Intrepid Capital Funds
*the constant pursuit of value*

# INTREPID INCOME FUND

## 1st QUARTER 2015 COMMENTARY

## 1Q 2015

MARCH 31, 2015

## PERFORMANCE

| | | Total Return | | | Average Annualized Total Returns as of March 31, 2015 | | |
|---|---|---|---|---|---|---|---|
| | Inception Date | Qtr. | YTD | 1 Year | 3 Year | 5 Year | Since Inception |
| Intrepid Income Fund - Inst.^ | 08/16/10 | 1.45% | 1.45% | -1.03% | 2.46% | 3.74% | 4.07% |
| Barclays US Aggregate Bond Index | | 1.61% | 1.61% | 5.72% | 3.10% | 4.41% | 5.27% |
| BAML High Yield Master II Index | | 2.54% | 2.54% | 2.05% | 7.47% | 8.40% | 7.92% |

^Institutional Class shares of the Intrepid Income Fund commenced operations on August 16, 2010. Performance shown prior to August 16, 2010 (5-Year and Since Inception) reflects the performance of Investor Class shares, which commenced operations on July 2, 2007, and includes expenses that are not applicable to and are higher than those of Institutional Class shares.

Effective January 31, 2014, the Investor Class shares of the Fund were closed, and any outstanding Investor Class shares were converted into Institutional Class shares.

**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, the Fund's annual operating expenses (gross) for the Institutional Share Class is 0.95%. The Fund's Advisor has contractually agreed to waive a portion of its fees and/or reimburse expenses such that the total operating expense (net) is 0.90% through 1/31/16. Otherwise, performance shown would have been lower.

April 1, 2015

Dear Fellow Shareholders,

What strange times we live in when central banks have such an intense fear of the business cycle that they will go to literally unprecedented[1] lengths to eke out meager economic growth and maintain asset prices, despite the long-term repercussions such policies might have. In January, the European Central Bank announced it would purchase more than €1 trillion in bonds over the next several quarters, despite the fact that interest rates were already at extraordinarily low levels in most European countries (and in some cases negative). Now, it's not just deposit rates that are negative; in many European countries investors must pay for the privilege of owning government bonds for maturities up to seven years! Germany sold 5-year government bonds last week that sport a juicy -0.10% yield-to-maturity. Clearly some buyers of such debt have no intention of holding to maturity and locking in a loss. Instead, most are trying to find a "greater fool" to purchase the bonds at even higher prices. While the European intervention is certainly disconcerting, Japan has taken quantitative easing to an entirely new level. According to the Wall Street Journal, since April 2013 the Bank of Japan has purchased Japanese stocks (via ETFs) on 76% of the days the market has opened lower in an effort to prop up prices. The BoJ is also the largest holder of Japanese government bonds.

The miniscule yields found in Japan, Europe and elsewhere have made U.S. government bond yields in the low-single-digits seem relatively attractive, and investors plowed into Treasuries in the first quarter. After defying the forecasts of nearly all market prognosticators in 2014, Treasury bond yields sank early in 2015. The 30-year bond yield continued its descent in January, hitting new all-time lows on several trading days before reaching 2.22% on January 30th. To illustrate a 30-year bond's sensitivity to interest rates, the roughly 0.53% decline in rates in January translated into a price gain of more than 11%[2]. The entire rally and more was erased in February as investors became concerned about a potential Fed rate hike occurring in the summer. Treasuries rallied in the last few weeks of the quarter to register moderate gains, but clearly the ride was anything but smooth.

Broad fixed income markets benefited from the rally in government bonds. The Barclays U.S. Aggregate Bond Index, which is representative of the investment grade bond market as a whole (and includes a large allocation to U.S. Treasuries) rose 1.61% in the first quarter of 2015. Investment grade corporate bonds, as measured by the BofA/ML Corporate Index, rose 2.26% as a result

[1] I know the term is absurdly overused, but we really are in uncharted waters.

