Intrepid Capital MANAGEMENT INC.

the constant pursuit of value

3Q'13 7/1/13 – 9/30/13

DOW JONES	2.12%
S&P 500	5.24%
NASDAQ	11.19%
RUSSELL 2000	10.21%

QUARTERLY MARKET LETTER | September 2013

Dear Friends & Clients,

The old adage "buy low, sell high" sounds simple, even easy, to implement. The simplicity departs when emotional biases are included in the investment process. Some "investors" employ highly speculative strategies that rely little if at all on business value. These practitioners could be accused of buying high in the hopes of selling to a "greater fool," or perhaps playing a game of musical (financial) chairs. But when the music stops, or the Fed stops printing money, hope will not be enough to secure a chair to sit in.

We at Intrepid Capital believe that our first charge is to do no harm, by carefully assessing the risk of an equity or debt position prior to its inclusion in the Intrepid Balanced Portfolio (the "Portfolio). Not to be a curmudgeon, but we feel that prices are high for the asset classes where we can add value over time. These generally include smaller capitalization U.S. equities, coupled with low duration U.S. corporate debt.

"It was the best of times, it was the worst of times…"
— Charles Dickens
A Tale of Two Cities

As we have just crossed the five-year anniversary of the Lehman Brothers bankruptcy and the financial panic that ensued, we thought it would be good time to reflect. This time five years ago there were many companies trading for less than our conservative estimates of business value, investment grade corporate bonds were offering double digit yields, and investors were so scared they were actually paying the U.S. Treasury to hold their money in T-Bills.

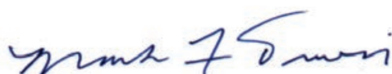
Today, very little is available in the equity or credit markets that meets our strict standards of underwriting on an absolute basis. I say absolute because we have never felt compelled to be fully invested or, to use an analogy, to buy the best house in a bad neighborhood by making a purchase because it was attractive relative to some index. At Intrepid Capital, each investment must stand on its own, with the potential for generating enough future cash flow to support its current price. As of September 30, 2013, small-cap stocks, as measured by the Russell 2000 Index, trade at 20x operating income, and the high-yield bonds, as measured by the BA ML High Yield Master II Index, yield close to 6%. We do not believe these prices offer compelling risk/reward opportunities, which is the reason the Portfolio ended the quarter with allocations of 46% equity, 20% debt, and 33% cash.

The Portfolio returned 5.08%, net-of-fees, in the quarter ended September 30, 2013, besting the return of the blended benchmark (60% S&P 500/40% BA ML High Yield Master II) of 4.06%. The top contributors to the quarter's performance were Bill Barrett (ticker: BBG), Securitas (ticker: SECUB SS), and FTI Consulting (ticker: FCN). All three constituted larger positions and produced double-digit returns in the period. In contrast, the Fund's largest detractors were Newmont Mining (ticker: NEM), The Pantry (ticker: PTRY), and Coach Inc (ticker: COH). Each security impacted the Portfolio's performance by less than 10 basis points. For the one-, three- and five-year periods ending September 30, 2013, the Portfolio's annualized returns were 10.53%, 10.46%, and 10.24%, net-of-fees, respectively. This compares to the blended benchmark's returns of 14.36%, 13.34%, and 11.54%, respectively, over the same time periods.

Our investment process is almost naturally counter-cyclical: when prices are high we are selling or have sold, holding the cash proceeds until compelling value presents itself. When it does, we have the cash on hand to invest at attractive absolute valuations. One may ask, “What if this time is different?” which could imply our methods are antiquated (they aren’t) or maybe we need to change our process (we don’t). If these answers come as a surprise, please consider that we heard a similar refrain in 1999 and 2007. As difficult as it is for us and our investors to remain true to the process, the process didn’t change in the past, despite being as testing as today, and we think our investors are better off because of it. We seek to participate in up markets and attempt to protect capital in down markets. We have been through a period of low volatility and rising prices, and therefore the Portfolio’s activity has been somewhat muted. However, we have still had success in identifying undervalued securities on your behalf.

I would like to thank you as a shareholder for entrusting us with your hard earned capital.

