Intrepid Capital MANAGEMENT INC.

2Q 2018

Index Returns	
4/1/2018 to 6/30/2018	
Dow Jones:	1.26%
S&P 500:	3.43%
NASDAQ:	6.61%
Russell 2000:	7.75%
MSCI EAFE:	(1.24%)

QUARTERLY COMMENTARY

July 2018

"The quickest way to double your money is to fold it in half and put it in your back pocket."
— Will Rogers

Dear Friends and Clients,

One of the lessons I have learned in rehabilitating various parts of my body is that often the real problem is not at the site of the pain. Consider the pain generated in various financial markets around the globe. Argentina has seen its peso lose 36% of its value against the dollar so far this year. Italy, with the third highest government debt to GDP in the developed world, is in the midst of a political crisis that has crushed government bond prices. A streak of soft economic data and trade war fears have pushed China's stock market down more than 20% since its January peak. These problems certainly have origins in local markets and the choices their politicians have made. However, I believe the trigger may originate here in the good ol' USA!

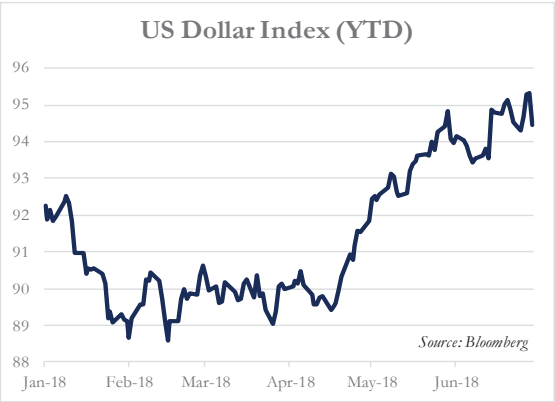
The smoke has cleared from the Federal Reserve's double-barreled shotgun of zero interest rates and Quantitative Easing (QE), and the central bank has effectively declared the experiment a resounding success. I think it's a bit premature to declare victory; after all, we've only watched the first half of the game. We are entering uncharted territory with the Fed now engaging in Quantitative Tightening (QT), the flip side of the policy that has been the modus operandi of central banks since the financial crisis.

What this means is that the Fed has become a net (although not an outright) seller of the $4.2 trillion in Treasuries and mortgage-backed securities it bought up over the last decade by letting them mature faster than it reinvests the proceeds. Starting at the trough of the market crash in early 2009, the various rounds of QE were put in place to boost financial asset prices. I have to believe QT could have the opposite effect.

The U.S. is the first country to begin unwinding its extended easy money policies by raising interest rates and putting its central bank's balance sheet on a diet. This major policy shift is already being reflected in the Treasury bond market, where risk-free rates have steadily increased since the beginning of the year (see chart (A) below), attracting foreign investors and causing the dollar to strengthen (see chart (B) below). As the world's largest economy, financial tightening by the U.S. will have global ripple effects; as a source recently quoted by *The Wall Street Journal* put it, "The happy-go-lucky great synchronized recovery is coming to an end."[1]

Chart A

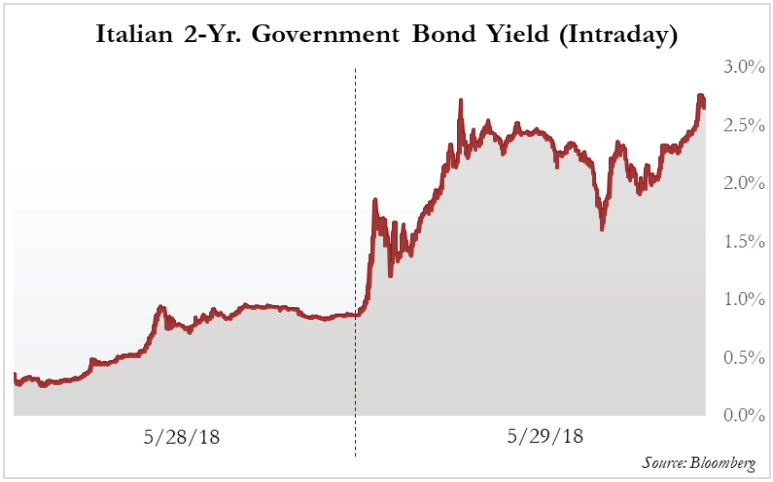
Chart B



1 Mackinstosh, James. "Is the Dollar to Blame for the Global Market Malaise?." *The Wall Street Journal*. 5 July 2018.

In a preview of what can happen as capital moves around the globe at the speed of light, I present as Exhibit A the Italian government's 2-year bonds (see chart (C) below). After trading at negative yields for the past year (a distortion of financial incentives I have talked about in past letters), the bonds' yield spiked from 0.3% to 2.7% in the course of two days. This chart reflects to me how quickly financial markets can go from ignoring to punishing risk – in this case, the risk that Italy will elect a populist government that has promised further deficit spending and could potentially exit the Euro, leaving the highly indebted country's creditors to be repaid in a new, less valuable currency.

Chart C



While we're on the topic of improperly priced risks, another trend closer to home that I suspect won't end well is the proliferation of corporate bond index funds and ETFs (Exchange-Traded Funds). Bond funds, especially passive ones, have driven much of the demand for new debt over the last decade. Federal Reserve data shows that mutual funds and ETFs have gone from owning just over 6% of the corporate bond market at the end of 2008 to almost 20% at the end of 2017. It's no coincidence that over the same period, the mix of passive products has more than doubled to 20% of all taxable bond fund assets, according to Morningstar. Vanguard's Total Bond Market Fund alone controls over $300 billion in assets, and it has another three bond funds worth north of $50 billion.

There are two problems with passive and marginally active funds driving an increasing share of bond buying. Like equity index funds, the underlying buyers are inherently price-insensitive. But unlike equity index funds, which are weighted by market cap and are thus skewed toward larger and ostensibly higher quality companies, bond indexes are weighted by the amount of debt issued. As a bond indexer, you're lending the most money to the companies that issue the most debt, leaving the index skewed toward highly leveraged issuers.

This is exactly the opposite of what we are looking for in the fixed income portion of the Intrepid Balanced Portfolio (the "Portfolio"). We want to lend to issuers who are intent on repaying their debt using free cash flow generated by the business over as short a term as possible, not ones who continue to stack additional debt onto their capital structure. Consequently, we are holding much shorter-duration and higher quality debt than we have historically.

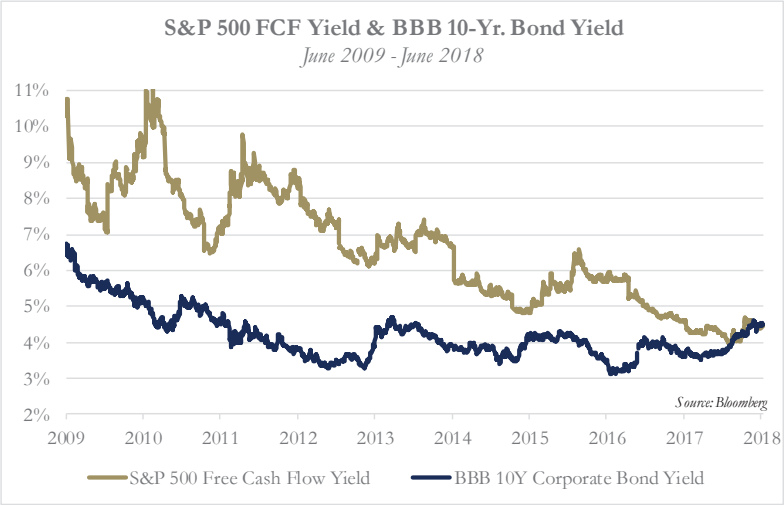
On the equity side, we also view our investments partly in terms of duration. A bond pays back its owner over a clearly defined period that ends when it matures. Stocks have no set expiration date, but the investor still expects to be paid back over a number of years as the company makes profits and generates cash. Hence, stocks are considered "long duration" assets because they have a long-implied payback period.

Equity investors are also at the bottom of the food chain and get paid after literally every other layer of capital in a company's balance sheet. Because stockholders have an inferior claim on the company's profits and cash flows than bank creditors, bondholders, or preferred stockholders and have to wait longer to be paid back, we usually require a meaningfully higher return for being equity owners of a company than we do for lending money to the same company, which we have done before.

One metric that can be used as a proxy to compare the return equity investors require with the return on bonds is equity free cash flow yield, which measures cash generated by the business that is available to shareholders as a percentage of the company's market value. A higher yield in theory translates to a higher expected return and shorter payback period.

Until recently, the market has agreed with us that stocks deserve a higher implied yield than bonds. But what we've seen in the last several years is that free cash flow yields on large US companies, measured by the S&P 500, are no higher than the yields paid by much-safer investment grade BBB corporate bonds (see chart (D) below).

In short, stock investors are demanding barely any additional yield today for taking on the extra risk of being last in line to be paid back if financial conditions tighten significantly. I think this is indicative of the blasé approach to risk that has characterized the U.S. equity market for the last several years.



There is a common theme here which I learned at my father's knee years ago when he said, "Son, it is very easy to borrow money, but it is very difficult to pay back." Truer words have never been spoken. So, we are now in a world where $17 trillion worth of "free" money is being withdrawn from the financial markets with an unknown outcome. If the Fed continues to tighten and the dollar continues to get stronger, it will undoubtedly put stress on parts of the financial system that have been riding the tailwind of global easy money policies.

