

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Investing in Companies with Insider Buying



JOSEPH M. BOSKOVICH SR. is Chairman, Chief Investment Officer and Portfolio Manager at Old West Investment Management, LLC. Prior to founding the company, he was Vice Chairman of Aletheia Research and Management. Earlier, he was CEO at Boskovich Farms. He received his undergraduate degree and his MBA from the University of Southern California, and is a member of USC's board of trustees.

SECTOR — GENERAL INVESTING

TWST: Could you please identify yourself?

Mr. Boskovich: Yes, my name is Joe Boskovich Sr.

TWST: Could you tell me what firm you work at and your title there?

Mr. Boskovich: I am the Chairman and Chief Investment Officer of Old West Investment Management.

TWST: Could you tell me a little bit about the firm?

Mr. Boskovich: Sure. We recently celebrated our eight-year anniversary. I founded the company in 2008 right in the middle of financial crisis with my son, Joe Boskovich Jr., and another business partner, Chad Cook. We're located in downtown Los Angeles. We are value investors, and we manage several strategies based upon the companies that we uncover through our simple yet sound investment process.

TWST: Did you want to discuss your basic investment philosophies?

Mr. Boskovich: Sure. The genesis of our process originated in the late 1970s. At the time I was in my early 30s, and I was invited to serve on the board of a small Southern California-based regional bank. For several consecutive quarters, I observed the board Chairman ferociously buying stock in the bank. I decided to start buying alongside him, and then lo and behold, a few years later, we sold the bank to the Bank of America for a real nice profit.

I learned a real valuable lesson through this experience, and the lesson learned was that you can never underestimate how much information is known to management that is

unknown to everyone else. Although the bank Chairman had never expressed his intention to sell the bank, it was clearly his intention now that I look back on it. This lesson is deeply ingrained in me and is really the focus of our investment process: identifying smart owner/managers of companies with track records of success and then closely following their investment activity in the transactions of their own stock.

TWST: Did you want to mention a stock that you find interesting now?

Mr. Boskovich: Yes, I've picked four different companies to discuss: **Abbott Laboratories** (NYSE:ABT), **Chesapeake Energy** (NYSE:CHK), **Cheniere Energy** (NYSEMKT:LNG) and **New Gold** (NYSEMKT:NGD).

TWST: Do you want to start with Abbott Labs?

Mr. Boskovich: Sure. **Abbott Labs** is a Chicago-based pharmaceutical company and represents an extraordinary opportunity. Miles White has been leading the company for the past 17 years as Chairman and CEO, and he has a history of creating value for his shareholders. The idea came to our attention this past July when a Form 4 was filed with the SEC showing that Miles White had purchased \$31 million of **Abbott Labs** stock on the open market. This was followed by another open market purchase of \$15 million in November of this year.

It's not often that we see transactions of this size by a CEO, and it's certainly a huge amount of money. These two open market purchases increased Mr. White's ownership in **Abbott** stock to \$127 million. In following our process, when we see such

significant insider buying activity, we are forced to take a closer look at the company and try to figure out why Miles White would make such large purchases.

As you may know, in April 2016, **Abbott Labs** announced that they were buying **St. Jude Medical** (NYSE:STJ), and I think that Mr. White has been frustrated at the market's lack of appreciation for the new combined company. The more that we study the significance of the new consolidated company, the more excited we become. For starters, **Abbott Labs** has demonstrated a history of value-added corporate actions. Several years ago, the company spun off its biopharmaceutical business, **AbbVie** (NYSE:ABBV). Today, **AbbVie** has over a \$100 billion market cap, so longtime shareholders now have shares in two separate companies with a combined market value of over \$160 billion.

Following the spinoff of **AbbVie**, Miles White decided to stay with **Abbott Labs** and continue to run that company as its CEO. **Abbott Labs** has a consumer division that has several very well-known brands such as Similac, infant formula, and Ensure, adult nutritional shakes; they have a medical instrument division, a diagnostics division and a cardiovascular division. We believe that **Abbott's** cardiovascular division becomes very, very exciting with the purchase of **St. Jude Medical**, hence the large open market purchase of stock by Miles White.

Both **St. Jude Medical** and **Abbott Labs** are market leaders in many of their cardiovascular products. What's particularly

Abbott Labs is number one in the world in coronary stents, number one in the world in transcatheter mitral repair and replacements, and number two in the world in atrial fibrillation.

St. Jude Medical is number one in the world in remote heart-failure monitoring, number one in the world in PCI optimization and number two in the world in heart valves.

