Intrepid Capital
MANAGEMENT INC.

the constant pursuit of value

1Q'13 1/1/13 – 3/31/13

DOW JONES	11.93%
S&P 500	10.61%
NASDAQ	8.51%
RUSSELL 2000	12.39%
E.A.F.E.	5.30%

QUARTERLY MARKET LETTER COMMENTARY | March 2013

"I want my cake, wanna eat it too."

— *I Wanna Be Rich* by Calloway

SMALL CAP PORTFOLIO

It's all about the Benjamin baby. In early March, Warren Buffett told CNBC, "Bernanke has sort of carried the load himself during this period," and, "There's no question stocks are higher — because interest rates are essentially zero — than they would be otherwise." We have a consensus. The stock market is breaking records thanks to the Fed. All hail the Incredible Ben Bernanke, greatest magician ever! He waves his magic wand and money appears from thin air. Penn & Teller levitate a woman, but Bernanke levitates markets. Houdini escapes from chains underwater, and Bernanke rescues a nation of underwater borrowers. Copperfield makes the Statue of Liberty vanish, while Bernanke makes interest rates vanish.

Observing the capital markets today is like watching your kid conduct a magic show. You know it's fake, but to keep everyone happy you pretend to believe in it. The stock market has rallied this year on relief from avoiding the fiscal cliff and any immediate disastrous impact from sequestration. A couple of famous bond market investors have recently proclaimed that fixed income buyers have it rough (no argument here), but equities look reasonable. We'll forgive them for their relativist rants. Has the economy improved enough to justify investor bullishness?

We don't believe the recovery story because it is not supported by a strong foundation. If you build your economic house of straw, it can be toppled by the slightest of winds. Imagine the impact of a 200 to 300 basis point rise in interest rates. Refinancing accounts for 75% of mortgage activity today and is generating significant fees for banks. Who would be refinancing their home if mortgage rates were 6%? Would home prices be increasing? The U.S. government paid $360 billion in interest on debt outstanding in fiscal 2012. In 1998, it paid $364 billion. Debt was $5.6 trillion then and is over $16 trillion now. The deficit would be hundreds of billions higher if the average government borrowing rate was 4.5%, which is in between the 1998 and 2012 rates. Low interest rates and high deficits have helped push corporate profit margins to record levels. We fear that too many investors believe current margins are sustainable.

We take most media reports of economic improvement with a grain of salt. The advertised unemployment rate ignores people who have stopped looking for work, which is at the highest level in over 30 years (highest on record for men). Additionally, the number of people who have part time jobs but wish they had full time jobs is 4 million higher than it was before the recession. Government Debt/Gross Domestic Product exceeds 100%, although some economists and politicians wearing rose-colored glasses argue that only the "public" debt matters. In other words, they claim we shouldn't count the $5 trillion of intragovernmental debt held as assets in accounts like the Social Security and Medicare Trust Funds. When Social Security is running a surplus, the government treats your payroll taxes as a loan to be spent on other things. Public Debt advocates claim this is money the government owes itself, not the people who have paid into these funds for years. Politicians will ultimately have to reduce benefits for future retirees, since unfunded liabilities exceed $80 trillion and could swamp our economy. Not helping matters is that a growing block of the working age population becomes lazier by the day — they want their cake, and they want to eat it too. More seniors reliant on the government + Fewer workers + Insufficient savings = Huge problem.

Our economic problems aren't insurmountable, but let's not pretend everything is peachy keen. We need to stop spending money we don't have. The near-term implications of this would not be welcomed by politicians: *Recession? Not under my watch!* Who will be the responsible ones? There's no easy way out of this situation. While the short-term repercussions of less Fed intervention, fiscal discipline, and a rebuilding of household savings would potentially be negative for the stock market, in the long run it should help us avoid economic calamity and ensure a brighter future. At Intrepid Capital, we are playing the long game. We are investing in what we believe are durable businesses when they can be purchased at a discount. We are not speculating by hopping on the Fed's market bandwagon.

