



Kopernik Global Investors, LLC

Edited Transcript of the 2nd Quarter 2016 Conference Call with David Iben

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Operator: Please stand by. We're about to begin. Good day and welcome to the Kopernik Global Investors Second Quarter 2016 conference call. As a reminder, today's call is being recorded. At this time, I will turn the call over to Kassim Gaffar. Please go ahead, sir.

Kassim Gaffar: Thank you. Good afternoon and thank you for joining us today for the second quarter conference call. My name is Kassim Gaffar and I have with me Dave Iben, our CIO and Lead Portfolio Manager for the Global All-Cap Strategy. Before I pass it over to Dave for the majority of the call, I would like to give a quick firm update. Since our last call three months ago, the firm has continued to grow from a personnel and asset standpoint. We are now 35 people strong and that includes a new hire who will be joining us starting on August 1 and will be a member of the investment team as a global research analyst.

Given the continued bifurcation in the market, we continue to bolster all parts of the firm, including the research and investment side. From an AUM standpoint, compared to the end of last quarter, we're currently at \$2.3 billion versus \$1.8 billion from three months ago. That number has grown due to market appreciation given strong performance of -- by the strategy coupled with positive flows from some existing and also from newer clients during this period. Interestingly, we have seen newer clients hire us as many of the capital allocators are starting to reduce their exposure away from quality growth and other investment styles into value, and we have been the beneficiary of this change.

Lastly, Dave will be referring to a presentation during the call and the link of the presentation and the actual presentation can be found on the website, www.kopernikglobal.com under the News and Views section.

And with that, Dave, please go ahead.

Dave Iben: All right, good afternoon to everybody and thank you for joining in. I also want to reiterate thank you all very much for support for what's been over three years. Time flies. Thank you very much. I figured we would start by talking. First of all, I'd let people know that in the posting on our website is our most recent commentary. The commentary is called The Passenger. It's a discussion of active versus passive management. Not too shockingly, we're in favor of active management. Secondly, for a long time we've been hearing is it too early for value investing. Now, a common question is are we too late, have we missed it? We don't know the future but we don't think we have missed it and we'll talk a little bit about that.

But to do that, let's start with we were fortunate enough to speak at a London Value Investor Conference a couple of months ago. It was very fascinating. I highly recommend it to anybody. I think it happens every May, but it was interesting to see just how far out of favor value is. Value investors aren't value anymore. The first speaker asked people to raise their hands, who here would consider themselves traditional value versus more of a franchise investor, and I think over half the people at a value conference didn't call themselves value anymore. Although, I do hear a year ago it was almost nobody left in value. So maybe the tide has turned. We'll see.

Whether value has more to go and last time we were at a place like this, around 2000, the run for value lasted for many, many years. But it all comes down to math and we think the math is still pretty compelling for value stocks and pretty challenging for a lot of other stocks. So we'll go into that. But value can't be talked about without talking about what value is. Well, let's start by where the index doesn't have as much value as



it once did and we put that we are unconventional. We have a pretty high active share. We look a lot different than the index as we look at numbers. I think we'll see that now is good time not to look like the index, but for good or bad, we look at lot different than the index and we'll try to tell you why we think that's good.

So what is value? Value can be lots of things. What we hear all the time is value is the intrinsic value of future cash flows. Maybe, but we don't know the future and so to try to -- as the cliché says, skate to where the puck is going, we have to look at where the value is. Where the value is today is probably where things are going to be working in the future. Discounted cash flow models, they look to the future or do they? We will notice that if we knew the present value of future cash flows that would be great. Cash flows right now are assuming margins that are double normal. So that might be too optimistic. Growth rates that have been sustained by massive debt buildups over the past, that could be a challenge. Discount rates, whether people should do six, eight, ten. I think over the years, ten was a number that was common. Now, a case can be made discount rates should be way lower. After all, quoted inflation has been very low for a long time and the "risk free bond rate" is lower than it's ever been in the history of mankind. So maybe we should use lower rates. On the other hand, the U.S. did print \$4 trillion out of thin air. The Europeans and Japanese have been trying to catch up quickly. The Japanese I guess are seriously considering helicopter money now.

