Kopernik Global Investors, LLC

Edited Transcript of the 1st Quarter 2018
Conference Call with David Iben

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Operator: Good day ladies and gentlemen and welcome to the Kopernik Global Investors 1st Quarter 2018 Conference Call. As a reminder, today's call is being recorded. At the conclusion of today's presentation there will be a question-and-answer session, instructions will be given at that time. And at this time I would like to turn the call over to Mr. Kassim Gaffar. Please go ahead.

Kassim Gaffar: Thank you, operator. Good afternoon and thank you for joining us today for the 1st Quarter 2018 Conference Call. My name is Kassim Gaffar, and I have with me David Iben, our CIO and lead portfolio manager for the Kopernik Global All-Cap Strategy, and co-PM for the Kopernik International Strategy. Before I pass the call over to Dave, I'm providing everyone with a quick firm update.

From an overall AUM standpoint, the firm assets as of the end of the first quarter were right around $3.5 billion. This represents an impressive growth of roughly 10% over the last three months, and we saw roughly $350 million in net new assets. This was due to the firm being awarded new mandates across all channels and also many existing clients that have been allocating more towards value and away from growth.

Both strategies have continued to attract smart and like-minded long-term investors that realize the optionality and the tremendous opportunities our portfolios exhibit. We do believe it is the case given the steep discounts the portfolios are trading at. Lastly, from a people standpoint, we're very well positioned with 38 people strong. We are excited going into 2018 thus far, and we very much appreciate the opportunity to serve you and your clients. Dave will be referring to a presentation that can be found on our website, KopernikGlobal.com, under the News and Views section. And with that, I'll pass it over to Dave. Dave.

Dave Iben: All right, thanks Kassim, good afternoon to everybody and thanks for joining us and welcome to the Kopernik 1st Quarter Conference Call for ***1973***. That's right, we did say 1973. Quick review. Following a tough decade back in the thirties we've had a three-and-a-half decade bull market that hit an all-time high in January of the first quarter and since then stocks have sputtered a little bit. It's been quite a quarter, stocks have hung in there near the top despite the fact that following a decade of shockingly undisciplined monetary policies, inflation is finally beginning to migrate from asset prices into CPI. The fiscal policy, which has been loose, continues to be loose. Interest rates, after being suppressed for a long time have started to rise in the quarter. As such, loan delinquencies have started to accelerate meaningfully. After a good number of years after the war, U.S. standing in the world is waning a little bit, price of gold starting to move up, U.S. is trying to extricate itself from a foreign conflict, resenting Russian meddling on the other side. At the presidential level, there's been a bit of turmoil, turnover of the cabinet, the president being accused of misconduct and even being investigated.

Through all this, the stock market remains near all-time highs. All right, with that as a review of '72, let's jump forward to 2018. And yes, we realize that Syria's not Vietnam, the Cold War is not World War II, Trump is not Nixon, FAANG and TATS are not the Nifty Fifty. Greenspan, Bernanke, Yellen, et al., I think are in a whole different world than the Arthur Burns policy of merely easy money. Whether we back out of NAFTA or TPP or other is a different matter than backing out of Bretton Woods, but the point is, whether it's '73 or '18 when things get tough, the market doesn't care.

I'll also point out that the market hit a new high of 1,000 back then, now it hit a new high of about 26,000. Outside of these differences, though, it is amazing how much things are similar. In the first quarter of 2018, the market hit a new high in January, began to sputter. After a quarter century following the Cold War, U.S. standing's been strong, starting to wane a little bit, monetary policies have been very lax, it all went into asset prices but now is beginning to migrate into CPI. Fiscal policy has been incredibly loose, remains so. Interest rates of course have been suppressed during the QEs. Now interest rates have started to move up, loan delinquencies are accelerating meaningfully, student loans, car loans, housing equity loans, gold's beginning to move up, had a nice quarter. U.S. trying to see if we can get out of the Middle East, resenting Russian meddling, turmoil at the executive level and accusations, and the market doesn't care.

So that's where we stand. Here's interest rates. Pretty interesting, was what, three, four years ago that the market took quite a beating on the news that they might bring interest rates from zero to 25 basis points. Here rates are much, much higher, and nobody cares. Volatility, people were liking the fact that volatility was low, so many people's pricing models are all based on volatility. They'll take more risk if volatility's low. Volatility picked up, people that were in the XIV and others were wiped out, wiped out overnight, but they couldn't wait to get back in, so volatility's heading back down. But any rate, volatility, who cares?

Debt and deficits, back in '73 people were talking about well, easy, been a loose monetary and fiscal policy under the Democrat, LBJ, and the Republican, Nixon. Here we talk about the Democrat Obama, the Republican Trump, party doesn't matter, everybody subscribes to neo-Keynesian economics and deficits continue to rise and the debt continues to rise.

The Fed has had a stated goal of making the CPI go up. They've been failing to do so until recently, now it's going up. I guess in their mind that's good news. Back in the early '70s people were freaking out about CPI of 2%, now they think maybe it's too low. But as the chart to the right shows, CPI of course doesn't really estimate the cost of living. I don't think most of us spend very much money on TV sets or cellular phone service, I think we're much concerned with the cost of housing and the cost of medical care and the cost of tuition and those sort of things. Those of course have been skyrocketing and now as things start to pick up even more. It could be a problem, but no one seems to worry.

