Kopernik Global Investors, LLC

Edited Transcript of the 2nd Quarter 2015
Conference Call with David Iben

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Operator: Please stand by, we're about to begin. Good afternoon, ladies and gentlemen, and thank you for joining us for the Kopernik Global Investors 2nd Quarter Conference Call. On today's call we have David Iben, founder, chief investment officer and lead portfolio manager to discuss Kopernik's views on the current market environment and the portfolio positioning of its Global All-Cap strategy.

Please note this call is being recorded, and the topics on this call are for informational purposes only and should not be regarded as a recommendation or an offer to buy or sell any product or service to which this information may relate. Certain products or services may not be available to all entities or persons. Please consider all risks carefully before investing. All participants will initially be in a listen-only mode. Following Mr. Iben's discussion there will be an opportunity to ask questions. To ask a question please press star one on your touch-tone phone. At this time I'd like to turn the conference over to Nick Roberts.

Nick Roberts: Thank you, Paula. Good afternoon, and on behalf of our entire firm at Kopernik Global Investors, we thank you for joining the quarterly conference call and also for your continued support. Kopernik recently celebrated its two-year anniversary on July 1st, 2015, and we are humbled and very appreciative of your continued advocacy, especially in these difficult times.

Our investment process and current portfolio reflect the commitment to our conviction that owning very good companies, including leaders in their respective industries, currently trading at or near all-time low valuations and prices will ultimately result in adding significant alpha to your client's portfolios. By almost any metric this is the cheapest portfolio Dave has ever managed. Before I pass the call over to David Iben, I'd like to provide you with a quick firm update. At the close of the second quarter of 2015, our firm is currently managing roughly $1.9 billion in assets under management, up from roughly $1.5 billion at the end of the first quarter of 2015. The feedback we get from many clients is that our lack of correlation to both other active managers as well as passive strategies make us a compelling option right now in an uncertain market environment.

During today's call Dave will be referencing a presentation whose link was sent to you in the invitation, but also can be accessed through our website, www.kopernikglobal.com. Again, thank you for joining us and I will now pass the call over to David Iben, our founder, CIO, and lead portfolio manager. Thanks, Dave.

David Iben: Okay, thanks, Nick, and thanks to everybody for joining us. Once again it's a very interesting time in the market; I think the perfect time to be having this discussion. We can start with page 6, and for those who believe the market's efficient, it's really difficult to explain times like now. For those of us who believe the market's inefficient, you have to get pretty excited at times like now because we think the inefficiency is at a pretty extreme level.

And page 6, just a cartoon, but really what the market's doing right now is paying a big premium for certainty. We think this is risky because we think they're paying for something that does not exist. Sooner or later they're going to have to deal with the fact that life is uncertain, so we go to page 7. In review those of you that have been with us for a while, you heard me last year talk about how much it reminded me of 1999. This year sure seems to be looking a lot like 2000.

As Mark Twain says, history doesn't repeat, but it rhymes. This is important. And if I can pause and step back a minute, this market right now is the reason we decided to create Kopernik in the first place, and this is a market that, as painful as it is, is a market that's very extended, quite bifurcated, highly correlated, and irrational. This is important because when things become highly correlated in their irrationality, it's an important time to differentiate oneself, and we like having somehow become an option that looks like as for lack of a better word, like we're the antidote to correlation.

And about 1999 - 2000, it was extremely painful for me and for most other value managers that I knew. But it was by far the most rewarding time in my career that's a third of a century now. The subsequent 12 years were a lot of fun, but they were nowhere near as rewarding as that time, when what seemed like pain at the time was really an incredible opportunity to make a lot of money, and make a lot of money by taking advantage of a market that priced things as a result of people's belief that Mr. Greenspan could control everything, and their belief that the Internet somehow had repealed the laws of economics and of mathematics, and we all know how that ended.

The current environment's pretty amazing too. The people seem to believe that Mario Draghi and Janet Yellen and the Bank of Japan and others right now are omnipotent. They can create wealth out of thin air. We think we know how that'll end. They, also like 1999, confuse an exciting story with a good investment. We believe the fact that people have gotten pretty good at mapping genomes does not make things a good price at 7 times the level they were at a few years ago. So to sum it all up, this is a pretty exciting time, as painful as it feels. It's the right place, the right time, as the song goes. No place we would rather be.

Where are we? We are in a market that's bifurcated. This is back to our first day at Kopernik, you can see emerging markets have done nothing and the world markets have done very little. Pretty much to perform you had to be in the U.S., the very market people hated four or five years back. That was the place to be. It's gotten pretty extended, and it's become a momentum market, and how does that happen? If we go to page 9, I think people misperceive risk. We've talked a lot about that, whether things like volatility and correlation and tracking error and things like that. Certainly they offer career risk, but not risk to the portfolio, and a matter of fact when things become expensive you don't want to be correlated. It is interesting, if people talk about shark attacks, oh, it is risky to go in the water, when someone gets attacked by a shark it makes all the headlines. It does not make the headlines when somebody has a heart attack on the beach. And so we go there and eat our Fritos and say I'm not going in the water.