With virtually no overlap in product lines, we believe that the new **Abbott Labs** will become a dominant market leader. In 2016, earnings are estimated to be \$1.60 per share. Next year's estimated earnings are \$2.50 per share, and will be \$3 per share in 2018, and this is for a company that today is selling at \$38 per share. So you can understand why **Abbott Labs** is a very, very exciting idea for the future.

TWST: Do you think with the acquisition of St. Jude Medical that they'll be more competitive against some of the other rivals in the medical device business like Medtronic?

Mr. Boskovich: Well, like I said, **Abbott** and **St. Jude** are ranked either number one or number two in the world in all of those cardiovascular products. I think that the new combined company will be a powerhouse. **Medtronic** (NYSE:MDT) is a great company, but I think that for the products that I mentioned, I think that they are standalone number one.

TWST: From what you're hearing, is there a reason for optimism as far as what the Trump administration

might do or Congress might do as far as medical devices and other types of items that Abbott would manufacture?

Mr. Boskovich: I don't know that the new administration is going to have an effect. The new administration is going to come down hard on pricing, but that will have more of an impact in biotech. For cardiovascular companies, I think that pricing is already competitive. Companies like **Abbott Labs** have huge potential with our worldwide aging population, and its future looks extremely bright.

TWST: Did you want to talk about the second company?

Mr. Boskovich: Another company that we are very excited about is **Chesapeake Energy**, which we believe is undergoing an extraordinary turnaround. Under its previous management team, **Chesapeake Energy** borrowed heavily to snap up oil and gas properties and drill more wells than its rivals. Between 2008 and 2013, **Chesapeake's** capital spending exceeded cash flow by an astounding \$47.4 billion, and corporate

Highlights

Joseph Boskovich Sr. shares his firm's investment strategy, which is identifying smart owner/managers of companies with track records of success and then closely following their investment activity in the transactions of their own stock.

*Companies discussed: **Abbott Laboratories** (NYSE:ABT); **Chesapeake Energy Corporation** (NYSE:CHK); **Cheniere Energy** (NYSEMKT:LNG); **New Gold (USA)** (NYSEMKT:NGD); **St. Jude Medical** (NYSE:STJ); **AbbVie** (NYSE:ABBV); **Medtronic PLC** (NYSE:MDT); **ConocoPhillips** (NYSE:COP); **Anadarko Petroleum Corporation** (NYSE:APC); **Calpine Corporation** (NYSE:CPN); **Gas Natural SDG SA** (BME:GAS); **Korea Gas Corp** (KRX:036460); **GAIL (India) Limited** (NSE:GAIL); **Total SA (ADR)** (NYSE:TOT); **Centrica PLC (ADR)** (OTCMKTS:CPYYY); **Alphabet** (NASDAQ:GOOG); **Facebook** (NASDAQ:FB); **Amazon.com** (NASDAQ:AMZN) and **Netflix** (NASDAQ:NFLX).*

1-Year Daily Chart of Abbott Laboratories

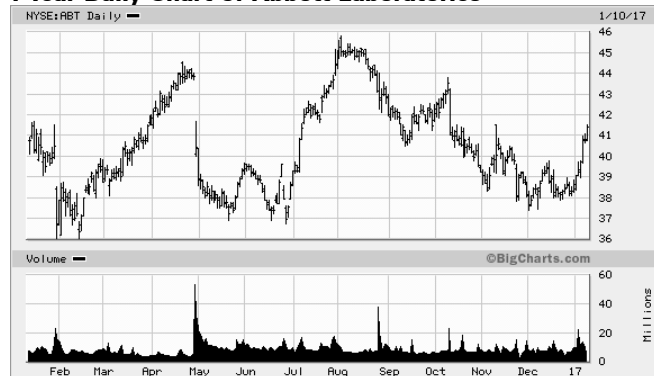


Chart provided by www.BigCharts.com

fascinating about this combination and makes it a natural fit is that there is very little overlap between the two companies.

debt nearly reached \$21 billion. We could never justify owning a company that lacks such financial discipline.

This all changed however in 2012 when **Chesapeake** brought in legendary oil man and longtime **ConocoPhillips** (NYSE:COP) executive, Archie Dunham, to be its new nonexecutive board Chairman. Six months after taking over as board Chair, Dunham fired Aubrey McClendon from the company that he founded and

produce a lot of operating cash flow, but because of the capital-intensive nature of the E&P business, most of the companies in the industry are free-cash-flow negative. This is not the case for **Chesapeake** going forward because they don't have the need to buy new reserves. Aubrey McClendon was such a prolific acquirer of assets that the company is in the unique position that they are actually a net seller of reserves and assets.