People blame what happened in the '30s on trade wars, who knows. There were trade frictions back in '72-'73, now we've got trade wars going on, but now we're supposed to believe that they are good and easy to win. All we know is China is pushing back, Russia is pushing back, Germany is pushing back, others are, and it is something to watch. Anyway, all that stuff happened in the first quarter and the market looked like it was going to correct, but it didn't. Here you see '09 till now, there's a little drop at the beginning of 2016, but for the most part it's straight up. It kept almost correcting, so I don't know. Who knows if it's going to fall or not, but globalization and free trade were good and now they seem to be ending, falling interest rates, falling for 35 years were really good, I've been lucky that my 37-year career interest rates have dropped the entire time, good for stocks and bonds, been fun.

But now they're going up, peace was good, I don't know about the global skirmishes now. Low volatility was claimed to be good, can't go much lower than the 8 it was at a few months back, possibly heading higher.

So can the reverse of all the things that were positive also be a positive? Who knows? We don't know if this is the top of the market or has a lot more to go, whether it ends like the January '73 top, don't know. We do suspect now is a dangerous time to follow the crowd, late in bull markets where momentum picks up a lot and it gets to be what many call the greater fool theory, no one wants to be the guy left holding the bag.

We do know that the Fed has succeeded in making stock prices and bond prices and housing prices the highest of all time. We know that it's caused some reckless behavior, we know there's been mal investment, we know currencies across the globe have been debased relative to the things people choose to buy. So here's where we are, a time that is dangerous but also a time that's pretty interesting.

If people subscribe to the idea that times when the herd is leading it's a good time to look different. We'll point out the obvious that everybody knows already, as we don't run with the herd, we are very different. And this chart I think is very interesting on one-year correlation to the index, call it zero, 0.1. So we do not look like the index, our international fund, and 0.3 also not remarkably far from zero. So we don't run with the herd and we don't follow the index. If the bull market ever comes to an end, that might be an attractive thing to people, even on a three-year basis, correlation of 0.6, fairly low.

High tracking error. When markets are going up, low tracking error is a good thing. When markets fall, high tracking error is a good thing. So we don't run with the crowd for good or bad.

The best times to deviate away from the crowd is when markets are expensive. The beauty is, as this chart shows, markets are expensive and yet our portfolio is very attractively valued, 70% of book value, less than three-quarters of tangible book value, cheap on sales, cash flow, you name it.

So not only are we managing to be not as expensive as the index, it's downright *inexpensive*. So all right, we're not running with the crowd, but there are opportunities to make a lot of money, so it's one thing to just avoid the risk. It's another thing to have great opportunity. And there is opportunity. People are pouring their money into the popular ETFs, that's slowed up a little bit, I'm aware. But after a decade of that, what's the best strategy? We think a lot of money can be made by following the advice of Wee Willy Keeler, "*keep your eyes clear and hit them where they ain't*."

Where they ain't is emerging markets, agriculture, Canada, resources in general. There are a lot of places that have been left behind in this stampede into the popular stocks. You can see here there's the areas represented by the gray charts, where people have stampeded into, and the places where the gray charts lower, that's more interesting and that tends to be where we are. You'll notice they also are very, very much invested in the U.S., still over half the money in one country. Even in the non-U.S. index, is okay, clearly not in the U.S. but a lot of money in Europe relative to Canada, Asia, other places, we think that presents some opportunity.

So hit them where they ain't, but you know, also where they are is problematic. They are in really exciting areas, areas that are growing fast, probably will keep growing fast and we've hammered on this in the past that our industry has this way of taking past numbers and using a ruler and extending them into the future. Now rather than rulers they're using computer models and what not. But extending the past in the future and saying that good numbers define value, we think that's backwards. Models don't define value, past earnings don't create value. We think intrinsic value leads to future profits. It's not estimated profits lead to value. It's a big distinction.

Where does value come from, things we need are valuable to us. So companies that give us what we need are probably value to us. People that have security, that give us what we need and they are able to where others aren't because of scarcity, because of barriers to entry, because of scale, because of a better value proposition, they're very valuable to us.

Here is this chart, the money's pouring into wonderful places like technology and health care and consumer discretionary and they'll do well, except for there is no scarcity value. Which means generating a good profit in the future might be difficult, and certainly the stocks are priced as if they will never have difficulty.

Gold isn't good for much other than storing value, but it's very, very good at storing value. It has done it for thousands of years, it is scarce, not likely to be disrupted. Food, all kinds of great technology but they haven't come up with anything to replace food. We think food is valuable, energy, we think we're a long way away from people not using electricity and electricity generated from cheap, clean sources are more desirable. Communications, infrastructure, eventually we'll move on to some other way to communicate but that's years off. Petroleum's interesting, a couple years ago people said we'd move beyond hydrocarbons. Maybe someday we will, but that's a long, drawn-out process and the price of oil's gone from $28 to about $70 since people pronounced the death of hydrocarbons. We think they made a mistake then like they're making a mistake with things like uranium now.

