Intrepid Capital MANAGEMENT INC.

the constant pursuit of value

2Q'12 4/1/12 – 6/30/12

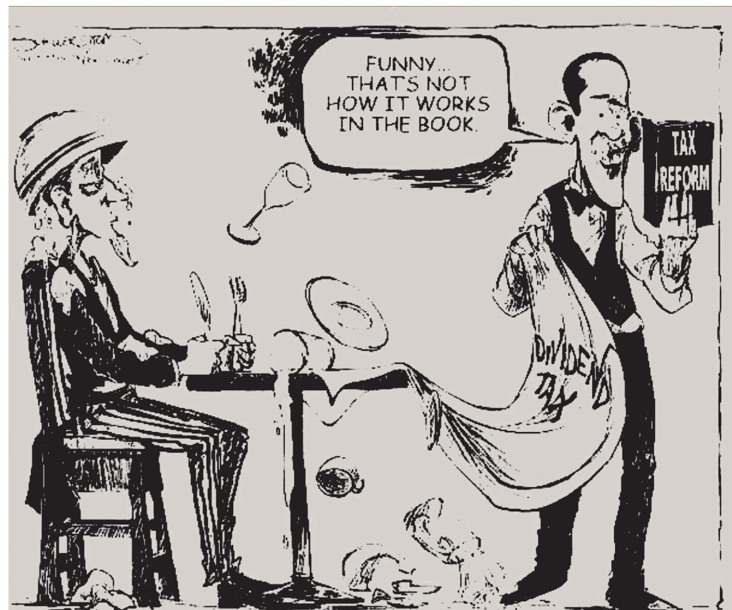
DOW JONES	-1.85%
S&P 500	-2.75%
NASDAQ	-4.76%
RUSSELL 2000	-3.47%
E.A.F.E.	-6.93%

QUARTERLY MARKET LETTER | July 2012

Dear Friends and Clients,

The second quarter was significantly more difficult for equity participants than was the first. At one point during the last three months, the equity markets nearly retraced all of the double-digit gains accumulated earlier in the year.

> "The good news is that, according to the Obama administration, the rich will pay for everything. The bad news is that, according to the Obama administration, you're rich."
>
> — P.J. O'Rourke

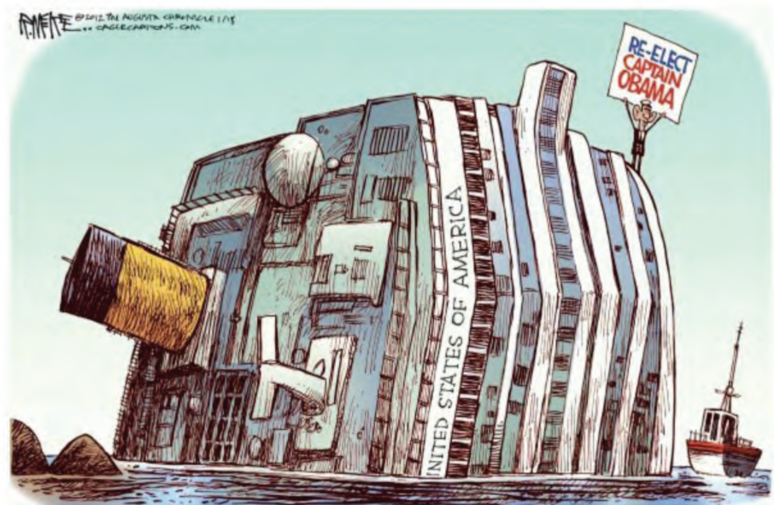


The financial headlines have been filled with abysmal news from Europe as the heads of state wrestle with the seemingly intractable problems, daily, in Brussels. Interest rates on 10-year government bonds in Spain and Italy have crossed 6% as the markets attempt to weigh which of the 17 nation members of the European Union will stay or go. The spark that started in Greece is now a wildfire across the continent. For comparative purposes, German 10-year bonds and U.S. 10-year notes both offer yields around 1.50%. High yields on peripheral nations' government debt show how the capital markets can administer medicine, even when politicians can't or won't.

I am reminded of a quote by James Carville, an advisor to Bill Clinton: "I used to think if there was reincarnation, I wanted to come back as the President or the Pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everybody." He was lamenting the fact that over time the capital markets may have more control than policy makers.

