Intrepid Capital MANAGEMENT INC.

3Q 2016

Index Returns	
7/1/2016 to 9/30/2016	
Dow Jones:	2.78%
S&P 500:	3.85%
NASDAQ:	10.02%
Russell 2000:	9.05%
MSCI EAFE:	6.43%

QUARTERLY COMMENTARY

October 2016

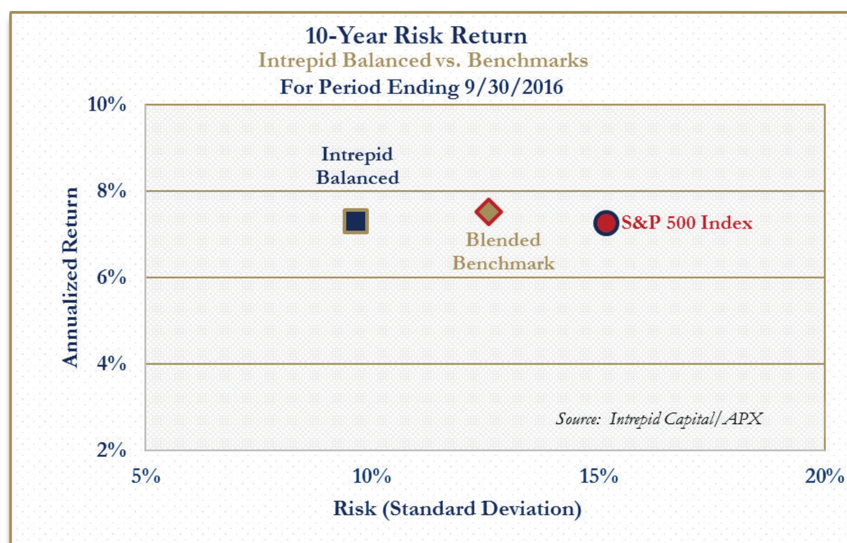
"Look for the ridiculous in everything, and you will find it."

— Jules Renard

Dear Friends and Clients,

We are pleased to announce the Intrepid Balanced Portfolio (the "Portfolio"), ended the third quarter of 2016 with an increase of 3.91%, net-of-fees, compared to 3.85% for the S&P 500 Index, a capitalization weighted index of larger U.S. companies, and 4.51% for the Blended Benchmark (60% S&P 500/40% BAML HY Master II), which consists of stocks and bonds. As an outsider looking in, one might review the close proximity of outcomes and suspect a "closet indexer," but in our case, nothing could be further from the truth. It's just pure coincidence. The Portfolio is designed to seek attractive risk-adjusted returns over time by holding stocks, bonds, and cash. As of September 30, 2016, the Portfolio consisted of 49.6% equities, 28.4% bonds, and 22.0% cash.

We find it interesting that by *going our own way,* our balanced portfolio has out-performed the higher-risk, all-equities S&P 500 with a return of 7.27%, net-of-fees, compared to the index's return of 7.24% with significantly less volatility, for the ten-year period ended September 30, 2016. The Blended Benchmark barely outperformed the Portfolio over the same time period, with a 7.51% increase, but did so with more volatility than the Portfolio.



As has been the case for several years now, we find ourselves confronting high equity prices, both here and abroad. On a trailing 12-month basis, the S&P 500 is trading at a Price-to-Earnings (P/E) ratio of 24.5. Some might say, "well, that is an 'earnings yield' of ~4%, which is competitive with the 10 Year US Treasury at 1.60%." However, investors can replicate that "yield" in the U.S. bond market with a superior claim to that of an equity investor, so we see little additional return potential to compensate for the higher risk inherent in stocks.

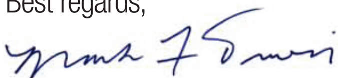
As the lead pilot of Intrepid Capital, like those at Delta, American, United, and Southwest, I think after 7 ½ years of a bull market, it would be prudent to review safety features that we believe are important to address before the advent of the next bear market.

1. **Consider holding some cash.** In over thirty years in the industry, I can count on one hand, with some fingers left over, how many investors I have met who were truly comfortable and committed to a 100% stock portfolio. If you wouldn't be able to sleep at night knowing you owned a cashless portfolio, or worse, not be able to watch your savings decline 30-50%, I would consider cash or a ladder of treasuries equal to a multiplier of six months to two years of your monthly expenses.
2. **Expand the scope of your equity investments.** At Intrepid Capital, looking across the globe in developed markets for companies with equity market capitalization north of $250 million gives us approximately 15,000 possibilities. U.S. stocks represent approximately 30% of the total value of global markets. Consider that the results of the market cap-weighted S&P 500 are essentially dominated by the share price performance of the largest 100 U.S.-based companies.
3. **Consider the position sizes in your portfolio.** Hopefully, the position sizes are neither too small (0.0010%) nor too large (10%). In the aftermath of the last two major bear markets (2000-2002 and 2008-2009), most investors have opted for what we call "di-worsification" with very diluted and diffused equity holdings. We encourage the "Goldilocks" (Just Right) mix of 2.5% to 4.0% positions at cost, resulting in a portfolio of 25-40 individual holdings. This results in a more intimate understanding of each holding, allowing quick deployment from cash reserves (see #1) if prices become disconnected from long-term value.
4. **Be prepared to hang on.** Rome wasn't built in a day, and the next bear market may not be over quickly either. Please keep in mind that turning over a portfolio regularly, like many tend to do, leads to high frictional costs in the form of commissions, bid/ask spreads, and for holdings held less than a year, higher taxes.
5. **Hold shorter maturity/duration bonds.** Don't reach into longer-maturity bonds just to grab a few extra basis points of yield. We are concerned that global central bank rate suppression has turned many of the "savers" of yesterday into the "investors" of today. Starved and groping for income in all the wrong places, they are now invested in long-duration assets (bonds and stock) that are most susceptible to an increase in interest rates when that day comes.
6. **Focus on "absolute" positive returns.** When the market only goes up, as it has for the last several years, many think only of return and forget about the evil twin sister, risk, until it is too late. Don't get caught up in how your portfolio is performing relative to the market. Focusing only on looking good against a benchmark index may be good for a fund manager's job security, as he's unlikely to be fired for being down 18% when the market is down 20%, but it has little practical benefit for individual investors. You can't eat relative performance, particularly if it is negative!

So there you have it, a pre-flight checklist that could potentially help you survive the next bear market; oh, by the way, the life vest is under the seat!

Thank you for trusting us with your hard-earned capital. If there is anything we can do to serve you better, please don't hesitate to call us.

Best regards,



Mark F. Travis

President/CEO

SMALL CAP PORTFOLIO – COMMENTARY BY JAYME WIGGINS, CFA, CIO, PORTFOLIO MANAGER

Please fill in the blank to this Wikipedia description: *"Some of the ill effects that ______________ has on society include a reduction in the value of real money; an increase in prices (inflation) due to more money getting circulated in the economy; a decrease in the acceptability of paper money…"* Did you guess "Quantitative Easing"? Close, but no cigar. This is part of the entry for "counterfeit money"—the world's second oldest profession.

The maximum penalties for counterfeiting are 20 years in the U.S., a life sentence in Japan, and death in China. The U.S. Treasury estimates there is $70 million of counterfeit currency in circulation. Almost everyone agrees that counterfeiting is bad. It's harmful to all except the people who get away with it. If you knew that your neighbors remodeled their kitchen and bought a new Mercedes with currency that they forged in their basement, you'd be at least a little irked, right? We don't like the idea of people getting something for nothing. It's not the American way. But is that changing?