The Intrepid Balanced Portfolio increased 1.60%, net-of-fees, for the quarter ending June 30, 2018. In comparison, the ICE BofAML US Corporate Index decreased 0.94%, the ICE BofAML US High Yield Index increased 1.00%, and the S&P 500 Index increased 3.43% for the same quarter. Year-to-date, the Portfolio has decreased 1.86%, net-of-fees, compared to the ICE BofAML US Corporate Index's decline of 3.12%, the ICE BofAML US High Yield Index's increase of 0.08%, and the S&P 500 Index's increase of 2.65%.

Please note that over half of the S&P 500's year-to-date return is attributable to Amazon (ticker: AMZN) and Netflix (ticker: NFLX) – both companies with wonderful services, but wildly expensive valuations; and in Netflix's case, a heavy debt load as discussed above. The other four constituents of the market darling FANGAM tech stocks – Microsoft, Apple, Facebook, and Google – make up the other half of the index's 2018 return, meaning the other 499 companies in the index (yes, there are 505 companies in the S&P 500) are flat on average.

At Intrepid Capital, we continue to execute on our disciplined and risk-conscious investment process. In 20/20 hindsight, with the level of rate suppression activity both here and abroad, our defensive positioning over the last few years has been seemingly unnecessary. I suspect that attitudes toward risk control are starting to change as the macro wind is now in our face.

Both our preference for short duration in fixed income and our discounting of equity free cash flows should help us in a more volatile and difficult environment. I chuckled when I reread my letter from the end of the first quarter where I speculated, "Maybe this is a bell ringing at the top?" after a discussion with a polite 80-year old woman who told me I was too conservative. So far, the S&P 500 has yet to breach its late January high, when that discussion occurred.

The Portfolio's largest contributors for the quarter ending June 30, 2018 were Jefferies Financial Group (formerly Leucadia National) (ticker: JEF), Greenhill & Co. (ticker: GHL), Discovery, Inc. (ticker: DISCK), Cheesecake Factory (ticker: CAKE), and Syntel (ticker: SYNT). Detractors for the quarter include Gattaca PLC (ticker: GATC LN), Biglari Holdings (ticker: BH), Western Digital (ticker: WDC), Berkshire Hathaway (ticker: BRK/B), and Royal Mail PLC (ticker: RMG LN).

Thank you for your continued support. I believe your patience will be rewarded as we continue to invest your capital and ours with a disciplined investment process.

Best regards,

Mark F. Travis

President/CEO

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

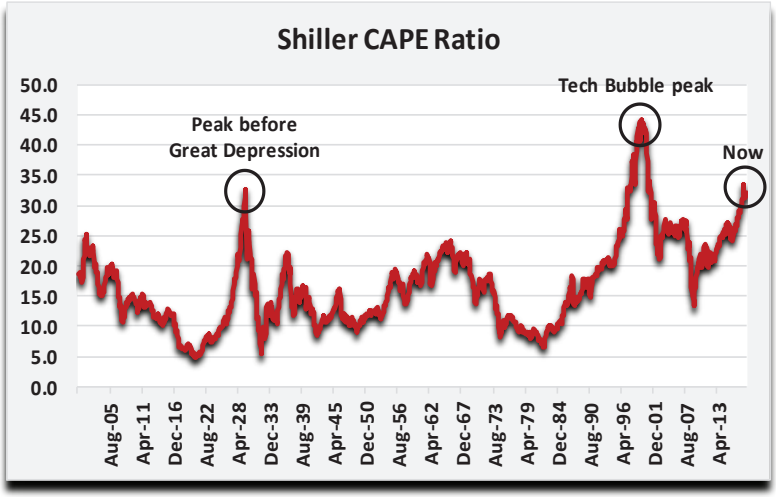
"Out of the frying pan and into the fire."

Small cap stocks rallied during the second quarter along with technology shares. The Russell 2000, S&P Small Cap 600, and Morningstar Small Cap Index were up 7.75%, 8.77%, and 7.02%, respectively, over the three-month period ending June 30, 2018. Many investors believe smaller companies offer a haven from trade wars, given their lower foreign revenue exposure compared to large cap companies. Additionally, investors appear to have "re-remembered" that domestically-focused businesses will enjoy a greater benefit from U.S. tax reform. We believe the rush toward riskier assets will prove to be a critical mistake.

There are few safe places to hide in today's market. Small cap indexes are not one of them, in our opinion, so beware of rotating from pricey large caps into pricier smaller securities. The magnitude and pervasiveness of overvaluation across domestic equities is frequently obfuscated by bad data and an overreliance on statistical weighted averages. The bad data includes treating dependably aggressive forward estimates as actual earnings, removing from income extraordinary charges that seem to repeat every year, and excising unprofitable companies from P/E ratio statistics. The dependence on major stock market averages might work for the typical index investor, but it makes little sense for small cap investors and those pursuing true active management.

The technology bubble that popped in 2000 is regarded as the biggest stock market bubble in history. Thoughtful valuation metrics such as Robert Shiller's CAPE Ratio[2] for the S&P 500 show the tech bubble to be in a world all its own, with today's market tying 1929 as the second richest market ever. *Second richest ever.*… that alone should be enough to give serious investors pause. However, there's more to this story.

The S&P 500 is an index dominated by its largest members. Today, that list is led by Apple, Amazon, Google, Microsoft, and Facebook. At the tech bubble peak, it was Microsoft, Cisco, General Electric, Intel, and Exxon Mobil. Back then the top 30 companies accounted for half of the market cap of the entire index, whereas it takes 50 companies today. On March 24, 2000, when the broader market peaked during the tech bubble, the S&P 500 P/E was 29.2x versus 23.7x when we ran the numbers a few weeks ago (June 21, 2018). Nevertheless, *median* statistics paint a different picture, and one that's more harrowing for active managers.



2 Shiller, Robert. *Online Data Robert Shiller.* Yale University. www.econ.yale.edu/~shiller/data. Accessed 9 July 2018. Cyclically-adjusted P/E Ratio calculated as price divided by 10-year average earnings, adjusted for inflation.

S&P 500 on March 24, 2000

P/E	29.2x	**Median P/E**	**18.9x**
EV/EBITDA	14.9x	**Median EV/EBITDA**	**9.3x**

S&P 500 on June 21, 2018

P/E	23.7x	**Median P/E**	**24.1x**
EV/EBITDA	13.5x	**Median EV/EBITDA**	**14.1x**

The median P/E of the S&P 500 at the top of the tech bubble was 18.9x, whereas the current median P/E is 24.1x. Therefore, the typical big cap company is trading at a higher multiple than it was during the biggest bubble in history. As an investor, maybe this would concern you, and maybe not. If you're unmoved, then try this on for size. At the market's peak in 2000, the median P/E of the Russell 2000 small cap index was 18.4x.[3] Today, the median small cap P/E is 38.5x—a double over 18 years.

Russell 2000 on March 24, 2000

P/E	45.9x	**Median P/E**	**18.4x**
EV/EBITDA	12.7x	**Median EV/EBITDA**	**9.8x**

Russell 2000 on June 21, 2018

P/E	70.6x	**Median P/E**	**38.5x**
EV/EBITDA	18.4x	**Median EV/EBITDA**	**17.4x**

It was the opinion of many value managers, including Intrepid Capital, that cheap stocks were available in the late 1990s, even though many companies were trading for obscene prices. Within the lowest P/E quintile for the Russell 2000 at the apex of the tech bubble, the median nonfinancial company traded for 14x free cash flow. Currently, the lowest quintile P/E stocks in the Russell trade for a median free cash flow multiple of 24.8x. It's much harder to find value now even when you're looking in the right spots. Small public companies are more indebted today, and they are more likely to be unprofitable (33% of the index now versus 23% then).

Contrary to popular belief, lower tax rates do not support today's heady small cap multiples. Russell 2000 members derive 20% of revenue from foreign sources, which is only about 10% less than large caps. They also import many products that could be affected by trade war-related tariffs. Some major small cap-heavy industries that have less foreign exposure, like banks, are the most cutthroat and will see diminishing benefits from tax reform through good old-fashioned competition. Rising interest rates also present a strong counterweight to falling tax rates, given the high leverage of many small caps. The Net Debt/EBITDA for the nonfinancial portion of the Russell 2000 is 4.8x, while the median net leverage ratio is a hefty 3.6x.

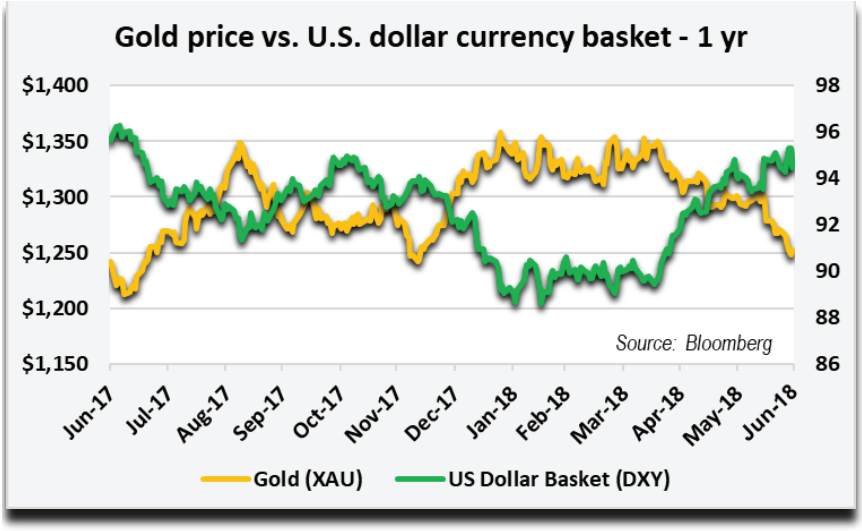
Top-line growth isn't likely to be investors' savior either. If our economic growth is entirely financed by debt, is our prosperity real? Over the past ten years, it has taken $3 of incremental debt to drive every $1 of GDP growth.[4] Perhaps the GDP Multiplier should be renamed the Debt Divider. The dependency of our nation's economy on borrowing isn't healthy, and if past is prologue, it will end with severe consequences.