I am watching with interest the proposed policies of the new French president, Hollande, as he tries to correct huge fiscal imbalances and offset some of the austerity proposed by the German chancellor, Angela Merkel, with "growth" initiatives. Some of his proposals include a 75% top income tax rate, a wealth tax for anyone with a net worth of more than €1.3 million, capping CEO pay at €450,000, cutting the retirement age to 60 from 62, etc. In response, Britain's Prime Minister David Cameron has rolled out the red carpet for anyone wanting to flee this silliness.

Meanwhile, across the pond, the Supreme Court of the United States ruled that "The Affordable Care Act" (a.k.a. Obamacare) is constitutional not under the commerce clause, but rather under the taxing authority of Congress, despite the argument by the administration in front of the court that the Act was not a tax. Regardless of the Supreme Court's decision, fiscal reality will prevail. Unfortunately, as a country we have just doubled down on a medical system that we simply can't afford, and Obamacare won't make it any better. A system free of bureaucratic price setters with no interference between buyer (patient) and medical service providers would be superior to the new Rube Goldberg entitlement the Supreme Court just blessed. As I have said before, only in Washington is insuring 30 million more people a way to save money.



This ruling does have the beneficial effect of removing one of the uncertainties weighing on the market. Others still in place are Europe, the presidential election, and the "fiscal cliff" if a bipartisan agreement is not reached by year end, resulting in substantially higher taxes on income and capital gains. If a punitive tax strategy actually worked, then California would be in the black, not underestimating its deficits by the billions.

In contrast to the course the U.S. and France are on, our friends to the north, Canada, have enacted meaningful growth-oriented tax reform. Canada's federal corporate tax rate has been cut from 38% in the early 1980's to just 15% today. Despite the much lower rate, tax revenues have not declined. Corporate tax revenues in Canada will be 1.9% of GDP with a 15% corporate tax rate. The United States is expecting to collect 1.6% of GDP at a 35% corporate tax rate. The high U.S. tax rate is not only bad for the economy, but it also doesn't help the government collect incremental revenue.

In March alone, the U.S. government spent $369.37 billion, or about $1,190 per American man, woman and child. To fund such lavish spending, the average American paid only $550 in tax. Covering just half a month's spending with tax receipts is, of course, totally unsustainable. As I said earlier, fiscal reality will eventually prevail.

At Intrepid Capital we continue to plug along, waiting for large enough disparities between price and value to give us a margin of safety between where "Mr. Market" prices a security and what we believe is a conservative estimate of long-term business value. Our portfolios have a significant amount of residual cash that we deploy more actively on down days that have rolled through in waves from the European continent. In the second quarter, several of our mundane holdings' increased share prices helped mitigate the negative performance the broad market experienced. The portfolios continue to be defensively postured, but we are ready to deploy our cash reserves when mispricings occur.

Thank you for entrusting us with your hard-earned capital. It is not a position we take lightly.

Best regards,

Mark F. Travis
President and CEO

SMALL CAP PORTFOLIO

The United States is the Charlie Sheen of world economies. Both are associated with Wall Street and have enjoyed much success. The U.S. is the world's number one economy and one of the best performing stock markets this year. Sheen's Two and a Half Men was TV's top comedy and he was the highest paid actor on television. This country and Charlie both know how to blow money on things that don't last. We can chant "Winning!" all day long, but it doesn't make problems go away. As a nation, we borrow and spend too much and have made promises we cannot keep. Small cap stocks are not discounting the pain that will be required to return America to a proper economic footing.

The Intrepid Small Cap Portfolio (the "Portfolio") declined 2.25%, net-of-fees, in the second quarter, while the Russell 2000 Index fell 3.47%. In the six month period through June 30, 2012, the Portfolio posted a return of 2.99%, net-of-fees, versus an 8.53% gain for the Russell 2000 Index. Our defensive, high-cash positioning helped modestly during the quarter, but it has negatively impacted our relative performance since markets began ascending last fall. The Portfolio's year-to-date returns have also been muted by losses in a small number of holdings. Gains in our top three performers have been offset by declines in our three worst performing holdings. While recent returns have been uninspiring, we have increased the average valuation discount in the Portfolio since the start of the year.

We like our positioning today. Cash was 45% of assets at the end of the quarter. Many managers are forced to fully invest their portfolios. They reason that the U.S. is the "cleanest dirty shirt" and therefore is the logical place to invest. We will only invest cash when we find an undervalued idea. To do otherwise would betray our process and the promise we have made to you. Our liquidity should come in handy when investors lose faith in the power of the Bernanke Put.

