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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Looking for Predictable Companies That Have Weathered Multiple Cycles

JASON LAZARUS, CFA, Vice President and Portfolio Manager of the Intrepid Income Fund, joined Intrepid Capital Management, Inc., in 2009. Mr. Lazarus focuses on research of high yield fixed income investments. Mr. Lazarus received his M.S. in finance and a B.S. degree in industrial and systems engineering from the University of Florida.

SECTOR — GENERAL INVESTING

TWST: Could you tell me a little bit about the firm?

Mr. Lazarus: Yes. Intrepid has a long history applying fundamental value-based analysis to small-cap stocks in particular. Of course, there are a lot of managers that follow the same philosophy, but we think we're truly unique in a few ways. First, we follow a strict absolute-return orientation, so we don't use relative valuation metrics to value companies. We've got a very long-term focus. So that frees us from the need to be fully invested at all times. This basically means that if we can't find an attractively priced security, the default will be cash or a T-bill.

Second, we don't subscribe to popular academic finance theories such as the capital asset pricing model, which if used in certain market environments can result in sort of distorted business valuations. Third point, we're primarily focused on avoiding downside risk and the potential for permanent loss of capital. So to mitigate this risk, we spend a lot of time determining a business's normalized earnings power, and then, we use realistic growth and discount rates to value that security. We're mostly attracted to predictable businesses that have weathered multiple business cycles and often have very strong balance sheets.

Fourth, we have minimal constraints, so we can invest across the globe. We don't have any sector limitations. And then lastly, we're very focused on maintaining emotional discipline. And what I mean by this is we employ a consistent process over a full market cycle. So the philosophy has served us very well in times of market stress, such as during the tech bubble and during the credit crisis.

And the process really extends nicely to high yield corporates, which have traditionally been an asset class with mispricings. Often, many small-cap stocks are also high yield companies simply because they're smaller. Traditionally, we've been high yield investors on the fixed income side, although right now the asset class is very picked over in our opinion. Like the equity process, we've got a very flexible mandate. We can invest in a broad array of income-producing securities, including investment-grade, high yield, convertible bonds, preferred stock, dividend-paying equity.

Our goal is to produce attractive risk-adjusted returns by taking educated credit bets while limiting interest rate risk. We want to outperform a traditional investment-grade bond fund while taking less interest rate risk. And when I refer to limiting interest rate risk, I'm not saying we invest solely in short-term securities because we're worried about interest rates going up. We just don't believe that speculating on the direction of long-term interest rates can be done with any consistency over time. So we think where we add value is by using our expertise in business analysis to take calculated bets that we think will pay off independent of changes in risk-free rates.

TWST: Did you want to highlight a stock you find interesting?

Mr. Lazarus: Yes, absolutely. As I stated earlier, we're finding high yield is quite picked over at this point. So we've been looking in a few interesting areas for ideas. One area

Highlights

Jason Lazarus discusses Intrepid Capital Management, Inc. Mr. Lazarus applies a value-based analysis to small-cap stocks. Rather than use relative valuation metrics, Mr. Lazarus follows a strict absolute-return orientation. He also has a very long-term focus and, as such, doesn't have the need to be fully invested if he can't find an attractively priced security. When managing investments, Mr. Lazarus is focused on avoiding downside risk and the permanent loss of capital. He is particularly interested in companies that are predictable, have weathered multiple business cycles and have strong balance sheets.

Companies discussed: Consolidated-Tomoka Land Co. (NYSEAMERICAN:CTO); Discovery Communications (NASDAQ:DISCA); Scripps Networks Interactive (NASDAQ:SNI); Netflix (NASDAQ:NFLX); Amazon.com (NASDAQ:AMZN) and Baldwin & Lyons (NASDAQ:BWINB).

that we've been looking is small issuers. We're a relatively small shop, and our fixed income assets allow us to take meaningful positions in smaller issues that a larger fund might not be interested in.

To give you an example, the most popular high yield index has around 2,000 high yield issues in the U.S. This index recently increased the cutoff for inclusion from $100 million outstanding to $250 million outstanding. Right now, there are over 1,000 junk-rated bonds that are not included in this index at all, and therefore might be off the radar. So that's one area we've been looking at. We've also been looking at busted converts. And we've had a lot of success there recently.

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1-Year Daily Chart of Consolidated-Tomoka Land Co.