Maybe discount rates should be higher than they've ever been for what the consequences of all this money printing will turn out to be. Time will tell, but risk is probably higher than it's been in my lifetime anyhow. As far as how things look, you buy where things look good. I always quote John Templeton who says people ask where things look good, and he says wrong question, where do they look challenging. People always buy where things look good. It just turns out that's the wrong place to buy. Things looked good for oil in 1980. They looked bad for oil in 2000. They looked really good for financials in 2007 and they really good for technology in 1999. Things look very good in a relative sense for the United States right now. Things look challenging for emerging markets. That's the reason why emerging markets are pretty cheap and that we find interesting.

We find that five or six years ago, people would pay big premiums for the emerging markets and now, it's roughly 10% of the index. 10% of the index for six billion people out of seven billion, and most of the economic growth in the world, and most of the resources in the world, a lot of the world's GDP, we find a lot of value there. And then we can move onto other things. Here's a slide I'm told maybe is getting old I've used it so much, but I plan to keep using it. I think it is the key thing right now. We are in a world where we can get zero from our bank account and zero from our money market accounts and zero from bonds. Some bonds pay better than zero. Some pay less than zero. I think 10, 20, 30 years ago we would have all said that is impossible that people would actually loan money to somebody knowing that if everything worked out perfectly, they would lose money on that investment. Fascinating concept.

And so as we've talked about in the past, whether you're making minus one, or positive one, or positive three, none of those are really compellingly when we can buy great railroads, and airlines, and wind farms, and regular farms, and goldmines, and hydroelectric dams at half of what they're worth. This chart, maybe I should pare it down because six months ago, 5X was a reality. A lot of these things have doubled. 5X isn't a reality anymore. Let's look at the chance of doubling it. If some of these things double in the next two years, that's 41% a year. If it takes ten years, that's 7% a year. We think good franchises that produce stuff that people need and are selling very cheaply make a lot more sense than bonds, make a lot more sense than cash, make a lot more sense than about anything for that matter.

Let's go through a few examples. A lot of things have run, but others haven't and even the things that have run are pretty cheap. So people will continue to eat food. We're pretty sure of that and the ability to make food we like some of the pieces that are Jeremy Grantham written in the past and others have written. It's been a miracle the last 100 years the productivity per acre. That better continue, but it might not. We're reaching some extremes and the amount of arable land is getting tougher. We're losing top soil. There's soil problems. There's salt problems. There's water problems. Owning good, quality farmlands in places like Indonesia, and the Ukraine, and Brazil, and Argentina, you name it, is pretty good. Just a reminder to everybody, we're not buying farmland. We're buying publicly traded corporations that have been growth companies and profitable for a lot of years that control the farmland. But one times book and five, six times earnings is a pretty amazing thing.





In the terms of have we missed it, we were saying how great it was to be able to buy hydroelectric franchises at 15% to 20% of what it cost to build these things. These things have now shot up to 40% or 50% of book value. We think 40% to 50% of book value for things that are six, seven, even 13 times earnings is extremely attractive, a lot more upside left. These were extremely depressed and they still are a far cry from where they were three to four years ago. So based on asset value, based on cash flow, based on you name it, these things look very attractive to us.

We've talked about energy. Oil is something we haven't owned much of. We've talked a little bit about what we have had, but gas we've had for a while. We think a third of book value and four times earnings is pretty cheap for the biggest, longest lived, lowest cost gas company in the world. We think we should get a big discount because it's in Russia and that's not any of our first choice, but we're getting way more than a moderate discount. You don't see a third of book value every day. You don't see oil at less than \$1 a barrel and most of the majors are 15 to 20 times that. So still lots of value there.

