Intrepid Capital
MANAGEMENT INC.

the constant pursuit of value

4Q'13 10/1/13–12/31/13

DOW JONES	10.22%
S&P 500	10.51%
NASDAQ	18.67%
RUSSELL 2000	8.72%

QUARTERLY MARKET LETTER | December 2013

Dear Friends & Clients,

The equity markets rose strongly in the quarter ended December 31, 2013, with returns ranging from 8-11%, or roughly equal to the long term annual average of the market. The Intrepid Balanced Portfolio (the "Portfolio") participated, returning, net-of-fees, 4.27% for the quarter and 15.17% for the calendar year, but not at the rapid rate of the equity indexes. We know this may be redundant to some of you, but in our professional opinion, prices of stocks and bonds are high. Unfortunately, we find ourselves in an environment where consideration of potential risks is given little thought. As is often said about the weather, stick around this will change. When volatility is low and the water is calm, a portfolio manager needs to be even more vigilant in detecting dangers lurking below the surface. Speaking of below the surface, who knew we had great white sharks near the shore of Florida's First Coast in the winter time? For the surfers at Intrepid, this is certainly a new risk to consider!

> "If your outflows exceed your inflows, your upkeep will be your downfall."
> — Dennis Ng

Back to the topic at hand. We know it may frustrate some of you that we are not "keeping up" in this environment of artificially supported financial markets, courtesy of the Federal Reserve. With the exception of extremely oversold market environments, such as March of 2009, we would not expect our performance to match the equity indexes. This presents us with an opportune time to reiterate our process. All Intrepid portfolios pursue absolute return strategies. This means that we will not deploy capital into overvalued securities just because they may look "cheap" relative to the alternatives. **We will only purchase a security that we deem to be undervalued when viewed on its own merits.** In the absence of such a security, we default to cash. We maintain a very strict sell discipline across our portfolios, exiting positions when securities meet our estimates of intrinsic value. Our criteria for purchases are equally disciplined. In times when markets have been rising quickly (now), this strategy frequently results in the sale of shares during a time when replacement ideas are scarce, leading to higher cash balances. The resultant conservative posturing often leads to short-term underperformance when markets continue to rally. However, we firmly believe risk aversion is paramount in the current environment, and we will continue to manage the Portfolio with this in mind. We would not be performing our fiduciary duty to you by forcing capital into overvalued securities. As we patiently wait for a period ripe with investment bargains, we are diligently adding to our "shopping list" and are prepared to deploy capital when opportunities present themselves.

Looking ahead to 2014, I see several obstacles that could potentially introduce some volatility to the markets and/or derail the economy. As a business owner, I want to bring your attention to the issues I see in the Affordable Care Act. Healthy males 25 – 35 years old are very unlikely to participate in the new mandated Gold, Silver and Bronze health plans. These offerings are very expensive relative to what had previously been available and what consumers have been willing to purchase. The Affordable Care Act needs about three million of these "young invincibles" to sign up in order to subsidize the bigger consumers of healthcare; citizens 55 years and older. We are asking these "young invincibles" earning $25,000 to $35,000 a year to pay around $5,000 annually for a plan with a $2,000 deductible. I, for one, don't see this happening. To add insult to injury, the law also mandates that the 55 and older crowd can only be charged 3X what the younger group is charged. As an employer of 17 hard-working people, I suspect our health insurance renewal on August 1st will give me heartburn.

Reviewing the performance of individual securities, World Wrestling Entertainment (ticker: WWE), Bank of New York Mellon (ticker: BK), Global Payments (ticker: GPN), and The Pantry (ticker: PTRY) were the largest contributors to the Portfolio's performance in the fourth quarter. Big Lots (ticker: BIG), Newfield Exploration (ticker: NFX), and Western Union (ticker: WU) were our largest detractors in the fourth quarter.

Thank you for your continuing support and entrusting your hard earned capital to us.

Best regards,

Mark F. Travis
President/C.E.O.