The Federal Reserve has printed over $3.5 trillion of new money in the name of QE. That's 50,000 times as much as criminals have forged. With these funds, they've purchased government bonds and agency securities, igniting a cascading reduction in risk premiums across all asset classes. Last week, Fed Chair Yellen said it would be good for Congress to think about allowing the Fed to buy stocks too. One month ago, Fed Vice Chairman Stanley Fischer discussed negative interest rates with Bloomberg: *"If you're a saver, they're very difficult to deal with and to accept, although they typically go along with quite decent equity prices."* Ken Rogoff, the Harvard professor and former chief economist for the IMF, argues in his new book that cash should be eliminated so central bankers have an even greater ability to implement extreme monetary policies. Rogoff writes about negative interest rates: *"If you are a saver, you will simply withdraw your funds, turning them into cash, rather than watch them shrink too rapidly...Take cash away, however, or make the cost of hoarding high enough, and central banks would be free to drive rates as deep into negative territory as they needed in a severe recession."* A lifetime of hard work and thrift could be stolen from you in an instant.

My teacher once told me that if I didn't have anything nice to say, don't say anything at all, but I didn't listen to her. You could collect more garbage by squeezing the heads of Ivy League finance professors than by trolling for trash in Rio's Guanabara Bay. Illegal counterfeiting is unanimously repugnant, but when it's performed by central bankers it's championed as a policy for the public good. It sure hasn't turned out that way. Easy money has created a windfall for a small slice of the population to the detriment of savers and many others. The worst consequences have not yet been felt but are coming one way or another. You cannot counterfeit your way to prosperity.

The Russell 2000 Index soared 9.05% in the third quarter, far outpacing gains in larger capitalization benchmarks. It also eclipsed the 1.68%, net-of-fees, gain for the Intrepid Small Cap Portfolio (the "Portfolio"). Cash ended the quarter at 79.5% of the Portfolio, which is an all-time high, despite purchasing new positions. Aggregate earnings for the Russell 2000 constituents are <u>negative</u> and haven't been this low since the recession. The "value" (used loosely) of household financial assets versus disposable income is above the last two stock market peaks and any point prior. Social benefits account for a larger share of income than ever before. Corporate debt has doubled since 2007. Household net worth is larger relative to GDP than at any point in recorded history, going back to 1945. Here's the U.S. economy in a nutshell: record high stock prices, record low interest rates, falling corporate earnings, growing corporate borrowings, and bifurcated incomes tied to government transfer payments on the one end and the over-financialized economy on the other.

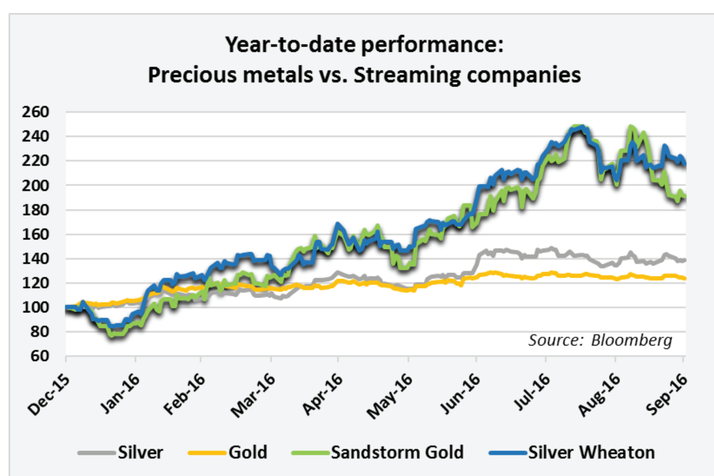
Over the past year, the convertible bonds of pawn operator EZCORP have been one of the Portfolio's top holdings. In an eerie parallel to the phenomenon where married couples start to look like each other, we've noticed that the Portfolio is being managed much like a pawn shop: we hold lots of cash, some gold, diamonds, and insurance. Intrepid Capital's investment process shares several similarities to pawn lending.

- Pawn shops only lend on a portion of the value of the collateral they receive, in order to protect themselves in case that value decreases.
  Intrepid always buys securities at a discount to our estimated fair value.
- Pawn lending is a stable business that often excels in tough times.
  Intrepid has historically outperformed its benchmarks during bear markets, and we favor businesses with less cyclicality.
- A pawn shop is a backdoor play on sound money. Gold jewelry comprises around two-thirds of collateral. Higher gold prices increase the value of pawn jewelry inventory and contribute to customers taking out larger loan balances.
  Intrepid believes central banker antics are propping up capital markets and will lead to adverse economic outcomes. We think investor exposure to precious metals makes sense.

Two positions cost the Portfolio more than 10 basis points over past three months: Corus Entertainment (ticker: CJR/B CN) and Dundee Corp. (ticker: DC/A CN). Corus finally experienced the positive inflection in advertising that we had long been expecting, with flat year-over-year ad results for its television networks and good growth in subscription revenue. However, advertising performance at the networks Corus recently acquired from Shaw Media were down about 13%. Shaw's advertising had held up well during the period when Corus was struggling. Perhaps it's a reversion to the mean. By the end of the fiscal quarter ending February 28, 2017, Corus will have had sufficient time to integrate the Shaw assets and should begin to realize benefits from its increased scale.

Dundee's shares fell after one of its large investment holdings, TauRx, announced disappointing Phase III trial results for its Alzheimer's disease drug. In the Portfolio's Q415 letter, we said we had no special insight into the likelihood of a favorable result, so were not including any upside to our valuation, but noted that the payoff was potentially huge. It appears that other investors were assigning a higher probability to a positive outcome than us. Dundee's management has taken a few positive steps to improve the firm's trajectory, like selling Dundee's unprofitable retail brokerage business. We think Dundee trades at a sizeable discount to Net Asset Value (NAV), but we are not committing new dollars to the name until management presents a clear path to offsetting cash burn.

The Portfolio's top gainers in the third quarter were EZCORP converts (CUSIP 302301AB2), Silver Wheaton (ticker: SLW), and Tetra Tech (ticker: TTEK). There was nothing striking about Tetra Tech's latest results; the company is growing modestly and generating solid cash flow. After bottoming in February at around 60 (18%+ yield), EZCORP's bonds ended September near par value (2.5% yield). The bonds moved higher due to improving fundamentals on the pawn side, where EZCORP is outperforming peers. More importantly, the company successfully sold its unprofitable Mexican payroll withholding subsidiary for a higher amount than investors expected. We have liquidated most of our position, as the investment no longer offers an equity-like return. The EZCORP dispositions accounted for most of the increase in the Portfolio's cash in the quarter, along with the closing of OSI Systems' purchase of American Science & Engineering.