People in general in active management, I've seen so many presentations about how we're all going to lose out to computers and AI and other things. Computers and AI are very good at many things, and mundane things they'll take away. Asset-gathering business, they're probably pretty good. People want to invest in the index, then really who needs people? But we think people in general still are pretty good at a lot of things, in the arts and in the services and you name it.

When it comes to active management, as opposed to asset gathering, we think people still have a lot to offer. As a matter of fact the computers now, instead of making things more efficient have made them much less efficient because they've been programmed to be momentum investors so that's going to make life better for active managers, we think. We could go on for many hours about, philosophically, where people stand versus machines, we'll spare you that for now.

So people are not scarce, they're becoming less scarce, more and more people, 3 billion people on the planet when I was born, approaching 7.5 billion on the planet now and growing. The planet hasn't gotten any bigger, the amount of resources haven't gotten any bigger. So what to do with that? Well, people like we say need electricity, we've probably got what we can get from hydro, probably not a lot more going to be built. Solar and wind will continue to grow fast but still be a very, very small part of what we need. Oil, generally, already is not being used, coal continues to lose share. Natural gas and uranium, probably need to grow.

Uranium's been fascinating, people loved it, hated it, loved it, hated it, and back ten years ago they loved it, it was cheap and clean, no greenhouse gases. There were seeming shortages but as we say here, the solution to low prices is low prices. Demand soared, supply fell, but then price went to $137. When the price went to $137, demand fell off and supply out of Kazakhstan went up ten times, *ten times*. So yeah, I guess economic theory works. The price fell from $137 down to $18 and now it's in the low $20s, we think that economic theory is likely to work again. You've had Kazakhstan cut back several times. You've had the Department of Energy say we're done selling, the Russians are done selling and that completely shut up the markets. And Cameco shut down the best mine ever, so you guys can correctly say, we were saying three or four years ago, we thought the fundamentals were good, true, we were early. But it looks like early, not wrong, everything's falling into place right now and as supply falls off, demand is not falling off, demand's picking up. The Japanese are finally bringing reactors back on, Chinese continue to build, others continue to build. These brand new multi-billion-dollar things are going to lay idle unless the price of uranium triples or more. Just to bring on the supply that's going to be needed.

Gold, I mean over the years we've talked maybe too much about gold but lately we're probably not even talking enough about gold. Gold is fascinating. In a world where, you know, the US didn't print last year but worldwide more money, more currency was printed last year than any other time in the history of mankind. That on top of our quintupling the money supply, you would think the price of gold would be up huge over the last six years, seven years. It's not, it's flat. It was higher, then it was lower, now it's flat. Gold has gone nowhere since January of 2011. So if you want to buy gold at the corner gold store, coin store, you'll pay the same price you would have seven years ago. If you want to buy gold in the ground, the very same element in the ground, you can now get a 65% discount from what you would have paid seven years ago. So the gold's worth the same, but we can buy it 65% cheaper than we could. If you're willing to go to the smaller companies that own the very same element underground, now you get an 80% discount. Fascinating sheet, you go into the first quarter. What happened in the first quarter? The price of gold went up more, and the price of gold in the ground went down more.

So it's pretty exciting. So gold looks really, really good. Gold miners look really, really good. Outside of that we've talked for years about how great it is that we can appraise businesses, we can appraise phone companies and drug companies and consumer companies and tanker companies and you name it. And wait for the market to decide they don't like a certain country or a certain commodity. As I mentioned, last year they didn't like oil, this year they do, now they hate gas.

Two years ago they hated coal, coal prices have tripled since they hated it. Ten years ago they loved the BRICs, two years ago they hated the BRICs and a lot of money was made by people that owned the BRICs the last couple of years. The last few weeks people have decided to hate Russia again. They're probably half right but they're not 100% right.

So, heck with Russia, what about a great company that controls the biggest amount of oil or gas reserves in the world and has some of the best pipelines and the cheapest prices and you name it? How cheap can you get, well there's a couple ways of looking at it. You can say despite the fact that their reserves are five times, five to six times bigger than Exxon's, the market cap is a fifth of Exxon's. Really, really cheap. To make it even cheaper though you can look and say "Look at them, the refining capacity. Look at them on their pipelines or look at them on generating capacity."

You can say looking at Duke Power, Southern Energy, Iberdrola, RWE, that the current market cap for Gazprom might be a fair price for just their generating capacity and if you buy that, you pay a fair price and then absolutely for free you get the world's biggest, best, lowest-cost gas reserves. There's cheap and then there's just you know breathtakingly cheap. So that's the sort of thing we're buying when we buy Brazil and Russia and Japan, we're buying not the countries, we're buying really, really good companies that just happen to be in countries that people have on sale. This is an extreme.

Elsewhere, we have pictures of industries that we think are valuable industries that meet human needs, not just wants, *human needs*. They do so in areas that probably will be sustainable five years from now, ten years from now, a quarter century from now. Most of them have oligopoly or monopoly status and are trading at very, very inexpensive prices. If these things can double or triple, there's a huge return on patience. People can get their clarity and buy a bond and lock up 2 or 3% for the next ten to 30 years, or they can say I'll take double-digit returns with less clarity. We're in the latter camp, we're thrilled with the opportunities we're seeing in the market, and with that, let's stop for questions.