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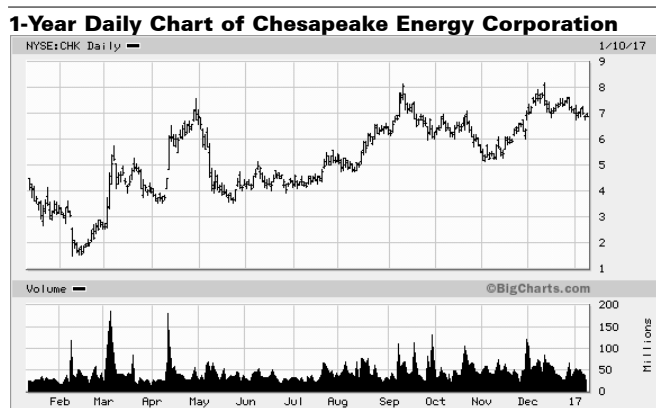


Chart provided by www.BigCharts.com

Since being hired as CEO, Doug Lawler has done an extraordinary job at cutting expenses, rightsizing the company, selling off assets and becoming more efficient. Under his leadership, **Chesapeake** has reduced its workforce by roughly 70%, it has shrunk its drillable land portfolio to 7 million acres, compared with 15 million at the end of 2012, and corporate debt has been cut from almost \$21 billion to \$10.9 billion. This year **Chesapeake** expects to spend no more than \$1.75 billion to produce between 617,000 and 637,000 barrels of oil equivalent a day. That is nearly 90% less than the \$14.7 billion **Chesapeake** spent in 2012 to produce 648,000 barrels of oil equivalent per day.

I just came back from their Investor Day in Oklahoma City and was very, very pleased to hear that expenses have been cut so aggressively and that their breakevens are extremely low.

"The United States has become the largest producer of natural gas in the world, and we're quickly becoming giant exporters of natural gas. Our country is shipping a lot of natural gas to Mexico, and we have massive LNG ports being constructed so that we can ship natural gas all around the world."

announced a worldwide search for a new CEO. In May 2013, after a diligent five-month search effort, the board announced the hiring of a rising star at **Anadarko Petroleum** (NYSE:APC) named Doug Lawler.

Chesapeake came to our attention as an investment candidate when on the same day of Lawler's hiring, Archie Dunham made an open market purchase of \$9 million of **Chesapeake** stock. As I mentioned earlier, open market purchases by insiders of this magnitude are not common, and my eyes light up when I see such a large transaction. One of the biggest challenges to owning E&P — exploration and production — companies is that they all lack free cash flow. When pricing is decent and times are good, E&P companies

The company expects to be break even at \$2 natural gas and \$40 oil, which is among the lowest in the industry and significantly lower than today's prices. The projections that the company used at its Investor Day were based on \$50 oil and \$3 natural gas, and at these prices, the company will have no problem servicing and paying down its debt, which means that significant cash will fall to the bottom line.

TWST: Is their future bright, too, because of the need for natural gas in electricity generation?

Mr. Boskovich: Absolutely. The United States has become the largest producer of natural gas in the world, and we're quickly becoming giant exporters of natural gas. Our country is shipping a lot of natural gas to Mexico, and we

have massive LNG ports being constructed so that we can ship natural gas all around the world. **Chesapeake** has huge production in the Haynesville Shale, which is in proximity to the export terminals in Louisiana and should be very beneficial for **Chesapeake**. With the world quickly moving away from coal toward cleaner burning fuels, the future worldwide demand for natural gas is tremendous.

TWST: Did you want to talk about Cheniere Energy?

Mr. Boskovich: Definitely. **Cheniere Energy** has been on our watch list for a quite some time. The two largest shareholders are also two of the smartest investors in the world and are both people that I have watched and studied for decades. Carl Icahn owns 33 million shares of stock and has board representation, and Seth Klarman owns 28 million shares of stock. Combined, these two investment icons own over 25% of the company. However, I was never comfortable with the previous CEO, and because of my lack of confidence in management, I was never able to pull the trigger. Charif Souki was overly promotional, making one too many appearances on Jim Cramer's "Mad Money," and he was too

of free cash flow within the next five years, and the company is confident that they will have no problem servicing and repaying their debt.