Continuing with monopolies and oligopolies, and companies that meet the basic needs of a growing population. Here again, the stocks have quickly gone up three times. So not 10% of book now. It's all the way up to 30% of book and four times earnings. This is the monopolist utility grid in Russia. Ships -- ships are the classic cyclical company. They make lots of money. They all buy a bunch of ships and they lose a bunch of money. Then they all scrap a bunch of ships and then they make a lot of money. We are at one of the biggest down cycles ever. It's a really tough time to be in this business.

The companies that are strongest and best managed are the ones to own at distressed prices. These are pretty distressed prices. The distress a few years ago was oil tankers. We owned them. Now, the distress is in the bulk tankers and that's where we mostly are now. Gold is on the run. Gold stocks have had a run. We were 25% gold. We are still 25% gold. Being still 25% gold means that we've sold lots and lots. We've been trimming every day our gold stock just to keep down. If the stocks continue to go up from here then you'll start to see the model weight fall below 25. Twenty five is something, we've been at three times in a third of a century. We first went there when the stocks were about this level three years ago. We're hoping these things continue. It's important to realize the intrinsic value of gold has undoubtedly gone way up over the last five years, even as the market price has gone down.

You see since the great financial crisis, the supply of money as defined by gold has been growing at less than 2% a year. The supply of money as defined by various fiat currencies has been growing a lot faster than that. And of course, the price of gold had doubled in that time. But it hasn't begun to keep up with the supply of others. More importantly, the gold mining companies, like some of the emerging markets, we no longer see the five times upside. It's more two times, but still very, very attractive. So we like those and as they continue to go up from here you'll start to see the model weight fall from where it's been.

So just to quickly go through other things before we move on, just to reiterate what we said, I think Jim Grant, he always put things better than we can because we're bearish on the money of overextended governments. We agree. They're bullish on the periodic table. We agree, although we'll expand that to say scarce and valuable things. That includes business franchises and resources, you name it. And fortunately, those are the things that the market no longer likes. So that's where we are.

A few other things that are probably worth mentioning. The portfolio was 45% of book now 75% of book. It's still very attractive to us. It was less than 3X times cash flow and now it's 4.5X cash flow. Very attractive. The enterprise values to sales is still less than 1.5X. So very nice valuations. We continue to be weighted in the growing parts of the world. And as far as activity, those of you that have known us for a long time know we don't trade a lot, except for when the market compels us to. The two very compelling times over the last 20 years were the really meltdown in '02 and strong bounce back, and the meltdown in '08 and strong bounce back. Both of those saw a turnover at roughly 100%. And now, it continues to, you know, the 20%, 30%. What we've had now is not -- there was certainly some volatility and there was an interesting market in January, and there was two days of downside volatility following the Brexit. People got over it on day three I guess.

And so there hasn't been enough to cause us lots of trading, but there has been lots of trims. We've, as I mentioned, constantly been trimming gold stocks. We've constantly been trimming the emerging market





stocks just to keep them where they are. Outside of that, we've been able to trim some of the technology such as Pandora Media and Yandex that have bounced back. We've continually trimmed SkyWest Airlines. That's why we've owned it, it's gone from 5 to 28. Still less than book value.

The other side of the equation, Japan has been notably left out. In Yen terms, it's been really bad. In Dollar terms, it's been a little better but it's still some good franchises have been getting very cheap. So we've been buying port companies at less than book and water purification companies, and technology companies for small fractions of book. And then with almost everything in the world running up, the notable exception has been the thing we've been most bullish about, and that's uranium. We find there the fundamentals compelling. There has been nothing in the last couple of years that would suggest things aren't as good as they've ever been. So we continue to see the plants are getting built, if a little slower than expected and things in Japan come back, if a little slower than expected. No new mines are being developed. Not a lot of money is being spent exploring or looking for it. The demand continues to be way in excess of the mine supply the secondary supplies are slowly running out. The Department of Energy cannot sell forever. The Russians, after 20 years of selling, have finished two and a half years ago.

