ISLAMORADA INVESTMENT MANAGEMENT FOR FEBRUARY 2009

TARPON FUND

Letter to Investors

FROM PORTFOLIO MANAGER CALE SMITH

CALE'S NOTES

FEBRUARY '09 RETURNS

The Tarpon Fund ended February down 8.4% from January versus a loss of 10.7% in the S&P 500.

TOTAL RETURNS

Since launch in Nov. '08, the Tarpon Fund is up 3.7% versus a loss of 8.8% in the S&P 500.

IN THIS ISSUE

The discipline of selling, a closer look at Tarpon Fund holding Cogent Communications (CCOI) and investor Q&A.

QUOTE OF THE MONTH

"I've come to believe deeply that business is as important as politics, as medicine, as religion, as the law - as any of the other large forces driving American society. The search for profits can cause businesspeople to do terrible things sometimes, but it can also cause them to do terrific, transforming things." Joe Nocera

Cale in the Keys

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Go forth and seek value

Turning Down the Noise

So it has come to this: the last twelve years of American progress, as defined by the most visible of barometers that is the stock market, have been erased. General Motors, once the world's mightiest company, limps pitifully closer to bankruptcy. Even Warren Buffett, the greatest investor of all time, had his worst year ever.

The markets have suffered their worst February since 1933, with stocks hitting a 12-year low. While down in February, the Tarpon Fund stayed in slightly positive territory as measured since inception. Since launch, the fund is up 3.7% in comparison to a loss of 8.8% by the S&P 500 over the same period. That's spurious outperformance at best, however, since some of our more recent investors have seen their accounts decline in value since joining us.

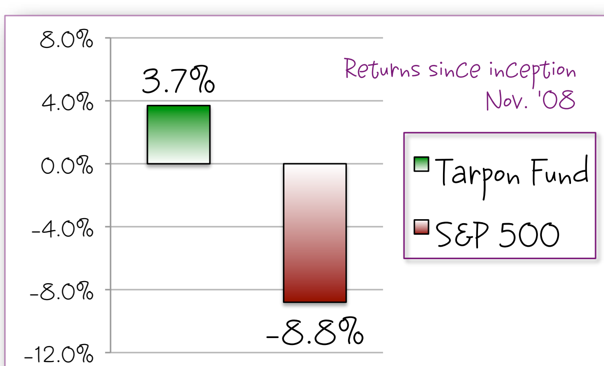
In spite of a daily deluge of pessimism, there are a handful of public companies which recently reported improvements to their businesses. We are fortunate to be partial owners of a few.

Discovery Communications was a bright spot, as distribution sales grew due to higher rates and subscriber growth in emerging networks while double digit ratings growth at Discovery Channel and TLC boosted advertising sales.

Cogent Communications is another business we own that dared to improve the last few months. I spent a few years working in telecommunications, first at a "backbone" provider and then a wireless engineering firm. Though far from an expert, I feel within my circle of competence in evaluating certain telecom companies. Cogent is one of them, and I hope after reading the profile on page three you'll understand why I am a fan.

I made no changes to our portfolio in February. I continue to keep a close eye on each company in the context of competitive strength and business economics. I'll talk more about when I might consider selling any of our holdings in this month's Value Investing 101.

Lastly, a word about patience. We are currently experiencing turbulence from the most speculative period by dollar amount in our nation's history. The market today is driven overwhelmingly by speculation, expectations and emotions from an army of prognosticators behind every keyboard and in front of every camera. While the perceptions of all these players in the market are totally unpredictable, I'd like to reiterate an important point:



In the end, opinions count for nothing.

The long-term returns of a portfolio of stocks are dictated by the economics of those businesses. Period. Everything else is noise.

BUFFETT ON MUNICIPAL BOND INSURANCE

CONSIDER YOURSELF WARNED

In 2003, Warren Buffett wrote in his annual letter to shareholders, "Derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal." I think its safe to say he has now been proven correct. In his most recent letter, Buffett discusses the issue of moral hazard in municipal bond insurance:

" When faced with large revenue shortfalls, communities that have all of their bonds insured will be more prone to develop 'solutions' less favorable to bondholders than those communities that have uninsured bonds held by local banks and residents. Losses in the tax-exempt arena, when they come, are also likely to be highly correlated among issuers. If a few communities stiff their creditors and get away with it, the chance that others will follow in their footsteps will grow. What mayor or city council is going to choose pain to local citizens in the form of major tax increases over pain to a far-away bond insurer?"

