KOPERNIK GLOBAL INVESTORS, LLC

Edited Transcript of the 1st Quarter 2021
Conference Call with David Iben

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Operator: Good day, ladies and gentlemen. Welcome to Kopernik Global Investors First Quarter 2021 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 and instructions will be given at that time. At this time, I would like to turn the call over to Mr. Kassim Gaffar. Please go ahead, Mr. Gaffar.

Kassim Gaffar: Thank you, operator. And welcome to the First Quarter 2021 Conference Call. My name is Kassim Gaffar and I have with me David Iben, the CIO and Portfolio Manager for the Kopernik Global All-Cap Strategy and Co-PM for the International Strategy. And also Alissa Corcoran, our Director of Research and Analyst.

Before I pass the call to Dave and Alissa for the bulk of the call, I'll be providing a quick business update. The firm ended the first quarter with overall firm assets of roughly $6.2 billion. This was a nice increase at the beginning of the year where the assets grew by roughly a billion over the previous three months due to strong inflows and market appreciation. As you can imagine, given our current portfolio composition and due to recent uptick in appetite for value-oriented managers, we have seen an increase in search activity. With this increase, as you may be aware, we soft closed our global all-cap mutual fund effective March 31, 2021. However, in addition to our International Fund, which is available for new investors, we do have other vehicles still open for new clients for our Global All-Cap Strategy. Moving along on the personnel side, no changes to report. And we ended the quarter with 39 employees strong and continue to be stable with minimal turnover conception of the firm.

Please note Dave and Alissa will be referring to the presentation, which can be found on our website, kopernikglobal.com under the news and views section. Also, we do have some new content including a recent ESG webinar, which was very well received by our audience and some great new thoughtful pieces that we have posted to our website. We encourage everyone to have a look at their convenience.

And with that, I'll pass it over to Dave.

Dave, please go ahead.

David Iben: All right, thanks Kassim and thanks to everybody for joining us. It's been quite an eventful quarter, so we have a lot of pages, but don't worry. We'll go through them really quickly.

Anyhow, our message, I think is mostly upbeat message especially for active management. But we must mention the world does seem a bit crazy lately, doesn't it? And it presents a lot of significant risks, risks that are different from what most of us have seen in our lifetime. So, certainly we haven't seen this sort of monetary or fiscal policy in our lifetime. So, this makes things especially dangerous, but the crazier the market, the better it is for active managers. And so, with maybe the craziest market ever, we think the opportunities right now are exceptionally good for active managers. But on the surface, things are good for everybody.

(Page 6) This is the age of abundance. So yes, go ahead and help but be reminded that Billie Eilish's song, I had a dream, I got everything I wanted. It sure seems for investors that we have everything we want. Seems like politicians, academics, everybody has everything they want on the surface very good. Certainly, the central bankers are committed to us always having everything we want. They have said they will do whatever it takes. (Slide 7) Powell, you name it. Lagarde, the Spanish, the British, the Italians, the French, the Japanese, the Chinese, every central banker on Earth have promised us that we can have abundance forever. They will do whatever it takes. And pretty much the academics said, if this is okay, they can do this. There is no side effects. There is no class. All of our dreams can come true. Certainly, the MMT ("modern monetary theory") advocates talk about the deficit myth. We don't need to worry about the deficits. We also don't have to worry about the money creation. Governments can just create money and we shouldn't have to work. It's the age of UBI ("Universal Basic Income"). Our valuations, of course, don't matter (Slide 8). So, when a stock has momentum as we're told, the sky is the limit. And if we just see ourselves living in abundance, we will.

It was that easy and thus far, it looks like it's true. Look at the results. (Slide 9) We're talking non-stop drop in volatility with occasional spikes, but not much volatility left. We are talking four decades, my entire career of interest rates pretty much going nowhere but down. They are very low in many parts of the world, they don't exist anymore. There are no rates of interest. The same for decades we've seen stocks only go up and real estate go up, then almost everything else go up. So, everyone everywhere is participating and it's free money.

