TARPON FUND

ISLAMORADA INVESTMENT MANAGEMENT

www.islainvest.com

(305) 522-1333

csmith@islainvest.com

Why the Tarpon Fund Owns Google

A special report for Financial Freedom Weekly

About The Fund

The Tarpon Fund was formed in November of 2008. For that first month, the fund achieved returns of 18.5%. While pleased with our results, and still optimistic about the long-term potential of the fund, we caution investors that such monthly returns are highly unlikely to continue. We were fortunate to acquire shares in 16 terrific businesses at a time when fear in the market seemed at its highest. At the end of November the market also realized the largest five-day percentage gain since 1933, though it received limited attention from most media outlets. We believe we are now witnessing one of the best buying opportunities for equities of the next five years.

> "The Tarpon Fund acquired shares of Google at an average cost of $278 per share. Opportunistic long-term investors might consider doing the same.
>
> Even under the most pessimistic scenario and using a highly conservative cash flow model, we believe the company is still worth at least $500 a share."

The largest holding in the Tarpon Fund by market cap is Google (GOOG) and the smallest is Pzena Investment Management (PZN). The Tarpon Fund is a "go-anywhere" fund, meaning it is not limited to any particular size of company nor industry. All companies held are domestic, listed companies. The market capitalization of the fund's holdings breaks down as follows: 36% small- and microcap, 29% mid-cap, 29% large cap, and 6% cash. The average trailing P/E ratio of the holdings in the fund at the time of purchase was 9.3. Sectors represented include financials, consumer staples, telecommunications, healthcare, industrial products, media and transportation.

Despite recent gains, all companies in the Tarpon Fund are still trading at remarkably low valuations. In this market, investors need not scour all corners of the market for such deals, either. Take Google.

Bears vs. Bulls

Google competes in numerous high-growth and emerging lines of business, making its future cash flows hard to forecast with a high degree of confidence. Shares are down 64% to $266 from a high of $747 in November of 2007.

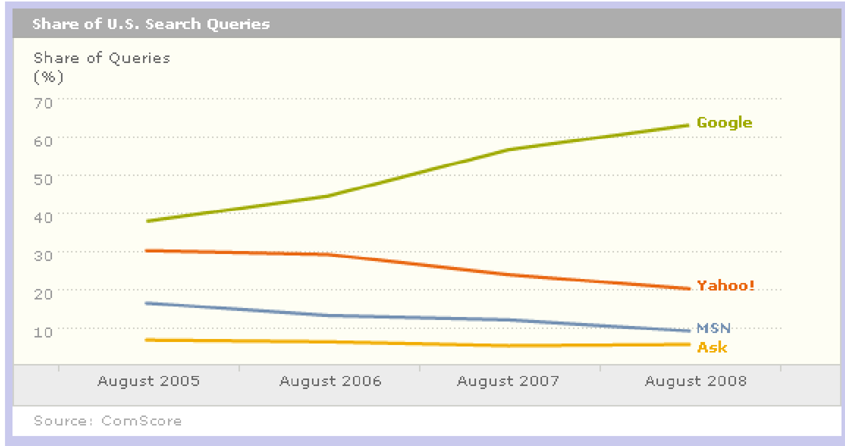
The bearish case for the company goes something like this:

"Online advertising may be more vulnerable to a recession that previously believed, and Q4 will likely be the weakest ad spend market on record. Two of the largest categories of online ad spending are financial and automotive, sectors having their own obvious struggles lately. Google also has yet to develop significant revenue streams outside of search, and the effects of foreign currency adjustments will be an additional headwind in the short-term."

Why the Tarpon Fund Owns Google (cont.)

Our bullish case for Google can be summarized as follows:

The bad news is already reflected in the current share price. Google will continue to be the major beneficiary of the secular shift of advertising budgets from offline to online and mobile channels. If online advertising were a bridge, Google would own the toll booth.



A Cheap, Wide Moat

The economics of Google's business remain strong, and the company continues to take market share in its key market of Internet search due to some underappreciated aspects of that business. Management is now initiating some (in our opinion) overdue cost containment policies and remains committed to long-term viability. CEO Eric Schmidt is fond of saying it will take the company 300 years to achieve its goals.

We believe shares anywhere under $300 are a tremendous long-term bargain. Even under the most pessimistic scenario and using a highly conservative cash flow model, we believe the company is still worth at least $500 a share.

At today's prices, Google's valuation is the lowest it has ever been as a public company. A simple way to illustrate that point? The company went public in August of 2004 at a price of $85 per share but trading at a P/E ratio of 58. Now, however, Google's '08 P/E ratio is 17, and we'd argue the economics of its business have grown considerably stronger in the interim.

Paid search, which represents 90% of Google's revenue, generates significant free cash flow – specifically, $4.7 billion over the last 12 months. The company's balance sheet is rock-solid, with more than $14 billion of cash and no debt. With the exception of some foreign currency hedges, the company is also blessedly free of any unsavory swaps and derivatives. The company's annual revenue growth has averaged a stunning 140% per year since 2001. While the company's profits are growing more slowly now, the odds are very high that they will continue to grow respectably for many years to come.

Google helped create the paid search industry wile building the largest syndicate of advertisers and content partners on the planet. Paid search is highly profitable and scalable. Marketers will continue to shift advertising from conventional media to the Internet for two key reasons – (1) online advertising provides them with a higher return on investment, and (2) search advertising is more measurable. Google will benefit most from this shift – which could accelerate meaningfully as its competitive position continues to strengthen.

The company's competitive advantage is its massive scale of search queries and clicks, which creates a positive reinvestment loop. The outsized profits generated by paid search are reinvested in additional computing power and human capital to constantly improve the company's search algorithms. That leads to even more relevant search results, happier users and higher advertising ROI. A massive trove of historic click-through rates also helps the company's search ad platform get smarter over time. Due to its massive scale, Google maintains a significant moat around its core business of search queries.

The Tarpon Fund acquired shares of Google at an average cost of $278 per share. Opportunistic long-term investors might consider doing the same.

Please contact Tarpon Fund Portfolio Manager Cale Smith at csmith@islainvest.com with any questions. For future e-mail updates about the Tarpon Fund, please sign-up for our newsletter at http://www.islainvest.com .