If Buffett is correct, municipal bonds could be a potentially dangerous place to park your money. If even just a few communities default on their insured debt, many others would likely be downgraded or cut off from the capital markets altogether - whether they risk default or not. Perversely, even healthy municipalities could be left with little choice but to default.

In other words, municipal bond insurance might be yet another Wall Street innovation which makes a lot of money for a few companies...right until it blows up on everyone else.

Value Investing 101

The Discipline of Selling

The question "When will the market turn?" is of such importance to so many on Wall Street that it seems hard for them to think of anything else. To the speculator, being uncertain is synonymous with selling. Contrast that with the value investor's approach.

On March 11, 1955, Benjamin Graham, the father of financial analysis and value investing, gave testimony to the U.S. Senate's Committee on Banking and Commerce. When asked by Senator William Fullbright, "What causes a cheap stock to find its value?" Graham replied, "That is one of the mysteries of our business, and it is a mystery to me as well as to everybody else. But we know from experience that eventually the market catches up with value."

Being patient, however, is not the same as being stubborn. While buy-and-hold-forever is the superior way to grow wealth in the stock market, there are times when it makes sense to sell regardless of how long shares have been owned. Its important to be as disciplined when selling as it is when buying, however, or else emotions can get the best of you - particularly in volatile times like these.

So when should we sell? I use these four instances as guidelines:

1. When the market believes the shares of a business to be more valuable than fundamental analysis warrants. This could mean either that shares have risen to their intrinsic value, or that new information arises that has high odds of dramatically reducing a company's true value.
2. To create the cash to buy something even more undervalued. In other words, when the opportunity cost is too high.
3. If the fundamentals begin to indicate permanent deterioration in the business. Its important to distinguish between a temporary trend and chronic illness as quickly as possible.
4. When events develop that otherwise reflect poorly on management's judgement. This could be a string of meaningful insider sales at a suspicious time, overpaying for an acquisition, an SEC investigation, or, for instance, any paragraph in a major newspaper than includes a CEO's name and the words "federal investigators," "cocaine distribution" or "prostitutes." (Google 'Henry Nicholas.' He nailed all three at once.)

Another instance which should get your attention but isn't necessarily a negative is a sudden change in the management team. This is the "leaving to spend more time with family" scenario. Its commendable if true, but it can also be spin for "we're throwing Bob under the bus before we surprise you with something unpleasant." That said, as value investors we're usually buying companies which are temporarily out of favor, and management changes often come with the territory. So they can just as easily be a positive sign.

Please note that missing from the above list is the "sell if you can't tell when the price will stop going down" scenario. This is what seems to be plaguing the market today. Selling after every uncomfortable drop will leave you insolvent from commissions and schizophrenic from second-guessing. Successful investing takes time, a clear head and a strong stomach - now more than ever.

Get to Know Your Company

The Only Moat in Telecom

Cogent Communications (CCOI) carries 17% of the world's internet traffic. The company owns a 47,000-mile fiber-optic network, services more than 17,500 customers in 130 major markets and interconnects with more than 2,500 other networks. Customers include NBC, YouTube, eBay and hundreds of cable companies. Remarkably, the company has just 530 employees. Competitors have ten times that many personnel.

Cogent's sole focus is providing internet access for two groups of corporate customers - users located in one of the 950 large multi-tenant office buildings hooked into the company's network, and companies which host their IT gear in offsite data centers. Cogent serves as an Internet "backbone" to companies within approximately 350 of these data centers around the world.

Cogent is unique among telecom companies because it was built from scratch on a heretical idea - providing high quality internet as a cheap commodity. The company's advanced network and low cost business model enable it to expand its market share in the downturn as new users seek more bandwidth and lower prices. Cogent's key insight is that over the long-term, the lowest price per megabit wins.

Why is This a Great Business?

The superior economics of an all-fiber network and the cost advantage that it creates. Struggling competitors and savvy management help, too.

Cogent took what was previously a network architecture for small, local area networks and deployed it globally. Imagine your office network on steroids. Cogent's network transports just Internet traffic, not voice nor the other mish-mash of legacy technologies provided by the big phone companies. To Cogent, those other networks are expensive, irrelevant and unable to reach critical scale.

Cogent needs very little capital to build out its network. It obtains long-term leases on strands of existing fiber optic cable from other companies, and adds equipment built just to amplify and redirect traffic. While competitors race to add more bells and whistles to their networks, Cogent provides, in the most positive sense of the phrase, a "dumb pipe."

The equation that describes the company's business model is this:

Highest traffic + most capacity + lowest costs = biggest moat.