SMALL CAP PORTFOLIO – Commentary by Jayme Wiggins, Portfolio Manager

At Intrepid Capital, we spend a significant portion of our working hours searching for investment ideas. Many in our industry refer to this activity as "making a shopping list." As we screen for small cap opportunities today, the results are sobering. We feel like we've visited the local, small town supermarket immediately before a Category 5 hurricane is about to hit. The prime merchandise—canned foods, bottled water, matches, etc.—is gone. You can still buy it through secondary channels for 2x or 3x markups to the original prices. The only things left on the supermarket shelves are damaged goods. They are expired, broken, or already opened. Such is the investment landscape today. Most small companies that we would classify as great, good, and mediocre are trading at much higher prices than they were only 12 short months ago. Some other firms are not, but many of these have serious, potentially chronic, issues.

The critical difference between our supermarket analogy and today's investment reality is obvious: People need food and water during a natural disaster, no matter the cost. No one is forcing investors to pay ever-higher prices to adorn their portfolios with small cap bling, although some would argue that Bazooka Joe Bernanke has blown a bubble too juicy to resist. According to Bloomberg, the aggregate net income of the Russell 2000 grew by 1% over the past year. Yet, small cap stocks surged 38.8% (Russell 2000 Index). Virtually all of the appreciation in small cap stocks came from multiple expansion. Multiples are a function of required returns and expected growth rates. Over the past year, there has not been any obvious change to the mainstream opinion on long-term economic growth rates. Therefore, essentially the entire increase in small cap stocks in 2013 can be attributed to a reduction in the discount rate, or return investors require for owning stocks. The typical Russell 2000 small cap is trading for 42x free cash flow today, implying a capitalization rate (discount rate – growth rate) of 2.4%. When the capitalization rate gets to 0%, stocks would be priced at infinity.

Our price targets are less than infinity. In fact, our typical capitalization rate is 7%, implying a 14.3x free cash flow multiple at valuation (1/.07). Since we require at least a 20% discount to our appraised value before purchasing, we have usually paid less than 12x normalized free cash flow for the businesses we own. You can currently find a couple hundred small caps trading for multiples within our target range. However, the vast majority of these are exhibiting free cash flows above levels that we deem normalized. Many are low quality or declining businesses that deserve to trade at low multiples, in our opinion. Others are generating strong cash flows because of record profit margins that we believe are not sustainable in a more controlled environment for household and government spending. Lastly, there are plenty of firms where high trailing free cash flows reflect the annual volatility of cash production compared to accounting earnings due to changes in working capital and capital spending. To be fair, there are also companies where cash flows are depressed for the same reason.

During the fourth quarter ending December 31, 2013, the Intrepid Small Cap Portfolio (the "Portfolio") rose 3.88%, net-of-fees, compared to an 8.72% gain in the Russell 2000 benchmark. For 2013, the Portfolio increased 12.46%, net-of-fees, versus 38.82% for the Russell Index. The principal contributing factor to the Portfolio's relative underperformance was our cash position. Cash ended Q4 at 67.6% of assets. Our equity holdings rose 35.2% during the year. We recognize that our cash position is unconventional, perhaps even shocking, in a fully invested world where most portfolio managers believe anything other than a single digits percentage of cash is high. Our substantial cash stake reflects our inability to find undervalued stocks in the middle of a frenzied small cap market. We do not hold positions once they cross above our fair value estimates.

We are often asked by shareholders, "Why don't you buy more of what you already own?" Theoretically, we could be fully invested today if we owned three times as much of each of our existing holdings. There are a few reasons why we don't manage the portfolio that way. First, we generally do not invest more than 5% of Portfolio assets in a single stock, given our keen focus on downside risk. There is nothing magical about this number. Many talented portfolio managers regularly take larger weights, and we also have in the past, on occasion. However, we aren't activist investors, so our ability to influence the direction of portfolio companies primarily comes from dialogue with management and how we vote our shares in annual proxies. Second, we do not believe in growing our exposure to a name as the discount to intrinsic value decreases. Most of our stocks are trading closer to our judgment of fair value than they were one year ago. It doesn't make sense to us to buy 50% more of a name trading at half of the discount it was a year ago, simply because we sold out of another name trading at full value. Lastly, we understand the value of having cash to deploy when stock prices correct. While we'd prefer to be invested in cheap stocks, we believe that our growing cash position appropriately reflects a small cap market that becomes more absurdly valued with each passing day. We did not purchase any new securities in the fourth quarter.