Silver Wheaton's stock increased further in Q3 along with the rest of the precious metals space. Silver Wheaton and Sandstorm Gold's (SAND) stocks became overvalued relative to silver and gold prices, so we exited both positions (see chart to the left).[1] We hope to own them again. We like the streaming business model, but their stocks began to imply precious metals prices that were much higher than spot ranges. We transferred a portion of the sale proceeds from these investments into the iShares Gold Trust (ticker:

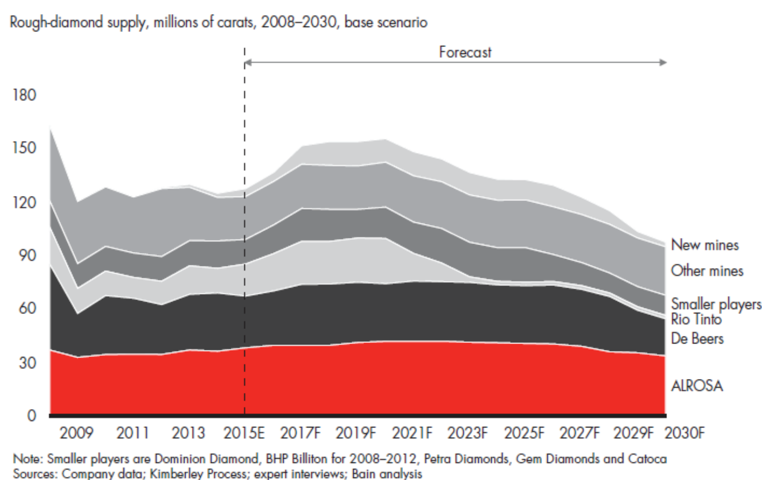
1 All starting values are harmonized to 100 for visual presentation of subsequent performance.

IAU), an ETF that is one of the most inexpensive ways to gain exposure to gold. It is also a much lower beta investment than Silver Wheaton and Sandstorm, which could prove useful if there is a temporary dip in precious metals prices.

We established a position in the convertible bonds of Primero Mining (CUSIP 74164WAB2), which mature on February 28, 2020. The yield at cost was over 11%. Primero is a gold miner and counterparty to both Silver Wheaton and Sandstorm Gold, so we were familiar with the company. In February, the Mexican tax authorities informed Primero that they sought to nullify the Advance Pricing Agreement (APA) established by the same authorities in 2012. The APA confirmed that Primero would pay taxes based on its realized silver price from its San Dimas Mine, which equaled a ~$4 per ounce streaming payment from Silver Wheaton rather than the higher, actual silver price. The Mexican tax authorities have changed their mind, so they want to reverse their prior decision and apply the change retroactively.

We do not believe Primero will be forced to pay back taxes, but we do anticipate they will pay higher taxes going forward. In our opinion, the San Dimas Mine can withstand the extra burden, as the cost structure should still be below prevailing gold prices. Primero issued equity in June, reducing the firm's Net Debt to below 1x anticipated EBITDA. Next year, the leverage multiple should decline further as the company moves past recent operating challenges. The yield offered on this small $75 million issue exceeds anything else we could find among gold and silver miners, yet we think the credit quality is solid. As with the iShares Gold Trust, we believe the price of this convertible bond will be less volatile than owning the equity of a streamer or gold mining company.

We purchased the stock of Dominion Diamond (ticker: DDC), which is the world's third largest diamond producer. The company owns interests in two mines in the Northwest Territories of Canada, one of the most politically stable mining jurisdictions in the world. Diamonds are not recession resistant and are tied to luxury spending and global GDP growth. Recent soft demand from China has contributed to weak prices. This may continue. However, a lack of investment into exploration has resulted in fewer development projects, creating favorable supply/demand fundamentals that should materialize in a few years as old mines are shuttered. Dominion's anticipated mix skews toward smaller stones that are desirable to growing middle classes in China and India, the second and third largest diamond consumers after the U.S.



Dominion's operating performance is expected to improve materially in the upcoming year, as the firm has transitioned toward higher-grade sections of its mines. The forward Enterprise Value to EBITDA multiple is 1.4x, the Price to Book ratio is 0.6x, and the dividend yield is 4.3%. Dominion's stock is valued at approximately half of the NAV multiple of comparable Canadian producers and has significantly underperformed peers over the past twelve months. The stock also appears inexpensive relative to Archon Minerals (ticker: ACS CN), a publicly traded firm whose only significant asset is a minority interest in a portion of one of Dominion's mines. Cash and diamond inventory account for 38% and 17%, respectively, of Dominion's market capitalization, which we believe provides downside protection. An activist shareholder is on the company's board, which may have influenced recent capital allocation decisions, including instituting a buyback and disposing of a highly valued office building in downtown Toronto.

While purchasing a diamond miner at this point in the global economic cycle may appear risky, we believe Dominion is undervalued based on the most likely long-term scenario for diamond prices. Unlike the fragmented oil industry, the top four producers control almost three quarters of global diamond production value and have demonstrated a willingness to restrain output in tough markets

like 2008-2009. Additionally, we think owning a diamond company offers an inflation hedge that is comparable to a gold miner, even if diamonds are not viewed as safe haven investments like the yellow metal. Since the stock market bottomed in 2009, rough diamond prices (+69%) have modestly outperformed gold prices (+43%). However, a basket of diamond producers has absolutely trounced the performance of gold mining stocks, with the former quintupling in price while gold miners fell over the period.[2] We think this is partly due to the more favorable industry structure for diamonds.

We forgot to mention one other similarity between Intrepid Capital and pawn shops—spotting fakes is crucial to survival. A pawn operator doesn't stay in business long if he pays $1,300 an ounce for tungsten coins with a gold veneer. Likewise, an investment manager won't add any value for clients if they dive headfirst into every mania and are never willing to adopt a countervailing view. There's growing agreement that Fed policy isn't helping the economy, but the game of musical chairs continues in the capital markets. Many investors will continue to calibrate their every decision to the utterances of pompous autocrats. We're going to rage against The Machine.

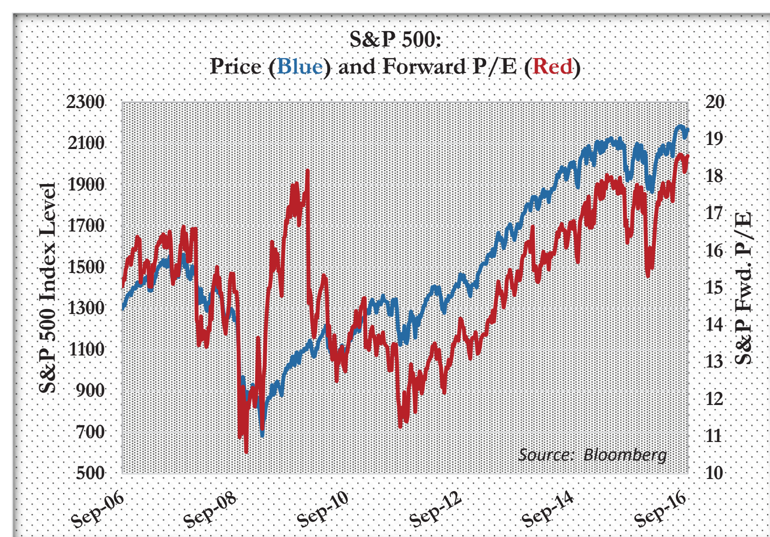
Thank you for your investment.