This is utopia and that concludes our presentation. Not. Just kidding. There's obviously more to go. So let's go back to Billie Eilish's song (Slide 10). I had a dream, I got everything I wanted. She continues, not what you think. If I'm being honest, it might've been a nightmare. That brings to mind the Twilight Zone episode I've read about in Grant Williams' wonderful Things That Make You Go Hmmm. Anybody that doesn't have his research should look into it. But episode 28, A Nice Place to Visit where the bad guys – yes, dies in a shooting after a robbery and he wakes up in a special place. A guy dressed in white, takes him in, puts him in a beautiful home, beautiful meals. He starts to get whatever he wants, wine, women, song, gambling, always wins, continues to win. He's enjoying it, but as the episode goes on, it starts to dawn on him that maybe this isn't so good. At the end it becomes clear this isn't Heaven as they put it. This is the other place.

So, where are we now? I think in the school of Austrian economics and most classical economics, people will say, we can have all this stuff, but there's a cost to everything. We've always bought off on their notion as there ain't no such thing as a free lunch. So, what are the consequences to what's been going on?

(Slide 11) Overvaluation, to the left we see PEs about as expensive as we've ever seen. Price to GDP is far and away the most expensive market in the history of our country. Price to sales, even more so. We can show a price to replacement value to cash flows, to book values to anything. This is the most expensive market ever. So, that's at least a concern.

(Slide 12) Secondly, printing money by definition is inflation and here you can see the quick doubling of money. So, we've pretty much had 100% money supply growth, thus inflation. Since 2007, it's up nine times I think. So, a lot of money has been printed, but people say fine, but there's been no inflation. Well, there has been inflation. Where have the symptoms gone? They have not gone to CPI. But we all know that NASDAQ's gone up seven or eight times with it. Real estate prices have gone up. Lumber has just doubled. Metals are up. Drugs are up.

Most things that matter to us are up substantially in price and probably will continue to keep going up. So, inflation is here.

When I came into the business, interest rates were really high and nobody thought inflation could be stopped. They were wrong. Now, interest rates are very negative in real terms and nobody thinks inflation can come back. It's here. It's going to get worst.

Third thing is inequality. I think most economists have argued for a long, long time that printing money always has been and will be a cause of inequality. The money printing almost always goes first into the price of assets. Rich people own assets. They make money. The people further away from the money supply, they get stuck without the asset increases, but they deal with the increasing cost of living. So that, and it's no coincidence, has gotten a lot worse over the last 15 years. Right now, it's seems with all the free money, borrowing is not a bad thing. So, everybody's borrowing.

Corporations once again are right back at it. Governments, we've all seen that everywhere, but just the U.S., if anybody has not ever logged on to the usdebtclock.org, it's fascinating (Slide 13). It's depressing to watch how fast these numbers go up by the 10th of a second. But already every taxpayer in the U.S. implicitly owes $366,000. It's not going to be easy to pay off.

So, something to watch. (Slide 14) Charlie Munger's show me an incentive I'll show you the outcome. How about we incentivize people not to work? So, we're now paying people a lot of money to not work. You've seen anybody that takes Uber, seeing that now it's harder to get an Uber and it costs a lot more. Uber can't get people to want to drive a car when they can get paid a few thousands to sit at home. The restaurants, bars, other things that are having a lot of trouble getting people to come in. So, that's one of them.

Another consequence, we've seen this everywhere, is wild speculation (Slide 15-16). And so it's really been final. I've always been a student of financial history, but I've never seen anything – even read about anything like this except for maybe tulips in Holland, although this might equal that, and then some. And when you can get paid a lot of money to speculate there again, why go to work? Why be a businessman? Why run an enterprise when you can get your check and speculate on Robinhood?

And this shows the more speculative, the better, the more money you make. (Slide 17) It simply looks to be that easy. And it spawns wild ideas. NFTs are a fascinating story. Picture of a portrait on a cell phone is worth $69 million or at least was. (Slide 18) So, it's all going to be interesting to watch. So, with the governments and the central banks in charge, what could possibly go wrong?

Basically, it looks like we're in an infinite loop (Slide 19). Once you start printing money, there is no stopping. And certainly the central banks have learned that printing money causes disaster. The thing to take away from that is they didn't print enough money. And so, with each time they're printing more and more money that has consequences. And so, you know, Billie Eilish might be right. The central bankers might've – wake up to find it was a nightmare they created, but let's – with that out of the way, this is actually good news in many ways for active managers.