Operator: And if you would like to ask a question, please press the star key followed by the digit 1 on your touch-tone phone. And also make sure your mute button is turned off to allow your signal to reach our equipment. Again, that is star-1 to ask a question. And we'll take our first question Dave from Brad Calder with TIFF Investment Management. Please go ahead.

Brad Calder: Hey, Dave. Just a question for you on some comments you made earlier about gold. Do you have a view as to what the appropriate discount should be for gold in the ground versus physical gold? Thank you.

Dave: Sure. Really quickly on gold itself, market might be right, we doubt it. But we look at that as one alternative, we look at gold as not what it costs to pull out of the ground but what will it take to replace it with an existing mine if we were going to keep the supply going and it's something more like $2000. We look at also monetary value of gold, the price of, you know, the amount of dollars printed relative to gold have gone from $400 to many thousands, that's another possibility.

So there's all kinds of ways to define what the right price of gold is. But then how much of a discount should we get to have it in the ground. Well, the numbers we give you are discounted for the price, so if we say gold's $1,300 above the ground and we're getting it for $1,000, that $1,000 is what would it take to buy the company on the stock market, pay off all the debt, pay the often billions it takes to build a mine, pay all the money it takes to extract it and to process it and to sell it, and then we're left with a number of $900 or $1,100 or $1,300, it depends upon the mine. And then valuation wise, we say what sort of discount do we have? To your question is it $100, is it $200, is it $300, and we say what is the value of this in terms of optionality value. We like it when there's different ways of looking at things and Wall Street looks at it one way and we look at it another, so if we're looking at a soap company or a drug company or a tech company, Wall Street will assume rapid growth in the future and they'll discount it back at a discount rate.

With gold, they will assume the price never goes up in the future and probably drops, and then they will discount that back. And so gold that is being pulled out of the ground in the future is worth next to nothing. We say "All right, well if we can pull it out of the ground at less than $1,300, we don't have much downside risk." So that gives us sort of downside protection. So now we can value the option, whereas a discount model says the longer, the less valuable it is. Options as we all know are worth more if you have more time for that option to play out.

And so if there's a chance, and there's certainly a chance, we don't know what'll happen, there's a chance gold goes to that $2000 that it would take to replace the stuff coming out of the ground, then if we have an option for one month, we're probably going to lose our money, it's not going to go to $1,000. If we have a year, probably still not going to, but now there's a chance. If we have five years there's a big chance, ten years it's quite likely, inflation runs itself.

Options are worth more, and so to answer your question if we value these things on how much it costs to dig it up, we get a small discount, but we get a discount. And if we value it to what the options were, these things are worth two to three times worth more than they're selling, some of them more than that. So we think we're getting a tremendous discount.

And on the downside protection I think an option value is the right way to do it, but we value them every which way.

Brad Calder: Thanks, Dave.

Operator: And we will now go to Chris Gates, with JP Morgan.

Chris Gates: Hey David, thanks so much for doing this call. My question has to do with the gold miners, and can you talk a little bit about the research process that goes into discerning which companies are actually well managed and are attentive to, just overall governance issues.

David Iben: The short answer is, too few of them are well managed. But a more important answer is, a lot of time goes into it, and we do different things. One, we send them all a letter every year saying we are long-term investors and we like this to be well managed, so please don't dilute the shareholders and don't give yourselves options, buy the stock instead. And don't save money and end up causing a pollution problem and don't fail to invest in the community, because trying to save $10 million might cost you a mine that's worth $2 billion. So let's not lose that $2 billion mine. And then we look at past M&A and past decisions to spend capital. Most of them are really bad, we have to admit, some of them are better. We also look at where they are. Every government expropriates some of the wealth, so the US might expropriate it through an income tax, and someone else will expropriate it through a royalty, and someone else will expropriate by saying "Give us a quarter of your mine or half your mine," and so we look at what mines are paying to the government and what's likely to happen, and the more dicey jurisdictions we want bigger discounts.

The less we like management, the bigger discount we ask for, and the less comfortable we are with the country, the bigger the discount we want. The less comfortable we are with the geology and the chemistry, you have to move a ton of earth just to get a couple grams. That's problematic on its own, but if we're less sure that there's really the couple grams there we want a bigger discount. If the grams are, you know, locked up and need to be roasted or autoclaved, that's worse than if they can just be leached out of an oxite.

So we look at that. That makes a big difference into how big a discount we want. So we do look at all of those things but also, the probability that gold goes way higher is a fairly good probability, and our chance of having these stocks go up two, three, four, five times we think are fairly high. But managements are a problem, and geopolitics are a problem. So we very much like the fact that we can diversify this.

So we have some of the biggest reserves known to mankind but they're in different countries. They're in different geographies, they're in different chemistries, and they are under different management teams. And so as happened in 2009 and as happened two years ago, and as likely to happen in the future, we can lose on a few of them and still make a lot of money because the upside is tremendous and the risk can be diversified.