During the three months ending March 31, 2013, the Intrepid Small Cap Portfolio (the "Portfolio") increased 4.58%, net-of-fees, compared to a 12.39% gain for the Russell 2000 benchmark. Our underperformance is primarily tied to our cash position, which swelled to 52% of Portfolio assets at quarter end. Lately, we have not found many durable businesses that can be bought cheaply. The absence of downside volatility makes true value investing difficult. Unfortunately, we can't manufacture a good investment idea. If we could, here's what it would look like:

- Predictable business that has weathered multiple economic cycles
- Significant recurring free cash flow
- Lightly levered balance sheet
- Management with a strong record of capital allocation
- Trading at or close to a double digit normalized free cash flow yield

During the first quarter, we purchased two new positions and sold four existing holdings. We bought SAIC (ticker: SAI) and Tech Data (ticker: TECD). SAIC is a defense IT services firm that we acquired in a pair trade with ManTech (ticker: MANT). SAIC is larger, more diversified, and has a higher proportion of non-defense revenue compared to ManTech. Additionally, SAIC is pursuing a split into two companies in an effort to maximize shareholder value. To date, we have been disappointed with ManTech's unwillingness to repurchase shares. When SAIC traded at a discount similar to ManTech, we sold some of our ManTech position and rotated into SAIC, which we viewed as a higher quality discount. We currently own stakes in both firms. Tech Data is an IT distributor and competitor to Ingram Micro (ticker: IM), which is a top Portfolio holding. Tech Data's stock fell sharply in March after announcing a restatement of earnings. The restatement should reduce cumulative operating profit over the past 3 years by 3.5%. We believe these accounting issues relate to one international subsidiary, and we viewed the stock price reaction as excessive. Our first quarter portfolio sales included Patterson UTI (ticker: PTEN), Potlatch (ticker: PCH), Iconix Brand Group (ticker: ICON), and Amerisafe (ticker: AMSF). Each of these names exceeded our valuation.

The top three portfolio gainers during the first quarter were Bio-Rad (ticker: BIO), Aspen Insurance (ticker: AHL), and Ingram Micro. All of these were larger positions. Bio-Rad is a leading life sciences company with substantial recurring revenue. It has traded cheaper than peers for years because of the family controlled voting structure. The company has a large amount of long-term investments that do not show up in common screens and are worth about 15% of the market cap. Aspen Insurance is an insurance and reinsurance company that we purchased in 2011 at more than a 30% discount to tangible book value. The firm has a history of consistent reserving. Favorable underwriting results in 2012 as well as recent share repurchases have contributed to gains in the stock. Ingram Micro's shares benefited from a solid earnings report. We think investors were overly pessimistic about the company's exposure to challenged markets, like PCs and the European geography.

The worst performers in the Portfolio over the past three months were Newfield Exploration (ticker: NFX), Pan American Silver (ticker: PAAS), and American Greetings (ticker: AM). Pan American's underperformance was in line with other precious metals miners and can probably be attributed to renewed hope in the economy and stock market. Newfield's shares fell significantly after the company announced that it intended to sell its Malaysia and China assets to fund domestic growth. Newfield's international assets account for a large proportion of current production but a much smaller part

of reserves. Sell side analysts said Newfield would receive a lower multiple on its short tail international EBITDA than the company's current EBITDA multiple, implying that the sale would be dilutive to Newfield's intrinsic value. They are valuing Newfield by using a multiple on EBITDA, whereas we primarily value energy companies based on reserves. As a result, the EBITDA multiple received for these finite assets matters much less to us than the sale price relative to the discounted cash flow stream. Newfield is trading at an Enterprise Value (EV) of $1.75/Mcfe per proved reserve ($10.50/Bbl), while the industry average is around $3.00/Mcfe ($18/Bbl). The company has a similar liquids mix and proportion of developed reserves relative to the industry, and we see no compelling reason for the large discount. At current commodity prices, we believe that Newfield is undervalued based on all relevant metrics including the discounted cash flow stream of its existing assets, EV/EBITDA and EV/reserves compared to peers, and transaction comps within its producing areas.

American Greetings fell slightly during the first quarter. Last September, management offered to buy the company for $17.18 per share, which was a 20% premium to the intraday low from the prior day. In spite of the offer, short interest in the shares remained close to 40% of the float or higher. In reaction to a 7% unexplained drop in the shares over a two day period in January, management issued a press release stating that they had almost secured the necessary financing and were "materially" raising their offer to $17.50 per share (a 1.9% bump). American Greetings' stock continued to trade at a persistent high single digit discount to the new offer price, likely because investors did not trust management to complete the transaction. We also have a negative opinion of the company's management team, but we saw little reason for them to temporarily game the share price with a fake takeover offer, and we believed there were limited obstacles to obtaining sufficient financing.