Switching from Billie Eilish to the Rolling Stones (Slide 20). I think the central banks are going to find they can't get what they want, but I think active managers, if they look hard and are willing to break away from the crowd will find they get what they need. And that's where we're going to spend the rest of this time talking about rather than mindlessly going with what's working. Let's do rigorous analysis. Let's search for the truth.

So, maybe the volatility that's being created is a good thing for investors instead of a risky thing for and maybe why intangibles certainly are very valuable. (Slide 21) Maybe tangibles still have values.

So we believe that if society is kind of the opposite of where it was when I came in the business, if people have a different idea on thrift and not savings and not hard work on an economic policy and debt and inflation, maybe people's portfolios should be positioned the opposite of how the audit was done 40 years ago.

So, that's of course what we think. (Slide 22) We think the whole Hayek versus Keynes was a great book. If anybody hasn't read it, it's interesting. Two contemporaries that knew each other and kind of admired and fought it out with each other. Is the government able to fix everything and make it better? As Keynes said, and are there formulas for everything or are the Austrian school more right? That really, you should leave it up to the private market and there are repercussions to everything. I'm a huge math fan myself, but I think Charlie Munger and FA Hayek are correct, Mathematics cannot lead to logic or common sense. So, anybody that hasn't read Hayek ought to.

Anybody who wants to have a little fun this video from 10, 12 years ago (Slide 23), fear the boom and the bust, but it's kind of a fun watch. Anyhow, I think that active managers should side with Hayek and position themselves to benefit from the inevitable consequences.

So, if the current school of thought is wrong, maybe they shouldn't be looking for stability (Slide 24). What if stability is in fact unstable? A lot of people should be going long on volatility instead of trying to suppress it. Maybe people should be buying scarce assets instead of buying things that are not scarce, whether it's money supply that's doubled or a debt that's growing at unbelievable rates or NFTs that are popping up left and right or SPAC's that are maybe things that are not scarce become less valuable, and we should be looking for scarce things, preferably scarce thing that meet needs that people need.

So, that's where we are (Slide 25). If the world is cyclical and financial assets and passive investing is what was working in the old world, what about the new paradigm? You know, where are we at? We agree that passive is great in many ways, cheaper fees but maybe people are getting what they're paying for. Maybe it's worth a little money to have somebody research and make decisions that are following the crowd, where indexing is cheap. Look how it works. Look at this Tesla chart (Slide 26), guess where the indexers bought? I mean, it wasn't exactly (this big), but pretty close. Indexers 20 years ago, their biggest holding by far was GE and it was about three times as big as the number two holding. After 20 years of torture, GE was kicked out of the index and the indexers, some of them had to sell, not quite at the bottom, but pretty well near the bottom. So, maybe people should try to position themselves counter-cyclically after a dozen years of momentum working. What goes up, comes down and then vice versa.

Maybe you keep that Tesla chart in mind as we go to the next slide here. (Slide 27) Where is Tesla on this? Anyhow, active investing has allowed Kopernik to keep our heads well above water during a horrible decade for everything of value. Almost all forms of value has had a bad time, but volatility and active management has allowed us to take advantage of that. And talking a little bit about how we do it, why we do that, why it's worked and why it makes us feel pretty good about the future, let's hand things over to our director of research, Alissa Corcoran.

Alissa Corcoran: Thanks, Dave. Yes, we're going to go through a couple of examples of where we view volatility, active management to our advantage and how it's helped our returns.

One area in particular is utilities (Slide 28). We've owned emerging market utilities for many years since inception. At 2014, 2015, we had a very large position in Eletrobras, which is the blue line. The company was trading at 10% of book value, 4% of replacement costs. We had a 4% position in this company.

As you can see, that Eletrobras went up six times in a year and in passive investing, this would have meant that now that's a larger percentage of the portfolio. For us, we trimmed along the way. We reduce our model weight. By August of 2019, our model weight was 1.5%. At the same time, as we're trimming Eletrobras, we were buying more of EDF, buying more of RusHydro, buying more of Federal Grid. So, as you can see, with the exception of Eletrobras, emerging market utilities have gone nowhere despite this fact we've made double digit returns in emerging market utilities.