DISCIPLINED VALUE PORTFOLIO – COMMENTARY BY GREG ESTES, CFA, PORTFOLIO MANAGER

The market accelerated its run from the second quarter into the third, with the S&P 500 Index up 3.85% and the Russell 3000 Index up 4.40%. This compared to respective returns of 2.46% and 2.63% in Q2. The Intrepid Disciplined Value Portfolio ("the Portfolio"), which was a net seller in the quarter, trailed both indices in the most recent quarter with a return of 1.89%, net-of-fees (the Q2 return was 3.83%, net-of-fees). For the first nine months of 2016, the Portfolio returned 10.14%, net-of-fees, versus 7.84% for the S&P 500 and 8.18% for the Russell 3000. Considering the cash level in the Portfolio over that time, we believe that is a striking outperformance.

We have been steadfast in our view that equity markets are expensive. As we have written in previous letters, the median S&P 500 company is not growing earnings right now. In addition, according to Factset, S&P 500 earnings are not expected to grow in Q3 either.[3] In our view, the prospect of earnings growth is an important factor necessary to drive up the Price-to-Earnings Ratio (P/E ratio). Why would an investor pay more for a dollar in earnings unless that investor expected those earnings to grow in the future? With flat earnings, paying higher prices for the same dollar in earnings makes less sense.

Perhaps we can explain the market's behavior by looking at a slightly different metric. Consider the Forward P/E, which simply takes today's price level and divides it not by the previous year of earnings, but by the expected earnings for the coming year. This too has been ramping up. As a matter of fact, we can see that it has been on an upward trend since August 2011 with only a brief drop and recovery near the turn of this year.



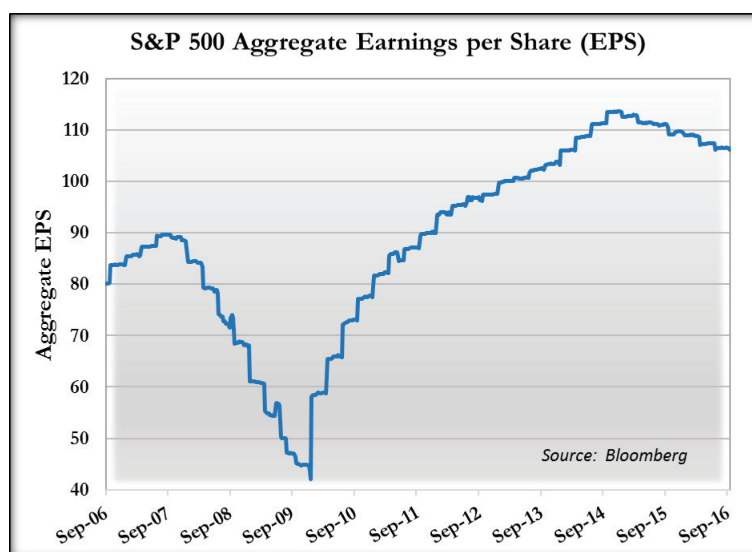
The chart to the left shows the S&P 500 level (in blue) over the past ten years along with the S&P 500's Forward Price-to-Earnings ratio (in red) on a weekly basis. The Forward P/E topped out at 18.59 times in August 2016 and ended September at 18.56 times expected earnings. Put in different terms, we could say that investors are willing to pay $18.56 for every $1 in earnings expected to be generated by the S&P 500 over the coming year. Has a future dollar

2 Equal-weighted diamond basket includes DDC CN, LUC CN, MPV CN, SWY CN, and PDL LN. Gold miners represented by GDX. The period referenced is from 3/9/2009 to 9/30/2016.

3 Butters, John. Factset Earnings Insight. 30 September 2016.

in earnings simply grown more valuable over time? Our answer is "No." The last time the forward P/E multiple was over 18, it was because the aggregate earnings per share for S&P 500 companies had declined to a 10-year low at the end of 2009. Have we seen a precipitous decline in aggregate earnings per share today? The answer, which we discuss below, is that aggregate earnings have only declined very modestly. By historical standards, we think that today's price for future earnings is rich.

The market, through the Wall St. analysts who estimate future earnings, is projecting a return to earnings growth beginning in Q4 2016. We think this is the rationale for the market's continued run in Q3. But let's take a walk back through the past ten years. Consider the chart below, which shows the aggregate Earnings per Share in the S&P 500 Index from Septembers 2006 through 2016. From the S&P earnings trough at the end of 2009 through the earnings peak at the end of 2014, the annualized earnings growth rate was 21.98% (an increase of about 270% cumulatively). Since the end of 2014, aggregate earnings per share in the S&P 500 have only declined 6.4% *cumulatively.* That is not much of an earnings decline. We think one of three things is happening here: 1) the past 1.75 years have been an extremely soft earnings recession and now S&P 500 companies will resume earnings growth, 2) weak earnings growth will take place, primarily because of an inflationary effect from extremely low interest rates, in which case the Forward P/E ratio is still too rich, or 3) the factors that have grown EPS from 2009 to 2014, such as tax minimization, stock buybacks, and wage reduction, continue to evaporate and leave aggregate earnings growth flat to down in the near future. We think (2) or (3) is more likely than (1) and we are positioned accordingly.



As we mentioned above, the performance for the Portfolio for the nine months of 2016 was 9.94%, net-of-fees. The Portfolio began the period with 48% cash and ended the period with 52.9% cash. So what explains the outperformance? The biggest factor was our exposure to precious metals. The top two performers were Silver Wheaton (ticker: SLW) and Alamos Gold (ticker: AGI). On a sector basis, our exposure to Materials was the top contributor, accounting for about a third of the overall performance in the period. You may recall that for 2015, the most return-detracting sector was Materials, represented solely by precious metal miners. We believed then that these miners were selling below their respective intrinsic values, even when accounting for weakening gold and silver prices through 2015. We were able to add to our positions incrementally that year. Of course, as spot prices increased in 2016, we have been trimming these positions and/or selling entirely, such as our exit from Silver Wheaton in the third quarter. On the flip side, we had relatively little in the way of performance detractors during the nine-month period. Oaktree (ticker: OAK), Northern Trust (ticker: NTRS) and American Science & Engineering (ticker: ASEI) accounted for less total detraction than the contribution from Silver Wheaton alone.

During Q3, the top three contributors were Western Digital (ticker: WDC), Teradata (ticker: TDC), and Silver Wheaton. We have already mentioned the benefit we saw from Silver Wheaton throughout the year. Last quarter, we wrote that we believed that WDC had the opportunity to reduce costs and realize synergies through its acquisition of SanDisk. During the quarter, management also upped its guidance on revenue. The market price for flash chips, which the company now manufactures via its SanDisk purchase, has firmed up as well, which is a net positive for the storage company. Teradata is a data analytics company that is shifting from a hardware-only model to one which includes a software-as-a-service version through platforms such as Amazon Web Services and Microsoft Azure. The interim CEO, Vic Lund, is pushing the company to focus its efforts towards offering its products in as many delivery modes as possible to gain more clients. It is challenging, given the relatively tight current

environment for client IT budgets. Given the medium-term timeline for the company to implement changes, we should expect volatility in this stock price given the short-term nature of investors.