Over the past three months, we sold Epiq Systems (ticker: EPIQ) and Bill Barrett (ticker: BBG). Epiq is a provider of technology -based solutions for electronic discovery, bankruptcy, and class action settlements. We owned EPIQ for several years. A few years ago, the company was mainly tied to the bankruptcy cycle, with a long tail of business from major cases. Epiq also had a small, high-margin eDiscovery software business. Since 2011, the company has dramatically shifted its profile toward lower-margin eDiscovery services through two large acquisitions primarily funded with debt. The stock price jumped to multi-year highs on the company's recent strong organic revenue growth. Nevertheless, while Epiq is growing revenue, earnings have increased at a much lower rate. We liked Epiq better when we viewed it as a niche software provider with a countercyclical bent and a clean balance sheet. The business mix has become more commoditized and procyclical.

Bill Barrett, the oil and gas producer, was sold during the fourth quarter once the stock briefly touched our fair value estimate. Drilling results on new oil wells near Denver continue to be solid, which validates the attractiveness of the firm's Colorado acreage. Additionally, Bill Barrett announced a major asset sale that will help it deleverage to more reasonable levels. While our first time owning Bill Barrett was profitable, our second round was disappointing. We incurred a small loss during a period when the market made significant gains. At one point, we were down by almost half, but the stock recovered significantly. Some facets of investing in E&P companies are beyond our control. In Bill Barrett's case, natural gas liquids (NGL) prices fell substantially since our purchase, and the gas and oil futures curves also deteriorated. The company's debt-fueled spending to transition away from gas was more aggressive than we anticipated, partially because of weaker-than-expected commodity prices.

Newfield Exploration (ticker: NFX), Big Lots (ticker: BIG), and Telephone & Data Systems (ticker: TDS) were the largest detractors to the Portfolio's performance in the fourth quarter. We were surprised by the market's negative reaction to Newfield's updated 3 year production plan that was issued in early December. The stock had performed well after the company's third quarter earnings and asset sale announcement, but the long-term production guidance was treated harshly by the market, even though it was an immaterial shift from last year's plan. Close-out retailer Big Lots dropped after the firm announced another quarter of comparable store sales declines and projected ongoing pressure. Retailers have high operating leverage, and valuations are very sensitive to changes in the top line. We had sold over 40% of our BIG shares earlier in 2013 when the valuation gap closed. Big Lots' new CEO has a sensible plan to stabilize sales by focusing resources on better performing categories including furniture, seasonal merchandise, and consumables. Currently, the valuation multiple is undemanding and far below peers, and the company's owned real estate offers investors some protection. Telephone & Data Systems' stock languished as investors remain concerned with subscriber losses at U.S. Cellular and questionable capital allocation by management. The company hopes to stem churn by now selling iPhones and rolling out a 4G network. U.S. Cellular remains the 5th largest wireless operator and would likely be snapped up quickly by a larger player if the controlling Carlson family was willing to sell.

WWE (ticker: WWE) was by far the largest gainer in the fourth quarter, and its contribution to the Portfolio was twice as much as the combined impact of the next top two gainers, Global Payments (ticker: GPN) and Amdocs (ticker: DOX). Global Payments, the payments processor and merchant acquirer, saw its multiple expand closer to peers' levels as the company demonstrated stabilization in its key Canadian market and posted strong growth of higher margin direct merchant relationships. We sold more than half of our shares. Amdocs is a larger Portfolio holding and was up modestly more than the overall market. Management indicated they might be willing to allocate a greater percentage of cash flow to share repurchases.