U.S. small caps have never been more expensive, and the positioning of our portfolio reflects this environment. The Intrepid Small Cap Portfolio (the "Portfolio") increased 0.60%, net-of-fees, during the second quarter and ended the period with 82.7% of assets held in cash and Treasury bills. If small cap benchmarks continue to rise in the near-term, it will be very difficult for the Portfolio to keep pace. We are prepared for market turmoil and a return to saner valuations. We believe the best approach is to own overlooked and uncorrelated securities. Recently we have found some value in the financial sector. In the absence of equity opportunities, Treasury bills yielding 2% are a good alternative in the current environment.

The Portfolio's top two contributors in the second quarter were Baldwin & Lyons (ticker: BWINB) and Hallmark Financial Services (ticker: HALL), two companies focused on commercial auto insurance. Both firms earned an underwriting profit in the first quarter, following a very tough 2017 that included significant adverse reserve developments. Baldwin's shares appreciated after the resignation of its Executive Chairman, who is also a controlling shareholder and manages a hedge fund focused on insurance stocks with a successful track record. Other shareholders may believe his departure reduces tension between management and the board. Both Baldwin and Hallmark continue to trade at a discount to tangible book value, and we feel they are a reasonable place for our capital while we seek compelling opportunities.

3 The Russell 2000 actually peaked on March 9, 2000, but we lined up the data retrieval with the S&P 500's peak

4 Includes nonfinancial sector business, household, and government debt as tracked by the Federal Reserve



The Portfolio's top three detractors were the iShares Gold Trust (ticker: IAU), Retail Food Group (ticker: RFG AU), and Net 1 UEPS Technologies (ticker: UEPS). Each of these contributed slightly more than the 10 basis point minimum negative impact we have defined for us to disclose them. Retail Food Group is discussed later in the letter. Gold prices sank in the second quarter due to rising interest rates and the strength of the U.S. dollar. Gold exploration spending is down, and production is becoming more challenging as the easy reserves have been mined. We expect loose monetary policy and a favorable supply and demand backdrop to help drive up gold prices in the long run; however, in the nearer term we also believe our gold position could flourish when other assets are in disarray.

Net 1 UEPS Technologies' (UEPS) stock rose sharply after first quarter earnings when the company reported the addition of several hundred thousand new customers for its EasyPay Everywhere banking offering, which will help offset the loss of the welfare distribution contract from the South African Social Security Agency. However, the shares gave back all those gains as the media continued to paint the company as a villain as it transitions the welfare contract to the South African Post Office (SAPO).

Predictably, it was reported today that hundreds of welfare recipients couldn't receive their grants due to a strike by Post Office workers for higher wages. UEPS never failed to deliver grants on time when it administered the entire contract. Whatever the case, our investment in UEPS is buttressed by the company's balance sheet and ownership of the third largest South Korean payments company, which have a current combined value that exceeds UEPS' stock price. The firm's continued provision of financial services to the underbanked population in South Africa would just be a bonus for us.

We acquired two new small positions during the quarter and sold one. We purchased Crawford & Company (ticker: CRD/A) and Donnelley Financial Solutions (ticker: DFIN). Crawford is one of the world's largest independent providers of claims management services to insurance companies and self-insured entities. The company's stock has underperformed for years due to weak top line growth, substandard margins, an underfunded pension, a muddied financial picture, and a dual class share structure. An aggressive restructuring program has significantly improved underlying profitability and the pension's status is much-improved. However, a declining contribution from administering the BP oil spill class action has overshadowed margin gains in Crawford's core outsourced claims management and third-party administration franchises. The recent sale of the underperforming class action business helps simplify the story. We acquired Crawford's shares at 5x EV/EBITDA. Competitors have been acquired recently at over twice that multiple. Crawford is selling for just over 10x estimated leveraged free cash flow.

Donnelley Financial Solutions, or DFIN, was spun off from the 150-year-old commercial printing company R.R. Donnelley in October 2016. DFIN supports the global capital markets compliance and transaction needs for corporations and their advisors and the investment management compliance requirements of mutual funds. DFIN helps companies comply with ongoing regulatory filings and deliver printed communications to investors, and it also provides language translation services. This creates a strong recurring revenue base (60%) to support the more volatile transactional revenue DFIN receives as a leading provider of data room solutions for corporate IPOs and M&A. DFIN still derives 40% of revenue from lower-margin legacy printing services, which are in structural decline, but this is being offset by fast-growing software and services. The shares had significantly underperformed since the spinoff due to volatility on the transactional side. We picked up a small position near the

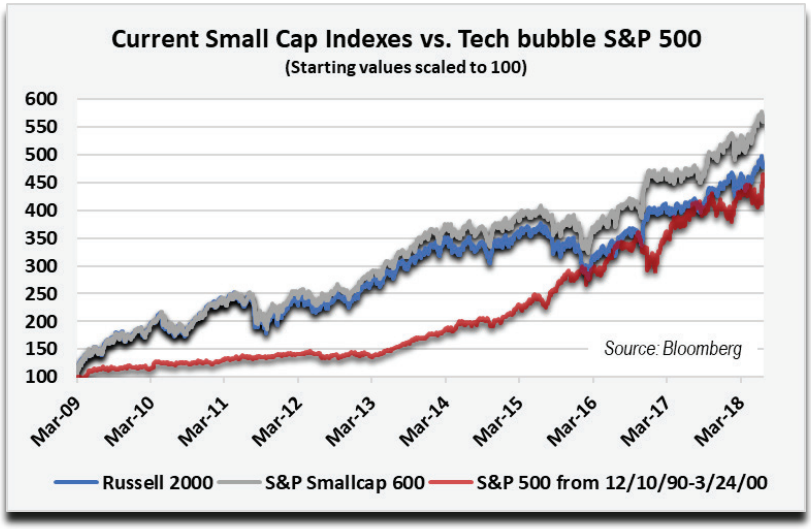
lows at a double-digit free cash flow yield but stopped buying when the stock rebounded due to sabre rattling from two small activist investors.

We sold Retail Food Group, the restaurant franchisor, during the quarter. *Men at Work* put it best, *"Do you come from a land down under?...You better run, you better take cover."* In last quarter's letter, we informed you that we were performing additional diligence on the name. We shipped two of our brightest blokes to Australia for a walkabout to uncover the real story on Retail Food Group (RFG). They witnessed a kangaroo get plowed by a speeding Jeep in the bush, but that wasn't their most frightening encounter. Maybe it was the fact that they couldn't find a single franchisee who was happy with the parent company. Or perhaps it was the call a few days into the trip from RFG's CEO, who warned us not to "intimidate" franchisees by politely asking them about their satisfaction. No, the final straw had to be a meeting with top management that was conducted in a dimly lit old nursery, where the only chairs were preschool-sized. Crikey! That up-close encounter made it clear that the people leading the firm were either incredibly dishonest or a few sausages short of a barbie. We bailed immediately.

It's not hard to determine where we went wrong on this investment. We bought the shares when they nosedived during an aggressive smear campaign by the media. We were able to internally disprove some of those accusations. We thought this meant the other claims were less likely to be credible or were blown out of proportion, and we felt we had a margin of safety in the relatively stable franchise royalty stream and unrelated wholesale business. Unbeknownst to us, the franchisee base was disintegrating. We didn't reach this conclusion until we traveled from store to store in Australia. While our exit was painful and marred performance earlier this year, we have avoided additional steep losses by selling when we did.

The Portfolio's Primero Mining convertible bond was retired at par in May upon the completion of the takeover of the company by First Majestic Silver.

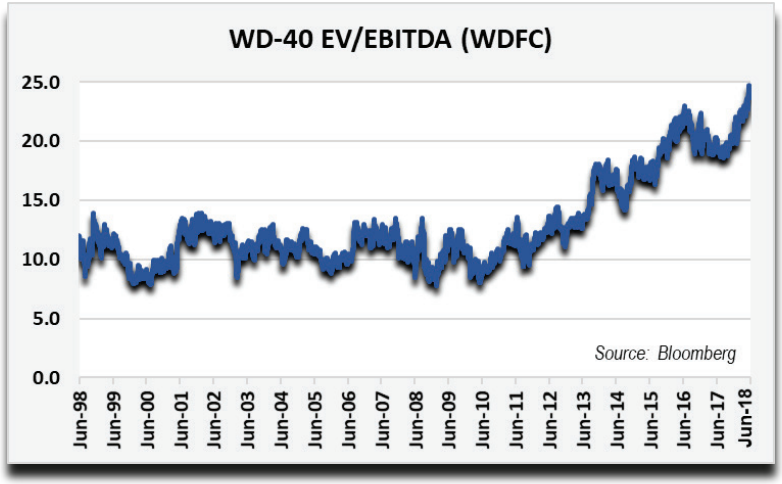
Did you know that the performance of the U.S. small cap market since the 2009 trough is greater than the performance of the S&P 500 leading up to the peak of the tech bubble?[5]



The S&P more than doubled its EPS over the nine-year period before the crash, while there has been minimal underlying EPS growth for small cap benchmarks. The small cap figures are admittedly diluted by unprofitable companies. Not every small cap is a speculation or massively overvalued today, but the majority are, in our opinion, with the average company trading for 38x earnings and over 17x EBITDA.