So, Utilities is one area, other areas that have basically done nothing, but we've been able to make strong returns emerging markets, Russia, Materials and Energy (Slide 29). They have contributed very strongly to our returns yet they've done , virtually, they've added nothing to the ACWI, which is our benchmark. It's important to note that these numbers are contribution. If you look at the annualized returns, they're much larger than that and all of these areas, we've made double digit returns. This is not bragging. This is more to say that active management, if you can keep your head above water during the bad times, that sets you up very well to do well in the future and during the good times.

Other examples, gold mining companies (Slide 30), just looking over the last 14 months we were buying in the first quarter, we bought a lot. When gold miners collapsed, they fell almost in half despite the fact that gold really was not down very much at all. And then we were using the price appreciation to trim. We trimmed all the way through the summer. And then bought again as they've been falling pretty much every day since August. Because of this, our annualized returns (Slide 31) are more than four times larger than what you would've gotten if you had just owned the GDX. So, using volatility to our advantage has been important for us.

Uranium mining, it's the same story (Slide 32). This is an area we have owned since 2013. Unfortunately, uranium has, until recently, gone in the wrong direction for eight years. Today, Dogecoin has a market cap that's larger than the entire uranium mining market cap. So, despite the fact that uranium miners have fallen from $35 to $18, we have had a positive contribution. We've done this by keeping our conviction, maintaining our patience, adding new names as the uranium mining companies have fallen.

Oil is the same story. (Slide 33) This is the Russell energy index and we really didn't own very much oil, but we have added names as the oil companies have fallen. We added a significant position in Synovus right as oil is collapsing in March of 2020. We all remember the negative $40 oil price. Again, oil down, contribution for Kopernik positive.

Natural gas (Slide 34) is also an area that we didn't own in inception. Gazprom is a name we've held since inception, but it's more of a hybrid gas oil name. So, until really 2015, when we added Consol, we didn't own natural gas. We waited for it to fall 80%. And then we waited again and we didn't own another one until three years later when we added Range and then added Southwestern even later on. This tells the same story. Natural gas companies collapsed. Our contribution has been positive because we've been very disciplined with our valuation process, disciplined trimming and adding as our position (as the price) has fallen and risen.

Copper mining (Slide 35), we've mostly own Turquoise Hill and Ivanhoe over the past 14 months. They've been beautifully volatile as you can see in this chart here. We've been mostly buying for the first nine months of 2020.

We were buying as we were trimming our gold names, as you can remember in the summer, we were trimming our gold companies. And then at the same time, when Ivanhoe goes up, we would trim that and if it was going up – while Turquoise fell, we would sell Ivanhoe and buy more Turquoise and vice versa.

(Slide 36) So, what we're trying to communicate is that while we've had positive returns in many of these commodity stocks have fallen, our thesis has really not played out. Many of the commodities that we own are still trading well below their incentive price. We expect the commodity to rise significantly. And also the mining companies that have the commodity in the ground to derive to give it something more. Further, while we don't need inflation for our commodity stocks to do well, inflation has happened as Dave pointed out, the money supply has gone up nine times since 2008, yet copper, oil, gold, platinum, silver, they're all much lower than they were in 2011 (Slide 37).

As this chart shows, these sorts of stocks should do well in a rising inflationary environment, raw materials do well, precious metals, mining companies. So from our standpoint, active management using volatility to our advantage has helped keep our head above water during the times when commodities have not done well, when value has not done well. And if we see inflation start making its way into commodities, which we're just recently starting to see, we'll have the wind at our back. And for those who believe that they've missed the reflation trade, this chart should make you think again. (Slide 38) They are still extremely cheap relative to the S&P. And despite the fact that many of these mines have gone up, this just shows how cheap they actually were.

Gold in particular is one of our favorite areas despite the fact that we have seen a lot of money printing. (Slide 39) Gold is effectively flat over the last decade and gold miners are down significantly. If you look back, even further back in 2011, this would show even greater magnitude. Many of these gold mining stocks are down 50-60% since 2011.

So, to go over some of the changes in the portfolio, I will turn it back to Dave.