Today, on April 1, 2013, the board announced it supported a final offer of $18.20 per share, and the shares quickly traded above $18. In the hands of better management, we think the stock could be worth significantly more. Unfortunately, there is no realistic option to replace the entrenched family management team, who collectively controls 43% of the voting power. While the merger requires a majority vote of shareholders other than management, we think it's likely to be approved. Voting down the merger would only hand the company back to existing management, who could continue to make bad capital allocation decisions. We're walking away from this one. We made a little bit of money on American Greetings, but it was not a very successful investment for the Portfolio.

There are still plenty of market skeptics today, but they are more likely to be retail investors burned by the credit crisis instead of professional investors. Stock prices are at highs. Mutual fund and hedge fund cash levels are near lows. Margins have stopped rising and profit growth has started to slow, yet expectations are robust. Whether it's March 2009 or March 2013, too many investors make decisions by looking in the rearview mirror. Today, they see a scene straight out of investment utopia. Bushy-tailed rabbits are jumping in lush fields of green stock prices, while rainbows beam from pots of gold and cut across the pale blue sky. Up in the heavens, written in soft white clouds is, according to some, the only investment advice you'll ever need: "Don't Fight the Fed." We need the occasional rainstorm to keep the investment landscape healthy. It's not in our DNA to be Fed puppets when investment fundamentals don't make sense. Given a choice between buying an overvalued asset or earning nothing, we'll take the latter. Small capitalization stocks continue to be priced richly, and we expect better opportunities in the future. Thank you for your investment.

ALL CAP EQUITY PORTFOLIO

The stock market has been on a tear in the past quarter, and we are doing our best under the circumstances to keep up. Make no mistake- this is not the ideal environment for a value investor. With investor sentiment increasingly expecting economic expansion (and the ensuing earnings increases caused by it), market highs are being tested. Put another way, prevailing investor sentiment believes that earnings will improve, so it has pushed stock prices higher *ahead of such improvement actually occurring*. To be fair, there are some signs of an economy that might be improving. Housing prices appear to be better, although housing inventory is incredibly low and may be forcing too many buyers to bid up prices on too few houses. Jobless rates appear to

be improving, although underemployment and wages appear to be no better. We think that this data is not at all definitive. And yet in the short-term, a wave of good feeling can propel a market higher, while investors like us, who always strive to be conscious of the prices we pay, must make a decision to either play along with the market, buying stocks that we believe are not cheap, or allow our cash levels to rise as we avoid paying higher prices. We have opted to forgo purchasing what we believe are overpriced securities.

Consider the Shiller P/E, a stock market measure developed by Yale University economist Robert Shiller. Rather than a basic P/E ratio, which takes a current stock or index price and divides it by the latest annual earnings, the Shiller P/E uses the current S&P 500 Index and divides it by the average of yearly earnings over the past ten years, adjusting for inflation. By using ten years, Shiller hopes to avoid looking at a particular part of a cycle (expansion or recession) and get a broader view that encompasses one or two economic cycles. Dr. Shiller is kind enough to make his data public, and we have produced the historical chart below:

The huge spike was the tech bubble from the 1990's. There was a short-lived reduction in the Shiller P/E after the tech bubble burst, and then the market corrected again from 2008 through early 2009. However, since that time, the market has quickly reinflated and, as of March 31, 2013, had a value of 22.57, which is well above the long-term median Shiller P/E of 15.87. Now, one might reasonably argue that this long-term median might not be as applicable in today's market. However, we believe that the Shiller P/E does provide some insight into the volatile nature of market outlook and expectations, especially in recent years. It appears to us to be an inflationary pattern, likely driven by an easy monetary policy along with large deficit spending. While we cannot accurately predict when corrections will occur, we can see that they are sudden and painful. This is not the experience we would choose for ourselves or for our shareholders.

For the quarter ended March 31, 2013, the Intrepid All Cap Equity Portfolio (the "Portfolio") gained 7.40%, net-of-fees, while the S&P 500 Index gained 10.61% and the Russell 3000 Index was up 11.07%. Our goal in the current climate is to participate in the market gain. The Portfolio's quarterly return was roughly 68% of the Russell 3000's return while the Fund's cash level rose from 33.5% as of December 31, 2012 to 41.9% at quarter end.