The bottom three performance detractors for the quarter were Corus (ticker: CJR/B), Coach (ticker: COH), and Dundee (ticker: DC/A). For Dundee, several of the company's investments had bad news in the quarter. At the top of the list was its investment in TauRX, which has an Alzheimers drug in development which unfortunately had disappointing drug trial results. In addition, the company took a loss on a casino project and opted not to file a public offering on its organic farming business, Blue Goose. Corus posted stabilized but flat advertising revenues. We believe that, with an inflection point reached on advertising revenues, the stock price should benefit, but that has not happened yet. Finally, Coach has been posting growth in comparable store sales, and its new store concepts are performing well. However, Coach has been weaning itself from "juicing" revenue via steep discounting in an effort to protect its brand. It will also be reducing its presence in department stores by 25%, or almost 250 locations in fiscal 2017. This is all being done to protect that brand's reputation as an "aspirational luxury" brand. That brand perception is tough to maintain if a customer sees a full-priced bag in the Coach store selling for 40% off in a department store. Such a move can lead to lower revenue growth in the short-term, but we believe that it is the smart thing for Coach to do.

During the quarter, we exited three positions: Silver Wheaton, American Science & Engineering, and the EZCorp convertible bond. After an announcement in June, AS&E was acquired by OSI Systems (ticker: OSIS) on September 12th for $37 in cash. We deemed an equity investment in EZCorp (ticker: EZPW) too risky, so we had purchased the pawn operator's convertible bond back in Q3 2015. As with our investment in Silver Wheaton, the EZCorp bond price rose as the spot price of gold increased, so we exited the position.

The average discount to intrinsic value within the Portfolio was 21%. This is derived by taking each position within the portfolio and comparing its quarter-end price to our intrinsic valuation, and then finding the average of those 22 positions. The average discount increased from the previous quarter primarily because we exited positions that were selling for a premium to intrinsic value. Although the market is expensive, we continue to search for value. We thank you for investing alongside us.

INCOME PORTFOLIO – COMMENTARY BY JASON LAZARUS, CFA, PORTFOLIO MANAGER

> *A man occasionally reaches a fork in life's path. One road leads to doing something, to making an impact on his organization and his world. To being true to his values and vision, and standing with the other men who've helped build that vision. He will have to trust himself when all men doubt him, and as a reward, he will have the scorn of his professional circle heaped on his head. He will not be favored by his superiors, nor win the polite praise of his conformist peers. But maybe, just maybe, he has the chance to be right, and create something of lasting value that will transcend the consensus mediocrity inherent in any organization…*
>
> — Antonio Garcia Martinez, *"Chaos Monkeys: Obscene Fortune and Random Failure in Silicon Valley"*

After the minor Brexit scare at the end of June, risk assets continued to march upward. In fact, Brexit may have been the impetus needed to propel markets to even loftier levels. The event solidified the belief that central bankers were not about to take the punch bowl away, but instead might add more grain alcohol to the mix. Worldwide government bonds rates dropped to all-time lows in July. Approximately $12 trillion in global sovereign debt currently trades at negative yields. The U.S.

10-year Treasury yield touched a record low of 1.36% before rising back to 1.60% by the end of September. In response, fixed income investors piled into higher yielding securities. The Barclays Aggregate, which is a broad measure of the U.S. investment grade bond market, returned 0.46% in the quarter ended September 30, 2016.

Corporate bonds outperformed by a wide margin as investors were attracted to the credit spread. Investment grade corporate bonds gained 1.44%, as measured by the BofA ML US Corporate Master Index. The U.S. high-yield bond market, as measured by the BofA ML High Yield Master II Index (the "Index"), returned 5.49% in the third quarter. Year-to-date, this Index has risen a whopping 15.32%, making U.S. high-yield bonds one of the best performing asset classes in the world. Historically low interest rates, the stabilization of commodity prices, and the promise of central bankers to implement even more audacious monetary policy have been driving forces behind the asset class's spectacular performance this year.

The Intrepid Income Portfolio (the "Portfolio") returned 2.42%, net-of-fees, in the third quarter ended September 30, 2016, bringing the year-to-date return to 8.32%, net-of-fees. We believe this is a favorable outcome considering the defensiveness of the portfolio. As we have discussed in past letters, we have found it quite difficult to find attractive investments for the Portfolio. Therefore, we have maintained a bias toward high-yield bonds issued by companies we believe have better-than-average credit qualities. Furthermore, we have maintained dry powder in the form of cash and short-term investment grade bonds when we are unable to identify suitable investments. Short-term investment grade bonds averaged 20% of the Portfolio's assets in the third quarter, and cash averaged 27%.

For the second quarter in a row, EZCORP's 2.125% convertible bonds (EZPW) were by far the top contributor to the Portfolio's performance. The bonds were one of the Portfolio's largest holdings throughout most of the quarter, and we benefited as the bonds rose by more than 18%. The notes took another leg up late in September after the much anticipated sale of their Mexican unsecured loan business was completed. Our thesis has largely played out as the yield has compressed to less than 3% from a high of over 18% in February. We have taken the opportunity to reduce our position size meaningfully. Our large position in competing pawn operator Cash America (CSH) was also a top contributor. Cash America merged with First Cash, another pawn shop operator, and Cash America's 5.75% notes were redeemed at a large premium. Lastly, the Portfolio's position in Alamos Gold 7.75% notes due 4/1/2020 contributed meaningfully as gold prices continued to increase. There was one material detractor in the third quarter. Our position in the common stock of Corus Entertainment (CJR/B CN) detracted about 0.10% from the Portfolio.

With bond yields at historic lows, we have found it very difficult to identify attractive investment candidates. We typically seek higher-quality high-yield securities, so the BofA/ML BB US High Yield Index is somewhat illustrative of our opportunity set. At the end of the quarter, the yield-to-worst on this index was just 4.55%. We purchased one new high-yield bond in the third quarter, the notes of Nathan's Famous, Inc., owner of the iconic hot dog brand. While the company runs several branded restaurants, the vast majority of the firm's business is derived from royalties and franchise fees. In 2014, Nathan's entered into an attractive 18-year licensing program with Smithfield Foods, which provides the business with significant recurring revenue. We believe the notes may be overlooked by larger investors due to the small issue size, which allowed us to purchase the bonds at attractive yields.

The global search for yield has forced fixed income managers to seek out income in unconventional areas, including less-than-investment grade bonds and loans, securitized products, and dividend-paying equities. "Covenant-lite" securities have received attention recently. Traditional loan and bond contracts place restrictions on borrowers called covenants, which are designed to protect the lenders' investment. Common covenants include limitations on the amount of debt the firm can have, restrictions on how management deploys cash flow (potentially to the detriment of lenders), and limits on asset sales. Covenants provide a means to prevent actions that could impair the lenders' claim on the business and also open an avenue for lenders to force faltering borrowers to take action. How restrictive the terms of a new lending agreement are relies heavily on the receptiveness of the capital markets. When investors are fearful, lenders require more onerous covenants.

When investors are complacent, borrowers have the ability to dictate looser covenants. As the global search for yield has intensified, investors have increasingly turned to covenant-lite loans to pick up incremental yield. A recent Bloomberg article cites covenant research done by Moody's and Xtract Research. According to Moody's, over 75% of leveraged loans (the loan equivalent of a high-yield bond) completed in 2016 are covenant-lite, compared to 46% in 2013. Even more striking, Xtract Research found that just 35% of leveraged loans made in the first half of 2016 included maintenance ratios, which require the borrowers to maintain certain financial ratios or be in default of the loan. In 2010, all leveraged loans were subject to maintenance covenants.