David Iben: All right. Thank you. All right. So, clearly a volatility that many people think is risk is actually opportunity. I know for - historically, we've had low volatility but it picked up a lot in 2002 and '03, which was very helpful to us. Picked up a lot in '08 and '09, which is very helpful to it and it picked up a lot last year and it wild volatility we had last year. Volatility was our friend, is our friend.

(Slide 40-41) As you can see here in the net reduced column, quite a few reductions of resource companies, inflation beneficiaries, emerging market companies, companies that we're able to buy at very distressed levels a year ago, less than a year ago. So that, we're happy with. Added to, while we're selling some resources, we're able to buy other resources that have come down. So this was a wonderful thing. And as Alissa mentioned, when people didn't like copper last year, we bought the gold companies that had a lot of copper, now we've been trimming them because (there of that lot) and buying back the ones that don't have as much copper that have fallen down. We've been able to take advantage over the last year of different conglomerates. People in the 1960s were being huge premiums for conglomerates. Now they're selling them at half the price. They don't like the idea of bundling a few companies together. So, that's nice.

I even had a consumer name with Carrefour which has gotten pretty cheap lately. Global/International, same story. Volatility has been helpful and we think will continue to be. But we are excited that the upside is really good for companies that have assets. It's really good for inflation beneficiaries. It's probably pretty good for emerging markets and whatnot, but we don't want people to have the wrong impression.

Pretty balanced portfolio, the traditional side is also a lot of value (Slide 42). You can see things that we're buying at half of book value was really nice dividends. We're talking in a consumer communication services so, oligopolies and phone business, what could be much better than the phone business nowadays. Half a book, almost 5% dividend yield. Financials not something we've owned a lot of historically but we've been able to buy them lately at discounts to book value, 4% yields. Utility, Alissa talked to you a little bit about that (Slide 43-44). But we're talking utilities that have, in general, pretty low variable costs that have next to no inflation, that have no greenhouse gases. We're talking hydroelectric. We're talking nuclear, many cases in growing economies. Monopolies was something that people need that has a competitive advantage. Less than half a book and 3.5% of yield.

So when you add it all together, we have a balanced portfolio of wonderful, tangible value and optionality combined with great, great franchises. We have quality companies that people like. And when you put it together, the valuations are fairly attractive in an absolute sense. They're extremely attractive relative to the market.

If there is no inflation whatsoever, this portfolio is well situated. If the inevitable inflation comes, it is very well situated. So, good companies, attractive valuations, and as the central banks continue to sow the seeds of a future volatility, we're getting very encouraged that the never-ending cycle back and forth from passive investing to active is handing the baton to active.

So that's what we see and we're happy to spend most of the time on Q&A. Thank you.

Operator: Thank you. Ladies and gentlemen, at this time, the floor is open for your questions. If you would like to ask a question, you may do so now by pressing star one on your touch-tone phone. If you are using a speakerphone, please make sure that your mute function is disabled to allow your signal to reach our equipment. Again, if you would like to ask a question, please press star one now.

And our first question comes from Dana Lambert with Morgan Stanley.

Dana Lambert: Hi, can you hear me okay?

David Iben: Yes.

Dana Lambert: Great. Just looking at the valuations across a lot of your portfolio where there are commodity producers owned, just curious how the valuations, relative to the underlying commodity, tend to look versus their historical range. And so, when you compare, for instance, in precious metals, I know a lot of the miners are trading at pretty low multiples and certainly very low levels relative to the underlying metal, but curious about some of the other sectors, if those two are sort of trading well below their range. I know the company itself may have a pretty interesting valuation based on traditional metrics, but just versus what they produce. Curious what you're seeing.

David Iben: Yes. Overseeing it's interesting. We like it when we have views that are quite different than the market does on how we should look at things. And here we do. And so, and if we can be right half the time, three-quarters of the time, it works out very, very well.

