TARKIO FUND

A No-Load Mutual Fund Managed by:
Front Street Capital Management, Inc.

Costco has been a core holding in the Tarkio Fund since the fund's inception, and it has been an important holding for the fund's advisor since 1997.

If you read our quarterly letters, you will know that we look for companies (and their managers) that exhibit:

1. Integrity and trust
2. A long-term focus
3. Purpose and passion
4. Teamwork (cooperation; not competition)
5. Employee empowerment (drive fear out of the organization)
6. Disciplined allocation of capital

We believe companies behaving according to these criteria can create an organization that unleashes the best in human potential. If done consistently over time, these companies develop a culture of continuous improvement that can perpetuate indefinitely into the future. We believe Costco is another shining example of what can be accomplished when employees at all levels of an organization are focused on the process of making the business as good as it can be.

The core of the Costco culture is putting the interests of the employees and customers first. The company's founder and board member Jim Sinegal believed that, by focusing on serving these two constituencies, Costco could produce the best long-term return for shareholders. His courageous adherence to this philosophy has produced one of the most loyal and durable customer bases in retail and, as a result, one of the most profitable compounding investments over the past quarter century.

Based on Costco's passion for building trust and delighting customers, Sinegal's vision incorporates a key strategic element: Costco's profit margins are almost identical to its customers' yearly membership fees. In other words, Costco's entire retail operation is run basically at cost. As a result, the goal of the entire organization is to delight its existing customers so they will renew their memberships and create demand for new members in locations where Costco opens warehouses. Sinegal and the company have shown admirable discipline executing this strategy in the face of constant pressure from Wall Street to raise prices in order to obtain higher short-term earnings. It has been an honor to be associated with a business that has been so singularly focused on the long-term health of the company. My confidence in this approach is reinforced every time I purchase a hot dog and drink (for the princely sum of $1.50) from my local Costco.

The entire premise behind our investment thesis is that when a company creates incentive systems focused on customer satisfaction and engaging employees – at all levels – to incrementally improve the business process, unique and powerful ideas can emerge. I could go on about the various aspects of Costco's business practices that have contributed to building an iconic brand, but for the purpose of this letter, I will focus on one example. I was fortunate enough to have had a working relationship early in my career with the CEO of an important retailer in the Pacific Northwest. He once told me that the biggest headache for a retail purchasing agent is how to handle a very popular product. If you do not stock enough of a "hot product," you will run out of it, and customers will be furious with the company. On the other hand, if you make sure there is more than enough of the product to handle demand, you will inevitably get stuck with excess inventory that will eventually be marked down at a loss.

Costco has an elegant solution to this problem that has evolved from its efforts to benefit its customers by finding ways to offer lower prices. By opportunistically purchasing trendy or unique products at very favorable prices and passing 100% of those saving along to its customers, Costco has turned the "hot product" problem on its head. The company's opportunistic buying approach, means that these "hot product" offers are often one-time deals. Consequently, Costco shoppers regularly come across screaming deals on popular products that can be available one week and gone the next. Customers have come to appreciate the value that accrues to them through Costco's disciplined opportunistic buying, instead of begrudging the company for lack of inventory. The company calls this phenomenon the "Treasure Hunt" aspect of its business, as customers are always on the lookout for something exciting and do not hesitate to act when it becomes available. Costco's customers know that its purchasing agents get incredible one-time deals and all of those saving accrue to the customer. It is no coincidence that inventory on the warehouse floor turns over at an eyebrow raising rate, and according to a CSI Market analysis, Costco's inventory turnover ratio for its most recent quarter was 43% higher than Walmart and 106% higher than Target.[i]

Lastly, our sixth bullet point for management behavior criteria is "disciplined capital allocation." We actually give most of our companies a bit of leeway on this particular criterion, as we believe most CEO's do not have a value based investment background to draw from when making capital allocation decisions. Costco on the other hand has had the luxury of having Charlie Munger (Warren Buffett's partner) as a board member since 1997. Not coincidentally, that is the same year I began accumulating Costco shares in the accounts I managed at that time. Costco has been superbly disciplined with regard to its capital allocation. The company has always maintained both a strong margin of safety and an astutely opportunistic approach to all aspects of its balance sheet. In addition, Costco has been disciplined in growing at a very measured pace, again pushing back on pressures from Wall Street to accelerate short-term growth. Finally, excess cash has always been opportunistically and intelligently distributed to shareholders either through one-time cash dividends or stock repurchases.

We regularly discuss how fortunate we are to have a committed group of like minded investors who appreciate unique companies that create corporate cultures designed to energize employees at all levels of the organization on a journey of continuous learning and improvement. We sincerely appreciate your continued confidence and support and look forward to our next correspondence.

Warm regards,

Russ (and Michele, Ginger, Dominic and Jeremy)

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[i] According to CSIMarket.com, Costco's "inventory turnover ratio" (cost of sales divided by average inventory levels during the period) for its quarter ending May 7, 2017 was 11.50, while Walmart's inventory turnover ratio for its quarter ending April 30, 2017 was 8.07 and Target's inventory turnover ratio for its quarter ending April 29, 2017 was 5.58.

On August 31, 2017, Costco was 4.92% of the Tarkio Fund Portfolio at a share price of $156.74 per share. The mention of any investments in this commentary should not be considered a recommendation to sell or purchase the security(ies) mentioned or similar investments. Please consult an investment professional on how the purchase or sale of such investments can be implemented to meet your particular investment objective or goals.   Investments in securities and/or similar investments are subject to risks. It is important to obtain information about and understand these risks prior to investing.

Mutual Fund investing involves risk. Such risks associated with the Tarkio Fund (including but not limited to Small/Medium Capitalization Risks, Foreign Securities Risk, Fixed Income Securities Risk, Non-Diversification Risk, and New Fund/Adviser Risk) as well as applicable investment objectives, charges and expenses must be considered carefully before investing. This and other important information about the Tarkio Fund is found in the Prospectus, a copy of which or current performance information may be obtained by visiting www.tarkiofund.com or by contacting 866-738-3629. We encourage you to read the prospectus before investing.

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