The Portfolio contains a large number of businesses whose performance is not acutely dependent on economic strength—firms that sell insurance, medical supplies, handle cable and telecom billing, offer bankruptcy services, provide security, etc. The energy sector has been hit hardest in 2012, and more recently we have found value in a few energy stocks. These introduce additional volatility to the Portfolio, but we feel we are being compensated for the extra risk. The combined quarter-end weighting in commodity-oriented stocks (e.g. energy, timber, precious metals) was still below 10%, up from 4% to start the year. We would continue to characterize the Portfolio as having a largely defensive posture.

The three securities having the largest positive contribution to returns in the second quarter were CSG Systems (ticker: CSGS), Cott Corp. (ticker: COT), and Iconix Brand Group (ticker: ICON). CSG's management said their visibility into achieving full year earnings guidance had increased. The billing company has two large contracts coming up for renewal over the next nine months, and we believe the share price already assumes a steep haircut to contract pricing. Cott Corp. is succeeding in passing through commodity cost inflation for its private label beverages, and the firm has received additional shelf space from some of its largest customers. We reduced our weighting as the stock appreciated.

Iconix Brand Group was a new addition to the portfolio during the quarter. We purchased a small position after the company's stock fell sharply due to a reduction in earnings guidance. Iconix is the world's second largest licensor of consumer brands after Disney. It is a royalty business, and Iconix only provides marketing support for brands such as Candie's, Joe Boxer, Mossimo, Ocean Pacific, Sharper Image, Starter and Peanuts. We are conscious of the dangers of increasing the Portfolio's consumer retail exposure at this point in the economic cycle; however, Iconix's royalty-based model reduces operating leverage and the company has a diverse customer base including Walmart, Target, Kohl's, and Kmart/Sears. The free cash flow yield at purchase was 15%.

The worst performing holdings in Q2 were ManTech (ticker: MANT), Bill Barrett (ticker: BBG), and Securitas (ticker: SECUB SS). ManTech's stock dropped as the company reduced its 2012 outlook, which had been set only two months earlier. Uncertainty over defense spending has taken a toll on the shares of ManTech and other contractors. We think the shares are already pricing in a scenario of lower defense funding under sequestration. The stock trades at less than 5x the operating income we expect this year, and the trailing free cash flow yield is 25%. Furthermore, the company recently announced the renewal of its largest contract and this provides enhanced visibility. Historically most of ManTech's cash flow has been used for acquisitions, but we have urged management to repurchase stock at current low levels.

Bill Barrett has the dubious distinction of back-to-back appearances on the Portfolio's quarterly decliners list. The combination of increased usage of natural gas for power generation, less new drilling, and a record heat wave has spurred a rebound in gas prices, which are almost back to the level they started the year. In contrast, oil and natural gas liquids pricing has been weak lately, and investors

seem to have suddenly discovered Bill Barrett's liquids exposure. The firm's aggressive capital spending plan, designed to transition its mix toward oil, may have also given investors pause. We think the stock remains attractive but recognize that commodities can be volatile in the short run.

Securitas, the security services provider, has performed relatively poorly since it was added to the portfolio last year. Fortunately, it has paid a 5% dividend yield and we were able to add to the holding when the stock was most stressed last summer. The company's European exposure hasn't helped perceptions. Securitas derives approximately one third of operating income from basic guarding services in Europe and another fifth of EBIT from higher margin mobile and monitoring services in the Nordic region. Management has been slow to pass through wage inflation in certain countries. Nevertheless, once Securitas halts its recent margin contraction, we think investors will once again appreciate the defensive qualities of the security business.

In addition to Iconix Brand Group, other Portfolio purchases during the second quarter were FTI Consulting (ticker: FCN), Patterson-UTI Energy (ticker: PTEN), and Newfield Exploration (ticker: NFX). This is our second time owning FTI, which provides consulting services for corporate restructurings, forensic accounting, antitrust cases, high-profile PR campaigns, and offers e-discovery software services to the legal industry. The company has performed very well when the economy is at positive and negative extremes. In the current muddle along environment, results have been mediocre. We view FTI as a good hedge against a rapidly deteriorating economy.