So it's, in our opinion, a matter of when not if the price of uranium triples from these prices. Time will tell if we're right but we continue to have Cameco as our largest holding. We've added to our Uranium Participation. We have added a little bit to a few small little names. So we continue to like that. Oil, we were able to add a little bit of oil back in January, February and the only pure oil name we bought was Marathon Oil. Since then, they sold stock at the bottom, which we didn't like and the stock tripled, which we did like. And we sold. So that's been in and out of the portfolio.

So that's it. Not a lot of activity. We continue to think we're in a world that's slowly but surely needs to recognize value and is starting to do so. Time will tell and let's save most of the time for Q&A. Thank you.

Operator: And ladies and gentlemen, if you would like to ask a question please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We'll take our first question from Mark Johnson with RBF and Company Wealth Advisors.

Mark Johnson: What's your take on coal? Notice that you still hold onto some Peabody and Cloud Energy looks like it's been doing pretty well for you. Thank you.

Dave Iben: Yes, Cloud's done well and Console has done very well. Peabody was a very painful investment. A few points to put there. Coal we believe as we always have believed that where coal will continue to lose market share, maybe forever, it's not going away. It will continue to be an important part of the world's electricity. People in certain parts of the world are continuing to build coal-fired plants. The supply of coal has been not coming on as people are going bankrupt as opposed to overinvesting like they were five or six years ago. We continue to think that the survivors will do very well, as lots of weaker companies go under left and right.

We can continue to think it doesn't matter what we think, but we continue to think that Peabody should not have filed for bankruptcy. They didn't need to. They could have made it another two, three, four years on the cash flow they had. We think cycles happen and the price of resources having fallen a lot over the last four years plus are starting to bounce back nicely almost across the board. They picked a very bad time to file. We think the firm is worth many, many, many times what it's selling at. That said, it's in bankruptcy. The lawyers will end with most of the money. So we're just hanging onto that just figuring there's not much downside and maybe there's some upside.

But another thing that's very important to understand, our strategy over the last couple years as it was back in 2008-09 is to buy good property that's at \$0.10 on the \$1, diversify that and when the market is selling things at 90% off, they're going to be right sometimes. 2008 we had a couple of our resource names go under on us. We made a lot of money on that portfolio that year. Stocks went up two times, four times, seven times. One of them went up ten times. Over the last six months, 12 months, 18 months, even 24 months, the world markets have struggled. Resources have done really poorly. We've owned a lot of resources and we had Peabody where we lost a lot.





And we made good money on our resources because of that strategy I talked about, as you mentioned, things like Cloud and Console have done pretty well. The goldminers have bounced back really strongly. Some of the other energy companies we've had have bounced back very strongly. And so when you add it all together in a really tough market, the strategy is working, not that we feel good about Peabody. We feel good about the ability to buy a diversified portfolio of good assets that are distressed and liking the math when the upside is much more than the downside.

So we think there will be a place for coal. We think there will be a place for gas. We think there will be a place for uranium for sure. We think there will be a place for hydroelectric and that's with lots of growth in wind and solar, which we think is a good thing for the planet and it's just not the end of hydrocarbon.

Operator: As a reminder, it is star one for questions. We'll take our next question from Matya Schachter with Battery Global Advisors.

Matya Schachter: Thank you so much for doing the call. I was wondering if you had any strong views on European either industrials or financials?

Dave Iben: We do everything from the bottom up. So our industrials analysts will look at companies and come up with a value he thinks is right and financials, same thing, we look around and come up with a theoretical value. Then with all companies, we don't use the theoretical value. We just use that as a starting point. We look for a margin of safety. The margin of safety in emerging markets is higher than the margin of safety for Europe. The margin of safety for banks is higher than the margin for a lot of the strong industrials and so forth. But we do that and we sit and wait. And it hasn't been all that often over the last 20 years that we've owned a lot of banks. We have owned emerging markets, but I will tell you that on the reaction to Brexit, we started very quickly looking at some more U.K. banks. And so there's a couple of them we're still working on. So this might be one of those few times where you see us buy banks in Europe. Our industrials analyst is looking at a few of them there. Europe has become more attractive. It is interesting to see Europe and Japan, you know, drop as the U.S. market hits new all-time highs. It's almost a broken record now, but that's the long -- the short answer is yes, we are looking at banks and industrials in both the Europe and Japan, and you might see some increases there.

