Intrepid Capital
MANAGEMENT INC.

Index Returns	
7/1/2014 to 9/30/2014	
Dow Jones	1.87%
S&P 500	1.13%
NASDAQ	2.24%
Russell 2000	(7.36%)

PRESIDENT'S LETTER

October 2014

"A government which robs Peter to pay Paul can always depend on the support of Paul"

— George Bernard Shaw

Dear Friends and Clients,

I was recently asked to speak at a lunch to a group of largely retired businessmen, and my self-titled talk was "5 things I have learned in 20 years of running Intrepid Capital." I find it useful to reflect in the hope I won't have an unforced error twice! By recreating it here, I thought it would help clients to understand our investment process a little better.

Lesson #1: There is more than one way to investment heaven.

I don't believe we have cornered the market (no pun intended) on how portfolios should be managed. In fact, I believe there are many ways "to investment heaven," but most won't make it for lack of sticking with a consistent, disciplined process, whatever that may be. At Intrepid Capital, our goal is to participate on the upside (when the market ascends) and protect on the downside when "the wind is in our face" (when the market drops). We do this with a careful and strict underwriting process, carefully assessing business value and attempting to pay significantly less. Much to the dismay of many, a valued oriented process like ours will often underperform the market 30-40% of the time. The incremental outperformance over a full market cycle (Bull & Bear market), compounded over a long investment horizon (20 years), will lead to a substantial dollar difference in terminal value, if you stay with it.

Lesson #2: Price matters.

Said another way, "price is not always indicative of value." At Intrepid Capital, we believe that the price you pay today is the largest determinant of your investment outcome, whether for a stock, bond, real estate or a private business. We try to pay such a cheap price so that our outcome is asymmetrical. In other words, we want a lot more upside than downside when we establish a position.

Lesson #3: Fish in a deeper pond.

Most of the financial press and many, if not most, portfolio managers in this country follow quite closely the movement of the 100 largest equity securities by market capitalization. At Intrepid Capital, we search the globe for mispricings, leaving what we generally regard as efficiently priced large capitalization companies to others. In the U.S. today, there are roughly 343 companies with market capitalizations north of $15 billion, but almost 9,000 companies with market capitalizations less than $2.5 billion, hence "the deeper pond" where we generally prefer to fish. In addition, we continue to look outside of this country, with more and more eyeballs devoted to the task.

Lesson #4: Don't do something . . . Just sit there.

Frankly, I have been amazed over the last ten years at the speed in which money comes in and goes back out of mutual funds, often to the detriment of the underlying shareholders. Until 1975, stock brokerage commissions were a high cost that made frantic trading difficult and expensive. Up until that time, portfolio turnover averaged maybe 30%

per year, implying a slightly over 3 year holding period. Today, commissions are "free" and portfolio turnover is 100% or greater in some instances. Please keep in mind our "friends" at the I.R.S. charge almost 2X in taxes for capital gains on a profitable position held 364 days versus one held 366 days. The top marginal rate for short term capital gains is roughly 44% versus 23% for gains held over one year. Lastly, I have heard the no load fund business, at times of heightened volatility, referred to as 1-800-GET-ME-OUT! Unfortunately, many, if not most mutual fund shareholders "buy high, sell low." A study by Dalbar and Associates of Boston found that over the last 20 years the market averaged roughly 8%; the average mutual fund investor roughly 4%. This is largely the result of emotion-driven purchase and sale decisions. Recently, I was reading of the departure of Bill Gross as portfolio manager of the behemoth Pimco Total Return Fund. This bond fund over the last five years has averaged 5.6% return per year. Unfortunately, from poor timing decisions on the part of individual shareholders, they averaged closer to a 4% return. This was in a bond fund. In equity funds which are inherently more volatile, the outcomes have been even more negatively pronounced.

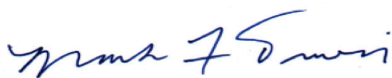
Lesson #5: Opportunities are the greatest when fear is the highest.

The last point is important to remember as we are now five and a half years into a bull market and the last three have been particularly benign as the Federal Reserve continues the "Morphine Drip" with a steady dose of interest rate suppression. As rates seek a higher level, either on their own or with the helping hands at the Federal Reserve, I would imagine that equity prices might reset lower rather quickly. The VIX, or Volatility Index, is a good indicator of fear in market participants. Our process is somewhat counter cyclic in that we tend to be fully invested when prices are absolutely cheap, and when prices are high, our cash levels tend to be also. Our job, when the fire bell rings and the VIX index spikes with rampant fear, is to come sliding down the fire pole, and wade into the market for mispriced securities!

Finally, I like the opening quote from George Bernard Shaw. Please remember that many have perished to give us the opportunity to vote. I will let you decide whether you are Peter or Paul, and please vote accordingly! Always remember freedom is not free!

Thank you for entrusting us with your capital, it is not a position we take lightly.

Best regards,



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