[2] Benchmark Treasury bond: 3% due 11/15/2044

of lower risk-free rates and tighter spreads. High-yield bonds outperformed both indexes in the quarter and experienced less volatility as spread compression helped to offset the jump in rates in February. The BofA/ML High Yield Master II Index (the "Index") rose 2.54% in the quarter. High-yield funds have experienced significant inflows in the last few months, which has forced portfolio managers to put cash to work regardless of fundamental credit quality. This demand for bonds always favors borrowers. Moody's recently reported that the covenant quality of bonds issued in February was at the weakest level the firm had ever seen. Nearly half of high-yield corporate bonds issued during the month were "covenant-lite," which means there were minimal protections to limit actions such as the incurrence of additional debt.

| Top Ten Holdings | (% of net assets) |
|---|---|
| Pitney Bowes Intl Pfd Stock | 4.5% |
| Brown Shoe, 05/15/2019, 7.125% | 4.4% |
| Regis,12/05/2017, 5.750% | 4.3% |
| Teleflex, 06/01/2019, 6.875% | 4.2% |
| EPL Oil & Gas, 02/15/2018, 8.250% | 3.6% |
| Ruby Tuesday, 5/15/2020, 7.625% | 3.6% |
| Smith & Wesson Holding, 6/15/2017, 5.875% | 3.3% |
| AuRico Gold, 04/01/2020, 7.750% | 3.2% |
| Northern Oil and Gas, 06/01/2020, 8.000% | 3.2% |
| PHI, 3/15/2019, 5.250% | 3.0% |

Top ten holdings are as of March 31, 2015. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

The Intrepid Income Fund (the "Fund") returned 1.45% in the quarter. Our invested assets outperformed the Index in the period, but our large cash allocation tempered the Fund's results. While we believe we have constructed a portfolio of attractively-priced securities, we continue to have difficulty finding new opportunities. The Fund's large cash balance reflects our disciplined investment strategy. If we cannot uncover mispriced securities, we will simply hold cash.

The top contributor of the first quarter was Northern Oil & Gas 8.000% due 6/01/2020. Readers might recall that Northern happened to be our largest detractor in the full year and fourth quarter of 2014. The bonds of the oil producer were battered last year as the price of crude declined from over $100 per barrel (bbl) to under $50. As was discussed extensively in last quarter's commentary, we believed investors were overlooking two critical points: 1) the large hedging position that locked in most of the company's 2015 production at $90/bbl, and 2) the significant value of the producing reserves, even assuming low oil prices in perpetuity. When the dust had settled (oil finally stabilized around $45/bbl) and investors began to sort through the wreckage, we believe some came to appreciate these points and realized Northern's bonds were trading at unreasonably low levels. The bonds returned nearly 20% in the first quarter despite oil prices remaining range-bound at around $50/bbl, and the notes are now trading above levels last experienced in November of 2014, when oil prices were around $75/bbl. While we took the opportunity to rebalance the position as the price rose, Northern continues to be a core position.

Our positions in AuRico Gold and PHI, Inc. were the Fund's second and third largest contributors to first quarter performance. Both bonds were negative contributors in the fourth quarter due to each company's exposure to commodity prices. AuRico is a Canadian gold miner, and spot gold prices tumbled in the second half of 2014. While gold prices were volatile in the first quarter, the March 31st spot price was slightly higher than the price on December 31st. We believe investors became more comfortable with the quality of AuRico's primary mine, which has been in start-up phase. The ramp-up of the mine has so far exceeded management's targets. PHI is a provider of helicopter transportation services to the offshore oil and gas industry and also supports the healthcare industry with an air ambulance business. The company's bonds probably benefited from the stabilization of oil prices, and perhaps due to positive comments industry executives have made on prospects for the Gulf of Mexico, PHI's primary region of operation in the oil and gas business.