Competitors see the same opportunity, but they are more focused on higher traffic or debt service than lower costs. They would have to blow up their existing businesses to capture the same structural cost advantages as Cogent. The small but growing moat around Cogent's business is reinforced by average costs that are lowered every time a new customer is added. And recently, that has been pretty often.

Due to new volume-based discounts initiated in June of 2008, Cogent realized a 25% growth rate in revenues from the third quarter to the fourth quarters of last year. Though unprofitable, the company is creating solid free cash flow, and the benefits of the company's high operating leverage should begin to become more apparent in the company's earnings. Management estimates that for every $1.00 of revenue added to its existing network, $0.95 cents becomes income - before interest, depreciation and taxes are deducted.

Cogent also estimates it is only using 22% of its network capacity, so it has plenty of pipes it can cheaply fill. Major backbone competitors Level 3 and Global Crossing have less spare capacity at a time when they are hampered in their abilities to buy more given already large debt loads. Neither firm can afford to fund further operating losses by undercutting Cogent's industry-low prices. It's good to be the low cost leader.

Why is it Cheap?

Forced selling last fall, missed guidance in the second half of last year and concern about the company's propensity to pick high-visibility fights with larger rivals.

Is it Cheap for Temporary Reasons?

Yes. Despite an 80% rise since our initial purchase, I believe shares are still undervalued, due in part to the angst that continues to hang over the market. As the recession continues, Cogent should benefit from weakening competition and greater demand, and long-term contracts mean customers will stay put after the recovery. Earnings should improve significantly over time due to high operating leverage. In the interim, Cogent can easily service or retire its $92M in convertible notes (due in 2027) as it continues to buy back shares.

What is it really worth?

By spending $60 million after the telecom bust in '01, Cogent acquired 13 companies that had previously raised $14 billion in capital and deployed $4 billion in property, plant and equipment. I believe the long-term earnings power of those assets is underappreciated. The market believes the company is worth only $275 million today, or $6 a share.

If we viewed Cogent as it wants to be seen - a transporter of a bulk commodity - then the company's real value lies in its huge distribution network, not unlike a fleet of delivery vans. More customers per fiber strand is like a van making more drop-offs per trip - both lead to more profitable transport and widen the barriers around the business.

I believe Cogent possesses the only true moat in the U.S. telecom industry, and that shares are worth $9 today. If Cogent can achieve sustainable scale, it will be able to generate higher profits than its competitors while continuing to underprice them. Its moat would also become wider, and our business will be even more valuable.

Q&A Ask The Geek In The Keys

What do you think about gold or commodities?

We won't ever have direct exposure to gold or commodities in the Tarpon Fund. Commodities are by definition speculative, and I'm only interested in investing. The value of commodities is determined exclusively by supply and demand, and they lack the internal rate of return that ultimately determines the price of a stock or bond. That said, we could conceivably invest in companies that extract, produce or transport commodities. Our newly launched Gecko Fund, for instance, is invested in several high yield pipeline operators. But I won't seek direct exposure to commodities through ETFs, derivatives, or other managed funds.

Are you concerned about inflation?

Yes, inflation is a real risk to all investors these days. The best protection we as stock investors have against inflation is owning great companies that have pricing power. The threat of inflation underscores the value of owning low-cost providers, like Cogent, that set prices in their industry rather than react to them. I am not nearly as concerned about inflation as the pundits, however, for two reasons. First, the dollar has been strengthening recently, which means the rest of the world still has faith in the U.S. even as we crank up our massive printing press. I also view inflation as a policy tool, not an unintended consequence. Here's why.

The assets and debt of the United States are increasingly owned by foreign investors. From T-bills to mortgages to toll roads to resort hotels, other people own our stuff, and that trend clearly can't continue. The most efficient way for America to systematically and legally devalue the claims that other countries have on our assets is through inflation. So a little inflation is not only okay, it's been our policy. Bernanke makes an easy target these days, and I'm skeptical of putting too much trust in any institution, but its hard to dispute that the Fed has plenty of experience in controlling inflation. I think its rational to assume that inflation will increase, but also that the Fed can continue to control it in the long-term. Otherwise, the dollar would be plummeting, and I'd be melting down my fillings and stockpiling soup.

The companies in the Tarpon Fund can handle modest inflationary pressure. For the time being, there's no point in worrying about much more than that.

What about the debt that Discovery Communications has?