On the other end of the spectrum, Patterson-UTI and Newfield Exploration are well-run businesses, but the stocks probably won't shine in a tough market. Patterson operates one of the largest fleets of land-based drilling rigs in the U.S. We originally bought the stock when oil prices cratered in 2008 and drilling activity fell, and we sold as energy prices recovered. This time around, Patterson's shares began sinking as natural gas rig activity fell, even though overall rig counts are higher due to robust oil drilling. The majority of the company's rigs can be used for either commodity, and utilization has remained solid. The share price already appears to reflect a steep drop in utilization similar to what occurred during the last recession. Even if this happens, Patterson has a healthy balance sheet and is trading at a discount to tangible book value and our estimate of asset value.

Newfield Exploration is a larger, less leveraged, and more oily version of Bill Barrett. Over 80% of the company's revenue comes from liquids. The stock has dropped from a peak of $76 last spring to below $30 in the second quarter. The primary short-term risk to this name is that a weaker economy sends oil prices down more. We think the shares are telegraphing lower energy prices at an EV/EBITDAX multiple of less than 4x. The current negative sentiment for energy stocks gave us an opportunity to establish a starting position that we would consider expanding in the event of an economic shock.

During the quarter, we exited our positions in Core-Mark (ticker: CORE) and Oil-Dri (ticker: ODC). We also sold out of the majority of our CoreLogic (ticker: CLGX) stake. In all of these cases, the stocks reached valuation. Core-Mark is a major distributor to convenience stores and benefited from the mild weather conditions in the first quarter. Kitty litter producer Oil-Dri is a long-term sentimental holding, but given the Portfolio's growth over the last few years, Oil-Dri was too small to make a meaningful impact on future returns. CoreLogic has benefited from record low mortgage rates. While we are fond of the business, we are concerned that refinancing activity will dry up in the coming years and growth in purchase mortgage originations will not be sufficient to offset this volume shortfall.

If you expect smooth sailing and large market advances for the rest of 2012 and beyond, then this might not be the portfolio for you. On the other hand, if you want an investment manager focused on downside risk, who aims to maximize returns over the cycle and who invests only when strict valuation criteria are met, then Intrepid Capital may be a good fit. Our process is designed to capitalize on fear, volatility, and the inevitable investment bargains they generate. Thank you for your investment.

ALL CAP EQUITY PORTFOLIO

For the second quarter ending June 30, 2012, the Intrepid All Cap Equity Portfolio (the "Portfolio") returned -3.28%, net-of-fees. During the same period, The Standard & Poor's 500 Index ("S&P 500") and the Russell 3000 Index returned -2.75% and -3.15%, respectively. Year to date, the Portfolio has returned 5.40%, net-of-fees, while the S&P 500 Index and the Russell 3000 Index have returned 9.49% and 9.32%, respectively. Although the direction of the market was down compared to the first quarter, the Portfolio's gap between both comparative indices remained about the same, and while the second quarter did give the Portfolio an opportunity to become more invested, it was not enough to improve short-term relative performance.

As stated in the previous quarterly letter, we are concerned that corporate profit margins are near peak levels. Within the

S&P 500, margins remain high at 14.02% at the end of June. Over the past several months, the tone of economic releases in the U.S. has increased fears of a stalled recovery. Consumer demand is flagging, there is growing concern of a slowdown in China, and even U.S. manufacturing unexpectedly declined for the month of June - the first time in three years. There is an ominous tone, and in light of it, we have no confidence that many companies might, on average, be able to maintain such high profit margins. Although the market did sell off slightly in the period, it was not enough for us to feel that we were being adequately compensated for committing capital. We continue to maintain what we believe is a more defensive posture.

Although the sell-off during the quarter was broad, some securities were impacted much more negatively than others. Dell (ticker: DELL) most negatively impacted the Portfolio's performance in the quarter due to a poor quarterly earnings release in which the company missed analyst estimates for both revenues and earnings. The market's fear is twofold: the PC market is an inherently low-margin business and the demand for PCs is weakening. In light of that, the only way for Dell to gain market share is to lower its prices and therefore the margin it earns. At the present, about 65% of Dell's revenues are PC-related, and the company continues to expand into higher margin, enterprise offerings, such as servers/networking, storage, and services. This business is growing, having gone from about 24% of total revenue three years ago to about 30% of total revenues today. This shift is being fueled by the cash which Dell generates from its PC business, and it has a lot of cash on its balance sheet. At the end of the quarter, Dell's share price was $12.51. On a per share basis, Dell has $2.64 in net cash. In addition, it has instituted a dividend yielding 2.58% and trades at a very low multiple of 6.5 times fiscal 2013 earnings. While there is risk in Dell's strategy to shift to enterprise offerings, we believe that we are being more than adequately compensated for this risk.