WWE's stock appreciated rapidly in the fourth quarter and more than doubled in 2013. Investors have become increasingly confident that the company's earnings will reset at a higher level after WWE renews its domestic television agreements in the spring. A crucial element of our investment thesis is that WWE is paid below market rates for its longstanding *RAW* and *Smackdown* programs, which together deliver around $100 million in domestic rights fees (the company receives another ~$60 million from international fees and other shows). We have noted previously that NBC Universal could double the fees it pays WWE just from advertising revenues alone, without the network even dipping into its lucrative subscription fees that account for over half of revenue. Although we think that a materially higher value on the television renewal is likely, we recognize that there are a limited number of buyers for wrestling-based content. There are less than half a dozen networks that would be interested in WWE's product, which delivers high, reliable ratings 52 weeks per year. Still, we think there are enough interested parties to drive the contract's pricing closer to market value. Based on a 10x EBIT multiple and assuming no other adjustments to the company's expenses, we believe the shares are pricing in an increase in domestic rights fees of around 70%, or an increase in global rights fees of 40%.

The other pillar of our WWE investment thesis was that the company's proposed WWE network would not succeed, and management would ultimately eliminate the spending associated with the network project. We thought it was possible that the company would terminate the endeavor before fully committing to a launch. This now seems unlikely, as there have been indications that WWE will soon launch an "over-the-top" network. This would be delivered to customers like Netflix, so the potential subscriber base would be limited to households with Internet-connected devices who were willing to watch wrestling in this manner. Previously, the company indicated it was leaning toward a premium channel network like HBO, but it appears they couldn't get cable partners on board. Ironically, we believe management's conviction about garnering higher TV rights fees has made them willing to fund the speculative network project. We will admit that if the network is even modestly successful, it would help stabilize a gradual structural decline in the pay-per-view business. WWE's individual monthly pay-per-views cost over $50, which is pricing many fans out of the market. A network subscription would include almost all of these events plus other wrestling shows for a price closer to $10 per month. What they lose in pricing, they make up in more predictable volume. It's definitely a better business model, if they can sell it. In light of the run-up, WWE's stock is now more fully valued.

We are more than five years past the brunt of negative returns from the credit crisis. Firms can now report five year investment performance that only covers a bull market. Others may disagree, but we believe the performance of investment managers should be assessed over a complete cycle, which includes both bull and bear markets.

Many people who give professionals their savings to manage believe it's not a portfolio manager's job to "time the markets" by deviating from a fully invested status. These investors are unlikely to place money with us. Our view is different. We aren't trying to time the market; we are only trying to live up to the promise we made to clients that we would seek out and purchase <u>undervalued</u> small caps. From our perspective, companies aren't worth 38.8% more than they were this time last year. As a result, we have sold a lot and bought only a little. Nevertheless, the investment climate will not always be so favorable, and we believe we have something to offer in such environments. Therein lies Intrepid Capital's value proposition. Those who just want plain vanilla small cap market exposure should enlist one of many available robotic, low-cost options. However, if you believe in the merits of a consistent investment approach based on stock valuations that are not influenced by swings in market prices, then Intrepid Capital might be a good fit for you. Thank you.

DISCIPLINED VALUE PORTFOLIO – Commentary by Greg Estes, Portfolio Manager

They say a rising tide lifts all boats, and today's market seems to fit that saying rather well. 2013 has been a very good year to invest in stocks: the S&P 500 Index was up 32.39% for the year, and the Russell 3000 was up 33.55%. In the fourth quarter alone, the S&P 500 returned 10.51% and the Russell 3000 Index returned 10.10%. I invite our readers to think about that. Over a long-term period of fifty years, the Dow Jones Industrial Average and the S&P 500 have returned 9.97% and 9.81%, respectively, on an annual basis. The fourth quarter of 2013 alone provided more return than the long-term yearly average. Are such returns sustainable? We think not, but in the meantime, it has been and remains a challenging period for value investors.