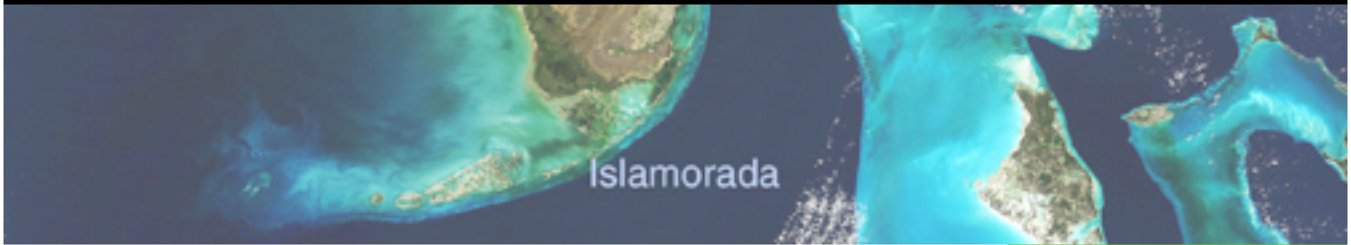
Discovery currently has $3.7 billion in long-term debt, which may sound like a big number until you look at its commitments and cash flows. Half of that debt does not come due until after 2014, and the company has expressed its intentions to refinance/extend the rest. Should that not be possible, Discovery would likely pay down its term debt through an existing $1.2 billion revolving line of credit. The company has approximately $670 million in principal and interest payments due in '09. Based on one rough measure, Discovery should be able to produce twice as much cash flow as it needs this year to cover all principal and interest payments, as well as all projected capital expenditures, too. So, I don't foresee any issues with Discovery servicing its debt.

Are any of our companies going to benefit from the economic stimulus plan?

Autodesk (ADSK) may see some direct benefit. The company's customers have traditionally included construction and engineering firms, which should be large beneficiaries of the plan. Any benefits to our other companies will be indirect.

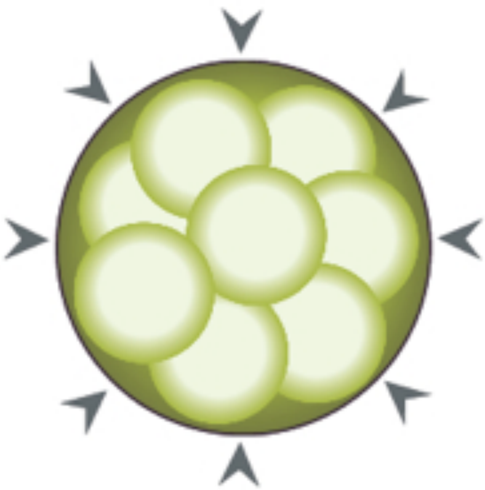
What's the quickest way to tell how my account is doing?

Log in to your account at www.folioclient.com. In the "Account Quick Links" drop-down menu, select "Performance." That will show how your Tarpon Fund account is performing compared to the S&P 500 - the broader stock market.



More about the Tarpon Fund

Our Hub and Spoke Model



Mutual Fund

Average fees of 1.73% based solely on amount of investor assets gathered

Only 43% of fund managers invest in funds they run

Fund must pass on all its taxes to its investors

All investors must have identical portfolios

Fees paid are the same regardless of performance

Owns average of 150 stocks that are frequently traded

Investors' selling can create higher taxes and lower the returns of others

vs.

Tarpon Fund

Fees based on 0.90% rate and adjusted for performance

Fund manager is a significant investor

Each investor can customize account preferences

Taxes are minimized and none are forced onto investors

Three levels of account insurance up to $11.5 million

Investors' selling does not affect any other investors

Owns an average of 15 stocks held for the long-term

Sources of above data available upon request.

DISCLAIMER: The historical performance data contained represent performance results as reported by the funds listed. The performance results are for illustration purposes only. Historical results are not indicative of future performance. Positive returns are not guaranteed. Individual results will vary depending on market conditions and investing may cause capital loss. The S&P 500, used for comparison purposes, is significantly less volatile than the holdings of the funds listed. The performance data is "net of all fees" reflecting the deduction of advisory fees, brokerage commissions and any other client paid expenses. The performance data includes the reinvestment of capital gains. The publication of this performance data is in no way a solicitation or offer to sell securities or investment advisory services.

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Calculations
Performance returns are based on a real portfolio of $12,000, the minimum required to invest. I have invested a significantly larger amount in the fund outside of this tracking portfolio. Returns mentioned in this letter are presented on a pre-tax, non-annualized basis, net of all fees and transaction costs. Returns are computed using a simple holding period return formula. Your returns may be greater or less than what is presented in this letter. Please see the full disclaimer at left.