This will be the last letter in which we refer to the Portfolio as the Intrepid All Cap Equity Portfolio. Effective April 1, 2013, the Portfolio name will be changed to the Intrepid Disciplined Value Portfolio. The decision to change the name was motivated by our desire to highlight the investment process and commitment to find value where possible. As we mentioned above, we may not always make the comfortable choice, but when it comes to our clients' investment in the Portfolio, we feel that our mandate is to maintain the discipline of our process above everything else.

Activity during the quarter was skewed more towards selling than purchasing, as five names were sold out of the Portfolio with only one being added. Potlatch (ticker: PCH), Johnson & Johnson (ticker: JNJ), Federated Investors (ticker: FII), Patterson UTI (ticker: PTEN), and Iconix (ticker: ICON) were all sold as the stocks hit our intrinsic value estimates. The sole addition to the portfolio was GameStop (ticker: GME). Somewhat of a contrarian idea, GameStop is a market leading retailer of new console video games. In addition, its used game business is highly profitable and has driven high returns on the company's tangible capital. The stock has been heavily shorted for a few reasons. First, some investors fear that when new consoles, such as Sony's PlayStation 4 and Microsoft's Xbox, are launched, gamers who buy used titles will be unable to play those games on the newer consoles. Sony has all but completely dispelled this notion, and we think Microsoft is unlikely to go it alone and prevent used game play on its new console for fear of consumer backlash. A second fear is that games sales have been weak for the past couple of years, but we are likely to be entering a new gaming cycle with the advent of one or two new game consoles in time for the 2013 Holiday season. We look at this as an opportunity to buy a business on share price weakness, believing that it can generate free cash flow even in a challenging environment.

Top contributors for the quarter were Dell (ticker: DELL), Staples (ticker: SPLS), and Patterson UTI. In our opinion, the respective stock price for each company had been suppressed by concerns specific either to the company's industry, as with Patterson and Dell, or to the firm itself, as with Staples' reorganization of its European stores. These stocks started the quarter with relatively larger discounts. In the case of Dell, the competing go-private offers have driven the stock price considerably higher from where it started the quarter. Patterson UTI exceeded expectations in its most recent earnings release. In the case of Staples, we suspect that the market felt that, given the attractive dividend and the credible steps management

is taking to control its costs in its international stores, the low share price was unwarranted.

The worst laggards in the quarter were Newfield Exploration (ticker: NFX), Pan American Silver (ticker: PAAS), and Telephone & Data Systems (ticker: TDS). In the case of TDS, the company continues to build out its 4G wireless infrastructure, which is weighing on free cash flow in the short-term. We believe that there is a potential for asset sales of the company's less profitable business geographies which could add to shareholder value. As a precious metals miner, Pan American Silver is in an out-of-favor segment. Newfield is a company that we believe is misunderstood by the market, which is pricing the company well below its peers in the energy exploration & production industry.

We will close this letter as we have often done, by citing our estimated average discount within the Portfolio. Each investment will have a discount to intrinsic value which is based upon its market price and our calculated intrinsic value. The average discount within the Portfolio is roughly 11%. This discount has shrunk as the market has made such a sharp move up in the quarter. Nonetheless, we continue to look for suitable new value investments, but we recognize that the current climate is challenging. We thank you for your confidence in our process.

BALANCED PORTFOLIO

> "We do better when the wind is in our face."
>
> — Warren Buffett
>
> *Berkshire Hathaway 2012 Shareholder Letter*

The stated corporate objective at Intrepid Capital is "to participate in a bull market, but to preserve capital in a bear market." As we crossed the four year anniversary of the March 2009 market lows, it has become increasingly more difficult for us "to participate in a bull market." The 150% return posted by the Russell 3000 since the 2009 market trough has made our job of finding high quality, conservatively-financed businesses trading at discounts an increasingly challenging endeavor.

We chuckled when reading Mr. Buffett's quote as he was lamenting that he only achieved a $24 billion gain for shareholders and that the percentage increase in book value was less than the performance of the S&P 500 Index in 2012. The Intrepid Balanced Portoflio (the "Portfolio") also underperformed in 2012, a relatively short time period. Our underperformance is to be expected in a sharply rising market where we believe valuations were, and continue to be, stretched. As we moved into 2013, the markets have continued to rise, increasing at virtually 1% per week in the first quarter!