For the period ending December 31, 2013, the Intrepid Disciplined Value Portfolio (the "Portfolio") returned 3.68%, net-of-fees, for the quarter, and 16.77%, net-of-fees, for the year. The Portfolio's performance trails also in trailing three- and five-year periods. Over the last three years, the Portfolio returned 8.79%, net-of-fees, annually, while the S&P 500 returned 16.18% and the Russell 3000 returned 16.24%. Over the last five years, the Portfolio returned 14.60%, net-of-fees, annually, while the S&P 500 returned 17.94% and the Russell 3000 returned 18.71%. Only when the bear market of 2008 is included does the picture change. For the six year period from the beginning of 2008 through the end of 2013, the Portfolio earned 7.73%, net-of-fees, annually versus the S&P 500's return of 2.16%% and the Russell 3000's return of 4.89% over the same period. The longer time period is illustrative of a full market cycle. All other time periods listed, the one-, three-, and five-year periods, only include a bull market. Prices continue to increase, and because we are very price sensitive, we are finding it extremely difficult not to find good businesses, but to find good businesses at what we consider good prices. The result is that the Portfolio's current cash level is near an all-time high at 63%. This is not something we desire, but we feel we are left with little choice at the moment. We believe we are acting in our investors' best interests by not committing capital to stocks that we perceive as being too rich.

One of the characteristics of the Portfolio is that it is contrarian. Oftentimes, when a stock sells off, it is due to some perception about a company's future earnings prospects being impaired. Because we seek to buy businesses at attractive prices, being contrarian is in the nature of what we do. A primary role for us as a team is to identify situations where we believe that the market has overreacted to a development and therefore oversold a good business. In the fourth quarter, we believe that we identified three such stocks: Crocs (ticker: CROX), LabCorp (ticker: LH), and Cisco Systems (ticker: CSCO).

Crocs is the maker and retailer of colorful clogs and lightweight shoes made from their proprietary Croslite material. The stock price had suffered due to questionable management and continuously disappointing shareholders with business underperformance. Early in the quarter, we felt that the beaten down stock price compensated us for the uncertainty in the business. As the quarter progressed, rumors of a potential buyout or strategic partnership began circulating. During the last week of the quarter, the rumors proved true. The company announced an investment by the private equity firm Blackstone, as well as their questionable CEO's retirement. As the uncertainty cleared, the stock price increased accordingly. We sold as the stock neared our estimate of intrinsic value.

LabCorp, one of the two largest independent medical lab providers in the U.S., has sold off due to concern over reduced reimbursement and lower utilization, which is to say that the number of lab tests went down as people are shifted into healthcare plans that require more out-of-pocket costs for patients. The reimbursement concern is due to a reduction in what Medicare and Medicaid will pay to lab providers. We think that, even assuming a lower level of reimbursement, the company's stock was oversold, and we were able to establish an initial position.

Finally, Cisco, which is the market leader in network switching and routing equipment, experienced a November sell-off caused by weak guidance in emerging markets of Asia. Because we take a longer view of a company's business cycle, we are less concerned about the next couple of quarters being below expectations. We believe we are able to buy a business that has a balance sheet loaded with cash and investments (more than $40 billion) and what we consider an attractive return on capital.

For the full year, the Portfolio's worst performers were our precious metal holdings: Pan America Silver (ticker: PAAS), Newmont Mining Corp (ticker: NEM), and Royal Gold (ticker: RGLD). Because market concern about inflation remains low, and investors' optimism about economic improvement remains high, precious metal stocks have suffered, and our holdings are no different in this respect. We continue to believe, however, that the market is underestimating the value of these companies.

In contrast to our bottom performers, our top performers for the year were World Wrestling Entertainment (ticker: WWE), whose stock price has rallied on optimism of a new TV rights deal; Bill Barrett Corp (ticker: BBG), which began the year near a multi-year low; and Bank of New York Mellon (ticker: BK), which has seen its billable Assets under Custody (AUC) grow due to the market's rise. This in turn has led to improved fees for the company, in addition to the prospect of our original investment thesis playing out: that increased interest rates will lead to higher net interest margin (this is the amount of net interest that a bank earns on its assets).

