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## INVESTOBLOG

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### Leucadia National – Annual Meeting – May 15, 2007

IC = Ian Cumming

JS = Joe Steinberg

Opening:

IC: Not much to say, everything we wanted to say about the year we put in the annual report.

<http://www.leucadia.com/TOC%20C&P%20Letters.htm>

One thing to note, Fortescue (Australian iron-ore mining investment) book cost is now \$711 million, a \$500 million gain (I think he may have meant to say “market value is now \$711 million). Inmet (mining company) book cost of \$78 million now has a market value of \$360 million, a \$280 million gain.

Former head of Kennecott Copper (guy was sitting in crowd – Kennecott is an enormous mine right outside of Salt Lake City, where IC and JS are based) is our advisor. He has been helping us with the business of scraping the ground.

This is a record turnout. I wish I knew why – it makes me a little nervous (laughter).

Prospects for Sangart? (medical product development company that Leucadia has invested \$85 million in)

JS – I know a guy named Bob Winslow, a scientist, worked for the U.S. Army. He is the most renowned blood expert in the U.S., one of the top scientists. I ran into him 5 or 6 years ago in San Diego when I was selling our condo units. He told me about this artificial blood he was developing. We declined to invest. We met the next year and decided to invest. The product is now in a Phase 3 test in Europe. Ian went to medical school, he should talk about it.

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IC – The Phase 3 test had 900 patients who took 1 to 2 units in hip surgery and other orthopedic surgeries. During Phase 1 and 2, there were no adverse effects. We are hoping to slog along and eventually have a product. It's actually a fortunate outcome of the tech bubble bursting – we were able to get a factory in San Diego with almost all the equipment we needed for 250k units of production for very cheaply. We don't know the retail price, it will depend on what they finally put on the label – it will likely be anywhere from \$200 - \$500/unit. It could be a substantial business based out of that little factory.

JS – Like all venture capital, in for a dime, in for a dollar. The original investment was \$5 million, and we are now up to \$85 million. We own 85%. Maybe it will be a big zero, it's high risk. I'm in love with it and drinking the Kool-Aid, or "taking the blood". Winslow is a gifted scientist and a wonderful person.

IC – It is still two years away from commercial production. We will move along to do a Phase 3 trial in the U.S.

Fortescue – seemed like a dicey investment. Any indication of production and amount of royalties? (The Fortescue investment was for 26.4 million common shares, 9.9% of shares outstanding, and a 13 year, \$100m note, where interest is 4% of revenue from iron ore production, net of government royalties).

JS: I am leaving tonight for Australia for a meeting on Monday and Tuesday. Building on the railroads and port is coming along, almost on schedule and on budget. There were 3 cyclones that cost \$100 million AUD in repairs and caused a 1 month delay. Iron ore demand continues. India just put on a \$7/ton export tax. Most of the iron ore in China is inland near the old steel mills. The new mills are on the coast and ready to take in seaboard iron ore. The current investment is planned to produce 45 million tons/year, which should be \$1 billion revenue. We are studying an expansion to 120 million tons/year, which would cost \$2 billion. We have expected the price of iron ore to level off, but we have been wrong so far. The conventional wisdom is that prices will rise when they are set in a few months. We have a good strategic relationship with Chinese steel mills, we hope to have a long-term relationship with them and to develop similar relationship in Taiwan and Korea. This is a development company with no revenue yet. Things could go wrong.

IC: The worry is that iron ore prices revert to the mean.

Jefferies High-Yield bond fund – area is frothy and spreads are tight.

Expectations? (Leucadia has a JV with Jefferies where they invest in and broker high-yield bond spreads. They have historically earned 20% annually on the deal and just reupped the deal at a \$600 million investment).

IC: The record of high-yield spread is up and down like a ping pong ball over time. Look at the paper and prices you see for assets. If you don't predict that something will unwind in the next few years, you are crazy. The cycles are caused by human nature, you see the herd run back and forth like a bunch of lemmings. Jefferies is a great business. They issue the credit, watch them all blow up, run in and rescue them, and then issue new great. It's a great business!

JS: If we held our breath waiting for the correction, we'd be dead. Jefferies is a liquidity business. It's a pretty good business. We hope to make a decent return while waiting for a correction. We could lose money holding inventory when spreads widen 200 bps some day, but that will be a big opportunity for us.