But according to this chart (page 9) one in five chance of a heart attack in a lifetime, one in 3.7 million chance of being attacked by a shark - people worry about the wrong risk. Talking to a colleague of mine outside of work who does athletic stuff, working with athletes and stuff talking about how much stress a cycle can take and whether humans are designed to take risk or run their risk, and they're saying isn't it interesting that roller coasters are something people pay for but you know, they're kind of risky. But no, that's not risky, that's the point. It is thrilling to ride a roller coaster but it is not risky. People do not pay money to go out onto a battlefield. They will pay money to skydive, but they won't pay money to jump from a plane with no parachute.

It is interesting how people behave there versus in the investment market, and we've talked in the past how people go to a store and they find the suit they wanted was marked down in price, they get excited and buy it. But if they go to the stock market and find a stock that was $12 yesterday and it's $8 today, they don't view that as a markdown, they view that as risky, and they have it backwards. It is interesting how people will not put money in volatile stocks. They don't pay for the roller coaster in the stock market. They fear the roller coaster, but just as if the heart attack is the real risk for those of us that go onto the beach, buying bonds at 3% for 30 years, as we've talked about, that's beyond risk. If your needs are to make 5, 6, 7, 8% a year and you lock your money at 3%, that's beyond risk. Why is it that people will not buy a stock that's yielding 10, 20, 30% on average, but it's volatile, and yet they'll lock their money up long term, at rates of return that are pretty well guaranteed failure? It's interesting though, not only do they have the risk wrong, it compounds itself, because if you want low volatility Wall Street and the Feds and others find a way to give you the appearance of low volatility. But that's just the things; stability in and of itself is destabilizing, and I think having taken short term volatility out of the market, the Federal Reserve has caused a lot of malinvestment.

I think we can find that the future will probably offer more volatility. As we go to page 12, it's interesting how four or five years ago the dollar was considered risky. Now the dollar is considered the safe place to be, the place you have to be. The question that comes up all the time is why don't we have everything in the dollar, just like 4 or 5 years ago people said why don't we get everything out of the dollar. Why in the dollar? Just so you know, I hear over and over and over again, the dollar is the cleanest dirty shirt.

So rather than having an opinion on whether it's the cleanest dirty shirt, I've got a matrix here of a bunch of pretty soiled garments, and which is best and which isn't? I don't know, I'll leave that up to you. I'm not going to say the dollar's better, I'm not going to say that the dollar is worse. I will say that looking at this, a prudent investor should not have all their money in any one of these currencies. I think diversifying beyond the dollar is a very important thing to do.

Further on the same subject, leverage I think is understood to increase risk. Here we have something showing the absolute level of leverage and the increase in leverage, thereby growing today at the expense of tomorrow. I think everybody understands Greece, Ireland, Portugal and Japan have their challenges, Spain and France too. But it's interesting how Argentina, Russia, and Brazil, the really risky ones (at least by this one measure) are the least risky ones. Returning to the U.S. it is a wonderful thing to have high margins, to have the highest ever, and double normal is a wonderful thing. However people are pricing in those margins to last into the future, then a good thing becomes quite risky because history, logic, theory, everything would suggest that margins do not stay above normal forever, especially in a zero interest rate environment.

The cost of capital was zero. At school they thought it was as the return on capital eventually approaches that cost of capital, the direction will be down. Another risk is financial engineering. Everybody's looking for the U.S. to keep growing, but this chart here (page 15) is interesting, because the amount of money going to dividends and buybacks from various studies I've seen pretty much it's 100%. No money's being reinvested in growth.

If you're a company, growing your business is really hard. Buying your stock back to manipulate up EPS at the expense of real wealth, that's an easy way. Make your book value drop, your return on book goes up, but at any rate the more money that goes into stock buybacks and dividends is at the expense of future growth, and it would be great if the market was efficient. Besides that, buying low and selling high was a good thing to do, but people are running companies, they have a long history of doing the opposite. They buy when the cash flow's high, which tends to be the top, and they panic at the bottom and sell. This just shows recent history the last 15 years. You can see that late '07 early '08 was this unparalleled amount of buybacks. They bought at the top. We all know what followed.

We now have surpassed that level. I think one, people should be suspect on the earnings estimates they're seeing. That two, wonder about stock prices, they're going up based on borrowing and buying at all-time highs versus economic growth. So a lot of things going on, a lot of psychology, so that's good. As Warren Buffett says, the market in the short term is a voting machine, in the long run, a weighing machine.

So with that let's try to weigh a few things. Time is an interesting thing. If you look at the last couple years, just like '98 - '99, the last couple years have been pretty painful for value people. You buy things that are way too cheap just to watch them drop, and two years seems like an incredibly long time, but really it's not. Maybe I'm getting older, but it's not, and so let's put things into perspective if we can.

Gold mines - and almost all gold mines now- they're going to take ten years or more to bring on stream. But let's take a well-known one, Pascua Lama that Barrick found 25 years ago. They have spent $6 billion on it. They planned to spend $8.5 billion by the time it's done. It's difficult building the mines, so all kinds of things can lead to cost overruns. You have to find it and you have to drill it out and you have to get feasibility studies and pre-feasibility studies and financing, deal with governments. And then you need to worry about the risks of geology, geography, chemistry, engineering and cost overruns and things turning out different than you thought. Then you have to worry about changes in regulatory, compliance, environmental and legal businesses. It's a difficult thing, so they spend 25 years on it. The market has just knocked down Barrick stock, 85% from the top.