And I could go on for another hour on that, but that's the synopsis of some of the work that goes into this.

Chris Gates: Thank you.

Operator: And as a reminder, please press star-1 at this time if you have a question. And we will go to Patricia Neubeller with Merrill Lynch.

Patricia Neubeller: Hey, Dave, hey would you elaborate on your comment about agriculture, I'm going to be very curious to hear how you're scratching that itch.

David Iben: Certainly. You know, agriculture in general of course is interesting. I showed that population chart, what we didn't show is the amount of arable land in the world, which really hasn't been growing for years now. So more people, less arable land, and peel off top soil erosion and salinization and urban sprawl and you name it, so some land comes on, while other land comes off.

Fortunately for hundreds of years now the yield has been increasing, that may or may not be coming to an end now. But relative scarcity with lots of demand over the last 20 years, there's been times where we were happy to own Agco and John Deere, and there's been times where we owned a lot of the fertilizer companies and we still keep our eye on that. There's been times when we've owned the various irrigation companies and been happy with that.

All those things are interesting, but the last few years, I mentioned being able to arbitrage between countries. And so if good topsoil in the US is going for $8-, $10-, $12,000 per acre, if you go to less-good topsoil, a few states over, then maybe it's $6- to $8,000. So maybe that's worth less, that's probably efficient. If you go to other places where there's tremendously good topsoil, Argentina, Brazil, Ukraine, there you're going to get good productivity, good soil, that's a place you want to be from an agricultural standpoint. It's maybe not your first choice from a political risk standpoint. So clearly there should be a pretty decent discount to Brazil and a bigger discount for Ukraine, even though Ukraine's maybe the best topsoil in the world, it's not everybody's first choice.

So instead of $10,000 should we be paying $5,000, $4,000? We've been able to do pretty well the last three or four years by buying in Ukraine at $1,000, at one point we were able to buy a company at $400 per acre, and that worked out very well. And those ran up, we trimmed back and bought Brazil, people didn't like Brazil and now this company Sociedad Quimica Minera de we've just sold that after a massive run, and now some of our biggest positions are in Indonesia through a Singapore-based company.

So we look for good publicly traded companies that have been well run for a lot of years that happen to own or have the rights to good-quality agricultural land, tend to be very profitable companies. So that's where we've been finding the most value. But from time to time we're happy to go back into fertilizer, irrigation or other things as well. Agriculture's unexciting but like I say, it's not going to be disrupted, it's here for the long term.

Patricia Neubeller: You bring up fertilizer, that's another good question, what do you think about that?

David Iben: Seems pretty interesting. Our biggest investments were 15 years ago or so, when we were able to buy them for a song and they ran to the moon and we got out probably a quarter of the way up, but we still did pretty well. A few years ago we were back also in a fertilizer company that ran up because they had lithium, so we don't own that.

But stocks are a lot cheaper, I just yesterday signed up for a conference next month, it's got a whole bunch of the fertilizer companies presenting and we're getting back up to speed. It's interesting again.

Patricia Neubeller: Great, thank you.

Operator: And we have a question from John Friesen with RBC Wealth Management.

John Friesen: Hey Dave, can you speak a little bit about natural gas and adding Range Resources in the portfolio.

David Iben: Absolutely. So one thing we've liked over the years if not the decades is, you know, people of course won't like energy and then like it less and then like it more, but more importantly, it's amazing how many times you see them go from loving uranium and hating oil and then they love oil and they hate uranium, and then they love coal and they hate coal and back and forth.

I don't know how many times I've seen natural gas go from a glut to a shortage to a glut to a shortage, and people go from "It's cheap and it's clean, and the US has a lot of it, it's the most wonderful thing on earth," to it's fairly worthless and it needs infrastructure, hard to store and you may as well light a match to it.

And so it's not counting Gazprom, which I talked about how cheap that was in Russia, we haven't owned natural gas for years. We owned Chesapeake back when it got really cheap with the problems they had years ago and before that we owned a few others, but we just haven't owned it. We were finding better value in electricity generation or uranium or oil or those sort of things.

Now oil's gone from $28 to almost $70 and the price of gas has not done much. More importantly the price of gas stocks has really fallen, so I can't remember what the high was for Range, $60-something maybe, but it fell and fell and fell and fell, and then all of a sudden a few months ago it was in the $20s and we say time to start looking at this, and then it got into the teens and we said "Time to think about buying this," and as fast as we could get the report done it's trading below $15 and we bought it and next thing we know it's at $12-something and, you know, if you've, all of you that have followed this for a while know, we don't quickly build positions usually. This thing got so cheap that we took it to a pretty big position at $12, it instantly bounced to $16 and we pared it back some.

But like everything we look at, we try to look at the positives, we try to look at the negatives, we try to have a view in the middle, and when people go to extremes and it seems like people are extreme now, that natural gas is abundant and we have 100 years' worth, we're never going to run out of the stuff, yeah, it's interesting to look at over the last year the price of Tesla and the idea that we're all going to stop using gasoline and start using electricity, that's going to have to come from natural gas and a few other things. There's a disconnect.