Our intent is not to imply these loans are poor investments, but simply to put perspective on the current state of the fixed income markets. The demand for higher yielding securities is allowing borrowers to negotiate lower coupons and less restrictive covenants. As always, we will not force your portfolio into investments that do not offer an appropriate return for the risks borne. We will continue to work diligently to find attractive investments on your behalf, while maintaining the emotional discipline that forms the pillars of our investment process. Thank you for your investment.

INTERNATIONAL PORTFOLIO – COMMENTARY BY BEN FRANKLIN, CFA, PORTFOLIO MANAGER

Markets were up during the third quarter as the Brexit threat appeared to scare only central bankers. Meanwhile, the market is growing greedier the more fearful central bankers become. The Intrepid International Portfolio (the "Portfolio") kept up with the markets as it outperformed the MSCI EAFE Index (the "Index") during the quarter, 7.28%, net-of-fees, to 6.43%. We do not usually expect to outperform in short periods of strong market performance, so consider this unusual. One quarter is a condensed time period, and while we're always happy with positive returns, we believe the time period is too short to be accurately evaluated. In fact, most of the time commenting on quarterly performance is not productive in our opinion. We lead off with this because we want to give our clients full disclosure and understanding of our process. Our long-term results will be the result of our philosophy and process, which is where our focus lies. Thus, this commentary will primarily discuss what is going on under the hood to give our clients a better understanding of our thought process.

The strong increase in global markets lifted most securities in the Portfolio. Our three largest contributors were Clere AG (ticker: CAG GR), Stallergenes Greer (ticker: STAGR FP), and GUD Holdings (ticker: GUD AU). There were several detractors, including Coventry Group (ticker: CYG AU), Corus Entertainment (ticker: CJR/B CN), and Dundee Corp (ticker: DC/A CN).

Clere AG is the new name for the company that used to be called Balda, and we have discussed this security in more detail in previous commentaries. A large part of Clere's significant contribution to performance during the period is the outsized weight of the holding in the portfolio. With a weight of approximately 12%, the security is far above typical. However, the company is expected to pay a large dividend in October that will reduce the weighting by about one-third. This dividend will be treated as a return of capital, meaning there should not be any taxes. Furthermore, we believe the downside is limited considering the makeup of the security is almost entirely cash and short-term securities, which we are buying at a discount. In our opinion, this one is difficult to mess up. We prefer to invest in ideas where we understand the risks and do not have to be perfect with our analysis in order to make money. Once we find securities like this, we typically give them a larger weight in the portfolio, indicating it is one of our best ideas. A 2010 study showed that active managers' best ideas within a portfolio tend to outperform, and furthermore that these ideas "are most effective in illiquid and unpopular stocks.[4]" We tend to agree with this statement. And while this is not our most illiquid security, we do think we can add value by investing in less liquid parts of the market where large competitors may not be able to invest. This means we are more likely to be competing against smaller, less sophisticated investors. Flamboyant poker player (and playboy) Dan Bilzerian was once asked how good he is at poker: "It kind of depends on how you define poker. If you define poker as a sport like baseball for instance, then I'd be like… maybe a minor league or high school ball player. But you know, I play with tee-ballers." We certainly consider ourselves better than minor leaguers, but that's the matchup we're looking for and we think can occasionally exploit with less liquid securities.

4 Randolph B. Cohen, Christopher Polk, and Bernhard Silli. "Best Ideas." May 1, 2010

Stallergenes Greer's strong performance during the period could probably be attributed to the weakness in the stock price prior to this quarter. The company, a producer of allergen immunotherapy shots, tablets, and liquids, has been struggling due to a recent product recall. These problems caused the stock to be a material detractor in the second quarter. As the stock fell in value, we took a long-term approach. The recall significantly impaired earnings during the most recent allergy season, but we do not see this as a long-term problem as there is a lot of patient churn each allergy season. Stallergenes Greer's primary competitor, ALK-Abello (ALKB DC), confirmed this in a recent conference call: *"The market is a so-called fickle market which means actually that there will be a pause, you could say, during part of the year where patients will not take treatment when we talk about pollen products. And of course,* ***that is a moment where we had a risk to lose these patients again.*** *And of course, one-third of the market will be renewed every year. So, you could say that there will be a* ***complete wash of the entire market three years after this disruption."*** Taking this multi-year approach when evaluating the security is different than what we believe many other market participants are focused on. John Meynard Keynes was just as right 80 years ago as he is today when he said of investors, "Most of these persons are in fact largely concerned not with most superior long-term forecasts of the probable yield of an investment over its whole life, but with foreseeing changes in the *conventional basis of evaluation* a short time ahead of the general public. They are concerned not with what an investment is really worth to a man who buys it for keeps, but with what the market will evaluate it at under the influence of mass psychology three months or a year hence." We took this advice when we purchased additional shares in the security during the previous period's weakness, which led to outperformance this quarter. We believe the ultimate value of this security will not be recognized in the short-run.

GUD Holdings has been one of our favorite businesses since the inception of the Portfolio. While we typically are not a fan of acquisitions, the management team at GUD Holdings had a strategy that we were completely on board with. This strategy included purchasing a company in their Automotive segment at what we felt was a fair price. It is not often we feel acquisitions are completed without the acquirer overpaying. Furthermore, we have been long-term fans of their Automotive business, and felt that it was a diamond-in-the-rough. As they have grown this segment, the underlying value became clear to the market which bid up the security.

Our investment in Coventry Group, an Australian supplier of products and services to the industrial market, rests on the strength of its balance sheet. It is currently trading as a "net-net," meaning the market value is below the net current assets minus total liabilities. However, the company recently reported poor results. The company is beginning to burn cash again as they build out their trade distribution business in order to reach the scale needed to offset overhead. The cash burn was not expected, and we are currently re-evaluating this position.

Corus Entertainment and Dundee Corp have been discussed ad nauseam in prior quarters. The former is suffering from concerns over cord-cutting, while the latter continues to be whipsawed by a number of factors. You can find more detail on each in the commentary for the Small Cap Portfolio.

We would like to thank all of our current and prospective clients of the Portfolio. In Ayn Rand's Fountainhead, the protagonist architect Howard Roark states, "I don't intend to build in order to have clients; I intend to have clients in order to build." We take a similar approach – we are especially thankful to all of our clients who allow us to do work we enjoy doing each and every day. While this may sound like a backhanded compliment, in reality it is a sincere thank you which results in an optimal relationship. This method might be somewhat different from what you would get from a typical wealth manager that will change strategies in order to make the client happy. In contrast, we will not compromise the integrity of our approach due to outside (or inside) pressures. Our discipline is our pleasure, and we are grateful to each of you for letting us "build."

Thank you for your investment.

SELECT PORTFOLIO – COMMENTARY BY JAYME WIGGINS, CFA, CIO AND GREG ESTES, CFA, CO-PORTFOLIO MANAGERS

The Intrepid Select Portfolio (the "Portfolio") increased 5.94%, net-of-fees, in the third quarter compared to a 9.05% rise in the Russell 2000 Index. The S&P MidCap 400 Index gained 4.14% during the period. The Portfolio's year-to-date return of 24.61%, net-of-fees, compares favorably to the 11.46% increase in the Russell 2000. Cash ended the quarter at 19.5% of Portfolio assets, which is above our target of 10% or less. The primary reason for the jump in cash was our sale of most of our EZCORP convertible bond holding near the end of the quarter. The Portfolio's cash was also impacted by the September closing of OSI Systems' acquisition of American Science & Engineering, a Portfolio holding. Lastly, the Portfolio reduced its exposure to precious metals investments during the quarter. We will begin rebalancing the portfolio toward our 10% cash goal but would gently remind shareholders that the Portfolio owns not only equities but also unique securities, such as convertible bonds, which must be acquired with patience. Moreover, the small and mid cap markets are not exactly serving up much value. Despite extremely difficult circumstances for value investors like us who won't knowingly overpay, we were pleased to purchase a few new positions in the quarter that are discussed below.