We bought in, we bought in too early, but we're buying billions of dollars of investment and decades of time and quality for assets that are scarce and cannot be replaced. I would rather be a year or two or three too early than too late to buy that kind of work, that kind of effort, that kind of irreplaceability, to miss out on that. The upside is tremendous. That's gold. Uranium may be even more so.

Next month I'm going to go visit this mine that just got finished, that Cameco has been working on for 35 years, pretty amazing thing, $2.6 billion there again to control the water, to go way deep underground and freeze things to make them mineable, all the technology and the engineering, it is just unbelievable what it takes to bring on a mine, 35 years' worth of effort. The stock's been marked down. We'll come back to that.

Once again, when things are trading at 10 or 20 cents on the dollar and it takes that kind of effort once again, I'd rather be a couple years too early than miss this incredible opportunity. Last year talking nonstop about - or half a year ago, Russia, and a year ago it was all China and various times gold, the topic lately is coal, and it's really phenomenal how stocks can drop 5% every single day.

I guess the idea is that we're not going to use coal anymore. Coal is pretty complicated, but coal is abundant and it's cheap. It's still over half the world's electricity. Might be wonderful it was going away, but it is not going away. After being a growth business my entire lifetime, it is no longer a growth business, but it's being priced as if it's going away, and that's a mistake.

But within that we have Peabody. So there are various coal companies that are really in trouble. There's a few of them that have gone bankrupt. There's more that have gone - that are going to go bankrupt. People are pricing Peabody for bankruptcy. We think they've missed it, and we think they've missed things like unprofitable hedges rolling off in the near future and CAPEX going lower than it was a few years back, and payments for the properties dropping. For a lot of reasons the costs are going to be more manageable, and coal's cyclical, the prices are going to come back, but for this analysis we're assuming they don't. Let's say things stay bad. The losses are far less than the billon and a half of capital that is available to the company, so there's some risk here. The market sees way more risk than there probably is. If we're going to take risks, there certainly needs to be potential return.

A couple points here that people have heard us talk about in the past, that you know, we can lose money on three out of ten stocks and make money on 7 out of 10 and on a portfolio basis still make a lot of money, so our goal is not to never be wrong, and we're going to like I say, be wrong on 30% of our stocks, and that's life. If we're wrong on Peabody, that's fine, because so many of our other stocks have 5 or 10 times upside.

But as the last slide shows (page 22), we don't think we're wrong on Peabody, and we have the #1 independent coal company in the world. It's diversified, it has properties in different continents and they have different types of coal, a huge range of coal, and they have a manageable balance sheet. They'll be okay, and if we're right they're going to be okay, there's all kinds of ways to evaluate, but they can take the coal that's already developed near infrastructure, and you say oh, the rest of the resources are worth nothing, the stocks worth 6 ½ bucks versus something that's trading at less than a buck and a half right now, a pretty amazing - oh and by the way they do own a lot of other stuff that can be developed if you - value, fairly conservative values for the coal down, and this is still not all the coal, but most of their reserves, the stock could be worth $61. Not a prediction, just what could be. So if we're wrong we lose $1.40. If we're right, make many, many, many times our money. That's the kind of risk/reward we like. Especially when we're buying a premiere company and a business that is not going away. I could go on a long time on this, but let me just go on a little bit on this.

It is said that all of us portfolio managers have ADD. That's maybe to some extent true. We all want something to happen now, so we don't have the patience to wait two or three years for something to work out. We really ought to, you know, the people like Warren Buffett and Howard Marks and others do have that kind of patience, and the results have shown.

Right now it's the extreme - rather than wait three years or even three minutes, people can conjure up billions of dollars in a microsecond. The last six or seven years they've conjured $4 trillion out of thin air. As Ben Bernanke has told us, it costs nothing or virtually nothing to do that, so here's something that takes seconds to produce or fractions of a second to produce and costs nothing and have grown like crazy. They yield nothing. They are not scarce. The Federal Reserve has told us it's their intention to make them continue to lose purchasing power, and yet investors hold it under really high esteem while simultaneously holding in low esteem gold mines, like I told you. Barrick is off 85% from the top. They hold in low esteem uranium mines. We've talked in the past how uranium's a growth business now and they're going to be building 60 some odd new reactors. They need to get the uranium from somewhere.

Cameco has just finished a mine, as I said, it took 30 years to build, the stock is now 75% off sale. Dams, hydroelectric dams are a fascinating thing. I might have mentioned the in the past this book, Colossus, it's a fascinating read about the Hoover Dam and the decades it took to get that thing up and going, and the feuds between the states and the regulatory problems, the hassles and the engineering nightmares and the deaths and you name it. And you know, I read about Three Gorges and Aswan and all that, it's an amazingly hard thing to do. We find that two of the best hydro properties in the world, RusHydro, off 83%, trading at a third of book value. Eletrobras in Brazil, 93% off sale, 14% of book value. This took decades to come up with this franchise. It's cheap, it's clean, and it's an amazing competitive advantage, way below replacement value. If we're a year or two early buying these things, so be it.

We've gone telecoms pretty successfully one country after another depending on where they're giving them away over the last few decades. I think a year ago we talked about the Chinese one that was the biggest and was trading at 8 times earnings. We sold it when it ran up to 14 times earnings. Korea Telecom, like all telecom in 1999 was very, very expensive and that now is on an 83% off sale also, two thirds of book value. The earned yield is 10%. It's a duopoly. It'd be very, very hard to replace. Nuclear power, as I say, it's not going away. The biggest nuclear fleet is in France. That's only 81% off instead of 83% off. It's a fraction of its replacement costs. Also Japanese trading companies, 70% of book. Also 10% earned yield, and people like bonds at 2%, 10% earned yield, that'd be very hard to come up with trading franchises and property ownerships and the sort of thing these companies we've talked in the past about.

