Intrepid Capital Funds
*the constant pursuit of value*

# INTREPID CAPITAL FUND

## 3RD QUARTER 2017 COMMENTARY

3Q 2017

SEPTEMBER 30, 2017

## PERFORMANCE

| | Inception Date | Total Return Qtr. | Total Return YTD | Total Return 1 Year | Average Annualized Total Returns as of September 30, 2017 3 Year | 5 Year | 10 Year | Since Inception |
|---|---|---|---|---|---|---|---|---|
| Intrepid Capital Fund - Inv. | 1/03/05 | 1.18% | 4.41% | 6.86% | 3.84% | 6.28% | 7.11% | 6.78% |
| Intrepid Capital Fund - Inst. | 4/30/10 | 1.25% | 4.53% | 7.13% | 4.11% | 6.54% | - | 6.99% |
| S&P 500 Index | | 4.48% | 14.24% | 18.61% | 10.81% | 14.22% | 7.44% | 8.23%^ |
| BofA Merrill Lynch US High Yield Index | | 2.04% | 7.05% | 9.06% | 5.87% | 6.38% | 7.72% | 7.43%^ |
| Russell 2000 Index | | 5.67% | 10.94% | 20.74% | 12.18% | 13.79% | 7.85% | 8.31%^ |

^Since Inception returns are as of the fund's Investor Class inception date. Since the inception date of the Institutional Class, the annualized return of the S&P 500 Index is 13.05%, BofA Merrill Lynch US High Yield Index is 7.52% and Russell 2000 Index is 11.90%.

**Performance data quoted represents past performance and does not guarantee future results.** *Investment returns and principal value will fluctuate, and when sold, may be worth more or less than their original cost. Performance current to the most recent month-end may be lower or higher than the performance quoted and can be obtained by calling 866-996-FUND. The Fund imposes a 2% redemption fee on shares held for 30 days or less. Performance data does not reflect the redemption fee. If it had, returns would be reduced.*

Per the Prospectus dated January 31, 2017, the annual operating expense (gross) for the Intrepid Capital Fund-Investor Share Class is 1.45% and for the Intrepid Capital Fund-Institutional Share Class is 1.20%. The Fund's Advisor has contractually agreed to waive a portion of its fees and/or reimburse expenses until January 31, 2018 such that the total operating expense for the Capital Fund-Investor Share Class is 1.15% and for the Capital Fund-Institutional Share Class is 1.15%. The Capital Fund-Investor Share Class may have Net Expense higher than these expense caps as a result of any sales, distribution and other fees incurred under a plan adopted pursuant to Rule 12b-1 under the Investment Company Act of 1940, as amended (the "Investment Company Act"), acquired fund fees and expenses or other expenses (such as taxes, interest, brokerage commissions and extraordinary items) that are excluded from the calculation. As a result of the calculations, the Net Expense for the Capital Fund-Investor Share Class is 1.40%. The Net Expense for the Capital Fund-Institutional Share Class is 1.15%. The Net Expense Ratio represents the percentage paid by investors. Otherwise, performance shown would have been lower.

October 3, 2017

*"We are what we repeatedly do. Excellence, then, is not an act, but a habit."*
— Aristotle

Dear Friends and Clients,

I recently picked up a copy of Joel Tillinghast's "Big Money Thinks Small." Joel is a longtime portfolio manager with Fidelity. I couldn't help but chuckle when in Chapter 1, "It's a Mad, Mad World," Joel outlines what he regards as the crucial steps to successful investing:

1. Make decisions rationally
2. Invest in what we know
3. Work with honest and trustworthy managers
4. Avoid businesses prone to obsolescence and financial ruin
5. Value stocks properly

The reason for my chuckle is that Mr. Tillinghast, in his five bullet points, outlines almost exactly what we attempt to do at Intrepid Capital, and more specifically for the purposes of this letter, in the Intrepid Capital Fund (the "Fund").