A few stocks within the Portfolio were net gainers in the quarter. First among these was Cott Beverage (Ticker: COT). Cott, a soft drink company which produces private label soft drinks such as Sam's Choice for Wal-Mart, had a solid quarter with free cash flow generation that was higher than expected by analysts. With management's focus on share repurchases and debt reduction, the stock bucked the market trend during the quarter. We took the opportunity to reduce the Portfolio's position.

For the quarter, the Portfolio was a net purchaser, with cash balances moving down slightly throughout the quarter. Most of the activity involved adding to existing positions in which the discounts to our intrinsic value grew. In addition, the Portfolio added small positions in Amdocs (Ticker: DOX), a provider of cable and telecom billing services, as well as Iconix Brands (ticker: ICON), a licensor of retail clothing brands.

Finally, we close this letter with a look at the average level of discount to intrinsic value within the Portfolio. Each security we own has a discount to its intrinsic value which is based upon its market price and our calculated intrinsic values. At the end of the quarter, that average discount was 19%. The number has grown a bit over the second quarter, which is encouraging. However, it remains challenging to find many opportunities which we would consider cheap. We remain ready to deploy capital should more opportunities arise.

BALANCED PORTFOLIO

For the quarter ended June 30, 2012, the Intrepid Balanced Portfolio (the "Portfolio") declined 2.14%, net-of-fees. This brings the Portfolio's year-to-date performance to a gain of 4.16%, net-of-fees, and 4.16% over the trailing year. This year-over-year performance looks reasonable when compared to the gains of 5.45% for the S&P 500 Index and 1.09% for a group of our peers (US OE Moderate Allocation – Morningstar). Given our bond allocation and relatively high cash balance, we would not expect to outpace an upwardly biased equity market, although it is satisfying to outperform one's peers in such an environment.

At one point in the second quarter, the equity markets nearly regurgitated all of the double-digit returns recorded through the first quarter, as the market strained to maintain lofty valuations, and U.S. growth and employment figures have continued to underwhelm. The increased volatility provided us the opportunity to put more money to work than at any point since the period surrounding the U.S. debt downgrade last August and September. This is in sharp contrast to the first quarter of 2012 when equity market volatility was almost nonexistent. Stretched valuations left us sitting on our hands as prices moved away and our cash reserves climbed. In contrast, we deployed cash throughout the second quarter as the market offered selective bargains. At quarter-end, cash represented 6.7% of the Portfolio's assets. One of our primary responsibilities at Intrepid is to aim to deliver what Mark Twain once described as his investment philosophy: "I am more concerned about return of my investment, than return on my investment." Preserving your hard-earned capital is our priority, but our goal is to use careful, thoughtful analysis as we seek to achieve both the return of and a return on your investment.

For the second quarter, the top five contributors to the Portfolio's performance were Cott Corp. (ticker: COT), CSG Systems (ticker: CSGS), Royal Gold (ticker: RGLD), CoreLogic (ticker: CLGX), and Travelers Companies (ticker: TRV). Our largest detractors for the same period were ManTech International (ticker: MANT), Dell (ticker: DELL), Bill Barrett (ticker: BBG), Securitas (ticker: SECUB SS), and Pan American Silver (ticker: PAAS). Commentary on several of these holdings can be reviewed in the Small Cap and All Cap Equity letters.