We're buying gas in the ground at a big discount to what we think what's in the ground is worth, and you know, it's taking advantage of, like I say, arbitraging in between one form of BTUs and another form of BTUs and right now gas and uranium are the two that look really cheap and we've pretty much exited oil. We don't dislike oil, it's just being reflected.

Operator: Is there anything else, John?

John Friesen: No, thank you, I appreciate it.

Operator: Thank you, we'll now take a question from Matya Schachter, with Battery Global Advisors.

Matya Schachter: Yes, I was hoping you would talk a little bit about the shipping industry, whether you're seeing anything interesting there. Some of the FFA markets and other futures on shipping seem to have collapsed over the past quarter or two and just wondering what you're seeing in that space.

David Iben: Yeah, we like shipping. It's a classic value play over the last 20 years. We've seen some boom/bust cycles and so this industry famously mints money at the top and bleeds profusely at the bottom. So we bought a lot of them in 1999-2000, around there. We're out of the area for quite a while, there's been mixed plays over the years but over the last four or five years, not only are shipping pretty interesting but just like I was talking about with energy where people can like oil and hate gas, and then change their mind, people three, four years ago hated oil tankers, and they still like cargo tankers.

And then we, you know, were able to buy big discounts on oil tankers and then a few years ago, people liked oil tankers because people were using them as storage vessels and so they started making money and so those ran up and we trimmed. At the same time they decided they hated dry bulk, and there was every reason to hate them, you'll never find an industry that looked uglier in terms of overcapacity and the money they were losing and people going bankrupt left and right. So we found a couple of them that we thought were well-enough managed and had a strong enough balance sheet to get through and bought them just above liquidation value, the ships went way, way lower than the normalized price of the ships would be. Then after that John Fredriksen, who's probably the richest guy in Norway, his company, he managed to do a deal with the banks where they would lower his interest rates and give him better terms if he could just find some equity investors, and so we were part of a team that were able to give them equity at a big distressed price, and that worked well.

And things like I say looked really, really ugly but over the next year that went up well. So that went up big, we sold Golden Ocean, Safe Bulkers and that went up big, we sold Safe Bulkers, Diana Shipping that we've treaded back and forth and are still happy to own that. But those have gone up a lot, and now the oil tankers are starting to get cheaper again, and so we're happy to own Tsakos Energy and we're looking at a couple other ones and then container ships, a few of them have gotten cheaper.

So we take what the market gives us, look for fairly well managed companies with okay balance sheets at the depth of the cycle is our approach to that. We say what is the ship worth over a five-year cycle, say, and let's buy it at a big, big discount to that median valuation. So a classic cyclical, classic value names.

Matya Schachter: What's going to cause this to turn or you're comfortable just owning this assuming they're not going to default between now and when it moves higher and just wait for the rally to come, whenever it happens to be.

David Iben: Yeah, this chart here that I showed earlier, a lot of people look for catalysts. Catalysts are wonderful, it's just that we don't spend much time looking for catalysts because with thousands of people looking for the catalyst so often the prices are up big before people can see the catalyst. You know, the dry bulk ships a year ago were up big before you could really see much of a turn in the dry bulk index, which actually has rallied big again recently.

So no, we like to buy these things at prices that are really, really stretched because not even we can imagine good things happening, but you buy them at a huge price and you buy them with enough of a margin of safety and you buy them with a good enough balance sheet to make it from here into when things turn. And this chart shows if we have to wait a year or two or five, if things go up 150% in five years, we're making 20% a year. So nothing against catalysts but we tend to buy when even we can't see the catalyst.

Matya Schachter: Okay, thank you very much.

Operator: And I'd like to give everyone a final opportunity, if you do have a question please press star-1 at this time and we will pause for just one moment. And we do have a question that comes from Nick Lewandowski with Allegheny Financial Group.

Nick Lewandowski: Hi, Dave, just wanted to ask one quick question in regards to Russia, you made a comment along the lines that the market was maybe half right about Russia. So wondering if you could elaborate on what the market is right about and what the market is still mispricing in Russia.

David Iben: Yeah, with Russia, Brazil, China, you name it, we always look at what are the positives and what are the negatives. I think, was it seven, eight years back when people said you must own the BRICs, people only saw the positives. They said emerging markets, China and others, were probably going to grow over the next few decades and they're going to need resources, and Russia has resources. That is true. People said the whole world has high, high levels of debt and pretty much one country doesn't, that's Russia. They have debt-to-GDP way lower than most anybody else's, that's true. People said that Russians are well educated, that's true. They have some of the finest companies around. I mentioned Gazprom, probably the lowest cost, biggest producer of gas, that's true. They have the pipelines from where the gas is to where it's needed in Europe, I think I saw yesterday that over the last year, not just gas but everything, the trade with Germany went rocketing up, and they're well located to sell stuff into Europe. They have one of the best-run banks in the world, I think, with Sberbank. They have some good monopoly utilities that they, a year or two ago we were happy to own the Russian equivalent of Google and the Russian equivalent of Facebook, that all worked well.