Telco acquisition – STi (prepaid calling cards business). IDT has struggled in this business. What intrigues you? (I am not sure this is accurate – IDT's prepaid calling segment has done very well – it has lost money on other side ventures).

IC: The spreads. It's a very profitable business. There is a great irony in the lawsuit in this area, the pot calling the kettle black. Look at the plaintiff's record.

JS: We have a high regard for the guy who runs it. We structured the deal in a way to protect Leucadia.

IC: We are very sensitive to accusations that will explode that customers in this business have been overcharged. We took great pains to go in and clean that up.

Sangart – why double down on investment?

IC: To simplify, in phase 3, we injected units into a few hundred skinny Swedes and they all survived. That's not true of other companies who have tested similar products in the past. The way the science works is that the molecule that attaches to hemoglobin is very big. It causes more oxygen to get delivered to the capillaries than the normal molecule. We don't know why. That is potentially very exciting and good for soldiers who are injured in the field. Getting doctors to change patterns is very hard. If it turns out that you can freeze-dry this stuff and reconstitute it with saline solution, the armies of the world will be all over it. This is high-risk stuff. There might be side effects that could turn up only after long periods of time, like Vioxx.

Update on gasification business? (Leucadia has expensed \$15 million over the past few years looking at developing a gasification business to produce clean energy?)

IC: The technology is out there. We are looking for finance opportunities for the gasification process.

Can you comment on the carrying value on investments vs. the market value?

IC: No. Do the digging yourself.

Costs of mining copper?

JS: This was a tactical investment, not a strategic investment. We invest because there are specific opportunities. We bought this mine 9 years ago and expect to start production in March, 2008. Cost is 0.40 Euro cents/pound.

IC: This is a bet on copper prices, period. Prices were at \$0.60/pound when we invested and are at \$3.60/pound now. This is a lesson you should all pay attention to closely; it is better to be lucky than smart.

China?

IC: Here is my take on it. Along came CNN, people around the world got television sets and everyone saw the U.S. and wanted some of it. The U.S. is financing the growth of China. They are building a vast infrastructure. It is hard to fathom unless you have been there. There is an arc of development from Korea to the 'Stans. I was just in Vietnam. It is seething with development. They are the most capitalist Communists you can imagine. There is a major shift of wealth from the U.S. to Asia because the labor rates are so low. It is nothing magical. Vietnam with their latest "5 year plan" is planning on building a fast railway the length of the country, 900 miles or so, along with a 4 lane highway. This will cost a fortune.

JS: The way economists oversimplify it is by saying that the U.S. consumes 25% of everything and China is on its way to equal that. There is a change in the supply/demand curve. Also, there are long waves of growth in commodity prices if you look back several hundred years. They go up for long periods of time. We may be in the midst of that right now (this sounds very similar to Jim Rogers' argument.) Of course, long trends from 200 years ago may not repeat. History has a way of doing that. I think we are in a long-term boom now due to the growth from China, India, Vietnam, and Korea.

IC: Ladies and gentlemen, you have just seen something I have not seen in 30 years, Joe is optimistic.

JS: No, I am not optimistic for us, I am optimistic for the Chinese.

10 years ago you were sitting up there with a Pepsi can on the lectern talking about how excited you were about Russia? (Laughs from board)

IC: That can of Pepsi cost us \$60 million (argument between JS and IC over whether it cost \$40million or \$60 million).

JS: These investments are scary! We could lose all our money!

IC: The only thing dictators do well is make the trains run on time, because if they don't, the engineers will kill them! Vietnam is still Communist. They call each other comrade.

Asset price bubble?

IC: (Referring to securitizations – he was talking about process of slicing and dicing securities) We don't know how this works over a long period of time.

JS: We go to auctions all the time, we just hired a few new guys to do this. It is very frustrating. When we do win and are the most optimistic people in the room, it is because it is a cyclical business that can't be leveraged or a screwy business with some quirk. It is difficult and discouraging.

IC: We have been in hundreds of meeting around the country where we tell someone what we are willing to pay and they look back blankly and say, "Private equity can pay more." and we say, "Adieu."