Best regards,



Mark F. Travis
President and CEO

SMALL CAP PORTFOLIO – Commentary by Jayme Wiggins, Portfolio Manager

Mammas, don't let your babies grow up to be big caps. Small cap equities were the best performing major asset class in the third quarter and year-to-date period. The typical non-financial Russell 2000 company now trades for 40x free cash flow versus 20x for the standard large cap found in the S&P 500 Index. Nearly 30% of Russell members did not make money over the past twelve months, which is why most people only include companies with positive earnings when they cite a Russell P/E. Who needs profits when you can give your corporation a name to tell investors what your stock is supposed to do? Take three aptly-named 2013 IPOs—Rocket Fuel, Gogo, and Xoom—which are up an average of 62% from their offering price through the end of the third quarter. Undoubtedly, small cap investing is the Wild West of the stock market today. There could be gold in them thar hills, but you might also find yourself shot in the gut at high noon outside of a dusty saloon.

In our opinion, stocks are broadly overvalued, and the small cap market is ground zero for the speculative excesses saturating the capital markets today. Bulls claim that smaller companies grow faster. Since 2000, the annualized growth rate of operating income for the Russell 2000 Index is 3.7%. For the S&P 500, it's 4.2%. Bulls say that small companies' higher domestic focus has to be a plus, since they argue the U.S. is the cleanest dirty shirt among the world's economies. Most of today's investors would rather borrow a shirt from Pig-Pen than visit the Laundromat. Our economy desperately needs a deep cleansing, to be purged of the albatross of debt and artificial influences of the government. Few seem willing to pay the short-term price. No one wants to sit out of the party while the good times roll, as the Fed DJs turn up the techno beat to max volume and shower the club with free liquid(ity) courage.

For the quarter ending September 30, 2013, the Intrepid Small Cap Portfolio (the "Portfolio") rose 4.22%, net-of-fees, compared to a 10.21% gain for the Russell 2000 Index. In the nine month year-to-date period, the Portfolio increased 8.26%, net-of-fees, versus a 27.69% rise in the Russell. Cash was 58.7% of Portfolio assets at the end of the quarter and was the primary reason for the Portfolio's underperformance in the three month period. High cash levels were also the largest contributor to the Portfolio's lower relative returns for the nine month period; however, the Portfolio's holdings also increased less than the Russell 2000 benchmark.

While the Portfolio is still positively correlated to the small cap market (0.56 for the trailing year), we are among the least correlated to the benchmark in our peer group. We believe this is due to our lack of sector weighting requirements and the type of companies we are purchasing (note that high cash doesn't reduce the correlation, just the volatility). Our businesses are often more mature and operationally stable than the average company you will find in the Russell 2000. Also, we like to find businesses that perform decently, sometimes even better, during economic downturns, and these firms usually aren't as levered to economic growth. Finally, our weighted average market capitalization is currently on the higher end of small caps, and in speculative market environments, the smaller, riskier names usually perform best. The S&P 500 was up 5.24% in the third quarter, which was about half of the Russell's return.

The positions contributing the most to the Portfolio's return in the third quarter were Ingram Micro (ticker: IM), Bill Barrett (ticker: BBG), and Securitas (ticker: SECUB SS). There were no losing positions that negatively impacted the Portfolio's return by more than 10 basis points. Technology distributor Ingram Micro announced decent second quarter results that belied negative industry trends in PC sales well-reported by the media. The company is making headway in lifting its margin profile by pursuing less-commoditized areas of distribution and services. The position was partially reduced as the stock's appreciation reduced the discount to fair value. Bill Barrett, the exploration and production firm, saw its stock rebound. The company's financial leverage has increased as the firm conducts an expensive transition from a natural gas-dominated portfolio to a more balanced oil and gas portfolio. However, management has promised an asset sale before year end to improve the balance sheet, and the company has also recently delivered positive drilling results in the promising Denver-Julesburg Basin. Lastly, Securitas delivered improved margins as a result of restructuring actions taken last year. Additionally, the delayed

implementation of the Affordable Care Act's employer mandate stretches out the timeframe for Securitas to address this increased cost with its customer base.