Take WD-40 (ticker: WDFC) as one example. It's a great business with a brand familiar to everyone. Over the last 20 years the company has grown EBITDA at a 4.1% compounded annual rate, which isn't spectacular but works just fine for us. We have owned this stock before, and we'd like to own it again. In the ten-year period prior to this market cycle (1998 through 2008), WD-40's shares traded for an average of 11x EBITDA. It's rare for WD-40 to ever trade at conventionally "cheap" multiples because of the high quality of the business. Its earnings are very predictable. As of June 30, 2018, WD-40 traded for 24x trailing EBITDA. This level of multiple expansion is the norm in this environment, not the exception.

5 All indexes use the same number of days. For the S&P 500, the line chart reflects performance from December 10, 1990 through the market top on March 24, 2000. For the Russell 2000 and S&P Small Cap 600, the period is March 9, 2009 through June 30, 2018.



The length and extremes of this bull market have created difficult circumstances for absolute return investors. While our relative performance in quarters like this one can be a difficult pill to swallow, we are confident in our time-tested investment process, which has excelled in prior full market cycles. Right now, the Portfolio is operating in a state of guerrilla warfare: watching the action closely and quietly from the periphery, under the canopy of the jungle, and intermittently engaging when we identify opportunities. We stand ready to launch a full offensive when the conditions are right.

The S&P 500 plummeted almost 50% from the tech bubble peak, and its constituents were more reasonably valued at that time than small caps are today. It will be tough to avoid a major drawdown unless you are invested in products uncorrelated to benchmarks that have the flexibility to adopt a defensive posture when conditions warrant it. We believe the Intrepid Small Cap Portfolio fits the bill, and our personal finances and those of our family and friends are deeply invested in the success of this portfolio and Intrepid's process. For anyone contemplating shifting money from large cap index funds into small cap index funds or from defensive portfolios into aggressive ones under the belief that it's a better home for their capital, we would urge caution at this stage of the market cycle. Don't jump from the frying pan into the fire. Thank you for your investment.

DISCIPLINED VALUE PORTFOLIO – COMMENTARY BY CLAY KIRKLAND, CFA, PORTFOLIO MANAGER

The second quarter of 2018 displayed a clear divergence in performance and volatility amongst asset classes and across geographies. President Trump's ongoing trade war has rattled markets and kept investors on edge as new headlines seem to hit almost every day. Foreign equity markets fared the worst—trade policy along with slowing growth has undoubtedly weighed on China's equity indexes. The Shanghai Composite Index crossed into bear market territory late in the quarter and is hitting new lows as I write to you. Emerging markets as a whole had a very rough second quarter led by Brazil's Bovespa Index which was down nearly 15% in the quarter. U.S. equity markets were not immune to all of the trade talk but remained resilient throughout. While we finally saw increased levels of volatility in the first quarter, it proved to be short-lived. The good news is we did have pockets of modest volatility that extended into the second quarter, providing a couple of opportunities to make new purchases in the portfolio, which will be highlighted later.

First, I would like to provide a quick update on the Intrepid Disciplined Value Portfolio (the "Portfolio"), as there was an organizational change made during the quarter. On May 18, 2018, I, Clay Kirkland, was named lead portfolio manager of the Portfolio. This means that I will be handling the day-to-day responsibilities of managing the Portfolio with the support of Mark Travis and the entire team here at Intrepid. By way of background, I am a Jacksonville native who grew up swimming at The Bolles School before going on to compete at Auburn University. I have been working at Intrepid Capital since December 2012 after interning here during the summer of 2010 while pursuing an MBA from Columbia Business School.

Rest assured that there will not be any drastic changes to the Portfolio or the way it is managed under my watch. I will be managing my own money alongside yours with the same philosophy and process that we have always adhered to at Intrepid. That is not to say that there will not be some subtle changes. For example, you may notice in the coming quarters a greater focus on mid and large capitalization securities in the portfolio. Exposure to this part of the market allows the Portfolio to better complement our strategies that have a heavier emphasis on small securities. Many of these companies have grown to the size

they are today because they have great businesses with clear competitive advantages and strong management teams. As we progress in our ninth year of this bull market, it is important to consider what may lie on the horizon. We believe high-quality stocks will fare better in a period of market turmoil than those that we believe have inferior businesses.

The U.S. equity markets held their own in the second quarter compared to most global indices. The S&P 500 Index returned 3.43% in the quarter while the Dow Jones Industrial Average grinded out a 1.26% return. The Intrepid Disciplined Value Portfolio rose by 2.59%, net-of-fees, in the quarter. Although stock market valuations are high by historical standards and it has been challenging for us as value investors to find cheap stocks, we were able to identify a few new opportunities in the second quarter.

We established a new position in Verizon Communications (ticker: VZ), a stock we have previously owned in the Portfolio. The stock has seen pressure due to increased competition amongst competitors, its large dividend, and high debt balance. Rising interest rates are generally bad for Verizon. As borrowing costs increase on its floating rate debt, less cash flow is available to fund dividends and pay down debt. Investors had been concerned in recent years that the company may have to cut its dividend, but tax reform is expected to increase cash from operations by $3.5 - $4 billion in 2018. The dividend is safe in my opinion, and the stock currently yields about 4.7%. Higher bond yields generally cause investors to require higher dividend yields, which was likely another factor in play affecting Verizon's stock price. We were able to buy the stock at prices where we believe most of the aforementioned risks were priced in.

The Portfolio also established a new position in WPP plc (ticker: WPP LN) during the second quarter. The London-based firm is the world's largest advertising agency with over 160 subsidiaries. WPP's services run the gamut, from traditional advertising where it helps plan, develop, and produce advertisements for clients, to media buying and public relations. Investors have become increasingly wary of the advertising agencies' ability to grow revenue, as digital giants Google and Facebook take ad market share and large consumer packaged goods companies respond to their own top line struggles by slashing marketing spending.

Despite these real concerns, we are attracted to the business as it earns very high returns on invested capital. We purchased it shortly after the founder and CEO, Sir Martin Sorrell, resigned amid allegations of inappropriate behavior and misuse of firm assets. The stock was near a 52-week low and down over 42% from its highs in early 2017. As the company works to find permanent new leadership, it has sold off some assets, and we believe additional asset sales of non-core businesses will help strengthen the balance sheet and calm investors' concerns over high leverage. If WPP can show improvement in its North American business and gain market share on the digital side, we are confident that the stock will react positively. Its shares trade at a high single-digit free cash flow multiple and sport a dividend yield of over 5%.

Dollar Tree (ticker: DLTR) is another new position for the Portfolio. We have followed the company closely over the past few years and owned its debt in other portfolios at Intrepid. While the ~6,700-store Dollar Tree banner, distinct for its $1 across the board price point, is performing extremely well, Family Dollar, which it acquired in 2015, has been inconsistent. The company is still working through the integration and turnaround of the ~8,000 acquired Family Dollar stores. We expect margins and profitability to improve in the coming years at Family Dollar to a normalized level similar to that of its closest peer, Dollar General. Retail has been shunned by investors in recent years for a variety of reasons, but we continue to like the dollar store businesses as they have proven to be resilient in even the worst of recessions.

Kroger (ticker: KR) is a new position that was established late in the quarter. Supermarkets, with their very low margins and intense competition, are not the kind of industry we would typically refer to as a "good business." Investors fled Kroger's shares when Amazon announced it was purchasing Whole Foods last year, and the stock has suffered under an overhang of sorts ever since.

Add to this the fact that the industry has just come out of an unusually long period of food deflation, and you can imagine why the stock is not loved on Wall Street. Now that it looks like the deflationary pressure is in the past, rising food prices going forward should benefit Kroger. As the largest supermarket chain in the United States, it has the scale and resources needed to fight off

competitive threats and take share as smaller competitors go out of business. The company is expected to generate over $6 billion in free cash flow over the next three years, providing it with a great deal of flexibility. Kroger has invested heavily in recent years and continues to focus on its online capabilities and delivery, which we believe is the next area of growth in the industry.

The three largest contributors to performance in the quarter were Cheesecake Factory (ticker: CAKE), Apple (ticker: AAPL), and Baldwin & Lyons (ticker: BWINB). The Cheesecake Factory has been a solid performer for us since we initially purchased shares. Rumors swirled in June that the company was in talks to be acquired, sending the shares to new 52-week highs. We used the opportunity to sell part of our position as the price exceeded fair value, but we still own a meaningful weight. We have always thought a takeout of the stock was a real possibility and could envision a takeout scenario at a price materially higher than the current level.

The three largest detractors were Western Digital (ticker: WDC), Royal Mail plc (ticker: RMG LN), and Net 1 UEPS Technologies (ticker: UEPS). Western Digital has been a great performer for us from initial purchase. Recently, it has been a volatile stock as concerns over NAND chip pricing have whipsawed the shares. NAND represents about half of Western's business, which is one reason why we believe the market has been too quick to pass judgment based on every little pricing data point. The shares trade at very low multiples and the business generates copious amounts of free cash flow–two reasons why we continue to own the stock.

We are at a point now where most market participants are acknowledging that valuations are high. Could things get even more extreme? Yes. Could the S&P 500 have already hit the highs for this cycle back in January? Yes. Anything is possible. Therefore, my goal is to position the Portfolio to protect capital on the downside while capturing a meaningful percentage of the upside. Thank you for your investment and please know that we are working tirelessly on your behalf.