Farmland. There's a book called Collapse, a rather depressing book but informative book. It's got a lot of chapters on different things, but one is on farmland, having really good qualities. Topsoil, it's not eroding, it's close to water that's close to infrastructure that can be utilized, a rare thing to be buying farmland. It earns yields of 10, 20, 30, 40%, a fascinating thing. Granted they happen to be in Brazil and Indonesia and Ukraine and places like that, but good quality, well-managed properties. Tankers, yes, it's a lot of work to build a tanker, a lot of capital involved. People buy a tanker; the stock market turns around and says here you can have it for less than half of price, sometimes 30%. Last year they gave us oil tankers for next to nothing. This year it's bulk tankers for next to nothing, and I could go on and on, but let's stop with that.

Continuing on, resources in general, people loved them four years ago. They hate them now. This shows that relative to financial assets we are approaching that sort of 1999 - 2000 peak. Commodities are incredibly cheap relative to financial assets. I hope people are familiar with Kiril Sokoloff, his 13D research, a fascinating piece and how he comes up with that much insightful stuff week after week, I don't know, but highly recommend it. A couple of weeks ago he was comparing commodities now to times like 1977. New York City, when the Reichmanns were in there buying properties for a buck. A time when town houses in Manhattan sold for 40,000. Why? Because they were negative cash flow in the near term. Things were so depressed that just keeping the maintenance up was an expensive thing. Talked about Don Bren and the Irvine ranch, and people hated negative cash flow. Talked about in the 80s when you had the last commodities collapse, people were able to buy things at zero that shortly thereafter were making $100,000.

He's talking about now, the things that were bought 2, 3, 4, 5, 6, 7 years ago in the commodities space, by big, well-known companies are just being dumped, 99% losses, get me out at any price. We have a lot of companies we're familiar with where the near term will be negative cash flows. You have to keep the maintenance up and going. Now is the time to buy great properties. Now is the time to be making 50 times your money.

They don't mention in this John Paulson's thing, it's interesting the few books that were written about him and others that were betting against mortgages in '05, '06, '07, negative cash flow in '05, negative cash flow in '06, negative cash flow in '07, and home run in '08, '09. Sometimes people pay a lot for a small positive cash flow, and they avoid great values as they don't see a lot of cash flow now. They avoid negative cash flow.

This slide here (page 27) we'll probably keep showing you. I know you've seen it before and as I've told you, in the past it's inspired by 1999 when I saw a gentleman comparing Intel to India and how could Intel have a larger market cap than the whole country of India? It turned out to be a mistake on the market's part, all these years later and Intel is not up but India is up massively.

Apple's a wonderful company. I do not believe that any one company is worth more than two of the biggest economies on earth, and ones with the most natural resources. But in general those two and emerging markets. In general, we've gone a long way from where you must own the BRIC's. Now you can't own the BRIC's at any price unless they're Chinese/Asian, until a month ago I guess. It's interesting, growth economies and then there's the U.S. You know, highest book value on this chart, second highest PE on the chart, highest price to sales on the chart. The U.S. is the most expensive market in the world right now. I don't think the next ten years will show that it's the fastest growing in the world. It seems highly unlikely, so U.S. and a lot of developed markets, no problem with them, great countries, good companies, aggressive stock prices.

Other places have great resources, great managements, cheap, cheap prices for monopolies, oligopolies, scarce resources, franchises that took decades to build, things that took decades to build that meet the needs of human beings I think in the long run will be worth more than pieces of paper that yield zero, and so with that let's take questions.

Operator: Thank you. And we'll first go to Michael Sheldon with RDM Financial.

Michael Sheldon: Hi, thank you for the presentation. A couple quick questions, one is you seem to be generally pretty upbeat about commodities. Obviously they're out of favor right now and there probably is a good reason for that. Can you sort of talk about your expectations for what's going on in China? They seem to be switching more from a commodity based growth cycle to a consumer goods and consumer services cycle.

And then also just had a quick question in terms of Peabody, you make a - you had a couple of pretty good slides on there with a balance sheet and income statement going out to 2020. Can you just talk about what makes you feel so confident in your estimates, given that other coal companies right now seem to be going out of business left and right? Thank you.

David Iben: Sure, no, very good questions, and certainly the right things to be discussed right now. We believe there is a price for everything. We also think when people have moderate expectations, and we have moderate expectations, then quibbling over a dime here and there is not so helpful. Those of you that have known us a long time, as much as we like commodities and as much as we like agriculture and energy in emerging markets and things, four years ago we were out of energy, and mostly out of our emerging markets and out of half our gold and out of 100% of our industrial commodities, because the market loved them. They loved them too much. To your point, they thought China was going to grow fast forever, insatiable appetite for commodities. China's grown fairly fast. It's just very disappointing people who were looking for insane growth forever.