Matya Schachter: Did you ever currency hedge any of that or you just let that ride?

Dave Iben: We let it ride. We believe that when we analyze businesses, we can be right more often than we're wrong. Currencies seem like they can get out of whack for a long time. They also seem to do the opposite of what they're supposed to do and the U.S. printed \$4 trillion out of thin air and the dollar went up for five years. Then Japanese and Europeans started printing and then the end Euro and Yen started going up against the dollar. And it's really hard to figure in the short run. The dollar does seem to be pretty expensive right now, but we'll see. But the important thing is a bond, if you get a good deal, you hedge it, you locked it in. Stocks are very different. Stocks are ownership in a business and what the underlying business is, is really important. A drop in a currency tends to help exporters. It tends to really help resource companies as doesn't help domestic companies, which makes it tough on outside investors.

So what we do with every company we have is we say what kind of business is this and how might currency impact this? And if it's more likely to hurt us, we want a bigger margin of safety. Then the last thing I will add is we have a whole portfolio. Having all our money in the dollar would be risky. It's one -- all your eggs in one basket. So we like having it diversified across currencies, across countries, across sectors, across industries, and as I mentioned, across businesses that will be helped with currency drop and businesses that will be hurt. And a lot of multinational companies too, or who knows.

So we think especially now, diversification is what's important, not hedging back to dollars, and we think we're extremely well diversified across businesses that aren't so exposed to that. We'll see.

Matya Schachter: Thank you so much.

Operator: We'll take our next question from Rick Speidel with Ameriprise.





Rick Speidel: Thank you. Staying on the commodity reflation theme, have you done any work on fertilizer companies and are anything meeting your criteria?

Dave Iben: Yes, 15 years ago or so, we owned a lot of fertilizers. We found them very, very attractive and they had big run. Over the last year, we've had one, Chilean Company that had fertilizer as well as lithium. That's bounced nicely so that's no longer a holding. And the other companies, yes, we're looking at them. Our analyst does -- reports quite often. We're looking at the main ones and they're in the sort of area that we could buy them. We find them fairly interesting here. And agriculture in general, we like fertilizer. We love the companies that are actually doing the farming. So we own one of the larger chicken producers in Europe. We own a big sugar producer. We own multi-type farms. We own coconut oil companies. We like agriculture.

Rick Speidel: Thank you.

Operator: As a reminder, ladies and gentlemen, it is star one if you'd like to ask a question. Star one. We'll pause briefly. And we'll take our next question from Dan Gallagher with UBS.

Dan Gallagher: Not a question, just a big giant thanks for staying disciplined and being available, and being added value, Dave. Appreciate you do things that few of us would be able to do directly and I just want to thank you and your team for putting in the work. That's it.

Dave Iben: Appreciate that and I want to thank you and everybody on the line that you guys had the hard part, staying in there with us, and thank you all very much. It's a market like the last couple years is not easy on any of us.

Operator: As a reminder, ladies and gentlemen, once again that is star one if you'd like to ask a question. We'll take a follow-up from Bruce Daigle with Raymond James.

Bruce Daigle: Yes, Dave, could you comment on -- I mean it's been a long, protracted bear market and value type investing. Do these cycles usually last multiple years?

Dave Iben: They do, yes, and I'm not an expert but I have spent a lot of time on it. I find they do. In the late '60s, early '70s was strong growth cycle. Then growth was walloped from '72 to '82. '82, when I came in, everybody was value, value, value and except for what a great time to be buying all the nifty 50 stock from '72 that had plunged for a decade. They went from way too expensive to way too cheap. Those did well for a long time. Early '90s was pretty good for value again, but the late '90s, as we all know, that was five, six years that was just growth all the way. Aggressive growth was the place to be. Value was almost extinct. There didn't seem to be too many value firms left by early 2000. And then you had a very strong seven years of value coming back as growth was capitulating.