What do you two disagree on?

IC: Everything.

(Long question on Russia and Putin pursuing a "Dr. Evil" strategy.)

IC: You are more sophisticated than we are. No, we haven't thought about that.

Japan?

IC: That question is floating towards a more strategic bent, although I guess our mining operations are kind of like that. Nothing in Japan is yummy.

JS: We invested in copper because we thought copper at \$0.60/pound was cheap. That was basically the cash cost to get it out of the ground and we had the chance to buy a lush 6.6% rich copper vein. A year ago, I went to Japan with Bud Scruggs and we were looking for stuff. I think that to work in Japan, you need to open an office and hire native Japanese who speak English. It is a long-term strategic commitment. Maybe it makes sense, but we aren't going to do it. When we don't control companies, we want to trust the people who are running them, and there is a vast difference between how we look at companies and how many of the Japanese do.

Coal gasification project?

IC: This is a massive project. It would take \$1.5 billion. We have several projects on the way, although something adverse could happen. We have a \$130 million tax credit for a project with Eastman Chemical in Longview, Texas.

Why do you split the stock, unlike Buffett?

IC: I don't know, it felt good. We usually split it when it gets to around \$60/share. We are acquaintances with Warren, but we disagree about a lot of stuff, including the length of annual meetings. Of course, he is way smarter than us and has a lot more money, so maybe you should side with him.

Opportunities in subprime?

JS: We have looked a lot. It is interesting, the losses are spread so widely, no one person is taking a lot of heat. The brokers were in the business of generating paper for Wall Street. There is nothing to buy. As soon as things calm down, the guys who started New Century will come back and start over. Every Tom, Dick, and Harry hedge fund is looking to buy paper when it is 5 points down.

Are you generally seeing a lot of opportunities?

IC: Yes, we are seeing a lot of interesting things. They tend to be more entrepreneurial and less buying companies. We're busy.

JS: Ian is correct. Instead of buying something cheap, we have to go in and do something.

IC: The opportunities in telco and Goober (said with heavy Texas accent) Drilling – we had to go in and restructure the back office, bring Sarbox to the poor people of the West.

Net Operating Losses?

CFO: There are two buckets. \$500 million of losses can offset any income. \$4.6 billion can offset income from certain areas of the company, areas where conveniently we have almost all of our assets. (A few members of the board snickered.).

Is size yet an impediment to returns? Is there a limit to the size of deal you would do? Are you looking for elephants?

IC: We are looking for small elephants. We are looking for value. If we saw it somewhere, we would finance anything. We have got friends in the world who have a lot more money than us who would help us.

Housing bubble?

IC: We pay cash when we buy real estate. If things go bad, we shut it off and pull the plug. Southern California has slowed down, and I think it should have slowed down more. It think there will be a crisis when the price of homes falls and people are underwater on their mortgages. This is a mysterious place that we live in. It has a remarkable capacity to absorb everything from ridiculous presidents to ridiculous financial stuff.

JS: If you buy a beautiful piece of real estate with cash, you will tend to do well. The properties we have in Maine are very high end, and the hedge fund types buying those have not seen any slowdown. I am very surprised that in the lower-end stuff, builders are still willing to buy lots of land for 10% less than they were paying last year. There doesn't seem to be any sign of blood in the water.

Jeffries high-yield bond relationship?

IC: We go out to dinner with Richie all the time and scream at each other and air out our differences. There is another guy there, Andrew Whittaker, who is great. We have a very long and good relationship with them.

Vineyards? (Big laugh from one of the board members)

IC: Our former controller, after getting \$5 million in Leucadia equity, immediately quit and went out and bought a vineyard. He is doing very well. We hope to replicate Archery Summit up in Washington state. It is very valuable. It's amazing, Duckworth (another vineyard) is for sale for \$300 million, and they are earning \$5 million. Asset price in Napa Valley are the Easthampton of the San Francisco set. They are tired of getting really pretty women and now they are buying vineyards. Archery Summit is on allocation also, which is good, and we are upping the basis (didn't understand this fully, but I think the way it is structured the tax basis of the investment is rising over time).

IC: In closing, we are both optimistic about the future.

POSTED BY BEN AT 11:16 AM

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