While we were happy to own all those things, we also say, well if you look at the last couple centuries, here's a country that's had its ups and downs in terms of capitalism. Here's a country that's been invaded a lot and has invaded others a lot, and has had political skirmishes and they've had off and on unstable governments, and also the rule of law there, if you go to Russia, they'll be the first to tell you that there's a high level of corruption. If somebody's paying a billion for a pipeline, you know, maybe $700 million of it went to the pipeline and who knows where the other $300 went. And Gazprom had to help pay for the Sochi Olympics. So you know, stuff happens. And so we have always said we want half price. We know stuff's going to happen and so despite the fact that it's an emerging market and it's growing and it has more land and resources than anybody else, we know stuff's going to happen and we want half price.

So couple years ago people were obsessed with stuff happens and they forgot about the good things, and as recently as a month ago people were back to liking Russia. I think Sberbank was the number one holding in a lot of emerging market funds. People loved it, you know, we sold the majority of ours and now they hate it again.

So were they half-right? They're right to think for, you know, sanctions are here again. Skirmishes are happening, they're dependent on natural resources, the fact that oil's gone up a lot has helped them a lot, but the next time oil goes down, that will hurt them a lot. They might get worse, they might get better. So people are right to worry about these things, but they're worried about it too much. You know, like I say, things were pretty nasty looking two years ago, and that was a great time to buy, and they were good looking two months ago and that was a great time to lighten up. They're right to be worried, they are wrong to be panicking now. And you know, half price, I think I pointed out that Gazprom's not half price, it's 95% off no matter how you look at it. So no, they're too bearish in our opinion.

Nick Lewandowski: Okay, thank you.

Operator: And we'll now go to Richard Carp with Lincoln Financial Advisors.

Richard Carp: Yeah, David, thank you for the presentation. Just a question on hedging. I understand you use S&P put options when things get really volatile. How do you manage that part of the portfolio?

David Iben: Hedging on its own is something we have not done in 37 years. There were various times in the '80s and '90s where options were expensive, so we sold some options against the portfolio, generally worked pretty well. Now, I imagine over the next 20 years stocks go a lot higher, they spend a lot of money and inflation's part of the world, so you know we're not saying we don't like stocks, as a matter of fact the stocks we own, we like very much at these levels.

We look for mis-pricings in the market. I mentioned people don't like Russia or they don't like uranium. In '99, they hated small companies and they hated value. There were times in the early '90s and again times in the, you know, '02 and times in '08 where they hated bonds. So we're running an equity portfolio that we say we're doing equity analysis and we're getting equity returns but less risk, let's put bonds in the stock portfolio because we're investors and we're trying to make money for you.

You see, if you've read the book or watched the movie The Big Short, the flak that some of those guys took for buying effectively put options on mortgages when that might not be their forte, but they said we're looking for mispricing, they were a few years too early, it was painful and then they did well. We look for mispricing, we say if a put is something that does well when markets drop, then the more expensive the market is, the more valuable the put is.

So the market's gone up the second longest in all time without a meaningful correction, I don't consider what happened last quarter a meaningful correction. It was about to, but it just didn't happen. And so the more expensive, the more that put option is worth.

Then like I say fine, it's been inflation, who cares about nominal prices, what about valuations. And we say all right, well, if we look at price to normalized earnings and price to sales and price to replacement value and price to GDP and price to about anything else you can think of, this is the first- or second-most expensive market of all time in the U.S. Therefore, the put options should probably be the first or second-most expensive they've ever been.

So we look, they were the least expensive they've ever been, a huge disconnect. You know like we say, well why is that? Why is that, is because people are, in my words, mindlessly shorting volatility. Fascinating how much people lost shorting volatility and went right back to doing it again. So beautiful thing I think for those of us who are hoping to make money when this all ends. Volatility, implied vol should not be low right now but it is.

And so if it averages in the low 20s, maybe it should be the high 20's now, but 12? Briefly, 8. So this is not a bet against the market, this is saying corrections happen, they always have and they always will, and the price right now should be abnormally high and instead it's abnormally low, a 25% correction could make 20-plus times on this investment.

So that's why we're doing it. The fact that it has hedge-like characteristics is a wonderful attribute but not the reason we're doing it. And our plan is to continue doing this until either we make a lot of money doing it or until the market starts pricing these things appropriately. It looked a few months ago like we were going to make money, it didn't happen, well a little ahead maybe, but haven't made up for the last year and then it was starting to look, they were going to price these things appropriately too, but they're back to pricing these things ridiculously cheap again.

So we'll see if and when it works, but it is really, *really* mispriced, in our opinion.

Richard Carp: Thank you.

Operator: And we'll now go to Dan Gallagher with UBS.

Dan Gallagher: Hi, Dave. What is the, roughly the cost of that hedge, you know, per annum, roughly carrying that? And then secondly in terms of, familiar with the major themes or consistent, are there any new positions that are entering the portfolio, you know, year to date? And then finally, are there any easy businesses that you own, consumer discretionaries, people, you know businesses that you know are less tough? You know, Coke, Nestle, just something kind of consumer side that I could get my mind around easier, if you could just give me one or two examples of those I'd love it.