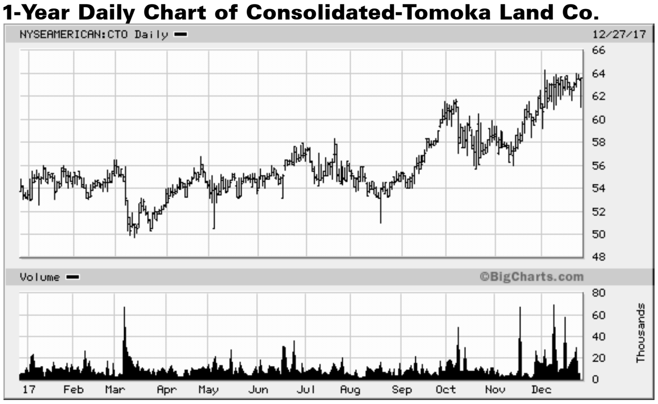

Chart provided by www.BigCharts.com

So one security that fits both of those criteria would be a company called **Consolidated-Tomoka Land Company** (NYSEAMERICAN:CTO). It's a Florida-based owner of office and retail income-producing properties across the U.S. It's got roughly 2.1 million in square feet in retail and office space. And it's concentrated in higher growth markets. The interesting thing about **Consolidated** is that it also owns about 8,000 acres of undeveloped land near I-95 in Daytona Beach, Florida, which it's been monetizing over the past few years.

The firm is over 100 years old. And at its peak, it owned almost 2 million acres of land in Florida. The remaining land holdings, obviously, were purchased initially for a tiny fraction of what the current market value is. So the company has been using 1031 exchanges to efficiently defer the capital gains taxes.

The company has a small convertible, as I said, that has about $75 million outstanding. It matures in 2020. And when we got involved, the bonds were trading with a reasonable yield for the duration and credit quality, without considering the value of the equity option at all. At the time, we were applying sort of a realistic discount to the market value of the land holdings to account for the time it takes and the cost to fully divest them.

But management surprised us this year recently by securing some very attractive prices on a large portion of that land. Based on these recent transactions, we think that **Consolidated's** stock actually has upside potential, which would obviously benefit the convertible bonds as well. Additionally, the firm has resumed exploration of converting to a REIT, which could result in investors applying a higher multiple to the income-producing properties, but we don't think that this is required to justify a higher stock price.

TWST: Do you think because a lot of their property is in Florida that this continues to be a growth area given the economic development going on there and also the fact that the retirees are still headed there?

Mr. Lazarus: Yes, absolutely. The land that they have already sold has gone to some, what you would call, active lifestyle retirement communities. One of them is actually a Jimmy Buffett-themed retirement community. That land package has been sold. But on the income-producing properties, they're fairly diversified by region. They've got a pretty big package of office properties in Raleigh. They recently bought another big office property in Portland. They've got some exposure in Silicon Valley, some in California. We're comfortable with the markets that they're in. They aren't overly concentrated in just one area.

TWST: Did you want to mention a second company?

Mr. Lazarus: Yes, sure. We like a company called **Discovery Communications** (NASDAQ:DISCA). **Discovery** is one of the world's largest media companies. It owns the Discovery Channel; it owns TLC, Animal Planet, Investigation Discovery. It owns a 70% interest in Oprah Winfrey Network. It's in the process of acquiring **Scripps Networks Interactive** (NASDAQ:SNI), which is the owner of HGTV, Food Network and Travel Channel. Discovery and HGTV are top-10-rated networks. Discovery is actually the number one non-sports for men, and HGTV is the number one for women.

1-Year Daily Chart of Discovery Communications

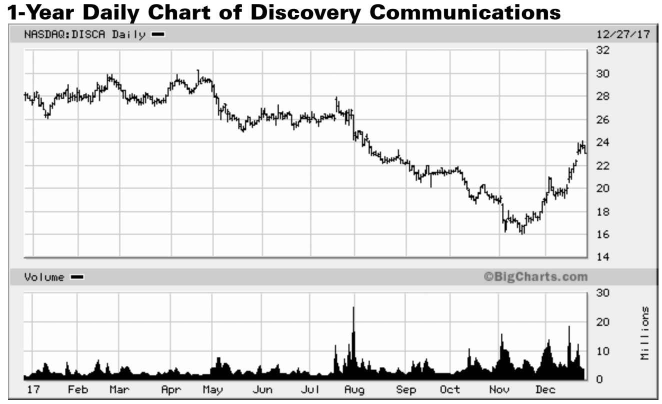

Chart provided by www.BigCharts.com

The combined firm will have about 20% viewing share for cable networks, but it will only collect about 8% of the affiliate fee economics. So the networks are relatively inexpensive to broadcasters to carry. **Discovery's** stock has suffered because the company's networks have been left out of some of these new skinny bundles like Sling TV and YouTube TV. **Scripps** is in almost all the new skinny bundles, and the combination should help **Discovery** gain some carriage since it will be hard for the skinny bundles to ignore networks that cover 20% of cable.