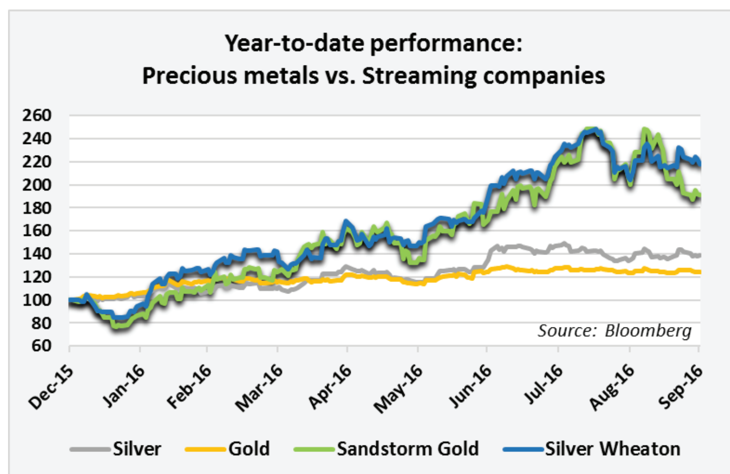
The Portfolio's three largest detractors in the quarter were Corus Entertainment (ticker: CJR/B CN), Dundee Corp. (ticker: DC/A CN), and put option positions on the iShares Russell 2000 ETF (ticker: IWM). Corus finally experienced the positive inflection in advertising that we had long been expecting, with flat year-over-year ad results for its television networks and good growth in subscription revenue. However, advertising performance at the networks Corus recently acquired from Shaw Media were down about 13%. Shaw's advertising had held up well during the period when Corus was struggling. Perhaps it's a reversion to the mean. By the end of the fiscal quarter ending February 28, 2017, Corus will have had sufficient time to integrate the Shaw assets and should begin to realize benefits from its increased scale.

Dundee's shares fell after one of its large investment holdings, TauRx, announced disappointing Phase III trial results for its Alzheimer's disease drug. In the Portfolio's Q415 letter, we said we had no special insight into the likelihood of a favorable result, so were not including any upside to our valuation, but noted that the payoff was potentially huge. It appears that other investors were assigning a higher probability to a positive outcome than us. Dundee's management has taken a few positive steps to improve the firm's trajectory, like selling Dundee's unprofitable retail brokerage business. We think Dundee trades at a sizeable discount to Net Asset Value (NAV), but we are not committing new dollars to the name until management presents a clear path to offsetting cash burn.

During August, the Portfolio purchased two deep out-of-the-money put option contracts on the Russell 2000 Index that cost about 1% of the Portfolio's assets. The strike prices on both were approximately 20% below the level of the Russell 2000 at the time of purchase. One contract expires in December 2016 and the other in January 2017. We are confident that the small cap market is overvalued but are unsure as to when conditions will normalize. The Portfolio was sitting on a sizeable year-to-date performance gain, making the cost of options more "affordable," and we thought it was worthwhile to build a small tail risk hedge into the portfolio that would pay off if the market fell sharply in the near-term. We believe the most likely outcome is that these puts will expire worthless. So far, they have declined in price as markets have climbed higher. Nonetheless, we think buying the puts was a good call, especially since options are historically cheap given low implied volatility.

The Portfolio's top gainers in the third quarter were Teradata (ticker: TDC), EZCORP converts (CUSIP 302301AB2), and Sandstorm Gold (ticker: SAND). Teradata is a data analytics company that is shifting from a hardware-only model to one which includes a software-as-a-service version through platforms such as Amazon Web Services and Microsoft Azure. The interim CEO, Vic Lund, is pushing the company to focus its efforts towards offering its products in as many delivery modes as possible to gain more clients. It is challenging, in light of the relatively tight current environment for client IT budgets. Given the medium-term timeline for the company to implement changes, combined with the short-term nature of investors, we should expect volatility in this stock.

After bottoming in February at around 60 (18%+ yield), EZCORP's bonds ended September near par value (2.5% yield). The bonds moved higher due to improving fundamentals on the pawn side, where EZCORP is outperforming peers. More importantly, the company successfully sold its unprofitable Mexican payroll withholding subsidiary for a higher amount than investors expected. We have liquidated most of our position, as the investment no longer offers an equity-like return.



Sandstorm Gold's stock increased further in Q3 along with the rest of the precious metals space. Sandstorm and Silver Wheaton's (ticker: SLW) stocks became overvalued relative to silver and gold prices, so we exited both positions (see chart to the left).[5] We hope to own them again. We like the streaming business model, but their stocks began to imply precious metals prices that were much higher than spot ranges. We transferred a portion of the sale proceeds from these investments into the iShares Gold Trust (ticker: IAU), an ETF that is one of the most inexpensive ways to gain exposure to gold. It is also a much lower beta investment than Sandstorm and Silver Wheaton, which could prove useful if there is a temporary dip in precious metals prices.

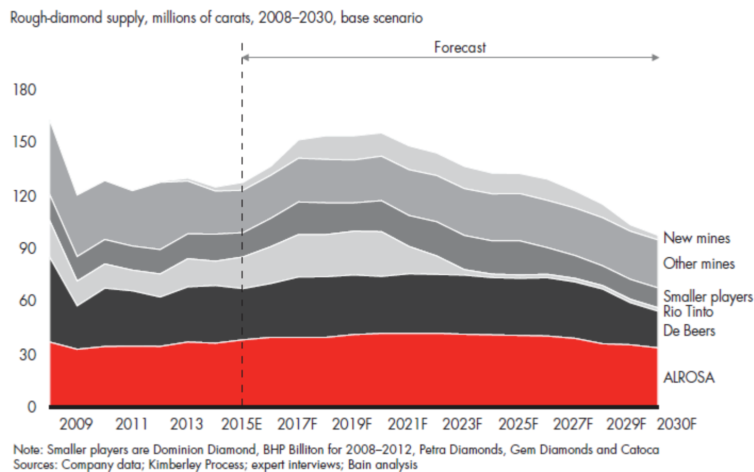
We established a position in the convertible bonds of Primero Mining (CUSIP 74164WAB2), which mature on February 28, 2020. The yield at cost was over 11%. Primero is a gold miner and counterparty to both Silver Wheaton and Sandstorm Gold, so we were familiar with the company. In February, the Mexican tax authorities informed Primero that they sought to nullify the Advance Pricing Agreement (APA) established by the same authorities in 2012. The APA confirmed that Primero would pay taxes based on its realized silver price from its San Dimas Mine, which equaled a ~$4 per ounce streaming payment from Silver Wheaton rather than the higher, actual silver price. The Mexican tax authorities have changed their mind, so they want to reverse their prior decision and apply the change retroactively.