Tetra Tech (ticker: TTEK) was the Portfolio's only significant purchase in the third quarter. The company is the leading provider of consulting and engineering services for water-related projects for public and private clients. They help determine the best way to treat water, store it, convey it, and protect coastal cities and waterways. For example, the firm helped design a massive surge barrier to reduce the risk of another drastic flood in New Orleans. They are also the general contractor on the Fox River Cleanup, which is the largest sediment remediation project in the world. The company also offers infrastructure services, such as green building design, and consults for wind energy and related projects. Tetra Tech provides the brains, not the labor. The company stumbled this year after drops in metals prices impacted the approximately 15% of revenues from the mining industry. Additionally, certain Canadian provincial governments revealed corruption issues, which deferred the award of projects to companies like Tetra Tech. They have not been implicated in any malfeasance. After the company's guidance revisions, we used the weakness in Tetra Tech's share price to establish a position at a free cash flow yield exceeding 8%.

In the third quarter, the Portfolio sold Securitas, SAIC (ticker: SAI), and Pan American Silver (ticker: PAAS). Securitas, the global security provider, experienced more drama than we anticipated over our two year holding period, especially during the swoon in European stocks in 2011. We raised our stake after a large drop in price and then reduced it as the stock approached fair value. Along the way, we collected a sizeable dividend exceeding a 4% yield. The stock made money for the Portfolio, but we were surprised by the aggressiveness of price competition by major security providers for large guarding contracts. SAIC was a profitable short-term investment for the Portfolio. We articulated our thesis in this year's first quarter letter, and it played out as expected.

In mid-September, we sold Pan American Silver in order to capture a tax loss. We simultaneously replaced it with a temporary basket of three different precious metals names. We normally do not engage in tax loss transactions because we never know when our holdings will increase to our intrinsic value estimates. In this case, however, precious metals stocks generally move in tandem in the short run, and we believed we would maintain similar exposure with our temporary replacement set. This has proven true, almost to a tee, through the end of the month. We also made a small investment in Royal Gold (ticker: RGLD), a precious metals royalty company, in early July. The stock rose sharply before we could create a meaningful weight at our required discount. We sold Royal Gold at valuation for a quick gain that only had a limited impact on overall Portfolio performance (+35 basis points), due to the small position size.

Wall Street's culture of blind optimism has fueled a market rally to new highs. Contrarian stances haven't paid off so far. Leonardo da Vinci once said, "It is easier to resist at the beginning than at the end." Recent mutual fund inflows have been strong and hedge funds are abandoning short positions, in spite of record stock prices created by high margins on top of lofty valuations. We are finding scant value in the small cap market and firmly believe your precious capital should be preserved until better opportunities arise. As a result, we expect that our defensive positioning will continue until market conditions change. There is a time for everything. Now is the time for patience. Thank you for your investment.

DISCIPLINED VALUE PORTFOLIO – Commentary by Greg Estes, Portfolio Manager

"Remain calm…all is well!"

The first nine months of 2013 have been great for equity investors. With the Dow Jones Industrial Index up 17.6%, the Standard & Poor's 500 Index up 19.8%, and the Russell 3000 Index up 21.3%, all in just nine months, one might be excused for simply assuming that all is well in the U.S. economy. Indeed, Federal Reserve Chairman Ben Bernanke has been playing the role of *Animal House's* Chip Diller, shouting to market investors, "Remain calm, all is well!" And yet, the Fed has decided to forgo its earlier summer decision to taper its purchase of bonds on concerns of economic weakness. Corporate earnings growth has

largely come not from revenue growth, but from cost cutting and tax strategies. In our view, stock prices have pulled ahead of profits. The Shiller PE, which compares stock prices to the ten-year earnings average, stands at 24.25, which is more than 50% above the long-term median multiple of 15.89 times. In addition, Congress cannot agree on funding government spending, which in and of itself does not seem to bother markets. However, the likelihood that Congress will come to an agreement on raising the debt ceiling seems to be diminishing, and that might be a greater cause for worry among investors. All in all, we think that the market's level today is unwarranted given the earnings and uncertainty present.