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

Global markets continued to experience higher volatility in the second quarter. Unlike Q1, much of the action took place in emerging markets. Stock indexes in China and Brazil slumped into bear market territory. The mood domestically was much improved, however, particularly for those with an affinity for black gold and sexy stocks. The NASDAQ and Russell 2000 roared back to new all-time highs in the quarter.

Fixed income returns varied widely by asset class. The Treasury curve shifted well higher across much of the shorter end, and more moderately out to 20 years. The benchmark 10-year rate rose 12 basis points to 2.86%. Higher rates negatively weighed on investment grade debt, as the Bloomberg Barclays US Aggregate fell -0.16% in the second quarter. Investment grade corporates suffered another poor quarter as spreads continued to widen from nearly the tightest levels in history. While investment grade credit quality certainly isn't poor, standard credit metrics, such as debt-to-EBITDA, are significantly worse than they were prior to the credit crisis. Despite this, earlier this year investors were accepting the lowest spreads in a decade. Spread widening, combined with higher risk-free rates, handed the ICE BofAML US Corporate Index another meaningful loss totaling -0.94%, bringing the year-to-date loss to -3.12%. However, the high yield market was quite resilient in the second quarter. Spreads ended the quarter flat, but with some volatility throughout the period. The ICE BofAML High Yield Index returned a tad less than one quarter of its annual coupon, gaining 1.00% in the period. We also track the ICE BAML 1-5 Year BB-B Cash Pay Index, which we believe is more representative of the high yield ideas we seek. This index returned 1.14% in the quarter.

The Intrepid Income Portfolio (the "Portfolio") gained 0.56%, net-of-fees, for the quarter ended June 30, 2018. The period appears relatively boring when examining the contribution of each security. Nearly every holding produced a small return. While the Portfolio has a large allocation to investment grade corporate bonds (approx. 42% at quarter-end), nearly all of these issues mature in the next 14 months. This muted the impact of rising Treasury yields. Our high yield positions mostly outperformed in the quarter, but there were no material contributors, which we define as having an impact of 10 basis points or more. There were also no material detractors.

The only material contributor to the Portfolio's second quarter performance was an equity security. Baldwin & Lyons common stock (ticker: BWINB) gained more than 12% in the second quarter and reached its highest level since 2016. A decent quarterly earnings report, the resignation of the controversial chairman, and higher than normal industry M&A activity were probably the primary factors that pushed the stock up. The strength of the U.S. small cap market certainly didn't hurt either. While we still view the stock as undervalued, we exited our small position in this thinly traded stock.

Last quarter we discussed two positions that warrant further updating. We reported to you that our position in Primero Mining's convertible bonds would be retired when First Majestic completed its acquisition of the company. That deal was concluded in May and we received par for our remaining bonds. We also informed you that we were completing further due diligence on Retail Food Group (ticker: RFG AU). RFG is an Australian restaurant franchisor that owns several concepts in the bakery, coffee, and pizza categories. The Portfolio's investment in RFG equity was a significant contributor to performance in late 2017, but that reversed in the first quarter of 2018 after the firm reported its semi-annual results.

RFG's stock has been battered by a series of negative articles released by an Australian investigative reporting outfit. While grounded in reality, we believed many of the claims made were overly sensational, but we were having trouble confirming or denying the information without interviewing franchisees and seeing the stores for ourselves. Our attempts to make contact with franchises by telephone were mostly fruitless. We decided we needed boots on the ground, so we sent two analysts to Australia to visit stores and interview as many franchise owners as possible.

Matt Parker and Hunter Hayes did a great job acquiring the information we needed. Unfortunately, their work confirmed our worst fears. Their conversations with franchisees were almost unilaterally negative across RFG's major regions. Additionally, the condition of the store base is significantly worse than we expected. Many of the stores are located in traditional malls, where competition is fierce, and rents are high. We thought we were buying the Australian version of Dunkin Donuts, but instead we got the Australian version of pizza chain Sbarro (which declared bankruptcy several years ago). The trip made it clear that management has been consistently misleading us about the quality of the store base, among other things. Matt and Hunter's account of their meeting with the CEO at a Brisbane coffee roastery is one of the most ridiculous stories I have heard in my career.

We concluded our additional work in late April and immediately proceeded to exit the position, which was completed by the end of May. While RFG's stock continued to decline over that period, our position was small enough not to meaningfully detract from the Portfolio's performance.

The Portfolio's two largest positions matured in the second quarter. Both issues were short-duration investment grade securities that we believed were attractive in an environment where most of our core high yield universe offered few opportunities, and short-term Treasury securities provided meager yields. We first purchased Total Systems Services' notes in early 2016 after the Federal Reserve raised its benchmark rate for the first time in nearly a decade. Our position in Dollar General's notes was initiated in the first and second quarters of 2017. Both positions outperformed comparable maturity Treasury securities by a significant margin despite what we believed to be very low credit risk. Additionally, several other short-duration investment-grade positions matured or were sold to redeploy funds into more attractive securities.

The combination of higher Treasury yields, wider investment-grade spreads, and stable high-yield spreads allowed us to effectively redeploy capital into new and existing ideas. We increased the sizes of several of our core high yield bond positions and initiated positions in four new high yield ideas in the quarter. In addition, we uncovered a number of investment grade corporates sporting attractive yields and maturing in one year or less.

Cimpress NV (ticker: CMPR) is a Netherlands-based printer and graphic designer that provides individuals and businesses with a broad range of marketing materials across the globe. The company's crown jewel is business card maker *Vistaprint*, which is likely well-known to readers due to its television advertising campaigns. The *Upload and Print* business consists of a network of websites and printing facilities, mostly in Europe, that help customers design and create marketing and

promotional materials. *National Pen* is a leading supplier of writing utensils. At first glance, the business appears to be operating in a structurally declining industry with few competitive advantages. However, Cimpress's management has created a world leader in "mass customization."

The industry has typically been characterized by high operating leverage. To charge a reasonable price, printers need to print a high number of identical or very similar business cards to overcome the fixed costs and achieve a profit. Local print shops typically handled small orders from the community but would justifiably need to charge more. Over the last decade, Cimpress has developed a supply chain capable of providing customized products at mass-produced prices. At Vistaprint, an order of 250 business cards requires "less than 14 seconds of human labor for all of pre-press, printing, cutting and packaging." These tasks consume an hour or more at traditional small printers.

The company has applied the same model to other types of marketing materials for small and medium-sized businesses. Cimpress is moderately leveraged at close to 3x debt-to-EBITDA and has the ability to generate significant free cash flow. We purchased the 7% notes due 4/01/2022 at what we believed was a very attractive yield. Unfortunately, the company surprised us with a new note issuance just a few weeks after our purchase, and it called our notes after a short holding period. We are hopeful Mr. Market will provide us with an opportunity to purchase the new notes.

As we reported to you last quarter, we are seeing more opportunities to deploy capital into income-producing ideas as a result of higher risk-free rates. At the end of the quarter, the Portfolio had just 3.2% in cash and equivalents. Our short-term investment grade holdings have laddered maturities over the next few quarters, which will allow us to reinvest your capital at higher rates, should yields continue to move higher. Ideally, we will unearth more solid high yield ideas yielding significantly more than U.S. Treasury securities. We continue to work diligently on your behalf.

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

The Intrepid International Portfolio (the "Portfolio") declined 3.74%, net-of-fees, during the quarter, compared to the MSCI EAFE Index's (the "Index") decline of 1.24%. This is the second consecutive quarter the Index has outperformed the Portfolio, and in a down market. This may sound like the opposite of what we have told investors to expect, but we believe we have been consistent in our message. Two quarters is a short time period. If the Index were to continue to be in negative territory for a long period of time, we would expect to outperform. The same is true on the other side. In the last two quarters of 2017, the Portfolio outperformed the Index in a *rising* market. In our fourth quarter commentary we stated, "Putting the record on repeat, we do not expect to outperform in a strong upward market." We are saying now that we do not expect underperformance on the downside to continue. However, our relatively concentrated portfolio can cause some short-term swings by individual securities. This was the case in the first quarter of this year, as well as the second. To better understand our performance, it's important to address the performance of our individual securities.

The top three contributors for the Portfolio in the second quarter were Coventry Group (ticker: CYG AU), GUD Holdings (ticker: GUD AU), and Mediagrif Interactive (MDF CN). The top three detractors during the period were Gattaca (ticker: GATC LN), Quarto Group (ticker: QRT LN), and KSB SE & CO. (ticker: KSB3 GR). There was nothing especially noteworthy about the contributors, so we will spare our investors the time and effort of reading about those.

Despite our efforts to hedge, we typically report our contributors and detractors based on their performance in dollars (i.e. unhedged). This is not precise, but when currency volatility is low it gives a good approximation. During the second quarter of 2018, the dollar strengthened, causing individual security performance in dollars to appear lower than in local currency or with hedges included. For this reason, we reviewed our performance in local currency as well (i.e. assuming the stock price is hedged to US dollars). Regardless of the weak currencies, the order of contributors and detractors was similar except for one: Dundee Corp (ticker: DC/A CN). For this reason, we will comment on Dundee as well.

Gattaca is a specialized recruitment firm in the UK focused on engineering and technology. Historically, the company has been accompanied by a growth story backing a hefty valuation, having doubled revenue over the six years ending fiscal 2017. However, a large acquisition made in 2015 now appears to have been a mistake. The acquired company, Networkers, is having issues with their Telecom customers, which has dampened revenue growth and profitability for Gattaca. These customers now make up a smaller part of the business, and management has made some changes that we believe will have a positive impact. Despite this, the enterprise trades at a cheap value of less than 4.5x EBIT, less than half of their respective peer group. The company is not falling apart; in fact, they grew revenue in the most recent period. Many of the previous owners of the stock held it for the growth potential. As they have sold out, there has been tremendous pressure on the stock. This has given us the opportunity to purchase at what we think is a discount to our calculated intrinsic value.