At the close of the quarter, the average discount within the Portfolio was 8%. Each stock's discount is found by comparing its stock price to our estimate of its corresponding intrinsic value. As the market rises, typically that average discount within the Portfolio shrinks, unless we can find replacement ideas that have greater discounts. This is where we must continue to scour the market. We are not satisfied with the number of attractive opportunities in the market today, but we continue to research companies, and when we feel we have an opportunity, we will purchase. When we feel we have a good business that is not at a discount, we add it to our watch list on the possibility that it may be cheap enough in the future to own. Today's market makes this process somewhat unrewarding for us, but it is necessary. As always, we truly appreciate your investment and wish you a prosperous 2014.

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

The quarter ending December 31, 2013 was marked by stronger economic numbers and an improved outlook, as evidenced by the Fed's decision to 'taper' its monthly asset purchases under QE from $85 billion to $75 billion. Risky asset classes concluded the year with solid fourth quarter performances, while securities with high interest rate exposure generally performed poorly as Treasury bond yields rose materially. High-yield bonds were not greatly impacted by higher Treasury rates because the asset class's duration is lower than other fixed income sectors, such as investment-grade corporates. Further, the impact was offset by spread compression as investors positively reassessed the credit risk of the asset class on the improved economic forecast. The additional compensation required by high-yield investors, known as the spread, reached the lowest level since 2007 as measured via the Bank of America Merrill Lynch Master II Index (the "High-Yield Index").

The High-Yield Index returned 3.50% in the fourth quarter. Investment grade corporate bonds, as measured by the Bank of America Merrill Lynch US Corporate Index (the "Corporate Index"), gained 1.02% in the quarter as spread tightening helped to offset the negative effect of higher risk-free rates. In contrast, the Barclays U.S. Aggregate, which generally reflects the performance of the entire domestic investment grade bond universe, declined 0.14%. U.S. Treasury securities did not fare well in the quarter, as the yield on the ten-year rose from 2.61% to 3.03%. To illustrate the impact of such a rate change, consider a ten-year Treasury bond issued on August 15, 2013. The security's semi-annual coupon payment is 1.25% of the face value, and this bond lost 3.21% in the fourth quarter alone. The Intrepid High Yield Portfolio (the "Portfolio") returned 1.03%, net-of-fees, in the quarter. In the full calendar year, the Portfolio gained 3.20%, net-of-fees. The High-Yield Index, Corporate Index, and Barclays US Aggregate returned 7.42%, -1.46%, and -2.02%, respectively, over the same period.

The Portfolio trailed the High-Yield Index in both the quarter and the year due to the high cash allocation and ownership of what we believe are higher quality (and therefore lower yielding) bonds. Cash averaged 31% of the Portfolio's assets in the quarter. As bond yields flirt with all-time lows, finding attractively priced fixed-income securities has become increasingly difficult. Additionally, many of our portfolio companies have repurchased their outstanding bonds in favor of issuing new, lower-cost securities. We are not forced to reinvest this cash into new ideas, and therefore the Portfolio's cash balance has remained high. However, as opportunities become available, we can quickly deploy capital into attractive ideas.

The top three contributors included two of our largest holdings, Northern Oil & Gas 8.000% due 6/01/2020 (ticker: NOG) and EPL Oil & Gas 8.250% due 2/15/2018 (ticker: EPL). Both securities outperformed the high-yield index. The last of the top three contributors was another energy credit, PetroQuest Energy 10.000% due 9/01/2017.