For the quarter ended September 30, 2013, the Intrepid Disciplined Value Portfolio ("the Portfolio") returned 4.01%, net-of-fees, in comparison to the S&P 500's return of 5.24% and the Russell 3000's return of 6.35%. For the trailing twelve month period, the Portfolio returned 13.79%, net-of-fees, in comparison to the S&P 500's return of 19.34% and the Russell 3000's return of 21.60%. The Portfolio captured roughly 68% of the return of the Russell 3000 Index for the quarter and two-thirds of the same index's return for the trailing one year period. This has occurred in an environment in which cash levels for the Portfolio have steadily increased over the twelve month period. On September 30, 2012, the cash position was 24.8%. By September 30, 2013, the cash position was 55.8% – almost double what it was at the beginning of October 2012. We think this is an incredibly challenging period to find attractively priced businesses.

Given the increasing cash level in the Portfolio, it should come as no surprise that most of the activity in the quarter came from sales. We sold Western Union (ticker: WU), SAI Corp (ticker: SAIC) and Staples (ticker: SPLS) when they reached our intrinsic valuations. Dell (ticker: DELL) was sold just prior to the vote on the buyout offer, because we believed that, given the stock's price near the buyout level of $13.75 and the recent court ruling authoring the voter record date change, there was little likelihood for the deal to be voted down. We decided to exit the position with the possibility to repurchase should the deal not pass. However, that is all history as Michael Dell was successfully able to stack the vote in his favor and get it approved. The final two positions sold in the quarter were Pan American Silver (ticker: PAAS) and Tellabs (ticker: TLAB). We sold these to realize capital losses to offset some of the gains incurred through the year. We replaced our silver position with a basket of precious metals companies to maintain exposure within the Portfolio: Newmont Mining (ticker: NEM), Royal Gold (ticker: RGLD), Coeur Mining (ticker: CDE), and AuRico Gold (ticker: AUQ).

During the quarter, the Portfolio's worst performers were Pan American Silver, which, along with most other precious metals companies, has been punished by the market. Microsoft (ticker: MSFT) was another poor performer in the quarter. The stock began the quarter selling off on a weak quarterly earnings report led by poor sales of its Surface tablet. By mid-August, Microsoft appeared to recover when it was announced that Steve Ballmer would likely step down in twelve months as CEO. However, only two weeks later, its announcement of purchasing Nokia (ticker: NOK) for €5.44 billion (about $7.3 billion) removed any positive push to the stock. Perhaps Microsoft could look into how to better manage the dissemination of information to the markets. Finally, Northern Trust (ticker: NTRS) sold off after a weaker-than-expected quarterly report that saw higher expenses which in turn led to a reduced operating margin.

The three top performers in the quarter were Bill Barrett (ticker: BBG), Telephone & Data Systems (ticker: TDS), and Ingram Micro (ticker: IM). Bill Barrett benefitted from some price recovery in crude oil during the quarter. Ingram Micro exceeded market expectations when it announced earnings in late July, which propelled the stock. In the case of Telephone and Data, we believe that the stock price moved less so because of the quarterly announcement than due to speculation once again of acquisition of certain pieces of the business, if not of the entire company. This speculation comes on the heels of some other telecom mergers and acquisitions (M&A), namely T-Mobile's purchase of MetroPCS and AT&T's proposed acquisition of Leap.

At the close of the quarter, the average discount within the Portfolio was 15%. Because we estimate our own internal values for each stock within the Portfolio, we can compare those values with their corresponding stock prices to calculate the discount for each position. Citing the average discount then gives you some idea of the level of discounts prevalent within the Portfolio. Today's average discount is rather low. When it is viewed in light of current cash levels, it indicates both that the general level of stock prices is high and that cheaply priced investment opportunities are becoming scarce.

Despite the dearth of value opportunities, we will not stop searching for value. We continue to hunt for quality companies that might meet our requirements. In cases where the

companies are not cheap enough, we do not feel like we have wasted our time. We keep them in our figurative back pocket, knowing that someday, the market should give us an opportunity to buy them. We thank you for your confidence in our investment approach.

HIGH YIELD PORTFOLIO – Commentary by Jason Lazarus and Ben Franklin, Co-Portfolio Managers

After struggling in the spring, the high-yield market, as measured by the Bank of America Merrill Lynch High Yield Master II Index ("the Index"), roared back and posted a 2.25% return in the quarter ended September 30, 2013. The High Yield Portfolio (the "Portfolio") returned 1.53%, net-of-fees, in the same period. The underperformance is primarily attributable to our elevated cash position, which averaged 45% in the quarter. In addition, our portfolio's holdings are generally more defensive and have higher credit qualities than the average high-yield bond, in our opinion. While these bonds typically have lower than average yields, we believe we are giving up small incremental returns for a dramatic reduction in risk. This posturing is directly related to historically low corporate bond yields and the absence of attractive opportunities.