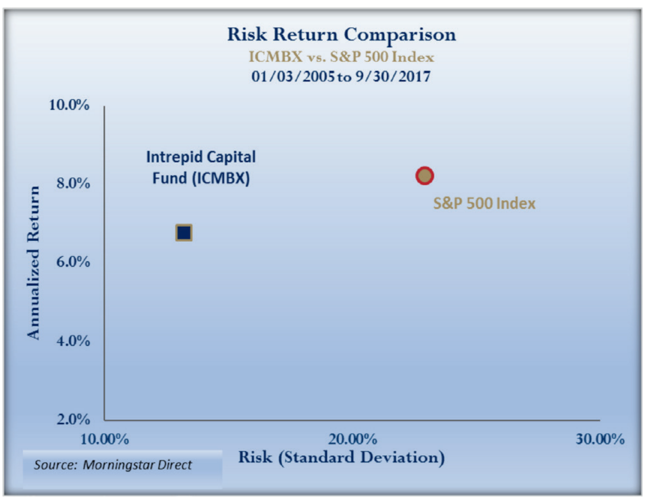
These principles might seem like a no-brainer, but you'd be surprised how many professional investors fail to consistently follow them, in my opinion. As I once heard it said of commodity trading, "The rules are very simple. Following the rules, however, is very difficult."

One reason it's so difficult is that the market doesn't consistently recognize or reward investors who try to adhere to such a philosophy. I would love to add "earn consistently high returns" as a sixth bullet inherent to our investment process, but there are periods when behavior that goes directly against the five rules seems like the profitable path – irrational decision making is rewarded, buyers of arcane and complex strategies seem to reap all the profits, honest and dishonest managers are treated alike by the market, unsustainable businesses are propped up by cheap debt, and valuing stocks seems to be a fruitless exercise.

| Top Ten Holdings | (% OF NET ASSETS) |
|---|---|
| Berkshire Hathaway, Inc. - Class B | 4.0% |
| Teradata Corp. | 3.4% |
| Syntel, Inc. | 3.4% |
| Leucadia National Corp. | 3.3% |
| Corus Entertainment, Inc. - Class B | 3.3% |
| Amdocs Ltd. | 2.8% |
| Dominion Diamond Corp. | 2.7% |
| Baldwin & Lyons, Inc. - Class B | 2.3% |
| Oaktree Capital Group LLC | 2.3% |
| Patterson-UTI Energy, Inc. | 2.3% |

Top ten holdings are as of September 30, 2017. Fund holdings are subject to change and are not recommendations to buy or sell any security.

These are the times when following the rules can be very difficult indeed. As the portfolio manager of the Fund, I am attempting to deliver equity-like returns with substantially less risk than an equity index. Since inception on 1/3/2005, we have been able to deliver on that value proposition as shown in the chart below.




I am always amazed at the short-term mindset of the average mutual fund investor. There is a great mismatch in this industry between the underlying term of different asset classes and the time horizon of investors in those asset classes. For instance, many yield seekers today are content to treat a high yield bond index, such as the well-known BofA Merrill Lynch US High Yield Index (the "Index"), as a nearly risk-free money market substitute in which they can put cash to work for a few months (or less). This may seem like a low-risk strategy to earn a little extra yield, but the securities that make up the Index are markedly riskier and longer-term in nature. The average bond in the Index is 6.3 years away from maturity, and the average issuer has a single B credit rating, according to Merrill Lynch, which is how Standard & Poors classifies a company that currently has the ability to meet its financial obligations but is vulnerable to defaulting if business or economic conditions worsen.[1] That combination of both interest rate risk and credit risk doesn't strike me as the characteristics of a short-term, cash equivalent investment.

Even more egregious than that, I've recently heard other investment managers[2] tell stories of clients asking if they should "park some money" *in the S&P 500* for a few months. For most of the last 100 years, such a blasé mindset toward stock market risk would have been unheard of. But when the S&P has averaged a 14.2% return over the last five years and has gone almost a full year without a 3% drawdown (as of this writing, only 7 days shy of the longest such run in history), and when investors' expectations of the future are naively based on the last few years, it's natural for such myopic behavior to become popular again.