We do not believe Primero will be forced to pay back taxes, but we do anticipate they will pay higher taxes going forward. In our opinion, the San Dimas Mine can withstand the extra burden, as the cost structure should still be below prevailing gold prices. Primero issued equity in June, reducing the firm's Net Debt to below 1x anticipated EBITDA. Next year, the leverage multiple should decline further as the company moves past recent operating challenges. The yield offered on this small $75 million issue exceeds anything else we could find among gold and silver miners, yet we think the credit quality is solid. As with the iShares Gold Trust, we believe the price of this convertible bond will be less volatile than owning the equity of a streamer or gold mining company.

We purchased the stock of Dominion Diamond (ticker: DDC), which is the world's third largest diamond producer. The company owns interests in two mines in the Northwest Territories of Canada, one of the most politically stable mining jurisdictions in the world. Diamonds are not recession resistant and are tied to luxury spending and global GDP growth. Recent soft demand from China has contributed to weak prices. This may continue. However, a lack of investment into exploration has resulted in fewer development projects, creating favorable supply/demand fundamentals that should materialize in a few years as old mines are shuttered. Dominion's anticipated mix skews toward smaller stones that are desirable to growing middle classes in China and India, the second and third largest diamond consumers after the U.S.

5 All starting values are harmonized to 100 for visual presentation of subsequent performance.

Dominion's operating performance is expected to improve materially in the upcoming year, as the firm has transitioned toward higher grade sections of its mines. The forward Enterprise Value to EBITDA multiple is 1.4x, the Price to Book ratio is 0.6x, and the dividend yield is 4.3%. Dominion's stock is valued at approximately half of the NAV multiple of comparable Canadian producers and has significantly underperformed peers over the past twelve months. The stock also appears inexpensive relative to Archon Minerals (ticker: ACS CN), a publicly traded firm whose only significant asset is a minority interest in a portion of one of Dominion's mines. Cash and diamond inventory account for 38% and 17%, respectively, of Dominion's market capitalization, which we believe provides downside protection. An activist shareholder is on the company's board, which may have influenced recent capital allocation decisions, including instituting a buyback and disposing of a highly valued office building in downtown Toronto.



While purchasing a diamond miner at this point in the global economic cycle may appear risky, we believe Dominion is undervalued based on the most likely long-term scenario for diamond prices. Unlike the fragmented oil industry, the top four producers control almost three quarters of global diamond production value and have demonstrated a willingness to restrain output in tough markets like 2008-2009. Additionally, we think owning a diamond company offers an inflation hedge that is comparable to a gold miner, even if diamonds are not viewed as safe haven investments like the yellow metal. Since the stock market bottomed in 2009, rough diamond prices (+69%) have modestly outperformed gold prices (+43%). However, a basket of diamond producers has absolutely trounced the performance of gold mining stocks, with the former quintupling in price while gold miners fell over the period.[6] We think this is partly due to the more favorable industry structure for diamonds. Thank you for your interest in our Portfolio.

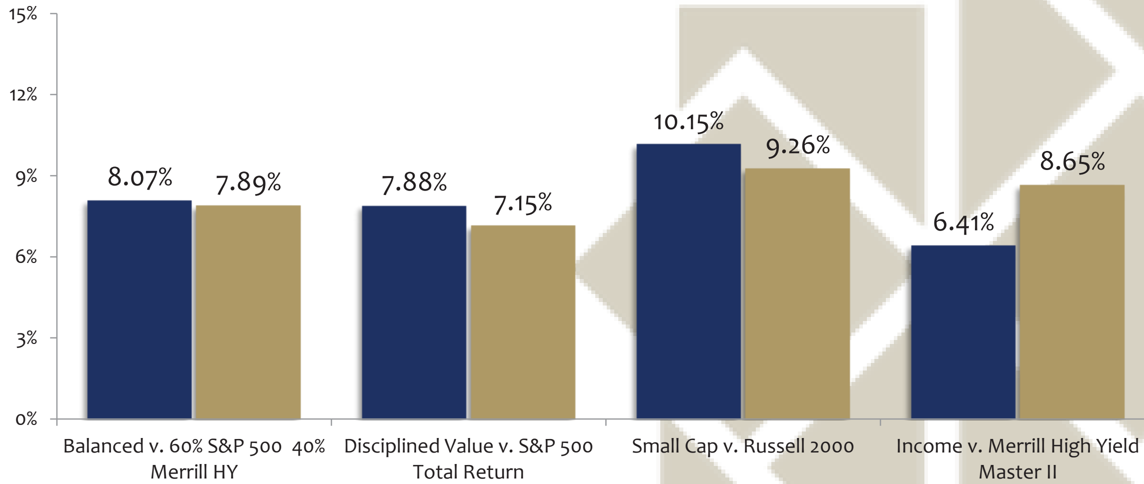
6 Equal-weighted diamond basket includes DDC CN, LUC CN, MPV CN, SWY CN, and PDL LN. Gold miners represented by GDX. The period referenced is from 3/9/2009 to 9/30/2016.

Annualized Performance

Intrepid Capital

Trailing 15 Year Annualized Performance

September 30, 2001 to September 30, 2016



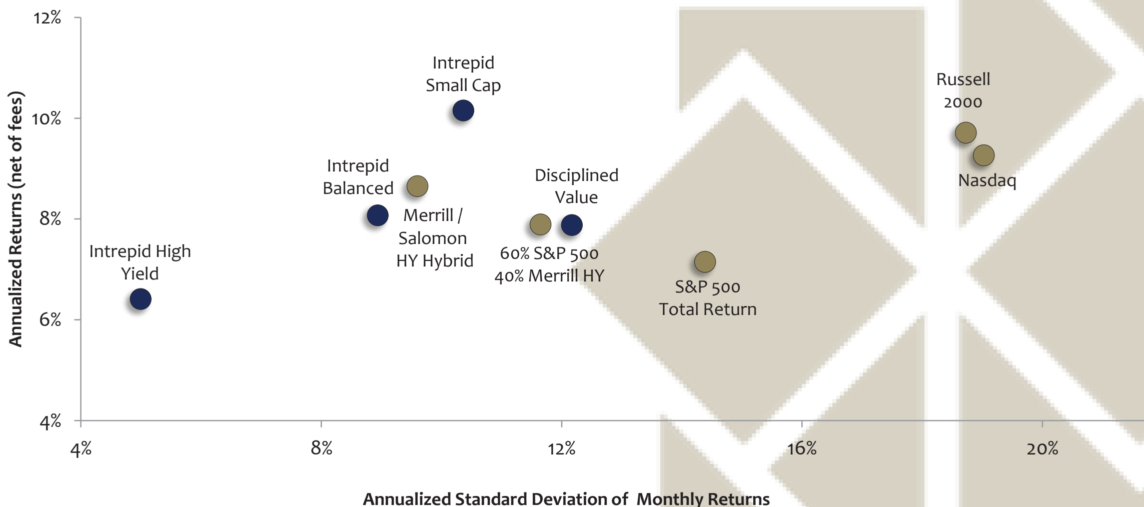
- Past performance is no guarantee of future results. Intrepid composite returns are presented net of investment advisory fees and all returns are presented annualized for the 15-year period ending September 30, 2016. Returns reflect the reinvestment of dividends and other earnings. The volatility of 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 Adjusted Returns

Intrepid Capital

Trailing 15 Year risk/return

September 30, 2001 to September 30, 2016



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