The Fund had only one material detractor in the first quarter, EZCORP's 2.125% convertible bonds due 6/15/2019, which happened to be the top contributor in the fourth quarter of 2014. The convertible bonds fell about 10 points as the company's equity sold off sharply. The firm's fourth quarter earnings were pressured by lower gold prices and weakness in the unsecured lending (payday loan) business, neither of which should have been a surprise to investors. Nevertheless, the stock sold off about 20%, which reduced the value of the convertible feature of our bonds. The stock fell sharply again later in the first quarter after the Consumer Financial Protection Bureau (CFPB) announced strict rules that many believe will shrink the entire payday loan industry to a fraction of its current size. The new rules will definitely reduce EZCORP's earnings power, but we have never relied on the payday loan business to support the credit quality. We estimate that the company's payday loan business represents only about one-third of normalized earnings, and the pawn earnings power and external investments easily support the credit quality of the issue, in our opinion. When we initially purchased the convertible bonds, we ignored any value the convertible feature might have; that is, we viewed the issue as a straight bond and assessed the yield relative to the company's credit risk. We still believe the yield offered by the notes is attractive in spite of the recent negative events.

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Portfolio activity was minimal in the first quarter, as we continue to have difficulty finding attractively-priced securities. The only significant purchase was the completion of our position in Teleflex 6.875% due 6/01/2019, which is now one of our largest holdings. Teleflex is a global provider of medical products primarily used in critical care and surgical applications. The company's products include central venous and peripherally inserted central catheters, endotracheal and laryngoscopy products, and closure products. The vast majority of the company's products are single-use, so revenues are highly recurring. Teleflex has a strong balance sheet, but management has historically used debt to fund acquisitions. However, we are not overly concerned about the risk of an overleveraged balance sheet. Management's M&A track record is strong, and it has not sacrificed credit quality to complete a purchase. We believe the notes offer an attractive risk-adjusted return but are likely to be called in June of 2015 if the high-yield market maintains its strength.

In past updates we mentioned that we expected some of our holdings to be called by their issuers in early 2015, and in the absence of new opportunities cash levels would likely increase. Two of our positions were called in their entirety in the first quarter: Oshkosh 8.500% due 3/01/2020 and Speedway Motorsports 6.750% due 2/01/2019. Taken together, these issues constituted about 6% of the Fund's assets. We expect some moderate call activity through the summer, which will lead to higher cash balances in the absence of attractive investment opportunities.

Our ultimate objective is to offer an attractive risk-adjusted return over a full market cycle. However, paying too much for even the highest-quality businesses will not lead to a favorable outcome. The only thing we can directly control in the investment process is the price we pay. If we don't believe we are being compensated to bear an investment's risks, we will simply hold cash and wait for better opportunities. Following this strict discipline during a time when fixed income yields hit new lows seemingly every day has kept the Fund's cash balance elevated for longer than we ever anticipated. Despite the perceived reputational risks that come with breaking away from the "safety" of the herd, we are as committed as ever to maintaining the integrity of the investment process. We are eagerly awaiting the opportunity to put capital to work in a more attractive environment. Thank you for your investment.

Sincerely,

Jason Lazarus, CFA
Intrepid Income Lead Portfolio Manager

**Mutual fund investing involves risk. Principal loss is possible. Investments in debt securities typically decrease in value when interest rates rise. The risk is generally 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 is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual securities volatility than a diversified fund. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods.**

The Bank of America Merrill Lynch High Yield Master II Index (BAML High Yield Index) is Bank of America Merrill Lynch's broadest high yield index, and as such is comparable with the broad indices published by other investment banks. Bank of America Merrill Lynch US Corporate Index (BAML Corporate Index) is an unmanaged index of U. S. dollar denominated investment grade corporate debt securities publicly issued in the U.S. domestic market with at least one year remaining term to final maturity. Barclays Capital U.S. Aggregate Bond Index is an index representing about 8,200 fixed income securities. To be included in the index, bonds must be rated investment grade by Moody's and S&P. You cannot invest directly in an index.

Free Cash Flow measures the cash generating capability of a company by subtracting capital expenditures from cash flow from operations. EBITDA is calculated as the company's Earnings Before Interest, Taxes, Depreciation and Amortization. M&A refers to Mergers and Acquisitions. Yield-to-maturity is the rate of return anticipated on a bond if it is held until the maturity date and all coupons are reinvested at a similar rate. A Risk-Free Rate represents the interest an investor would expect from an absolutely risk-free investment over a specified period of time.

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

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