While we are of course mindful of short-term performance, we are much more interested in how we look over the trailing 10 years. I can hear many of you now: "That's a nice thought Mark, but we will give you three years!" Yes, that is unfortunately the time horizon over which most performance is evaluated and money is allocated in this business.

1 "S&P Global Ratings: RatingsDirect." *Standard and Poors.* August 18, 2016. Web. 12 October 2017.
2 Bilello, Charlie. "Is the S&P the New Money Market?" *Pension Partners.* October 2, 2017. Web. 12 October 2017.

I like 10 years because it is more likely to encompass a full market cycle of both a bullish phase and a bearish phase. Full market cycles are the time horizon we focus on at Intrepid and the time frame over which we think all investment managers' performance should ideally be measured. Truthfully, it doesn't take excessive skill to passively ride a bull market; a skillful manager should be able to participate in an up market while also protecting and preserving capital in a down market.

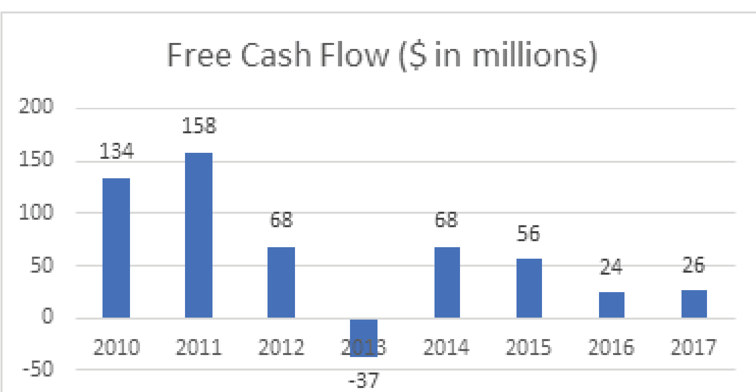
In contrasting our Tillinghast-esque philosophy to current market thinking, I have marveled for quite some time at the cult-like status of both Elon Musk and his electric car company Tesla. Wall Street analysts expect Tesla to sell 121,000 cars this year (they sold 76,000 last year). This level of production will generate an expected 2017 pre-tax loss of $1.4 billion (with a "B"), and next year's loss is forecasted at a mere $550 million. The company will likely have to continue tapping the capital markets for funding until they reach a break-even level of production, which Wall Street believes will happen in 2019.

To clarify, I'm not disparaging Mr. Musk or the company itself, but rather the market's collective decision to value such a cash-burning enterprise at almost $66 billion and to price its recent oversubscribed debt issue ($1.8 billion of 8-year senior notes) at a 5.25% yield, which is an *all-time record low* for a B- rated issuer. To me this seems to violate, at a minimum, rule #1 above. Personally, if I were a creditor of a small, unprofitable electric car manufacturer with large, entrenched, deep-pocketed competitors and an uncertain growth runway, I would demand a much higher return than 5.25% to compensate for the chance that I might not be paid back..

On the flip side, going back to Mr. Tillinghast's Rule #2 (invest in what you know), I present the Regis Corporation 5.5% notes due 12/2/2019. Regis is a company we know well, as we at times have owned both their equity and their debt. Regis is in the business of giving haircuts, and I frequent my local Supercuts, one of Regis' brands.

These bonds also satisfy Rule #4 (avoid businesses prone to obsolescence and financial ruin), as obsolescence is highly unlikely to occur for Regis between now and when this bond matures in December 2019. The company's operations are generating positive free cash flow (see below), and the most recent filings disclose $172 million in cash available to cover its $121 million in debt. Despite these favorable credit conditions, the bonds offer a yield of 5.5% to maturity – an attractive premium to that offered by Treasuries considering the risk assumed. Based on my past attempts to shear my own hair and the unlikely event that this business is "Amazoned," I feel more comfortable about the return of my principal in Regis than I would in Tesla.

