you will, also in the last month, D. E. Shaw showed up, got a couple of directors, and FedEx, partly in a collaboration agreement with D. E. Shaw, partly just on their own program of dividend increase and share repurchase, did a lot of shareholder-friendly things to raise the dividend 50%. They'll also continue major share repurchases. And then the two directors that came as kind of this settlement are extremely good in their own right. As opposed to sometimes, if an activist gets board seats, they're just putting on associates, and that doesn't necessarily help the boardroom. So that was all incredibly encouraging. And the stock reacted well short-term, but it's still a PE of 10.

Staley Cates: 10:01 The second one is MGM, which is interesting because you could also say from the macro snapshot that everything's going wrong on three pieces. So, their core strength of Las Vegas dominance, that suffers from discretionary travel cutbacks in a recession, so that's obviously bad and you see that in other hospitality

companies. Their regional casinos would be hit the most. That's where we'd expect the most earnings damage coming up because those are auto travel destinations where the gasoline price increase is meaningful on top of just the normal people cutting back on travel. Now that's one that we've been waiting for anyway and have baked in and we're not that worried about, but that's not directionally good in the short term.

Staley Cates: 10:46 And then the third thing is Mr. Market has fallen out of love recently with the whole online gaming group, as evidenced by the pure plays like DraftKings. And that's affected how MGM's version of that, BetMGM, is viewed, but all is going well there. The growth is huge. Online gaming is going to continue to grow regardless of the environment, and MGM's position within it is extremely good. So, there's a sports betting part, which is the most competitive, and you see those ads on TV every minute, but then there's iGaming, which is just basically general gaming going online. And in that really important category, because it's the highest margin, MGM is number one in that. So, the whole online gaming long-term huge value builder that brought Diller and company into this in the first place, that is intact and that transcends any short-term recession.

Staley Cates: 11:45 Then also just as a sidebar, not about the economic sensitivity, but about insider votes on this. It's really important when we're making the case of yes, there are these short-term problems, but the long term is fine, that we see confirming votes from the people who know best, the insiders. And we're seeing that to a huge degree at MGM on both. So, in terms of insider transactions, both the company and IAC teamed to do about a \$400 million purchase back from Corvex, who still maintains a really large position. But they did that deal in the mid-'40s. That's an insider purchase way above today's stock price. And then separately, they have done huge insider share repurchase all the way through for the last couple of years to really large numbers at higher prices than this. But the share

repurchase program is still additive to value and is an extremely meaningful vote.

Ross Glotzbach: 12:40 Another one I think falls into this bucket that was a detractor is Warner Bros. Discovery. In the normal type downturn, people worry about advertising revenues, they worry about subscribers going away. We think those will be valid concerns depending on how severe this downturn is. But then we look at this unique situation at Warner Bros., where they have so many levers within their control to grow their free cash flow per share in the wake of this transaction, that we still think it's really smart to put together Warner Bros. and Discovery.

Ross Glotzbach: 13:17 We also just continued to be blown away that Netflix, which had been the thorn in this industry's side for so long, had this very dramatic quarter, where the stock went down a lot, and they said they were going to do spending discipline and get more to advertising and free cash flow. That's very good for Warner Bros. Discovery after for so long Netflix's business model had been paying 20 to 30% more for the same kind of content that HBO Max and others were making. So that's good, but it made all the stocks in this whole industry trade down together. And this gets to what are the people doing about it? We saw eight different insiders buy shares personally in this quarter, which is an extremely strong vote of confidence from people who have gotten under the covers already at Warner Bros. after these assets were purchased, so they know if there were any skeletons in there.

Ross Glotzbach: 14:19 Of course, in the very short term on any merger like this, there will be messy things, there will be headlines. Media likes to write about the media. But longer term, this path to \$3 plus per share of free cash flow seems very intact, and this stock should not be less than \$15 like it ended the quarter. Another one that would fall under the economic sensitivity pain would be GE. You just look at a stock chart: GE in 2000 down a lot. GE in 2008, down a lot. What the market is missing is how different this company is today for a lot of different



reasons. First, the GE capital enormous balance sheet scary part is basically gone. So that's wonderful. Its balance sheet is stronger than it has been in a very, very long time at this company.

Ross Glotzbach: 15:11 And then each of the three remaining segments have their own paths to increasing earnings through a down economic environment. You've got Aviation, which normally does have some economic sensitivity with it, but it's still coming back from COVID, and that's just going to be a tailwind for a bit after it was a very painful moment that they had to live through there. Then you've got the Healthcare business, which historically has not been cyclical. We do not think it will be all that cyclical this time either. And then Power, which could have some slight ups and downs depending on what power markets do, what natural gas markets do, but servicing a third of the world's electricity is still a pretty valuable, steady business to be in.

Ross Glotzbach: 15:58 Finally, the leadership at this company is also the best it's been in an extremely long time with Larry Culp taking a firmer grip on the reins. Insider purchases here as well. Repurchases, stock repurchase much sooner than people thought would happen. And then still on a path to break into three parts. And that will start becoming more apparent to the market as well.

Ross Glotzbach: 16:22 Maybe one last one, just to talk about a little more briefly than those two would be Hyatt, where yes, again, standard environment, hotels, economically sensitive with less business and less leisure travel. But again, there are still some COVID comeback dynamics. Hyatt skews a little bit more towards the group and business side of things than leisure, so that is still coming back somewhat. And then they continue to just execute extremely well on an asset divestiture program where they are selling hotels one by one for more than our appraisals of them. And now they too just announced again, surprisingly earlier than people thought, that they will be getting back into share repurchase because their stock is undervalued, and they have a good path to see where this free cash flow per share can be going up

based on these moves to continue to be a more franchise-fee driven company than asset-heavy company, which the market probably still views it as.

Question:

What new investment opportunities are the team finding in the current environment?

Ross Glotzbach: 17:25

So where we're finding new opportunities would be a few places. Number one, which is often our most obvious way to find things, are just things that are left behind for unique reasons, and we've got some of those in the pipe and some of those that we could be close on. But the two broader categories would be fallen growth favorites. Now, there were a lot of things in that world that were 300 cent dollars and other 100 cent dollars, but there were certainly some good companies, and we've been spending a lot of time on sorting through all of those, and from big to small and from well-known to very off the radar. So, it's been a lot of work there and stay tuned to what we've been finding.


Ross Glotzbach: 18:14

Then over on the other side of things, I'd say building products related, from housing starts with mortgage rates going up, other things in that world where again, we've been surfing through a lot of them, meeting, talking with a lot of these companies, their competitors, their suppliers, others in their industry, and finding some interesting ones. Now we've got to make sure we're capitalizing the right trend line earnings and coming on in at the right time. But we think we've found some interesting things to do there as well. So, our on deck list is really quite nice when you look at it compared to relative historical times and just in good absolute terms. We feel like there will continue to be some new ones coming on into the portfolio and other things that we look forward to talking more about.

Gwin Myerberg: 19:08

Thanks, Ross and Staley for the discussion, and many thanks for joining us. We look forward to discussing more next quarter. Please feel free to email us at [info@SEasset.com](mailto:info@SEasset.com) if there are any questions you would like to see us cover on the next quarter.

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