Quarto Group is a UK illustrated book publisher that sells its products around the world. Toward the end of 2016, the company sold a large quantity of books into the retail channel--more than the retailers needed. When the company reported 2017 results, there were significant costs associated with retailers returning these books. This negative development sent the shares tumbling. We believe that earnings were overstated in 2016 but were probably understated in 2017 and will likely revert to normal levels throughout 2018.

Adding insult to injury, the company's founder, who was kicked off the Board in 2012, fought his way back onto the Board, causing the CEO in place at the time to step down. This may look like mayhem, but we believe the founder has shareholder interests in mind. In fact, we think he's too aggressive with shareholder friendly acts, especially in the case of desiring a dividend reinstatement despite a large debt balance. We don't think the banks will allow him to reinstate the dividend and believe debt repayment over the next couple of years will cause the value of the equity to improve substantially.

KSB SE is a German pump company we have owned for several years, albeit at different weights of the portfolio. Coming off strong results in 2017, the outlook for 2018 was rosy. We took this time to reduce our position in the portfolio. In early May of this year, the company announced that a former project in Great Britain will cause earnings to decline about €25 million this year, meaning they will not hit their forecast for growth. Since making the announcement, the stock has been trading lower. The project, assigned to KSB in 2010, relates to underground pumps in London that remove excess water when rainfall is heavy. A recent analysis suggested that KSB needs to exchange these pumps. We believe this is a one-off event. This is what we consider a normal risk in investing in businesses. These things happen, and when they do we don't believe our analysis is wrong. In fact, we expect events like this to happen from time to time. We still believe the business fundamentals are strong and continue to hold on to the investment.

Dundee Corp continues to be a detractor for the portfolio. Despite having net assets on the balance sheet worth substantially more than the value the shares trade for, the stock continues to suffer. We now believe much of this is warranted, as management has disappointed time and time again. The business continues to burn cash and has been a steady detractor to our portfolio. We are currently evaluating the position.

There were no new securities added to the Portfolio in the second quarter, but we exited four securities. Three of these were companies that were acquired: LifeHealthcare Group (ticker: LHC AU), Primero Mining's 5.75% Convertible Notes (CUSIP: 74164WAB2), and ToxFree (ticker: TOX AU). We have discussed all three in previous commentaries and were simply waiting for the deals to close. The fourth security – Retail Food Group (ticker: RFG AU) – is a little more complicated, as we concluded this investment was a mistake.

Retail Food Group is an Australian restaurant franchisor. We have experience with domestic franchise businesses, which tend to be stable operations with fat, boring cash flow streams. We felt our understanding here could be parlayed into adding value with an Australian franchisee. We were wrong. We purchased the stock as the price was falling precipitously in the fourth

quarter of 2017 amid negative media reports. We determined some of these allegations were false, and we discovered similar articles about other companies written by the same author that ultimately did not create any significant long-term decline in business value. To us, it looked like a Boy-who-cried-wolf situation featuring a deeply discounted business.

We were reassured when the company's management told us its franchisee base was largely healthy and as profitable as they had been in prior years. As things got worse, we determined further research was required and decided to put boots on the ground. Two of our brightest analysts, Matt Parker and Hunter Hayes, traveled Down Under and interviewed franchisees, a lobbyist, former employees, and management.

Their findings were disheartening, to say the least. It was clear franchisees were struggling more than we expected. And even more concerning, the company's management appeared clueless to their plight, as nearly all franchisees interviewed mentioned they were forced to purchase supplies at inflated prices (negating the purchasing power benefit of joining a franchise system). After a meeting with the management team, we were not convinced there was a sound plan in place to put the business back on track.

Despite the fact we lost money on the investment, the amount of time and energy spent researching the company after we purchased it was well spent. We sold the stock when we concluded we had made a mistake, and the stock continued to fall significantly. Nassim Nicholas Taleb explains in his book "The Black Swan" that avoiding losses is equally important as generating gains: "Although…these are economically equivalent for the bottom line (a dollar not lost is a dollar earned), they are not treated equally in our minds."

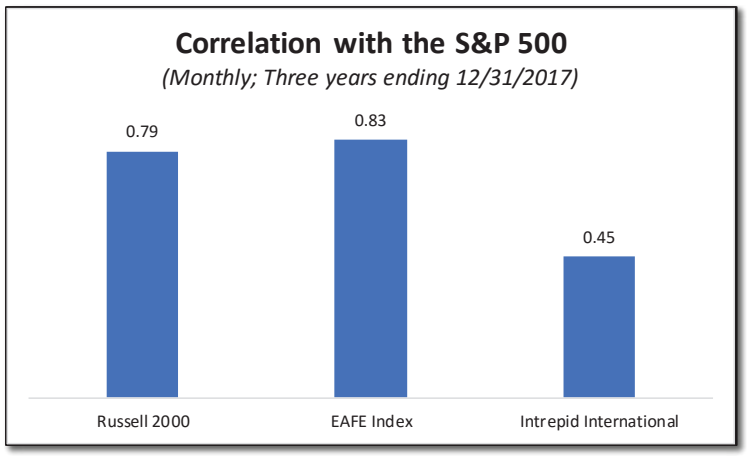
Our mistakes here include not initially investigating further, believing franchise businesses tend to be stable, and assuming franchise disclosure requirements in Australia are on par with or close to American standards, when in reality the company was able to dodge and stonewall our requests for documents that in the U.S. are easily accessible.

We believe investing in the Portfolio gives clients access to unique, uncorrelated securities that should provide attractive risk-adjusted returns over time. Historically, we have focused our commentaries on some of the unique securities we're invested in. Here, we will explain the lack of correlation the Portfolio has with the overall market.

Many investors allocate capital to international portfolios with the hope of being more diversified and adding exposure to something uncorrelated with the domestic markets. We believe investors are overstating the positive impacts most index-tracking international products add to their overall portfolio.

Take the EAFE, one of the most popular international indexes designed to track developed equity markets outside the U.S. and Canada (EAFE stands for Europe, Australasia and Far East) and the Portfolio's primary benchmark. For the 20 years ending December 31, 2017, the Index has been more correlated with the S&P 500 than the domestic small cap index, the Russell 2000. We use the S&P 500 as a proxy for the domestic market as it is what most US-based investors think of when discussing "the market."

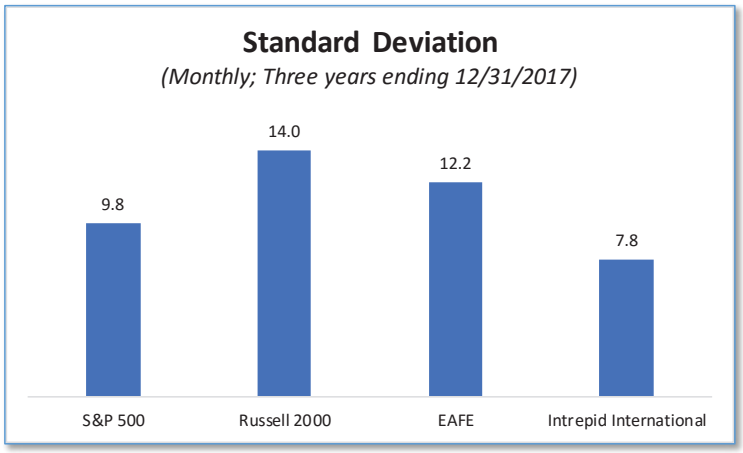
Since the Intrepid International Portfolio has not been around for 20 years, we cannot perform the same long-term analysis. However, over the three years ending December 31, 2017, we see that the EAFE again has a higher correlation with the S&P 500 than the Russell 2000. The Portfolio, on the other hand, is not even close – despite investing primarily in the same developed markets as the Index, its correlation with domestic large cap stocks is roughly half that of the EAFE!



Source: Bloomberg

For those unfamiliar with correlation coefficients, fear not. CFA level 1 reading material lays it out in succinct fashion: "As the correlation falls, the risk becomes smaller and smaller."[6] To simplify further, most investors try to find uncorrelated assets to increase the benefits of diversification. We argue that investing in many of the traditional international asset options does not help investors achieve these diversification benefits. In fact, the diversification benefits were *worse* than investing in domestic small cap stocks.

We believe part of the beauty of the Portfolio and its intentional construction lies in its superior diversification benefits relative to the Index, as well as most other international funds. International active managers tend to buy the same stocks that are in the index. By contrast, only one of the stocks held in the Portfolio is a member of the Index. For this reason, the Portfolio's performance tends to be independent of the factors many macro investors are focusing on. For example, if international equities continue to underperform and assets begin to flow out of ETFs tracking the EAFE or ACWI indexes, causing pressure on their constituent stocks, the Portfolio should not suffer the same fate.



Source: Bloomberg

We believe another fear investors have when investing in international small cap companies is that risk is much higher. We think it can be, but it does not have to be. Standard deviation is the measure that most investors use to define risk. For the three years ending December 31, 2017, the Portfolio has had a lower standard deviation than the Index or the Russell 2000 Index. In fact, volatility has even been lower than the S&P 500. We attribute this to higher cash levels, as well as security selection. Many of the companies we have invested in have what we believe to be defensible business models. Additionally, we focus on companies with little leverage that sell to stable end markets. We are proud that our research discipline shows up in the portfolio numbers.