One of the things that I really like about **Cheniere's** business is that they have very little commodity risk. They simply get paid a fixed fee to liquefy and ship natural gas. To do this, natural gas is delivered to **Cheniere's** terminals where it's chilled to -240 degrees Fahrenheit, a temperature that transforms vapor into a liquid, and the LNG is put on a vessel for shipment. Once it arrives at a foreign destination, the LNG is deliquified for use.

Cheniere has long-term, 20-plus-year supply contracts with power producers all over the world, such as **British Gas**, **Gas Natural Fenosa** of Spain (BME:GAS), **Korea Gas** (KRX:036460), **GAIL Limited of India** (NSE:GAIL), **Total** (NYSE:TOT) of France, **Centrica** (OTCMKTS:CPYYY) of the U.K. and **PT Pertamina** of Indonesia. By 2018, the company is forecasted to have \$3 billion in revenue and \$260 million of net income. There will be significant demand for LNG for a long time, and **Chenier** stands to benefit in a big way.

"With everything I see going on in the world today, I like having exposure to gold in the portfolios. I view it as a hedge, and I see it as the ultimate flight to safety."

highly paid to justify taking a position in **Cheniere** across our investment portfolios.

My views on the company quickly changed, however, when the **Cheniere** board voted to replace Souki in December 2015 with a new CEO, Jack Fusco. Jack Fusco has a great reputation in the energy industry and previously ran **Calpine Corporation** (NYSE:CPN). **Calpine** is America's largest generator of electricity from natural gas, so my eyes naturally lit up at the announcement of his hiring. I couldn't think of a better person to run **Cheniere**. Another detail that really piqued my interest was Fusco's compensation package. **Cheniere** granted Fusco \$10 million of restricted stock, but he also agreed to purchase an additional \$10 million of stock with his own money through open market purchases.

A major concern of mine with **Cheniere** is its balance sheet. This is a huge project. **Cheniere** has two locations where they operate what they call trains. Each train is a terminal where natural gas is liquefied into LNG — liquefied natural gas — and transferred onto a vessel. **Cheniere** will have six trains at Sabine Pass, Louisiana, and three trains at Corpus Christi, Texas, both locations situated on the Gulf of Mexico. Total construction costs are estimated to be more than \$30 billion, and **Cheniere** will need to take on close to \$20 billion of debt to complete the project. Although that's a big number, I don't know how you build such enormous infrastructure without taking on that much debt. **Cheniere Energy** estimates that they will have in excess of \$1.0 billion

1-Year Daily Chart of New Gold Inc. (USA)

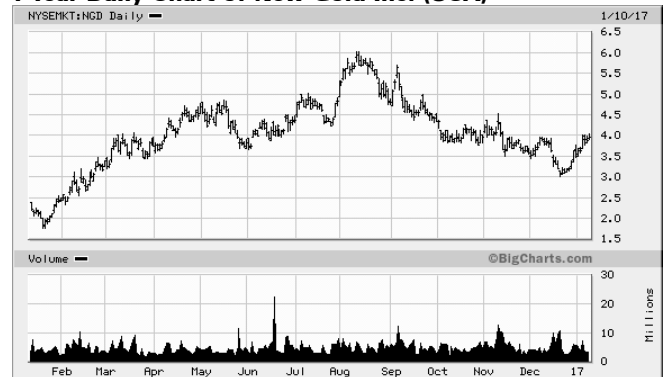


Chart provided by www.BigCharts.com

TWST: In the energy companies involved in natural gas, does it appear that they stand to benefit from what seems to be a priority in the Trump administration, wanting to increase exports?

Mr. Boskovich: The new administration is an energy producers' dream. From Secretary of State Rex Tillerson, to the new head of the EPA, to Rick Perry leading the Department of Energy — if you're a producer, you couldn't ask for a friendlier environment to be operating in. Yes, it's going to make life a lot easier for everybody.

TWST: Did you want to mention a fourth company?

Mr. Boskovich: I do. It's **New Gold**. **New Gold** is a Vancouver, Canada-based gold producer. With everything I see going on in the world today, I like having exposure to gold in the portfolios. I view it as a hedge, and I see it as the ultimate flight to safety. If you think there is a place for gold in your portfolio, then the question is how are you going to own it? There are a few choices. If you wanted to own the actual metal itself, the most popular way to do that is through the ETF, GLD. If you wanted to own mining companies, most people own the ETF GDX or the Gold Miners ETF. We have never owned an index fund, and we have never owned an ETF. As bottom-up stock pickers, we'd rather follow our investment process and find great companies instead of buying a basket of stocks.

We believe that **New Gold** is best-of-breed. Randy Oliphant is the longtime CEO of **New Gold**, and he has done a tremendous job of running the company. He is also Chairman of the World Gold Council, to give you an idea of his breadth of knowledge and his reputation.