The Portfolio returned 5.63%, net-of-fees, in the three month period ending March 31, 2013. While we consider ourselves to be true absolute return investors and therefore do not manage the Portfolio to an index, we compare the Portfolio's performance to a blended benchmark consisting of 60% invested in the S&P 500 and 40% invested in the Bank of America/Merrill Lynch High Yield Master II Index. Over the same three month period, the benchmark returned 7.48%. For the one, three and five year periods ending March 31, 2013, the Portfolio's annualized returns, net-of-fees, were 9.02%, 10.33%, and 9.19%, respectively. The benchmark returned 13.71%, 12.10%, and 8.18% over the same periods.

The top contributors to the Portfolio's performance in the first three months of 2013 were: Dell (ticker: DELL), Big Lots (ticker: BIG), Bio Rad (ticker: BIO), Patterson UTI (ticker: PTEN), and Berkshire Hathaway (ticker: BRK/B). In contrast, the largest detractors for the same period were: Newfield Exploration (ticker: NFX), Newmont Mining (ticker: NEM), Royal Gold (ticker: RGLD) and Pan American Silver (ticker: PAAS). Several of these holdings are discussed in our Small Cap Portfolio and Disciplined Value Portfolio commentaries.

The rules at Intrepid simple: buy low and sell high. One could say the rules are easy to understand but hard to follow. As prices for equities and fixed income securities have climbed and surpassed our conservative estimations of intrinsic value, we have been exiting positions. If attractive replacement ideas are in low supply, our sale proceeds are comfortably (or uncomfortably, depending on your perspective) held in cash, patiently waiting for opportunities to appear. We would like to draw a sharp contrast to many of our "index centric" peers who feel compelled (or pressured) to be fully invested, all of the time. In our opinion, to be fully invested today is to operate under the assumption that no better opportunities will appear in the future. That is not an assumption we have been willing to make.

Our hometown NFL team, the Jacksonville Jaguars, had a motto for the 2012 season: "All In." We can say the same for our personal investments in Intrepid Capital – we're "all in." We appreciate your continued support. It is not a position we take lightly.

HIGH YIELD PORTFOLIO

The high yield market continued its strong performance into the first quarter of 2013 in conjunction with equity indices hitting all-time highs. The Bank of America / Merrill Lynch High Yield Master II Index completed its 10th straight month of positive performance. **The yield-to-worst offered by high-yield bonds hit a new all-time low of 5.60% during the quarter, and stood at 5.71% on March 31, 2013.** We believe the apparent optimism of market participants is largely misguided, and is rooted in the actions of "Helicopter Ben" and his sidekicks at the Federal Reserve. Unprecedented levels of market intervention, combined with chronic budget deficits, leave us increasingly wary of committing capital to risky asset classes.

The Intrepid High Yield Portfolio (the "Portfolio") underperformed the high-yield index in the first quarter of the 2013 calendar year. The Portfolio gained 1.23%, net-of-fees, in the three-month period ending March 31, 2013. In the same period, the index rose 2.90%. Returns were diminished by our under-allocation to lower-rated bonds, which outperformed the broad market, as well as the high cash balance.

The Portfolio is positioned differently than a traditional high-yield portfolio or an investment-grade corporate bond portfolio. We generally have a higher-quality bias and hold cash to take advantage of market dislocations. Further, the Portfolio's duration, a measure of interest rate sensitivity, is short in this record low interest rate environment. Investment grade bonds typically have a much longer duration and are therefore more exposed to interest rate risk. Given the higher-quality holdings and elevated cash position that averaged 27.2% of assets, the Portfolio performed as would be expected. Investment grade credit spreads remained essentially flat near 150 basis points, and prices declined in response to higher Treasury rates.

Portfolio activity was relatively muted in the quarter. Two of our largest holdings, Gibraltar Industries 8.00% due 12/01/2015 and Spartan Stores 3.375% convertible notes, were called in their entirety. It can be frustrating to see our portfolio companies call our notes and issue new longer-dated, lower-coupon bonds. In most cases we don't believe the new paper is particularly attractive and therefore don't get involved. Case in point is Gibraltar's new issue, sporting a 6.25% coupon with a 2/01/2021 maturity. It's difficult for us to get excited about a moderately-leveraged, cyclical building products company even if it were trading near par. Apparently market participants disagree with us, as the notes are trading near $107 and offer a measly 5.1% yield for the next eight years.