All the firm's networks together would cost only about $2.65 a month to the distributors, a relatively little amount. But unlike other media companies, **Discovery** and **Scripps** own almost all their content. So we think it will be easier for them to go direct to consumer one day, if they have to, as TV bundles unravel slowly.

The unscripted programming that they have, we think, competes less directly with big-budget scripted shows such that you might find on **Netflix** (NASDAQ:NFLX) or **Amazon** (NASDAQ:AMZN). We also think that the content travels pretty well. And it can easily be shown in international markets. It gets about half of its revenue from overseas. And so it's probably the most global U.S. media company. We think that this overseas exposure will help insulate them against the changes that are going on in the U.S. pay-TV markets.

The stock is down about 40% from the summer. It troughed a few weeks ago, and the acquisition will stretch the balance sheet. Leverage is going to go up to about 4.6 times net. But we think that cash flow is going to be adequate enough. They're going to rapidly pay down that debt. It's only trading for about 6.3 times 2018 free cash flows. And that's ignoring any synergies from the deal. So there is really a valuation disconnect if you look at the long-term **Discovery** bond yield at 4%, and the free cash flow yield on the stock is at almost 16%. Somebody is right; somebody is wrong. We think that the equity investors are overly discounting the stock.

TWST: How does it ensure it remains competitive? It seems like a lot of the content changes so rapidly. How do you make sure that it remains competitive over the next five to 10 years, let's say?

Mr. Lazarus: I think that's absolutely a good question. My personal opinion is that the content that they own right now or that they've developed over the last several years has very decent staying power. I don't think you have as much of a risk as, say, **Netflix** coming in with the "Stranger Things" and pulling some of those eyeballs over. I think that established "Deadliest Catch" and the unscripted shows that have high followings make it probably more competitive than the average network would be to all the new content that's coming on to **Netflix** and **Amazon**, etc.

TWST: Did you want to mention a third company?

Mr. Lazarus: Sure. The third company is called **Baldwin & Lyons** (NASDAQ:BWINB). **Baldwin & Lyons** is a P&C insurer that writes business mainly in fleet trucking. The company has a very long history writing these types of policies. It's got a lot of experience in properly reserving for these types of long-tail claims. It's historically been very conservative in over-reserving for future claims, but its recent underwriting results have been abnormally poor due to under-reserving for prior years. Also, the recent jury awards in this area have been at unprecedented levels.

So we think that there are signs that the business is improving. It appears that the industry, as a whole, is seeing some solid pricing improvement. Several larger insurers have exited the commercial auto business, which is a positive for forward pricing. We think the new management team is actually going to be a lot more committed to growing the company than the past team.

We don't love **Baldwin**. We don't think it's an unbelievable operator, but what we do like is the stock price. The stock is trading at a 15% discount to what we think is a very, very conservative book value. And a few months ago, it reached the lowest price to book since the financial crisis. Management and the board seem to agree with us. **Baldwin** recently instituted a stock buyback for the first time since 2008, when the price to book was obscenely low. And insiders have been buying in the open market when the price to book gets around the same level it's at right now. On top of that, it's been paying about a 5% dividend.

TWST: What might the sector see in the next year or two, not just Baldwin & Lyons, but some of their competitors? What might be going on in 2018 and 2019?

Mr. Lazarus: We think every indication is that pricing is going to continue to get stronger, in particular because there were two large insurers that exited that market. We've looked at several of the peers, and they're all telegraphing the same thing that pricing is strengthening up from capital leaving the industry.

TWST: Why don't we switch gears to fixed income now? What are some of the things that you might see happening with fixed income over the next year or two?

Mr. Lazarus: Well, that's a really, really tough question. Like I've said before, we pride ourselves on our bread-and-butter credit analysis, not speculating on interest rates. We think it's extremely difficult to do that.

I think that one area that investors really need to be careful in — in particular, some retail investors that may be approaching retirement and have large allocations to fixed income — is that I think that they really need to be aware of what risks their managers are taking at this point in the credit cycle because you've had a lot of managers reaching for yield in a number of different ways, whether that's extending duration of the portfolio or increasing credit risk or increasing their equity exposures well beyond what historical levels have been. So we just think that it's important for any fixed income investor to really know what types of risks their managers are taking to achieve their stated yields.

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TWST: When you and your colleagues interact with the Baby Boomers, let's say, that are either in retirement or nearing retirement, are they still interested in equities, and especially given the way interest rates have been going in recent years?