As we have stated time and time again, when we cannot uncover securities that are attractive on an *absolute* basis, we will hold cash. We emphasize the word *absolute* because a prevalent argument for increasing exposure to high-yield bonds is that the asset class is *relatively* attractive. But relative to what? Surely a 6% prospective return is attractive relative to the measly 1.4% offered by a 5-year U.S. Treasury bond. It also seems attractive relative to investment grade corporate bonds, which currently have a yield-to-worst of 3.4% as measured by the Bank of America Merrill Lynch US Corporate Index. But shouldn't investors betting on relative bargains ensure the reference securities (Treasuries or investment grade bonds) are not overvalued in the first place? This consideration seems to be missing from the relativists' argument. The relative value argument is further weakened when considering default rates. Bond yields are predicated on a successful return of principal at or before maturity. The stated yield would only be realized if there are zero defaults and all coupon payments are reinvested at the same yield. However, a number of high-yield bonds default every year, and in many cases not all of the principal value is recovered. While default rates are currently low, a pick up could materially impact the actual return realized by high-yield investors. For these reasons, we have elected to upgrade the quality of the portfolio's holdings, as well as hold cash when an attractive security cannot be identified.

The largest contributors the Portfolio's performance in the quarter were EPL 8.250% due 2/15/2018, Ruby Tuesday 7.625% due 5/15/2020, and ManTech 7.250% due 4/15/2018. All three securities constitute larger weights in the portfolio, and each outperformed the benchmark in the quarter. The contributions of EPL (ticker: EPL) and Ruby Tuesday (ticker: RT) were aided by opportunistic purchases made as the high-yield market sold off in June. The Portfolio had no detractors.

As a result of the rebound in high-yield bond prices, the Portfolio's activity was relatively muted in the quarter. We added incrementally to a few positions, and established a material holding in only one new credit idea. Four of our holdings were called partially or in their entirety, two of which constituted large positions in the portfolio: Bill Barrett 9.875% due 7/15/2016, and Bio-Rad Labs 8.000% due 9/15/2016.

The Intrepid process of seeking absolute value frequently leads our portfolio managers and analysts to scour beaten-up industries in search of the proverbial diamond in the rough. Over the last few years we have found several ideas in the energy industry, where we cherry-picked the securities we believed offered the most attractive potential returns for the risks taken. In recent months, the precious metals industry has been fertile ground for our search, including miners and service providers. After completing deeper research on several potentials, we uncovered AuRico Gold (ticker: AUQ), a Canadian-based gold miner. AuRico has a small convertible bond issue paying a 3.5% coupon and maturing on 10/01/2016, which we were able to purchase near the end of the quarter. The Portfolio's flexible investment mandate allowed us to venture outside of the traditional high-yield universe to seek attractive opportunities.

AuRico has gold mines in Ontario, Canada, and Sonora, Mexico. Over the past few years, the company has drastically reorganized the business. Additionally, much of the company's value is dependent on the success of an upcoming project. Combined with significantly lower gold prices, these issues have weighed heavily on AuRico's stock. Since the bonds have a convertible feature, the market determines the bond's value in part based on the stock price. In the past year, the bonds have declined from over 110 to below 95. At prices below 95, the notes offer a yield of approximately 5.5%, and the issuer has no

call protection. We believe this is attractive when considering what we believe to be significant asset coverage that minimizes the potential for credit impairment. Note that this view excludes any potential upside from higher gold prices. Essentially, we believe we are being given a free option on higher precious metals prices.