Now, you're right, China has slowed down. They've got a bubble that's collapsing it looks like, so probably slow down even more. In addition to the slowdown, you're right, they're transitioning more to a sustainable model, consumer and what not, which is good. The capital intensity of their growth four or five years ago was off the charts. It was beyond what you saw in Korea and Taiwan and Japan and other places. It was something that could not be sustained, so there is no optimism priced into commodities right now, and I don't know anybody that's saying "oh yes, China's going to bounce back strong and start buying a bunch of commodities". I'm not hearing that anywhere. People who were worried four or five years ago that printing money is inflationary now are yawning at the fact that we did print 4 trillion and that the Japanese and Europeans are racing to see how much they can print.

But nobody's pricing in the fact that that might be inflationary. The amount of resources that have been found, there's been really no major discoveries of uranium or gold and not a whole lot of copper. There's been some, but so the supply's not there. People are assuming no demand forever. We think there'll be demand someday. When they come, what will the price be? Both logic and history suggest that when things are trading well below the incremental cost of production, you need to get the price above that or there won't be production.

So we believe there is demand - we're not even predicting pick up or do well. If demand continues, we think you need to see the price of uranium double, and you need to see the price of gold go up $1000 from here and you'll most likely see the price of coal go up from here and a lot of things are trading below sustainability levels and so we think prices go up, and it like I said is not predicated on trends changing in China. They're doing what they ought to do. Unsustainably high growth has slowed down and unsustainably high capital intensity is transitioning to a better model, so that's all good. You don't need much of anything good to happen for eventually these commodities to pick up in price, and then of course we're not even buying the commodities out there in the market. We're buying these commodities at big discounts on Wall Street.

And so that's even better. On Peabody, yes, no, things are really bad for coal. The coal industry went nuts. They also fell into the myth that the demand from China four years ago was sustainable. They paid a lot of high prices. They all leveraged up at the top. The industry over expanded. They are paying the price, but we are not fully short term on the industry and you know, the models I showed were not showing any growth, any improvement.

But what ought to happen is the weaker players go under, and that's what's happening. The weaker players are going under. Now the market is starting to say that the fairly sound priced players are going to go under. We think they're wrong, and we think that the company is a survivor. We also like the math.

Michael Sheldon: Thank you.

Operator: Moving on we'll go to Hal Haselton with Merrill Lynch.

Hall Haselton: Hey, Dave, thanks a lot for your time today. My question is - you're still buying companies based on their fundamentals, because I know you have strong beliefs about the Fed and about other macro situations. But are you still buying your companies based on the fundamentals of each and every company. Is that correct?

David Iben: That is absolutely correct, which has always been the case and always will, but it is nice to have a backdrop that's probably, you know, icing on the cake if you will, but your point is also the point I mentioned earlier, it's cyclical and fads come in and fads come out. Passive investment I think is a cyclical phenomenon, so there are times where lots of people do what we do, where a lot of people analyze companies and say "what are the company's fundamentals?" and "what is a good price to pay for this?"

And when everybody's doing that it's tougher to add value to be better than they are at establishing fundamentals and better than they are at valuing it. You know, we think we could do that, but it's tougher, and then there are times like 1999 and now, where very few people even bother. People don't care about company fundamentals. They don't care about valuation. They say what's hot? Oh, let's buy the biotech ETF. Let's buy a U.S. ETF. Oh, let's buy a China ETF, oops let's sell the China ETF.

And it becomes a casino out there, and like I said earlier that short term, that's very frustrating. Long term that is a wonderful thing. Passive investing means we don't care about price, we don't care about the fundamentals of the company. We may or may not know what companies are even in the index, and we're happy when a company gets added to the index to buy it at a new high, and when it gets thrown out to subsequently buy it after it drops.

And I understand and don't disagree with the positives of passive investing, but people forget the negatives, and for passive investing to work, few people have to be doing it. You have to be riding the tails of all the investors that are doing the analysis and making the market semi-efficient, but when almost everybody's doing passive investing, then you're - the tail's wagging the dog.

But people riding the coattails of the other investors are - there's nobody establishing the fundamentals anymore. There's no anchor to reality. That usually ends better for the active investors than it does for the passive investors and I think we are at pretty extremes once again between the price of popular stocks versus the price of unpopular stocks.

Hall Haselton: Yes, that's great. Thank you very much.

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

Dan Gallagher: Dave, I understand that we can be wrong on three out of ten and still get great returns, but in just in terms of the risk controls, on something like Peabody when the debt starts trading below 70, and I'm looking on my screen and I'm seeing debt trading at 24, 25, highest at 30 cents on the dollar, it doesn't seem like the fixed income people who do really good work, you know, agree with you and that point of view.

And I'm wondering, from just an anchoring, "I know I'm right on this", when the bonds are telling you something totally different, is it possible, do you own too much of the common to move into the debt, in case things go splat and you end up with the entity? I mean, are you looking at other alternatives of having Peabody exposure and how do you make sure that you're not being pigheaded?

David Iben: A couple excellent questions all buried into that one. We do look at the debt. I actually spent a fair amount of my career doing bonds as well as stocks. I've always liked the fact that sometimes the bond market and the stock market do look at things entirely different, sometimes the bond market is right on and the equity markets are crazy and other times the bond market gets kind of crazy and equities are more rational.