And now, you know, growth having done very well for the last five, six years and value, not only has it been many years, but the depth of the drop is phenomenal. So both math and history would suggest that if this last six months has been the turn -- it could run for years -- but we don't know. It's too early and the market is famous for outsmarting us all. But we certainly like the valuations and these things usually do run.

Bruce Daigle: Thank you.

Operator: We'll take our next question from Daniel Morgan with Independent Financial Planning.

Daniel Morgan: Hey, Dave. I have a question in regard to the possibility that multiple nations are going to be doing infrastructure spends as a way to be able to stimulate their economies. And if that's the case, that seems to make sense why infrastructure around the world electricity producers and so forth are trading at discount to book value. You can have a huge spend that's going to either debase a lot of those companies or, you know, probably just going to go into it. Or you're going to have new and hydroelectric dams and so forth billed. So can you give us a comment on that or a thought on maybe that's why they're trading cheaper?

Dave Iben: Yes. We're bottom up so we just look for where the values are. But we do try to pay attention to what's going on around the world. It's hard not to worry about some things. My entire lifetime, most governments have been spending more money than they make. They've been spending on various things. So you can make a



case that infrastructure spending over the world has been too strong, massively debt-financed and it won't pick up to where it used to be. You can make a case that in the developed world, healthcare spending has been way too fast. This country, especially the U.S have poured government money into healthcare and they cannot continue at that rate.

You can say the same thing on tuition and a lot of financial areas. I suspect that's right. I suspect that the last 50 years, certainly, even much of the last six of seven years, this neo-Keynesian thought process of let's spend a bunch of money we don't have and that will make us all richer somehow cannot last. So I share your concern. I do think the markets are telling us that the future will be a little tougher than the past. But that's not important. It is important but it's not as important as the fact that the market thinks that.

So five years ago, people thought things are going to grow forever. Now, there, as you're suggesting, these kind of companies are priced very cheaply. So whereas the future might not be a debt infused fast growth, 7.4 billion people and growing, and the emerging markets, they're struggling but that's cyclical. Over the long run, those people are going to want to drive cars and talk on phones, and live in houses. So I think if growth is going to be slower than in the past, but the markets are pricing in negative growth, that's an opportunity. So I think it's a good time to be bottom up and just buy good companies at very cheap prices and assume that there won't be Armageddon, things will be okay.

Operator: We'll take our next question from Lance Newlin with RBC.

Lance Newlin: Hi, Dave. I've got a question just about the broad market. Do you guys ever look at like market cap to GDP and does it mean anything anymore? Because it just seems so out of whack for such a long period of time now.

Dave Iben: We like to look at lots of different metrics. We think that a lot of metrics have strengths and weaknesses. And so the more we look at, the more we're likely to identify things. We do look at market cap to GDP. I think that if you look at market cap to GDP and see that it's one of the three highest ever in the U.S. that has to give people pause. Then if you throw on the debt to GDP, which is far and away the highest ever, and that of course is a senior claim to profit, then between the two of them the claims on GDP are very, very high. And then if you throw in an off balance sheet and claims on Social Security and healthcare, and things like that, market cap, plus debt, plus other claims on the economy are stifling.

And so we do think that people should -- this kind of goes with the last question -- people probably should be pricing in slower growth and there are more risks than there is in the past. But, you know, the U.S. has that problem. Japan has that problem. Various other countries have that problem, but not everybody does and so we think now is a good time to either own companies that do business all across the world and/or do -- own companies around the world. Because a lot of the world doesn't have as a big a debt build up. And a lot of the world doesn't have the off-balance-sheet claims. So there's a reason to look at other countries. And then if you look at the market cap to GDP is way lower in a lot of other places, especially emerging markets. It's misleading. It's true that U.S. companies have more foreign income and therefore maybe deserve to be a bigger percentage of the pie and it's also true that a lot of emerging markets, the companies don't entirely float. There's more private companies and government owned companies. So that's another reason why the markets could be misleading. But the difference, the market cap to GDP is so much cheaper in some of these other countries that it quite possibly is signaling that the claims on growth economies aren't that big, and so there is potential that claims on non-growing economies are huge and less potential.

