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VMCH Corporation - Annual Report

VMCH Corporation performance (in USD)

	Annual percentage change		
Year	**in Per-Share Book Value (NAV) of VMCH**	**in S&P500 with Dividends Included**	**in MSCI Europe with Dividends Included**
2012	24.8%	16%	19.9%
2013	27.7%	32.4%	25.9%
2014	(2.7%)	13.6%	(5.6%)
2015	(1.4%)	1.3%	(2.3%)
2016	6.1%	11.9%	(0.4%)
2017	5.5%	21.8%	25.5%
2018	(8.9%)	(4.3%)	(14.8%)
2019	(12.4%)	33%	24.2%
2020	55.8%	18.4%	5.9%
2021	16.6%	28.7%	16.9%
2022	17.1%	(18.1%)	(14.5%)
Compounded annual gain	10.1%	12.9%	6.2%
Overall Gain	190%	282%	94%

"First rule of investment is don't lose. Second rule of investment is don't forget the first rule."

Warren Buffett

Dear shareholders,

In 2022, NAV increased by 17% compared with a decrease of (18.1%) in the S&P 500, including dividends. MSCI Europe decreased (14.5%) including dividends during the same period.

The past year was reminiscent of the year 2000. The Nasdaq fell (33.1%) in 2022, in a similar fashion to the year 2000 when it fell (39.2%). In both times federal reserve interest rates increased throughout the year, popping the bubble for many overpriced stocks. Back then, the decline continued in 2001 and 2002 as well, due to the massive overpricing of the tech stocks before the crash.

Today the market seems less overpriced compared to early 2001 based on several valuation metrics. However, it is safer to assume that it is not the end of the price adjustment for the market as a whole. It is less of an issue for us perhaps as we tend to avoid the more expensive and hyped up sectors, but is probably still a headwind in the coming year.

One thing that may be different today compared to 22 years ago is the situation in the energy sector.

During the 70’s and 80’s, energy prices roared due to lack of investment and embargoes. In 1989 all of this changed completely as the iron curtain lifted and the world was flooded with cheap energy. At the same time China was on the rise, and western companies kept investing huge amounts to keep pace. Prices were crushed in the process, and investors started losing money as projected returns never materialized. By 2013-2014 investors were fed up, capital spending was cut in half, and during the next several years many companies went bankrupt.

One of these companies was Alpha Natural Resources. In 2011, it was valued at 10B$. In 2015 it was bankrupt. By 2018 it was back, this time at a more modest valuation of around 1B$. Former bondholders received a warrant on the new common stock which we purchased in 2018 for 10% of our portfolio.

My reasoning was that with the elimination of 90% of the debt load, another bankruptcy is off the table. On the other hand, the company was valued at around 3 times its free cash flow at the time. In hindsight my reasoning was correct, but the timing could be better.

Instead of going up, the stock price went down fast. We started buying at 25$, bought more at 15$, then eventually loaded up even more at 1$ (we averaged around 15$). The reason was that metallurgical coal prices went mostly down, and stopped at a point at which the company was just breaking even. Many more competitors went bankrupt again, but the company survived. That was very important by late 2021 when coal prices went through the roof, and in 2022 to the moon.

The company was now making roughly 500M$ **a quarter**. They eliminated their entire debt and bought back 20% of the shares in one year. We ended up making almost 10 times our original investment, which is the main reason we reported a 17% percent return in such a difficult year.

We were out of the investment by the middle of the year, which provided a huge influx of cash just in time as other parts of the portfolio were getting cheap. We took full advantage to massively increase certain positions at advantageous prices.

With regard to the turmoil in the energy markets that I previously described, I believe this to be a return to the economic conditions of the 1970’s. Higher energy prices, higher inflation, higher interest rates.

The market however seems to disagree. Even after a massive run up in 2022, most energy companies still trade at very modest valuations. I believe this to be a massive opportunity. Even if somehow energy prices go down to where they were in the past 20-30 years, the debt levels of the companies in the sector are minimal and the cash flows are too large. They are returning earnings to shareholders with massive buybacks. The investment level in new supply is still too low and will take years to bring to market.

A final comment with regard to relative returns to illustrate the importance of not losing money (not too much, anyway).

In this example we will have two investors. One makes 40%, the other 0%. So next year, the other investor would have to make an extra 40% just to catch up with his friend. So far so good.

Now consider if one makes 20% and the other loses 20%. It would seem like the difference between them is still 40%, but in reality it is 50%.

This is because in order to get from 80% to 120% it takes an increase of 50%. A 40% increase would only get us to 112%.

This simple example illustrates the importance of not losing money, and why it is not so much by gaining more but by losing less that fortunes are built over time.

Eduard Gorban