Sometimes they're both rational, sometimes neither of them are rational. So that's one thing, we've looked. Should we roll out of the common into the various bonds that are out there, and there's lots of different bonds. The bonds look good now, we like them. The equity is however - it's the equity might be worth somewhere between $6 and $60. Hard pressed to want to roll into the bonds, even though the bonds are attractive. That's one point. Another point is, yes, we are looking at other coal companies. We did own China Shenhua, made a profit on it. Earlier on we decided that Arch Coal was pretty equal upside to Peabody but more risk, and so we rolled out of that and since then I think Arch has done a little worse, but hasn't been spectacularly better, but yes, we are looking at other ones because the industry's been hit.

As far as pigheaded, it's an interesting business we're in because you need to be very confident and not blow at the wind and buy high and sell low when things look bad and at the same time not become pigheaded or arrogant because that's when you blow people up. We try to anchor things into some concept of intrinsic value; that becomes helpful, so when things go up or down for cyclical reasons we stay pinned to the long run normalized intrinsic value. That's one thing we do that's helpful. Another thing, we say all right, if it's a company specific thing, maybe we're missing something. Usually, as I said earlier, when everybody's just saying, buy biotech, and sell commodities. All right, well, if Peabody was going down, that's fine, but when you look at all commodity stocks of all kinds just plunging. Good balance sheets, bad balance sheets, good supply/demand, bad supply/demand, people are just getting out.

So this doesn't seem to be a Peabody specific thing, although, that gives us some comfort. Another thing, we've done the math, we've shown you that. Another thing, I've always liked that saying that if we're all sitting around playing poker and I look around the table and I can't identify the sucker, then I'm probably the sucker. And so when we're buying and somebody else is selling, have I done a model and he's done a model, and my math analysis shows one thing and his is another and maybe if I say I'm right and he's wrong, then maybe I'm arrogant. If he doesn't even have a model, he doesn't even care. He's just selling coal because the Norwegian government ordered him to or because Obama has been attacking it and its politically incorrect to own the stuff or because NGOs are sending stuff saying get out and it's just massive panic and it's going down anytime.

But I don't know, you know, people that are selling this because they don't think it's worth more. They're selling because they need out. They do not want commodities and they sure as hell don't want coal, and so I like buying when the people on the other side are selling for uneconomic reasons. That I find is helpful. A last thing to consider, if we're going to be right 7 times and wrong 3 times, let's not put our whole portfolio in the three that are wrong.

So we don't put more than 5% in any one name, that would be stocks and bonds put together. We have put as much into Peabody as we're going to. We still think we're going to be right. We are not putting more money into it. If we're wrong it's contained to what we already have now. That's a discipline we've been using for 30 years, and it works well too, so that also can keep us from being pigheaded and causing damage. So that's an important question you had, thank you very much.

Dan Gallagher: No, thank you for that answer. As also you know, these commodity businesses that they're price takers, and some of them have debt and you know, they're forces of nature that kind of dictate you know, how well they do in the short to intermediate run. Can you give me, or us you know, a couple examples of better businesses, you know, that have bigger moats around their business that are expanding, and just kind of ideas that you have that you know, a neophyte like me might think is you know, is compelling. You know, examples like you have a value that aren't in industries that are as troubled.

David Iben: Sure, let's try and answer that several ways. If you take healthcare in 1991, it was one of the most overvalued businesses imaginable and the stocks plunged for years and years and when Obama was elected people gave them away, so we were able to buy Eli Lilly for eight time earnings and Pfizer for eight times earnings and Aetna, things like that. We're very happy to buy stable businesses like that.

So we definitely have done that kind of thing. We've been very happy to buy - for a lot of years we had the U.S. railroads, they were cyclical growth but they were growth. You look at what their earnings and sales has done over the last 15 years, and they had a wide moat around them. You know we do spend a lot of time on the moats, a lot of time on the moats as a matter of fact. As - I think most people know, but really quickly, a lot of value based investors say we want a margin of safety.

Your number's like 30%. We say why 30%? If the moat is really wide, 10% discount's fine. If the moat's less wide then we want maybe 30% or more. If in addition to the moat not being wide, there's other risks such as geopolitical risk or things like that, we want more. And so I think Johnson and Johnson and Nestle and things like that, we'd be happy to buy them at a 10% discount to a conservative estimate of intrinsic value, where the businesses that are more dicey we want a way bigger moat.

Over the years certainly we've owned the Wal-Marts of the world and we've owned beverage companies and food companies and transportation companies and still own phone companies. As a matter of fact, you know, the businesses we have aren't generally stable earnings, but they tend to have wide moats. You know, there's a wide moat around if you have a railroad, and we've owned railroads in Japan and China. And there's a wide moat if you have a cellular infrastructure, such as China last year and Korea right now. And there's wide moats, right now, we have say SkyWest Airlines where they have over 50% of the regional airline business. That's not a wide moat, but it's a decent moat, and that's a company that's grown business, grown book value a lot over the last 25 years, although not over the last few.

Also, if you want some of the companies with pretty wide moats and quite profitable that we can actually afford at value prices, just associate Russia with a name and you can have Sberbank and get one of the most profitable banks on earth that you're in, you're out, very wide moat, dominant business, Gazprom how about you own the infrastructure that goes from where the gas is to where the gas is used, whether that's Europe or in the future, China. That's an incredibly wide moat and pretty stable and they just announced that volumes have been the highest on record, so no, we are happy to do that. But I will say in 1972 the "Nifty 50" was the wrong time to buy big, stable Coca-Cola and Proctor and Gamble and Gillette and all those things, and in 1982 I was buying all that stuff. It was a beautiful thing. They were very cheap. Right now the market is willing to pay outrageous prices for bonds. And stable, wide moat U.S. businesses are being priced as a derivative of bonds if you will. People are using low discount rates and so I love those companies. I think owning those stocks will work out about like it did for people that bought those stocks in 1972. There is a price for everything.