And then the other thing, too, with all the QEs in the past and whatever QEs in the future, and the helicopter money in Japan and all that, that can actually be a bullish thing for stocks because if the claims on the economy are too big, the bondholders need to get hurt or the stockholders need to get hurt. Everybody's clamoring into bonds even though every government around the world has made the decision that we're going to hurt the bondholders. Yes, that could be good for the equity holders. It's just a theory but it's fascinating that you get paid nothing for owning bonds now and you get paid quite a bit for owning the right stocks.





And so your question is an interesting one and we do look at all that, and we do think now is the time to own some emerging markets. You don't want to have all your money in the countries that have a huge market cap to GDP.

Lance Newlin: Thank you.

Operator: We'll take our next question from Patricia Neubeller with Merrill Lynch.

Patricia Neubeller: Hi, David. Would you care to comment on the central banks, and the passive index funds and ETFs, and the fad of today?

Dave Iben: Yes, conceptually, I'm not a fan of central banks, but they're here. I think that it's possible to print money, but it's impossible to print wealth. So I don't think that printing money makes us richer. I think all it does is transfer wealth from savers to debtors and it transfers wealth from middle class to the rich. So I think that's all a bad thing. It also increased the risk of bonds, even as the new money is used to buy bonds to increase the price. So the risk is higher than ever, but the price is higher than ever. That I think is a conundrum and something that's going to work out poorly.

But I like the fact that, you know, we don't have to worry about bonds or whether the central bank things cause inflation or don't cause inflation, because if we can build a portfolio of businesses that are trading at ten times earnings and four or five times cash flow that if there is no inflation whatsoever, if people are right that central banks can't inflate, won't inflate, I think we'd do very well holding companies with 10% earnings yields and 20% cash flow yields. And so it's the place to be.

And then if printing money is inflationary, as all logic would suggest, then you would really prefer good businesses to owning bonds. So we are bottom up. We do not make predictions on what the central bank activity is going to do or when it's going to do it. But we like the fact that we have a free call option on the fact that it might blow up in their face.

Patricia Neubeller: And the index funds and the fads.

Dave Iben: Thank you, yes. That is in the letter that was just released so look at that, but I will comment. The earlier question value versus growth, very similar answer to index funds and ETFs versus active management, which is good, which is bad. They're both good and bad. They're cyclical. Index funds are cheap. It doesn't cost you very much and it gives you liquidity and it gives you ability to get in and out pretty quickly, and if markets are efficient, why not? It saves a lot of money. So they're a good idea. But once too many people start doing it, the market is no longer efficient because there's no research being done. All the stuff they teach you about efficient markets that all these people are getting equal access to information, and they're analyzing it, and they're establishing valuation, and they're rationally acting on it, no one is doing that with an indexed fund or an ETF. They're not doing that. They are playing a theme and when too many people do that, the price of the companies that are in the popular ETFs become way more expensive than the price of the things that aren't.

While that's happening, it gets its own momentum and the ETFs and indexes become more and more expensive and more value managers are fired to give more money to the index fund, and the value managers then have to sell their stocks at cheaper and cheaper prices. You get huge bifurcation. Everybody decides active management is dead. They decide that at the wrong time and then put this in a historical perspective, I think money printing leads to these big bull markets that leads to people loving passive management and buying the big popular stocks in the index. So the U.S. came off the gold standard in 1971, i.e. easy money. They started printing money, freed up the dollar, and then you had what was known as the nifty 50, the big popular stocks became expensive. Take a look at the AMEX, the predecessor of the NASDAQ. It was getting creamed. That was followed by active managers doing really well as the big stocks were getting killed. The late '90s was Alan Greenspan printing money in response to every conceivable problem, real or not. All that money went into index funds. The markets went up. The more the index funds went up, the S&P 500 became way more expensive than any major companies that weren't in that. Active managers were being canned left and right. The index was all the rage. People threw in the towel on active management.