The second idea we would like to highlight is PHI Incorporated (ticker: PHII). We have been slowly accumulating PHI's 8.625% notes due 10/15/2018 since late 2012, and did not want to discuss it in our letters before we reached the target position size. PHI provides helicopter transportation services to the oil and gas industry in the Gulf of Mexico and to the medical industry in various U.S. markets. Investing in an energy services company when energy prices are high is typically a risky proposition, but we believe PHI's business is more immune to the cyclicality of the industry. PHI's business is not highly dependent on exploration like a drilling contractor is. Sales are driven by production levels, which are much more stable. Additionally, nearly all of PHI's oil and gas sales are contract-based. The company receives a fixed fee on half of this amount, regardless of the number of flight hours. Further bolstering the credit quality is what we consider to be substantial asset protection. PHI owns 210 helicopters that we believe are worth $690 million. A liquid secondary market for helicopters exists, and we believe PHI could easily unload excess fleet if necessary.

We recently came across a mountaineering book by legendary American climber Ed Viesturs entitled "No Shortcuts to the Top." While we expected the book to be a quick pleasure read, we found many parallels between climbing and investing, particularly on the subjects of herd behavior, patience and risk management. We would like to share Ed's view on risk but urge you to read the book to more fully appreciate his accomplishments. We hope you find the connection between safe mountaineering and investing practices as interesting as we do.

Ed Viesturs has taken an activity most would think is incredibly risky, climbing the world's highest peaks, and made it seemingly pedestrian and routine. Ed's view on risk is encapsulated in his saying that, "Getting to the top is optional; Getting down is mandatory." In following this motto throughout his career, Ed has at times forced himself to turn back down a mountain only several hundred feet from the summit. Think for a moment about the sunk costs involved in making such a decision. He and his climbing partners have spent tens of thousands of dollars and travelled halfway around the world. They have spent weeks acclimatizing to the high altitudes in order to prepare their bodies for a summit attempt. In some cases, they may have been waiting for days at a high elevation base camp with limited resources, waiting for the weather to clear before leaving for the summit. We appreciate the patience it takes just to reach the point where a summit bid can even be considered. After all of this preparation, Viesturs has exercised extreme risk control and abandoned summit attempts on several occasions. On one trip, Viesturs elected to turn around only 300 feet from the peak of 29,029 foot Mount Everest.

The parallels to investing are obvious, particularly to the absolute value strategy we employ here at Intrepid. We will continue to remain disciplined in our search for undervalued securities. Thank you for your investment.

RISK ADJUSTED RETURNS

TRAILING 10 YEAR RISK/RETURN

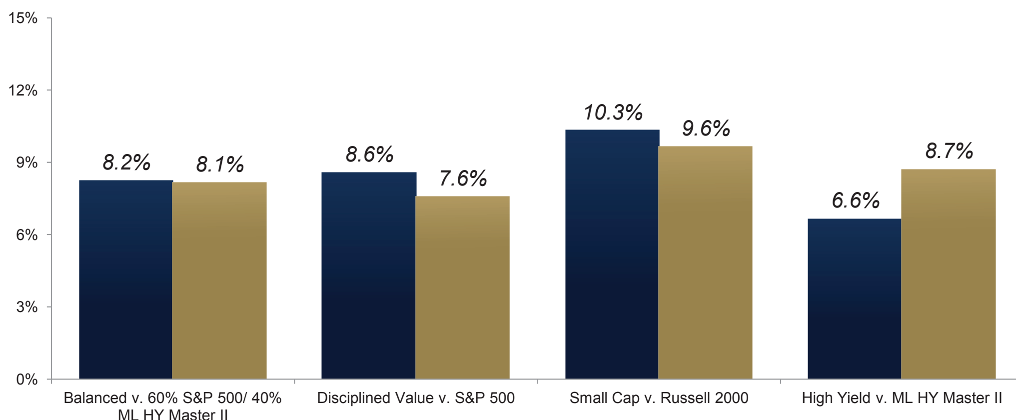
SEPTEMBER 30, 2003 TO SEPTEMBER 30, 2013

* Past performance is no guarantee of future results. Intrepid composite returns are presented net of investment advisory fees and all returns are presented annualized for the 10-year period ending September 30, 2013. Returns reflect the reinvestment of dividends and other earnings. The volatility of the listed benchmarks may differ materially 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. Risk is the annualized monthly standard deviation.

ANNUALIZED PERFORMANCE

TRAILING 10 YEAR RETURN

SEPTEMBER 30, 2003 TO SEPTEMBER 30, 2013



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