Dan Gallagher: Okay, so in the current portfolio your best examples of kind of healthy companies with wide moats are you know, are domiciled in Russia?

David Iben: Yes, I think the Russian companies even though they're in a recession right now, tend to be doing very well, but phone companies are very healthy too, so we have an Italian phone company and a Korean phone company. I think the passenger rail companies in China and Japan are healthy, consistently profitable companies. And then we have the Japanese trading companies. They're healthy. They make money pretty much year in, year out. They're single-digit P/E's. We have Mitsui and Mitsubishi, those I think are healthy. We have a port company in Japan. It pretty consistently makes money year in, year out. The agriculture companies we have, they've taken hits on their debt but they are pretty consistently profitable companies, well managed, so, volatile but healthy and certainly growing nicely. So no, I think we have a lot.

We, three or four months, ago bought our first consumer discretionary company in a while, which was Hyundai in Korea. People tend to be knocking everything in Korea down, and that's been over the last 20 years, pretty much a miracle story how well they've done.

Dan Gallagher: Great, thank you for that.

Operator: Next we'll go to Matya Schachter with Battery Global Advisors.

Matya Schachter: Hi, good afternoon, thank you so much for the call. I'm wondering if there's anything that would you know, break your gold thesis. Looking around what's been going on in the world the past month or so, it seems like we've seen every possible headline one could hope for in order to push gold prices higher and they haven't moved. If gold stays at these levels or goes down over the next, you know, two, three, four quarters, or longer, how much room is there for the gold stock positions in the portfolio to really appreciate?

David Iben: Yes, it's been a fascinating time, isn't it, to watch gold friendly news come out day after day after day just to watch the price of gold drop almost every day, it's fascinating. What would break the thesis? If gold is a commodity and the incremental cost is $2,000, it would be tough to break the thesis. I don't think that gold's a commodity, I think gold is *money*. So right now that's even more bullish because the amount of dollars that have been printed per ounce of gold owned has gone from $400 an ounce in 1980 to $15,000 right now.

But to break the thesis, I guess, would take the Fed, the Bank of Japan, the Bank of England and the European Central Bank and everybody to say we've found religion. We do not believe in QE, we'll never do it again, and not only that, we're going to pull out the $4 trillion that we just put in and we're going to take interest rates to higher rates, and we're going to do like Paul Volcker did.

And so instead of people's choices be - you can earn 0% on gold like it's been for 6,000 years and kept its value, and 0% for currencies that are being devalued actively, your choice is now 0% on gold and 15% for dollars and euros and things like that. That would break my thesis on gold, though God help people that own stocks and bonds. That's highly, highly unlikely. So I think you know, if we see that happen, yes.

But right now, everybody believes that printing money is the answer to every problem, but everybody that has control over such things. I'm not aware of anybody in the world that is saying differently. And so currencies all around the world are being printed. Everybody takes turns printing them. The yields are zero on the short term almost everywhere. There is no financial discipline, and every problem is met with money printing.

It would be a major, major change in society to break the thesis for gold. And then keep in mind that gold relative to money is the cheapest it's ever been. Gold relative to cost of production is the cheapest it's ever been, and gold held by mining companies relative to the price of gold out there on the stock market is the cheapest it's ever been. Gold stocks are the cheapest they have ever been, relative to gold. So there's a huge, huge margin of safety.

If gold goes to $1,000 and stays there for three or four years, no, we will not do well. Although I don't know anything if people are looking at toothpaste companies or beer companies or chemical companies or anything, and if people assume the price drops in half from where it was a few years ago and stays there, I don't think there's too many industries that are going to do well. We find that when things get way below their cost of incremental production, if that huge corrections and the whole industry is suffering, that's usually a bottom. It sure as hell is not a top. And like I was saying, in Peabody it isn't near as stressed as that, the downside is there. The upside is phenomenal and the industry fundamentals are absolutely compelling as I suggested.

Matya Schachter: Great, but you know, for your toothpaste and beer can examples, you know, those things get consumed and then if anyone wants to consume them next year, it needs to get made again, whereas with gold there's a very significant stock of it, available above ground that could hit the market and you know, continue to provide supply outside of you know, what would be mined out of the ground.

David Iben: That is an important point. It is simultaneously the bearish argument on gold and the bullish argument on gold. To me that's the argument about why gold is not a commodity, gold is money. So if you compare gold to like say beer or wheat or food or anything else, then yes, it's not consumed like everything else is. Everything else needs to be repeatedly produced, and so that makes demand more sustainable over time.

So with gold it's more of a supply story. Now gold's not consumed so you know, people are right, it yields nothing, you don't eat it, it's not used industrially, and it has really no use other than as money. That sounds a whole lot like dollar bills and euros and yen and all that, so yes, all the gold produced is still there. Yes, all the dollars produced are still there, all the euros produced are all still there. They're not eaten, they're growing.