Through the first six months of 2018, our performance has not been what we desire. However, we believe the portfolio is well positioned to profit from individual positions, as well as being protected from a large market selloff. Part of this comes from a large cash balance of over 20%. As always, we're more than happy to discuss the portfolio with current and potential investors. Feel free to call, write or email us. Thank you for your investment.

SELECT PORTFOLIO – COMMENTARY BY JAYME WIGGINS, CFA, CIO, PORTFOLIO MANAGER

Small cap stocks rallied during the second quarter along with technology shares. The Russell 2000 and Morningstar Small Cap Index were up 7.75 and 7.02%, respectively, over the three-month period ending June 30, 2018. The S&P MidCap 400 rose 4.29%. The Intrepid Select Portfolio (the "Portfolio") increased 4.41%, net-of-fees, over the same period. The Portfolio ended the quarter with 9.9% of assets held in cash, but cash averaged a mid-teens percentage over the three-month period.

The Portfolio's top three contributors in the second quarter were Baldwin & Lyons (ticker: BWINB), Greenhill & Co. (GHL), and Discovery Communications (DISCK). Baldwin earned an underwriting profit in the first quarter, following a very tough 2017 that included significant adverse reserve developments. Baldwin's shares appreciated after the resignation of its Executive Chairman, who is also a controlling shareholder and manages a hedge fund focused on insurance stocks with a successful track record. Other shareholders may believe his departure reduces tension between management and the

6 CFA Institute. *CFA Program Curriculum* 2015 Level 1. Vol. 4., pp. 308-309.

board. Baldwin continues to trade at a discount to tangible book value, and we feel it is a reasonable place for our capital while we seek compelling opportunities.

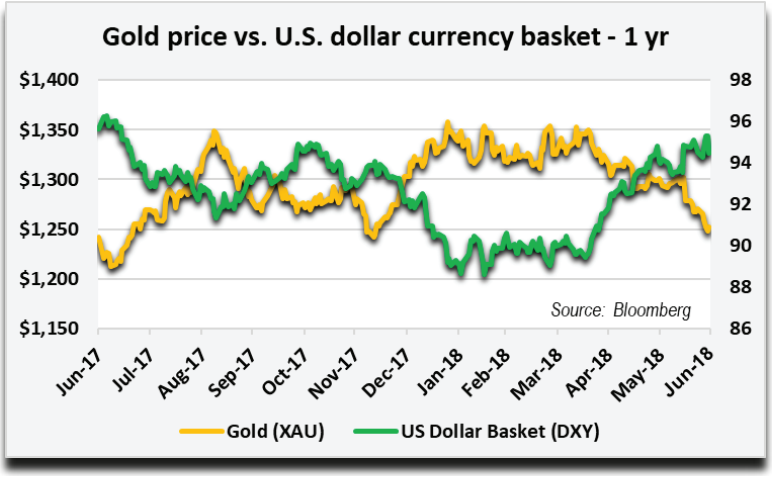
Greenhill's shares continued to rally after the firm posted record first quarter advisory revenues and a strong operating margin. The firm is still demonstrating much more strength overseas than for domestic M&A deals. We believe the stock fully reflects a stabilization of Greenhill's market share that is not assured. We were pleased to sell our remaining position at a material gain to our cost basis in the $15 range.

Discovery Communications' stock performed strongly amidst consolidation activity in the media sector. Takeover activity may continue following the U.S. District Court's approval of AT&T's acquisition of Time Warner and a bidding war for assets of 21st Century Fox. When it reported first quarter results, Discovery's management significantly raised expected synergies from its Scripps Networks acquisition. Despite ongoing attrition of cable subscribers, Discovery owns several leading networks and is producing low-single digit EBITDA growth. The firm is also actively investing in sports content such as the Olympics and PGA Tour for its European streaming product, while pledging not to pay aggressive prices for sports rights like soccer.

We think Discovery is better positioned to deal with competition from Netflix and other OTT players because its content is low cost and unscripted versus the high-budget scripted fare produced elsewhere. Engaging in an arms race against Netflix and Amazon would be futile. While it is likely that digital entrants will devote growing budgets to unscripted content, Discovery owns a very deep library and still trades for a modest multiple of free cash flow. With industry pressures and a leveraged balance sheet, Discovery must operate judiciously and remain open to combinations with other players. Several insiders have purchased shares at higher prices than our entry point, including Discovery's new CFO, board members, and even cable magnate John Malone.

The Portfolio's top three detractors were Western Digital (WDC), the iShares Gold Trust (ticker: IAU), and Net 1 UEPS Technologies (ticker: UEPS). Western Digital's shares remain under pressure from investor fears over NAND flash memory pricing, despite the company's position as the leading hard disk drive (HDD) producer in the world and the second largest manufacturer of solid state drives (SSD). HDD sales are supported by the expansion of cloud computing, which is offsetting decreases from traditional computers. Judging by the low P/E of 6x on the stock, the market appears to be expecting NAND price declines to outpace cost reductions. Western Digital's management predicts the market will firm up later this year.

Gold prices sank in the second quarter due to rising interest rates and the strength of the U.S. dollar. Gold exploration spending is down, and production is becoming more challenging as the easy reserves have been mined. We expect loose monetary policy and a favorable supply and demand backdrop to help drive up gold prices in the long run; however, in the nearer term we also believe our gold position could flourish when other assets are in disarray.



Net 1 UEPS Technologies' (UEPS) stock rose sharply after first quarter earnings when the company reported the addition of several hundred thousand new customers for its EasyPay Everywhere banking offering, which will help offset the loss of the welfare distribution contract from the South African Social Security Agency. However,

the shares gave back all those gains as the media continued to paint the company as a villain as it transitions the welfare contract to the South African Post Office (SAPO).

Predictably, it was reported today that hundreds of welfare recipients couldn't receive their grants due to a strike by Post Office workers for higher wages. UEPS never failed to deliver grants on time when it administered the entire contract. Whatever the case, our investment in UEPS is buttressed by the company's balance sheet and ownership of the third largest South Korean payments company, which have a current combined value that exceeds UEPS' stock price. The firm's continued provision of financial services to the underbanked population in South Africa would just be a bonus for us.

We acquired several new positions during the quarter, including Crawford & Company (ticker: CRD/A), AmerisourceBergen (ticker: ABC), Omnicom (ticker: OMC), FibraHotel (official name: Concentradora Fibra Hotelera Mexicana S.A. de C.V.; ticker: FIHO12 MM), Donnelley Financial Solutions (ticker: DFIN), Molson Coors (ticker: TAP), and Big Lots (ticker: BIG).

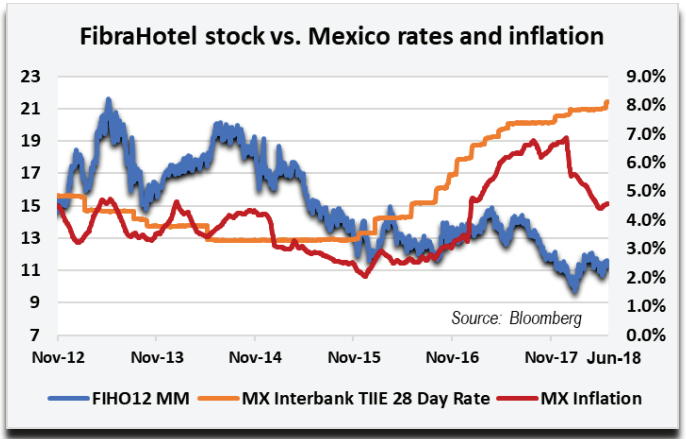
Crawford is one of the world's largest independent providers of claims management services to insurance companies and self-insured entities. The company's stock has underperformed for years due to weak top line growth, substandard margins, an underfunded pension, a muddied financial picture, and a dual class share structure. An aggressive restructuring program has significantly improved underlying profitability and the pension's status is much-improved. However, a declining contribution from administering the BP oil spill class action has overshadowed margin gains in Crawford's core outsourced claims management and third-party administration franchises. The recent sale of the underperforming class action business helps simplify the story. We acquired Crawford's shares at 5x EV/EBITDA. Competitors have been acquired recently at over twice that multiple. Crawford is selling for just over 10x estimated leveraged free cash flow.

AmerisourceBergen is a pharmaceutical distributor that connects drug manufacturers with pharmacies, hospitals, and other health care providers. It is one of the "Big Three" wholesalers along with McKesson and Cardinal Health. We believe Amerisource is an efficient operator with a solid balance sheet and is a good way to participate in the robust growth of the healthcare industry. While Amazon has recently entered the space through its acquisition of the online pharmacy PillPack, we think Amazon's main targets will be pharmacies like CVS, Walgreens, and Rite Aid, as opposed to lower-margin distributors. Nonetheless, Amazon is not afraid of low margins and has logistical expertise, although it generally relies on outside carriers like USPS, FedEx, and UPS for the bulk of its deliveries. Walgreens Boots Alliance is a 26% owner of Amerisource, and we would not be surprised by a future takeover attempt as Walgreens vertically integrates to strengthen its competitive profile. We acquired ABC at a 12.5x multiple to normalized unleveraged free cash flow.

We purchased the advertising agency Omnicom for largely the same reasons as our earlier acquisition of WPP. While Omnicom's shares have not fallen as much over the past year, it is also not experiencing management and boardroom drama like WPP. Omnicom's shares are valued at a similar multiple to WPP. We believe it is a strong operator and has recently enjoyed slightly better revenue growth than WPP. We view our purchase as a way to spread our bets in a space where major accounts can shift between competitors.