How to value these things? There's different ways and people can argue for things. How not to value these things? We think on last year's cash flow or last year's earnings, we like to say if we pull out a coins or gold coin, say what's this worth and then we can all agree $1,800 plus or minus. And we dig a hole in the ground and we throw it down and bury it and say, what's it worth now? Well, what is the last quarter's cash flow? That has nothing to do with it. Last quarter's earnings have nothing to do with it. It is still worth that $1,800 minus the cost of digging it up. And so, we figure it's worth that now on Wall Street and Bay Street. People say, no, it's underground. You know, we'll sell to you for a $1,000 adjusted for all the costs. We say we're a buyer. We like that. Now, it's not simple. So, we looked at it lots of ways. We say, what's it worth now? Well, $1,800 is what it's worth now. So, we looked at it as an input. We say over the long-term, you run out of supply of something unless the price is high enough to make people build mines. With gold, it's for a long time, man, at least $2,000. So, you'll probably notice there's some small minds being built, but nowhere near fast enough to stop the existing mines from depleting themselves. So, sustainability will require a price of $2,000 or more. So, we value it at $2,000 as well as at $1,800. That's obviously a better number that obviously it gives us some pretty good upside. Then we say, well, the dollar used to be backed by gold and through history, eventually we come back to that, under Bretton Woods each dollar is pretty much backed by a, quarter-way backed by gold. In 1980, it was a 100%. You could have more than fully backed all the dollars with the gold to actually build what's worth a lot more. Now, there's been this tenfold in increase in money supply.

So, if they wanted to go back to the Bretton Woods and somewhat back, now we're talking many thousands of dollars. And so, we don't pay for optionality. We like free optionality. If gold were $1,800, we think these stocks are selling below that. They could liquidate. We make money. We make pretty decent money at $2,000 and there's free optionality that maybe gold is worth thousands of dollars and so we really liked that.

Even more exciting especially on the other things we have whereas gold is what a couple of hundred dollars from its all-time high. Uranium was $137 a pound back in 2007, somewhere like that. It fell to $18 and for years now it's been bouncing between $18 and $35.

We believe, talking to a lot of people, that somewhere in the $60 to $90 range is the price that would be required to get people to start building mine, that incentive price. Now, people are building nuclear reactors a lot faster than they're closing them down. China, in particular, is building a lot of them. Japan seems to be headed back in that direction. So, all these multi-billion dollar reactors need uranium. Uranium inventories were obscenely high after Fukushima. They've been dropping for a dozen years. They're now getting dangerously low. They're going to need to start building mines. They are not building mines at $30 uranium. They're doing the opposite. At $30 uranium, Kazakhstan has cut back supply a couple of times and Cameco three, four years back shut their biggest mine and it is still shut. A couple of times they've shut their next best mine. The Chinese have shut a few big mines. People are setting up funds just to buy and hold uranium.

So, it's not even debatable that $30 is way too low, right? Whether it's $60 or $90 or a hundred something, us smart people can debate that. But at any rate, we think these companies are selling too cheaply, and if it hits $60 massive upside. If it hits $90, these will be very, very attractive.

Natural gas has bounced between $2 and $14 most of my career. It's at the lower end of that range. People really, really hate hydrocarbons right now. They may go away in the next half century or century, but it's not easy to go off of hydrocarbons. And natural gas is the cleanest of the hydrocarbons. It's also abundant and very cheap in the U.S. And if we do go to electric cars, most of that incremental mine is going to have to be met by gas. You can only build so much solar and so much wind. We're probably not going back to coal. We're definitely not going back to oil for electricity generation. It's going to be natural gas.

So, there again, we've tended to own companies with very long yields that are okay at current prices. But if prices go up another dollar, then there's really nice value to these companies. And if ever it gets back to the high end of its old range, then massive money.

Copper now is doubled up the bottom so it's less attractive than it once was, but the copper stocks, they still have some value we believe. So, yes, it's not a matter of us liking or not liking commodities. We like commodities that one, are selling below that incentive price that it would take to keep supply going; two, are valued by mankind and generally needed; and three, sell cheaper on the stock market than the spot market. And so, we very much like natural gas and uranium and gold and silver and platinum.

Operator: Thank you. Again, if you'd like to ask a question, please press star one now. Speakers, at this time, we have no further questionnaires in the queue.

David Iben: Okay. Maybe just mentioning volatility scared people up off. We certainly appreciate everybody dialing on and we look forward to the coming quarter and we'll talk to you again in three months.

Thank you very much.