And so you know, this analogy of all this gold sitting there, it's true but you shouldn't really compare gold to wheat. You should compare gold to dollars, and so then it's not a demand story, it's a supply story. The supply of gold grows 1% a year plus or minus. The supply of currencies has been growing double digits. Like I mentioned earlier, if you view all the gold in the U.S., in the world it's getting a little bigger, but you know, all the gold the U.S. had in 1975 or whatever, 1980, they probably still have it.

Let's assume they still have it, and they have not bought anymore, so yes, you have this pile of gold that's done nothing and it's produced nothing and you've got this pile of dollars that has gone from $400 for each ounce of gold to $15,000 for each ounce of gold, so if rather than look at gold as a consumption commodity, we view it as a store of value, it's kept its value for 6,000 years. The currencies have never kept their value. The U.S. dollar since we went off the gold standard has lost 90 some odd percent of its value. You print them, they lose their value. So no, it is from a sustainable demand thing a bad thing that gold's not consumed. For money, it's a wonderful thing. Money, you want it to be something that's not influenced by cyclicality of demand. You want money to be not consumed, not used industrially, something that is divisible and non-corrosable and cannot be printed by anybody, and cannot be anybody else's liability.

Gold is perfect for money, or damn near, and it's certainly over thousands of years been a much better form of money than fiat currencies, always have and arguably always will be.

Matya Schachter: Okay, thank you very much.

Operator: And next we'll go to Stephan Rothe with JP Morgan.

Stephan Rothe: Yes, thank you. On the gold situation, how much of the gold price do you think is affected by the West versus the East? I've read the papers about China coming up with the gold exchange and they and India rotating between one and two number consumer, but it seems like the price is controlled more in the Western markets that we see here. So I'm just curious if you had thoughts on that.

David Iben: Yes, we could talk all day and get all kinds of views, and don't worry, I won't, but I think it's an interesting topic. I read all these articles lately about the pricing, that the price fix in London and now that China's in on that, does that mean anything and doesn't it give the people the ability to manipulate the price of gold even though they don't sell it?

And I don't know that it does. I don't quite follow that argument. I think what is happening, and like I said people have to look long term as opposed to any month or year or whatever, what is happening is the wealth, gold representing the wealth, is going where it ought to go. If you look at China and Russia and India and places like that, that have - that create stuff and sell stuff and generally run trade surpluses, they sell stuff to the world that the world wants.

And they deserve to get paid for that, and they are, and so where's the gold going? The gold is going to those countries. You know, you see nonstop there is gold being bought by the central banks in the emerging markets. So gold is going where it ought to go. Where it's coming from is a matter of conjecture. Is it all coming from the wealth - the West liquidating it or is it coming from a flood of financial institutions selling futures on gold they don't even own?

I don't know, but certainly the gold is migrating from West to East, and I believe it's migrating at a price that's way below any economic price, so this is working out very well for China and India and Russia, and then it's going to work out poorly for people in the West that are selling gold I think. But as to whether the West has undue control of it, maybe, but I don't know why they want to keep the - I know theories, but I don't know why they want to keep the price too low. They have - it won't stay this way forever.

Stephan Rothe: All right, thanks, appreciate the feedback.

Operator: And next we'll go to Joseph Choi with PSQ Capital.

Joseph Choi: Hi, thank you for the presentation and I just want to share about your view on Bitcoin. It looks like recently the value of Bitcoin went up with the Greek situation while the price of gold went down and I'm just curious to know if you think Bitcoin has any chance of competing against gold in the form of currency.

David Iben: I think over the next 50 years gold is pretty well assured to hold its value and the U.S. dollar is fairly well assured to lose most of its value. You know, what did Jim Grant say? That over a normal lifetime at the Fed it achieves its goal of devaluing 2% a year, that prices will go up five times in a normal lifetime, 80% of the value gone, so gold good, the dollar, you better get paid a lot to hold it because it's going to lose most of its value.

Bitcoin is a fascinating thing. I'm not going to pretend to be an expert. I find it kind of intriguing. I think that it's bringing in the scarcity value, so if they say we're going to fix the supply and the Fed and the European bank and the Japanese and everybody, they'll say we are not going to fix the supply. We're going to print, Bitcoin seems kind of intriguing. Isn't it? It should gain value, so I like that part of it.

The model all seems pretty good. The idea of allowing people to transact without being affected by government motives and things, I like all that a lot, so I mostly like it. However the dollar and the euro and the yen and everything would actually be wonderful money too if governments could be trusted, and we all know they can't. Can the computers and everybody else that are behind Bitcoin be trusted?

I presume so, but I don't know so. I'm highly confident nobody's going to print a bunch of gold. Whether bitcoins get materialized here somewhere I don't know, so I guess I'm intrigued by Bitcoin, but I'll stick with gold.

Joseph Choi: Okay, thank you.

Operator: And that does conclude our question and answer session. At this time I'll turn it back to Mr. Iben for any additional or closing comments.

David Iben: All right, thank all of you for listening in, for the good questions, and these are fascinating times, and it's been tough the last few months, but we love the situation it leaves us in right now. I don't know if I did point out, but our portfolio of what we think are wide moat companies are trading at less than 2/3 of book value right now. It trades at a fairly huge discount to the index on price of book, price of earnings, price of cash flow, and price of sales. And these are companies that control scarce goods and scarce franchises, so we're optimistic, but time will tell and thanks once again to everybody.

Operator: And once again that does conclude today's conference. We'd like to thank everyone for their participation.

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