Mr. Lazarus: I think they absolutely are because they've seen a material decline in the income that they are receiving. So they want income, they want it from somewhere, and I don't think this is going to be unique to our firm. I think this is probably industrywide is that they want the yield. They want the extra return, but they also don't want the risk. Especially if you're in retirement, they can't absorb another 25% or 30% drawdown. So it's definitely a task, and it's work to marry the reality of the situation to what their expectations are and really ensuring that they're not taking more risks than they should be at this point in the cycle.

TWST: When you talk with investors in general about 2018, what have been a couple of their concerns as they look forward to next year?

Mr. Lazarus: That's a good question. There has been some talk about Bitcoin from people like my father, for example, who knows little about markets. So that's kind of been the hot topic. I can't point to anything specific on my side. I don't have daily interaction with clients.

But to expand upon what we were talking about earlier about the risks that people may not be realizing that they're taking in this type of market, say, for example, you've got on the credit side, and we know that there have been a lot of managers taking more and more credit risk. And the argument will be, "Well, high yield spreads aren't terribly tight compared to historical levels." While this is true, there are a few caveats to point out.

One is that the indexes' yields are not immaterially impacted by distressed issuers. So if you remove the distressed issues from that index, it puts the spread much closer to the lows that we experienced in the mid-2000s. The other point that I would make is that the absolute yields on junk right now is near the lowest levels ever. So when this really matters is if default rates return to historical levels, the losses on defaulted bonds could essentially wipe away any of the return that you're seeing in the asset class. And there's a pretty good argument to make that forward recoveries on defaulted bonds can be much lower than average, which would put more pressure on what the total returns of the asset class are.

We're trying to be realistic. We're trying to let clients know that prospective returns for the fixed income classes, as a whole, are going forward, sub-6% on junk and then investment-grade corporates are in the threes. We're really wanting people to exercise some caution here going forward.

TWST: When you speak about caution, is that applicable to Bitcoins and other digital currencies, even if people are seeing that the numbers go way up on these things that some economists are saying might be in a bubble?

Mr. Lazarus: We don't have a view on whether Bitcoin is going to be an actual asset class, but the best way that I can think about it is, if I bought it and it went down 50%, would I double down on it? And I can't make a case for that, right? Because there's really no fundamental value. You can't value it because there are no cash flows. So for us, it's something that would just be pure speculation.

TWST: Do you think that the Millennial generation is going to get more involved in the stock market as the economy continues to improve? And have they been scared off by maybe what happened to their parents in 2008/2009?

Mr. Lazarus: I think they're probably too young to be scared away from it. I think it's really going to take an improvement in earnings power on their part to get involved. It's obviously easier than ever for them to get involved with robo-advisers and all the apps they have out there now. I definitely don't hear from anybody that I know that the Millennial generation, that they're afraid of investing in stocks because of prior crashes, if they've accumulated the funds to do so.

TWST: Thank you. (ES)

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Investment Grade is a bond with credit rating of BBB or higher by Standard & Poor's or Baa3 or higher by Moody's. Duration is an approximate measure of the price sensitivity of a fixed-income investment to a change in interest rates, expressed as a number of years. Cash Flow measures the cash generating capability of a company by adding non-cash charges and interest to pretax income. Free Cash Flow measures the cash generating capability of a company by subtracting capital expenditures from cash flow from operations. Yield is the income return on an investment. It refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value. Free Cash Flow Yield is calculated by taking the free cash flow per share dividend by the share price. Price-to-Book compares a stock's market value to the value of total assets less total liabilities.

While the fund is no-load, management and other expenses still apply.

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Intrepid Capital Management, Inc. is the advisor to the Intrepid Capital Funds. The Intrepid Capital Funds are distributed by Quasar Distributors, LLC.

TOP TEN HOLDINGS as of 12/31/17	(% OF NET ASSETS)
Regis, 12/02/2019, 5.550%	5.3%
Dollar General, 04/15/2018, 1.875%	4.5%
Dollar Tree, 03/01/2020, 5.250%	4.3%
Total System Services, 06/01/2018, 2.375%	4.3%
Silgan Holdings, 02/01/2022, 5.500%	4.2%
Multi-Color, 12/01/2022, 6.125%	4.2%
Jabil, 03/15/2018, 8.250%	4.1%
Dorel Industries, 11/30/2019, 5.500%	4.1%
Apple, 05/03/2018, 1.000%	3.9%
FTI Consulting, 11/15/2022, 6.000%	3.3%

Fund holdings and sector allocations are subject to change and should not be considered a recommendation to buy or sell any security.

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