One of the most important considerations when investing in a gold mining company is the locations of the company's mines. I feel that it is imperative for reserves to be located in friendly and stable countries. Many mining companies have reserves in countries like South Africa and the Congo, and if the price of gold got high enough, nationalization would become a real possibility. **New Gold** has mines in Canada, Australia, Mexico and the good old USA, so the company is exposed to very little political risk.

If you study the gold markets, it is well-known that new discoveries are falling off of a cliff, and I believe that we will see production decline significantly over the next five to 10 years. At the same time, I believe that demand will continue to escalate. If you look around the world at the fastest-growing economies like India, China, Vietnam, Singapore and Indonesia — each of these populations covet gold. Gold has been traditionally seen as a commodity, but I believe that in the future it will be seen as a currency. It's the world's oldest currency, and it's the only currency in the world that is limited in supply. With fiat currencies, you can just press a button and print more money, which is exactly what every central bank is doing today. In a world of competitive devaluation, mass printing of fiat currency, and central bank manipulation and intervention, I think gold makes more sense than ever before.

In the case of **New Gold**, Randy Oliphant has done an excellent job of positioning the company as the low-cost producer. Currently, their all-in sustaining cost of production is \$680 an ounce. So even though the price of gold has sharply corrected since the election and is currently trading at \$1,127, their all-in cost of \$680 is extremely profitable.

The company has a huge mine in Ontario, Canada, called Rainy River that they have been working on bringing to production for several years. They have close to \$1 billion dollars invested in developing the project, and it is going to be an outstanding mine for the company. They are getting ready to begin production in February 2017, so the wait is just about over. The Rainy River mine has an extremely long life, a very low cost

of production, and it's going to nearly double **New Gold's** cash flow next year.

TWST: And even what the Federal Reserve might do with interest rates, in the long run companies like New Gold are still a strong investment?

Mr. Boskovich: Historically, interest rates have very long 20- to 40-year cycles. In the most recent cycle, interest rates peaked 35 years ago in July 1981. In 1981, you could have bought a 30-year Treasury bond yielding 15%. It appears that the bond market has peaked, and that interest rates may have bottomed this past summer and will begin to gradually rise. How does gold do in such an environment? Well, I think that we are truly in a unique situation today because of all the debt in the world. Our world has never seen this type of debt before, so I don't know that we can look to history as a proxy for where we go from here.

One would have hoped that since the Great Recession the world would have delevered, but just the opposite has happened. There's been an explosion of worldwide debt over the past eight years, so it will be interesting to see how this plays out. If interest rates do rise, I think we may see a lot of pain due to the extreme pressure added to the cost of servicing the debt that every government has accumulated. As I said, I'm not quite sure how this all plays out, but I am fairly certain that such an environment will be very favorable for gold.

TWST: In looking toward 2017, what advice can you give to investors? What are some of their concerns, and what advice can you suggest to them?

Mr. Boskovich: We have a macroeconomic view of things, but we really aren't in the business of trying to predict what the markets are going to do. We are bottom-up investors that just look for great companies run by great people. I do believe that many of the market darlings like the **Googles** (NASDAQ:GOOG), **Facebooks** (NASDAQ:FB), **Amazons** (NASDAQ:AMZN) and **Netflix's** (NASDAQ:NFLX) of the world are priced for perfection, but those aren't really the companies that draw our attention. We are value investors looking for companies with strong balance sheets and run by great management teams. If you stick to a sound process and look for a margin of safety in each investment, I think that one will stay out of trouble.

TWST: Advice for institutional investors for this year?

Mr. Boskovich: I strongly believe that the movement toward index investing will have a disastrous ending. The popular belief is that index investing is the way to go. It's cheaper, and why should you pay for an active manager when returns have been just as good or better for index funds? That seems to have become common thinking, and I think that is extremely dangerous.

It reminds me of a great saying by the legendary investor, Sir John Templeton. He brilliantly suggested that if you had an illness, and you went to 10 doctors for a diagnosis and nine doctors gave the same diagnosis with one telling you something different, you should definitely go with the advice of the nine doctors. However, if you were looking for investment

advice, and you went to 10 investment advisers and nine gave you the same advice with one telling you something different, you should absolutely go with the one that was different. I think this really harkens to the idea of index investing and passive investing for equities. With the market at an all-time high, I firmly believe that now is the time to find a great active manager that will protect you during turbulent times that may lie ahead.

TWST: Thank you. (ES)

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