HIGH YIELD PORTFOLIO

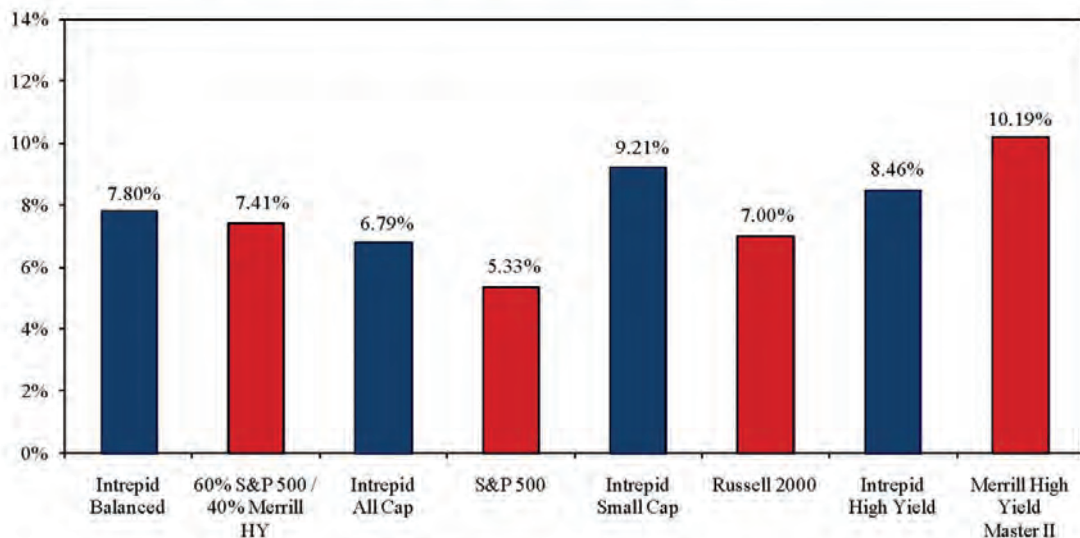
The high-yield market continued to charge higher in the second quarter of 2012 as investors piled into the asset class. Record low government and investment-grade bond yields have forced fixed income investors to accept lower credit quality in return for higher *potential* returns. The Intrepid High Yield Portfolio (the "Portfolio") returned 0.97%, net of fees, in the quarter ended June 30, 2012, while the Bank of America / Merrill Lynch High Yield Master II Index gained 1.83% in the same period. Our relative underperformance is due to our continued conservative positioning with regard to both credit quality and interest rate risk. As has been the case since the Portfolio's inception, our primary holdings tend to be of higher credit quality and shorter duration, and we believe this posturing is prudent when assessing the available opportunities. The Portfolio's cash cash balance also contributed to the underperformance.

We added to several of our existing holdings in the second quarter, the largest of which were FTI Consulting 7.750% due 10/01/2016 and Energy Partners 8.250% due 2/15/2018, but new position activity was limited. We established a position in one new fixed income security, Pantry 7.750% due 2/15/14. Pantry is a regional convenience store operator in the southeastern United States, primarily utilizing the *Kangaroo* banner. The company has a considerable debt load but is actively reducing the burden through free cash flow generation. Additionally, Pantry owns approximately one-quarter of its stores, which provides some asset coverage if the business were to deteriorate. We believe the 7.5%+ yield offered by the notes is attractive for a short-duration credit.

On the sales side, Levi Strauss 8.875% due 4/01/2016 was called by the issuer. We also exited a portion of our Central Garden 8.250% due 3/01/2018, which we feel has become riskier over the last several quarters. Central Garden has performed more poorly than expected, which combined with several irregularities and inconsistencies (unexplained margin compression, hidden gain from doubtful accounts, and an apparent change in attitude toward leverage) led us to feel less comfortable with holding a full position.

The largest contributors to the Portfolio's performance in the second quarter were Pep Boys 7.500% due 12/15/2014, Collective Brands 8.250% due 8/01/2013, and Gibraltar Industries 8.000% due 12/01/2015. Energy Partners 8.250% due 2/15/2018 and Central Garden and Pet 8.250% due 3/01/2018 were the largest detractors, but were largely immaterial to the Portfolio's overall performance.

In the prior quarterly update, we stated that some holdings would likely be called in the summer. Several of our portfolio companies have since announced the redemption of our notes, including HSN Inc and Mobile Mini. While we continue to discover interesting situations, the current opportunity set is rather limited. As such, we expect our cash to increase from the current level of 6.6%. Our cash balance will fluctuate in proportion to the opportunities available and is not an attempt to time the market. Higher cash levels, combined with our shorter-duration credits, should keep the Portfolio's duration low for the foreseeable future. Thank you for your investment.


Intrepid Capital Management
Trailing 10-Year Annualized Performance
June 30, 2002 to June 30, 2012
14%
12%
10%
8%
6%
4%
2%
0%
7.80%
7.41%
6.79%
5.33%
9.21%
7.00%
8.46%
10.19%
Intrepid Balanced
60% S&P 500 / 40% Merrill HY
Intrepid All Cap
S&P 500
Intrepid Small Cap
Russell 2000
Intrepid High Yield
Merrill High Yield Master II
* Past performance is no guarantee of future results. Intrepid composite returns are presented net of investment advisory fees for the 10-year period ending June 30, 2012. 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.