**Regis Corp**




*Source: Company filings*

In summary, be rational, invest in what you know, and be careful with speculative business investment. Our process is built around these principles. I believe that by following this process, we will deliver attractive risk-adjusted results over a full market cycle (>10 years).

The Intrepid Capital Fund ended its most recent fiscal year on September 30, 2017 with a return of 6.86%, which is just a hair ahead of the since inception result of 6.78%. The Fund ended the fiscal year with a mix of 46% in equity, 33% in debt, and 22% in cash or T-bills. Coincidentally, the mix in the Fund was similar at the end of the prior fiscal year, with 49% equity, 29% bonds and 22% in cash. The Fund's defensive cash holdings have muted its recent performance, but the securities we invest in have yielded very competitive results. For the fiscal year, the Fund's equity holdings were up 12.14% and fixed income securities returned 4.39%. Since inception annualized returns of 11.59% for equities and 6.79% for fixed income bear similarly compelling testimony to the strength of our research and security selection.

This performance compares unfavorably to the rapidly rising S&P 500 and Russell 2000 equity indexes over the last three months. As they say of the weather in Florida, "Stick around, that will change." The since inception performance is closer to the blended indexes consisting of stock and bonds. In almost every case, we are attempting to take less risk.

As for the quarter ended September 30, 2017, the Fund's five largest contributors were Syntel (ticker: SYNT), Teradata (ticker: TDC), Verizon (ticker: VZ), Dominion Diamond (ticker: DDC), Berkshire Hathaway Class B (ticker: BRK/B). The Fund's five largest detractors for the quarter were G.U.D. Holdings (ticker: GUD AU), Baldwin & Lyons (ticker: BWINB), Royal Mail (ticker: RMG LN), Patterson UTI Energy (ticker: PTEN), Leucadia National (ticker: LUK).

Thank you for entrusting us with your hard-earned capital, it is not a position we take lightly. If there is anything we can do to serve you better, please don't hesitate to ask.

Best regards,

Mark F. Travis
President
Intrepid Capital Fund Portfolio Manager

**Mutual fund investing involves risk. Principal loss is possible. The Fund is subject to special risks including volatility due to investments in smaller companies, which involve additional risks such as limited liquidity and greater volatility. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments by the Fund in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. The risks of owning ETFs generally reflect the risks of owning the underlying securities they are designed to track. ETFs also have management fees that increase their costs versus the costs of owning the underlying securities directly.**

The S&P 500 Index is a broad-based, unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. The BofA Merrill Lynch US High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule and a minimum amount outstanding of $250 million. The Russell 2000 Index consists of the smallest 2,000 companies in a group of 3,000 U.S. companies in the Russell 3000 Index, as ranked by market capitalization. The Russell 3000 Index consists of the 3,000 largest companies in the U.S. as measured by total market capitalization. You cannot invest directly in an index.

Standard Deviation is a statistical measure of portfolio risk used to measure variability of total return around an average, over a specified period of time. The greater the standard deviation over the period, the wider the variability or range of the returns and hence, the greater the fund's volatility.

Active investing has higher management fees because of the manager's increased level of involvement while passive investing has lower management and operating fees. Investing in both actively and passively managed mutual funds involves risk and principal loss is possible. Both actively and passively managed mutual funds generally have daily liquidity. There are no guarantees regarding the performance of actively and passively managed mutual funds. Actively managed mutual funds may have higher portfolio turnover than passively managed funds. Excessive turnover can limit returns and can incur capital gains.

Opinions expressed are subject to change, are not guaranteed and should not be considered investment advice or recommendations to buy or sell any security.

References to other mutual funds should not be viewed as an offer of these securities.

The Intrepid Capital Funds are distributed by Quasar Distributors, LLC.