David Iben: Certainly. You just asked the opening question that I could add an hour to the call but I won't. Let's see, take the first one, it already came up, but Range natural gas is something we haven't owned for a long time in the U.S., then we took it up to 3.5%. It's since bounced, but it's still very cheap. So natural gas is an area. Over the last half a year we've nibbled at a few technology sort of names, not the popular ones, not the social media but the, you know the payment companies, Pax Global, Diebold, a few other ones.

But to your question, you know, what we've talked about arbitraging between countries and between types of fuel, we take what the market gives us. Quality companies are worth a premium to challenged companies, sometimes that premium's too low, sometimes that premium's too high. It is our opinion that in 1929 and 1972-3, which we started this presentation highlighting what the Nifty Fifty / '99 / Now, those are times in the last century, those are four times where, well the first three times for sure, and I'm, I'll conjecture that the fourth time will be now, where owning good companies that are clearly good with good margins and good prospects and easy to get your arms around are dangerous to own.

Good companies and good investments are two different things. And so right now margins are generally at all-time highs for many of these companies and then in addition to that high margin, the world is putting a high multiple on high margin earnings. 1973 January, Coca-Cola and Johnson & Johnson, Procter and Gamble, you name it, Xerox and digital equipment and K-Mart, these were companies that couldn't lose. I came in the business ten years later and I'm saying how is it these stocks were down 75% and it wasn't because the companies stumbled, a few of them did, Polaroid and Avon and what not, but a lot of them grew like crazy, and the stocks plunged.

I think the companies that are easy to get your arms around will probably do well, and I think their stocks will not because I think their margins will come down and I think their multiples will come down, and things like consumer stocks, you know, the Nestles of the world are really good companies but consumer in general I think we're starting to see signs here and there that when you have a lot of people selling stuff, it's tough to maintain your margins.

So you know we'll own those companies after they fall for a couple of years. And that'll happen, people will get tired of them, then we'll own them. So I think they're more dangerous than they appear. More importantly than whether I'm right, I could be completely wrong, hopefully they do fine but more importantly is, the stocks we happen to own, they're pretty good companies too. They're companies that tend to be monopolies and oligopolies, they tend to be companies that are hard to compete with. They tend to be companies that aren't going to be obsolete. You can have the best cell phone but two years from now you better be the guy who invented the new cell phone because the old one's not worth anything.

You know, where corn and wheat and electricity, they're still going to be worth something two years from now, five years from now, 20 years from now. And so we're buying really good companies with low multiples that are predicated on low margins. We think the margins likely go up, we think the multiples likely go up. If we're right there's tremendous upside and then hopefully for everybody saying I'm wrong on what's going to happen to the really well-liked, well-followed ones that are being bid up every day by ETFs, it's you know, I think not sustainable.

Dan Gallagher: So most of us are communicating to clients that the markets are trading at 16.5 forward earnings, and obviously those earnings are helped by low tax rates and really great margins, so you're just saying those margins are not sustainable, it doesn't seem like the valuations are nuts relative to a ten-year trading where it is.

David Iben: The valuations, well let's look at that. If stocks as a percent of GDP are one of the highest ever and if you throw debt in there, the claims on the economy are the highest ever. The price-to-sales right now is far, far more expensive than '07 and '99 and '29. So it's really expensive but I agree with your point that on forward P/E it's not that expensive. So how do we reconcile that? The only way to reconcile that is to say margins are extremely high right now, and not only are they extremely high but forward earnings, I had to double-check this because I didn't believe it, but it's true. Analyst expectations are for earnings to go up 27% this year.

So things have been good for nine years, so we're not at trough earnings, we're what may or may not be close to peak earnings and analysts are looking for a 27% gain from there, and I understand that tax rates are better and a lot of things are better. I will just say if people are right and earnings go up 27%, then maybe you make a little money, maybe you lose a little money, 20 to 16.5's not a high multiple, it's certainly not a low multiple, I don't see where people make that much money if things turn out to be perfect.

Future earnings, people are right. You know we talk about this a lot around here, people are right most of the time, they're only wrong when it matters, and that's an inflection point. And this may or may not be the top, I have no idea, I just know the economy's grown for a lot of years without a downturn. If the economy does fine, then great, you maybe make a little money.

If the economy turns down and I think I showed what's happened with interest rates and what's happened to delinquencies and we know that the Fed's balance sheet is actually shrinking now and the volatility's picking up and global trade is threatened and all this stuff, if people are wrong about earnings going up 27%, and they don't go up, God forbid they go down, people can lose a lot of money buying those really good companies.

So the upside, there's some. The downside is bigger. So we will let other people do that trade, and you know like I say hopefully the economy keeps going, we're not rooting against those stocks, we hope they do well. We just don't let the risk/reward, the stocks we own, we see some risk and massive reward. So we'll stick with our niche and we'll wish well for everybody else as well.

Dan Gallagher: Thank you.

Operator: Thank you very much. There are no other questions in the queue so Dave, I'll turn it back to you for any additional or closing remarks.

David Iben: Okay, well it's interesting times and a lot of really good questions and we appreciate everybody dialing in and thank you all for your support and look forward to talking to you again.

Operator: Thank you very much and that does conclude our conference for today, I'd like to thank everyone for your participation and you may now disconnect.