What happened then, the next seven years active managers crushed the index because the index went from outrageously expensive down to pretty cheap. By 2007, people were all about active management. They were rushing to pay two and 20 to hedge fund managers. They wanted to be as far away from the index as they could. They got it wrong again. From then until now, indexes and various passive things have crushed active managers. We're all looking very stupid now. I think that the price of the popular stocks right now, the index passive type stocks are way more expensive than sort of stocks that we just showed you in our portfolio. We think that the next half dozen years is going to be good for active managers and not for passive. That's speculation but the math and history would suggest that's possible that any rate, there's no doubt in my mind it's a cyclical phenomenon.

Patricia Neubeller: Thank you. That was fun.

Operator: And once again, ladies and gentlemen, it's star one to ask a question. Star one and we'll pause briefly. We'll take our next question from Dave Oscar with Morgan Stanley.

Dave Oscar: Dave, can you -- everything you said I totally understand or at least I can get where you're coming from. I guess I just don't understand Pandora. Can you help not -- just what got you into the stock and what made you, you know, buy that, build that position, et cetera?

Dave Iben: Certainly. You know, we -- with a lot of the things we have, we try to look at positives and we try to look at negatives. And with a lot of these companies, including Pandora, there are a lot of positives and there are a lot of negatives. When the market is in one of its moods where the gorilla wins the first mover is worth any price and they continue to be in that mode in terms of what the right price is for Facebook, and for Google, and for Netflix, and for Amazon. And we're not saying the market is wrong on that. Who knows. But once upon a time, they thought somebody like Pandora that was first to be taking this model to the internet and have the biggest market share by far, and has grown, and does have a big competitive advantage over Apple, and Google, and people that have to pay way higher shares for the music than these guys do. They're the guy with the competitive advantage and the likelihood to be the gorilla that wins, and therefore is worth many billions of dollars.

Now, people are focused on while they should have been profitable by now, but they're not profitable yet, and their competitive advantage is still big, but it's a little less than it used to be because they now pay a little more for music than they used to, and Google, and Spotify, and Apple are people that crush everybody in their path. And so these guys are doomed from the start. Nobody competes against these guys and wins.

We suspect that truth is in the middle. We think that there are a lot of things that can happen. We think that they may or may not do well against Spotify, but they probably crush the terrestrial radio players, the old Clear Channels that are struggling again, you know, iHeart, whatever they call it now. I think their model is much better. Just like used to happen with satellite radio, it's gotten easier to put it into cars. They have -- it seems to be decent management and decent share. And they could just continue to grow and once the profitability has cleared everybody, the stock could go way higher there. It could be that it was a market cap that had been bouncing around between \$2 billion and \$3 billion, which is next to nothing in the scheme of most media companies. This is not a prediction, but it could be that the satellite companies or the Google's, or the Spotify's, or the radio channels, or the TV's and CBS's of the world could be these people say, oh, let's just take them out for \$4 billion. It beats the heck out of spending billions forever trying to start from scratch. So that's a possibility. But we see lots of risk, but we don't see that much risk of complete downside and we see big opportunity that this could easily be worth two, three, four times where it's selling at.

There are a lot of things to like and most people I know use it. I think I know more people that prefer Spotify but they use both and a lot of people use it. So it's amazing the little nothing companies out there that are selling for \$10 billion, \$20 billion, \$30 billion and \$2 billion a few months ago is an awfully cheap price. It's up 50%. We've trimmed some but more to like than not like I guess is the answer.

Dave Oscar: Thank you.





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Operator: And that will conclude the question-and-answer session. I'd now like to turn the call back over to Dave Iben for any additional or closing remarks.

Dave Iben: Well, I just wanted to thank you all for listening to us and for your support, and we'll talk again soon. Thank you.

Operator: And that does conclude today's conference. Thank you for your participation and you may now disconnect.

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