FibraHotel is the first and largest hotel FIBRA in Mexico. FIBRAs are the Mexican versions of REITs and must pay out 95% of their income. FibraHotel owns 87 properties spread around Mexico and has enjoyed consistent growth in Revenue per available room (RevPAR) and Adjusted Funds from Operations (AFFO) per share.[7] The hotels mainly serve business customers, but the firm recently acquired a resort in Cancun. The company has a net leverage ratio of approximately 1.5x estimated EBITDA, which is far below U.S. hotel REITs, which carry lower leverage than other REITs due to more volatile occupancy. We acquired the shares at a double-digit dividend yield, which was more than twice the yield offered by most U.S. comps.

7 RevPAR, or revenue per available room, is a performance metric in the hotel industry that is calculated by dividing a hotel's total guestroom revenue by the room count and the number of days in the period being measured. The AFFO, or adjusted funds from operations, of a REIT is generally equal to funds from operations (FFO) with adjustments made for recurring maintenance capital expenditures. (Source: Wikipedia)



FibraHotel's shares have been pressured since 2015 by increases in local interest rates. The tightening cycle may be almost finished, since inflation has turned lower. The shares trade at a significant discount to the capital FibraHotel has invested in its relatively young portfolio. The biggest risk is economic turmoil in Mexico that pushes down occupancy levels, possibly induced by changes in trade agreements or an acceleration of drug violence. The company offers English-language filings, presentations, and conference calls. We sold forward enough Mexican pesos to offset the currency risk of the equity position.

Donnelley Financial Solutions, or DFIN, was spun off from R.R. Donnelley in October 2016. DFIN supports the global capital markets compliance and transaction needs for corporations and their advisors and the investment management compliance requirements of mutual funds. DFIN helps companies comply with ongoing regulatory filings and deliver printed communications to investors, and it also provides language translation services. This creates a strong recurring revenue base (60%) to support the more volatile transactional revenue DFIN receives as a leading provider of data room solutions for corporate IPOs and M&A. DFIN still derives 40% of revenue from lower-margin legacy printing services, which are in structural decline, but this is being offset by fast-growing software and services. The shares had significantly underperformed since the spinoff due to volatility on the transactional side. We picked up a small position near the lows at a double-digit free cash flow yield but stopped buying when the stock rebounded due to sabre rattling from two small activist investors.

MolsonCoors is one of the world's largest brewers and owns brands including *Blue Moon, Coors Light, Miller Genuine Draft,* and *Miller Lite*. Major brewers have been negatively impacted by growing consumption of craft beers and other alcoholic beverages. More recently, MolsonCoors' shares have been hurt by the prospect of tariffs on aluminum imports, which will increase packaging costs. *Coors Light* and *Miller Lite* are the second and third best-selling beers in America, and *Coors Light* is also the "Right Beer Now" for your Portfolio Manager.

The Portfolio acquired a small position in Big Lots near the end of the quarter. Big Lots was a previous successful holding for our firm. The company's earnings are in the process of roundtripping since we sold in 2014. Same store sales have been stubbornly weak since the middle of 2016 but worsened last quarter as Big Lots posted a -3% comp. Management blamed the weakness on cool weather that impacted sales of seasonal merchandise, and they project same store sales to grow over the rest of the year.

The jury is still out on how well Big Lots will navigate increasing online and offline competition, ranging from websites like Overstock.com to large format close out retailers like Ollie's Bargain Outlet to dollar stores that specialize in consumables. Big Lots possesses an excellent balance sheet and we bought the stock below 7x trailing EBIT and 12x free cash flow. Free cash flow is currently suppressed because the company is remodeling locations to a more polished "Store of the Future" concept, which is arguably sorely needed based on our visits to local stores.

We exited three positions in the second quarter: Retail Food Group (ticker: RFG AU), Greenhill (ticker: GHL), and Primero Mining's 5.75% convertible notes. The Primero bond was retired at par in May upon the completion of the takeover of the company by First Majestic Silver.

We sold Retail Food Group, the restaurant franchisor, during the quarter. *Men at Work* put it best, *"Do you come from a land down under?...You better run, you better take cover."* In last quarter's letter, we informed you that we were performing additional diligence on the name. We shipped two of our brightest blokes to Australia for a walkabout to uncover the

real story on Retail Food Group (RFG). They witnessed a kangaroo get plowed by a speeding Jeep in the bush, but that wasn't their most frightening encounter. Maybe it was the fact that they couldn't find a single franchisee who was happy with the parent company. Or perhaps it was the call a few days into the trip from RFG's CEO, who warned us to not "intimidate" franchisees by politely asking them about their satisfaction. No, the final straw had to be a meeting with top management that was conducted in a dimly lit old nursery, where the only chairs were preschool-sized. Crikey! That up-close encounter made it clear that the people leading the firm were either incredibly dishonest or a few sausages short of a barbie. We bailed immediately.

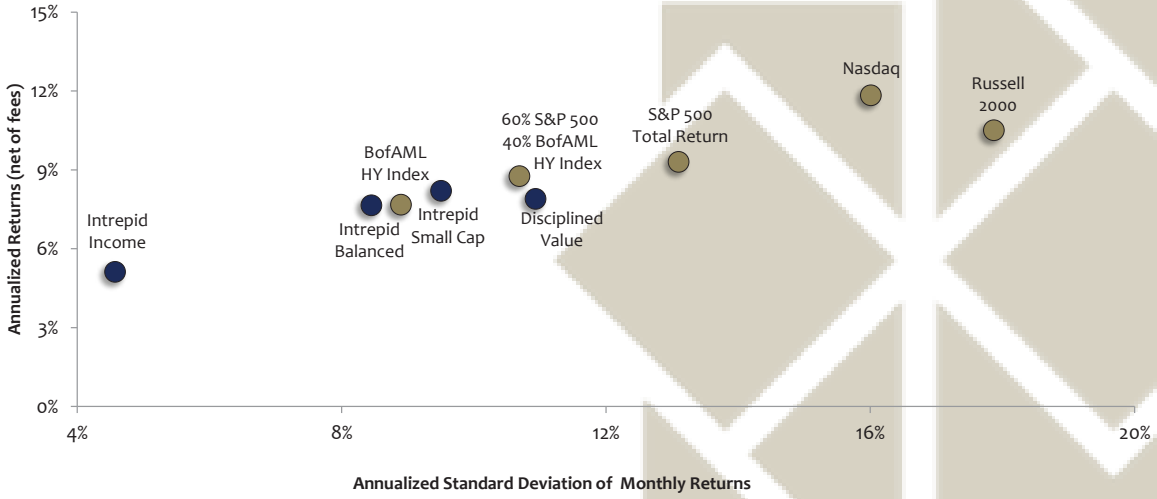
It's not hard to determine where we went wrong on this investment. We bought the shares when they nosedived during an aggressive smear campaign by the media. We were able to internally disprove some of those accusations. We thought this meant the other claims were less likely to be credible or were blown out of proportion, and we felt we had a margin of safety in the relatively stable franchise royalty stream and unrelated wholesale business. Unbeknownst to us, the franchisee base was disintegrating. We didn't reach this conclusion until we traveled from store to store in Australia. While our exit was painful and marred performance earlier this year, we have avoided additional steep losses by selling when we did.

Risk Adjusted Returns

Intrepid Capital

Trailing 15 Year Risk/Return

June 30, 2003 to June 30, 2018



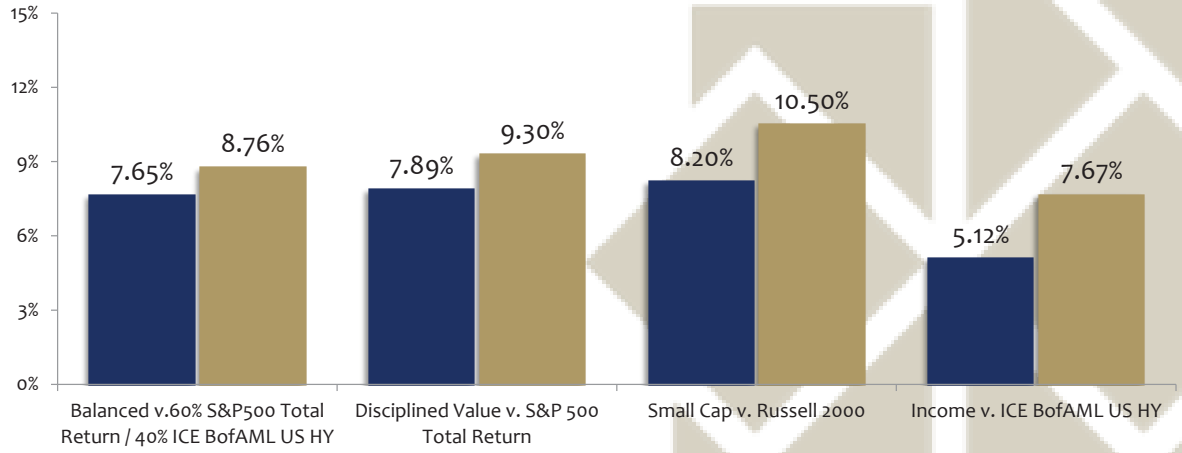
- **Past performance is no guarantee of future results.** Intrepid composite returns are presented net of investment advisory fees and all returns are presented annualized for the 15-year period ending June 30, 2018. Returns reflect the reinvestment of dividends and other earnings. The volatility of 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 which, through name changes is currently the ICE BofAML US HY.

Annualized Performance

Intrepid Capital

Trailing 15 Year Performance Returns

June 30, 2003 to June 30, 2018



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