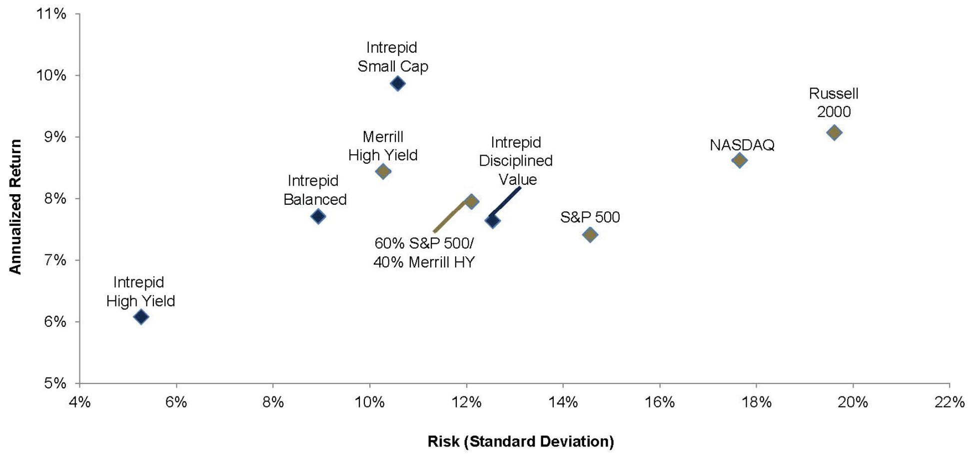
There was only one material detractor in the fourth quarter; Ruby Tuesday 7.625% due 5/15/2020 (ticker: RT). The company is struggling through a turnaround, which caused comparable store sales to fall a whopping 11% in the most recent quarter. The company cut advertising as it prepares to introduce menu new items. While the turnaround continues to weigh on earnings, we are satisfied with our holding due to significant asset coverage. The company owns the land and building on over 300 stores, and the building only on more than 250 additional stores. Further, RT has $36 million in cash and $23 million in properties for sale. Lastly, part of the turnaround strategy consists of spending roughly $50 million on television advertising, which we believe can be cut if the new strategy is not effective and redeployed back into the historically successful couponing strategy.

We put some cash to work in the fourth quarter as we entered one new position and added to several existing holdings. For the first time in quite a while, none of our holdings were called by the issuers, so the Portfolio's cash balance declined from 33% to 29%. It should be noted, however, that we expect call activity to increase early in 2014. As always, we are continuing to search for undervalued securities on your behalf. Thank you for your investment.

RISK ADJUSTED RETURNS

TRAILING 10 YEAR RISK/RETURN

DECEMBER 31, 2003 TO DECEMBER 31, 2013

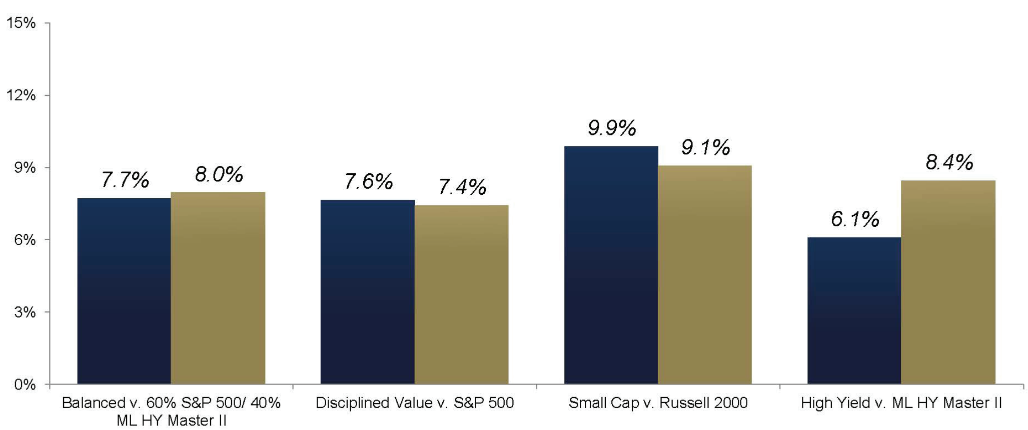


• Past performance is no guarantee of future results. Intrepid composite returns are presented net of investment advisory fees and all returns are presented annualized for the 10-year period ending December 31, 2013. Returns reflect the reinvestment of dividends and other earnings. The volatility of 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

DECEMBER 31, 2003 TO DECEMBER 31, 2013



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