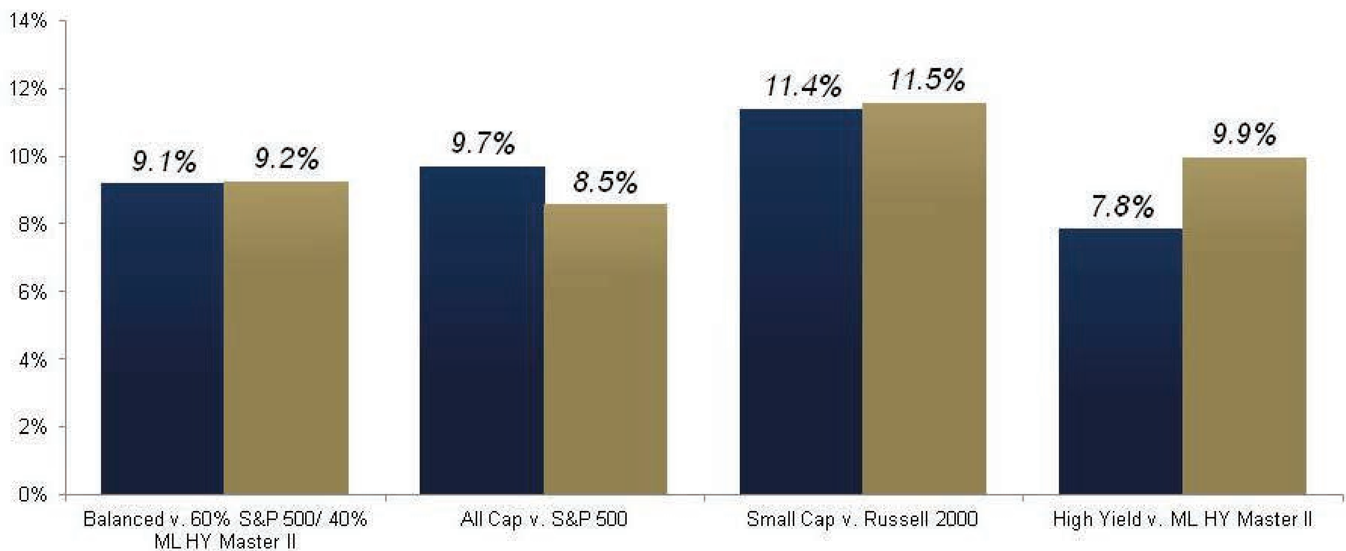
The largest contributors to the Portfolio's performance in the quarter were PetroQuest 10.00% due 9/01/2017, EPL Oil & Gas 8.25% due 2/15/2018, and Quality Distribution 9.875% due 11/01/2018. PQ and EPL were top contributors in the fourth quarter as well. These securities materially outperformed the market and constitute larger positions. A combination of higher energy prices and more conservative capital allocation plans for 2013 probably supported the energy names. Additionally, lower-rated bonds such as these generally outperformed better quality high-yield bonds in the quarter (although we don't believe these issuers are low quality). The few detractors had an immaterial impact on the Portfolio's performance.

As regular readers of our letters know, our holdings have been called consistently over the past two or three years as high-yield rates continue to descend to historic lows. We expect several holdings to be called through the summer if the high-yield market remains strong. As we have stated in past letters, we are not required to reinvest this cash. If we cannot find securities that can stand on their own merits, we will default to cash and await more attractive opportunities. Absent a significant increase in interest rates or widening of credit spreads, our cash position could continue to grow.

To reiterate our view on cash, one that has been stated consistently in our commentaries, our cash position is solely a function of the opportunities available in the market. It is not a top-down call on asset prices. We believe our current holdings offer attractive returns for the risk borne, but unfortunately opportunities such as these do not abound. With that said, attractive ideas can be unearthed even when the environment is toughest for value investors – when prices are unreasonably high and opportunities are scarce. We are consistently finding new ideas, but must be increasingly selective in the process. Looking forward, we think it is prudent to maintain our defensive posture, both from a credit risk and interest rate risk perspective. We will continue to focus on higher-quality businesses while maintaining our short duration. Thank you for your investment.

INTREPID CAPITAL MANAGEMENT
TRAILING 10-YR ANNUALIZED PERFORMANCE

MARCH 31, 2003 – MARCH 31, 2013



*Past performance is no guarantee of future results. Intrepid composite returns are presented net of investment advisory fees. Returns reflect the reinvestment of dividends and other earnings. The volatility of the listed benchmarks may be materially different from the volatility of any Intrepid composite. As of December 31, 2004, the firm changed its fixed income benchmark from the Salomon High Yield Short-Term Index to the Merrill Lynch High Yield Master II Index.