HIDDEN INVESTMENT TREASURES

The title of this letter to shareholders is the same as that of my new book, which will be published by Grada this month. Approximately 20 years ago my book *Learn to Invest* was published, 10 years ago my book *Stock Investing* came out, and now *Hidden Investment Treasures* is being published. As soon as the book arrives from the printer, we will send it to all of our shareholders in the Czech Republic and Slovakia. To shareholders in other countries, we will send the English edition intended for foreign markets that should be out later this year.

If sales of *Hidden Investment Treasures* come anywhere near the numbers for the first two books, which are still hard for me to believe, and if the new book perhaps also becomes a bestseller, that will be a great feeling, but my ambitions are much more modest. What would bring me the most joy will be if it attracts more readers to invest in stocks. That, in essence, is the main reason why I wrote these three books. There's nothing nicer than when readers write to me to tell that they started investing in the first place because of my books.

I generally never wrote about the first two books in my letters to shareholders because writing them had been more or less my own private activity. For the same reason, I would not even consider devoting a letter to shareholders to the book *Hidden Investment Treasures* but for the fact that I have one compelling reason to do so. Common to all three books is the fact that beginning and perhaps even very experienced investors alike can find something of value in them, but *Hidden Investment Treasures* differs from the first two books in one respect. The people who could benefit most from this book and those who can relate most intimately to its contents are you, the shareholders of our fund. It took me about 100 days to write the first version of the manuscript, and every morning when I sat down at the computer to write the next bit, I always thought of you first and foremost, imagining that I was talking to you through the keyboard, and striving to write in a way that would most benefit you.

The book has a very unusual form. It consists entirely of individual stock investment ideas. After a foreword beautifully written by Václav Dejčmar and an introductory chapter, there follow 15 chapters, each of which presents one of these investment ideas. The thought to write the book in this way came to me quite unexpectedly. In May, I was at the Nordic Value investment conference in Denmark, organized by my friend Ole Søeberg. This conference has the format I like best. It is attended by professional investors, participation is by invitation only, the public has no access to it, and each participant presents one specific stock investment idea. I have several similar conferences on my calendar each year, including Value Spain in Madrid that is organized by Christian Freischütz, Chris Bloomstran's Tulipomania in St. Louis, as well as John Mihaljevic's online Investment Summits from MOI Global. My Prague Value conference is in the same format. In equities investing, as I prefer and as we also practice at Vltava Fund, while it is interesting to consider the more general topics concerning investment philosophies and strategies, various macroeconomic perspectives, or debates about trends in economies and around the world, it always comes down ultimately to which specific investments we make and why. That's why I prefer to listen to other investors and their particular investment ideas. I feel that this is what adds the greatest and very concrete value.

So, while listening one fine day in May to one of the presentations at Nordic Value, it occurred to me that I would like a book consisting solely of individual stock-picking ideas. I started to think back as to whether I had ever read such a book, but, among perhaps a thousand books on investing and related topics that I had ever read, I could not think of any that were written in this style. I would have loved to read a book describing individual investments while at the same time explaining for each one why the investors had been drawn to make it, what were their reasons for doing so, and how they went about analyzing these, but I didn't know of any such book. Gradually, the thought took shape in my mind that maybe I should try to write for myself something that I most look for in other investors. Ever since I was a kid, it has been easy for me to get excited about something, and so while running along the sea near Kronborg Castle on that morning I would not even have dreamed of ever getting around to writing another book (I considered my writing books to be a matter already settled long ago), and yet by evening I already had sketched out in my head a list of chapters and the main outline of the book and was looking forward to sitting down to start writing when I would be home two days later.

Hidden Investment Treasures therefore describes specific, individual stock investment cases from actual practice. By examining those cases, I want to demonstrate that today one can find in the markets a whole range of companies whose stock prices are significantly lower than their value, whose quality of business is very high, and whose associated risk is often much lower than is the risk of the market as a whole. Varying lengths of text are allotted to the 15 cases described here. Some require more extensive description, while others can be much shorter. In selecting the individual investments, I have also undertaken to ensure that their investment rationales include more general investment themes that are transferable to other companies and that have long-term validity.

So now I'm finally getting over to why I think the book is addressed first and foremost to you, the shareholders of Vltava Fund. It has to do with how I selected the individual investment cases making it into the book. That determination most certainly was not made by looking at the returns of various stocks in the markets over the past 5–7 years, identifying those yielding the highest returns, and then retrospectively constructing investment stories around the investment returns making it clear that the stocks should of course have been purchased then and there. I picked stocks that we actually bought into Vltava Fund and that we still hold to this day, with the exception of one that has since gone private and so we had to sell it. I also tried to make sure that each of the chosen stocks demonstrated a different origin or form of the value we were looking for, that the companies we selected came from various sectors, and that, taken together, they indicated the breadth of opportunities that today's markets offer. To these 15 selected companies (in 1 case a market index), I then added two additional examples from our portfolio that we regard as investment mistakes. The first is the case of a stock that we never even should have bought, and the second, by contrast, is an example of a stock that we should not have sold. Even when a person does one's best, sometimes he or she cannot avoid making an error, and describing mistakes can likewise be very useful to the reader.

Together, the investment cases described in *Hidden Investment Treasures* represent more than 80% of Vltava Fund's current portfolio, and therefore it will provide to you in a single place a comprehensive and yet highly detailed view of what we own together and why we own it. As you read the book, you certainly will get the impression that you have heard some of these arguments from us before, whether at Shareholder Meetings, our regular webinars, at breakfasts with shareholders, or that you have read about them in letters to shareholders. That will certainly be true, but the book also will give you the opportunity to go into this in much greater depth. Moreover, it will provide you a possibility to place the individual investment cases into the existing investment landscape. That has itself changed dramatically in the more than 30 years that I have been an investment practitioner. We strive to view markets in a manner that is wholly agnostic, objective, and noncritical. Far more important than to point fingers that one doesn't like this, that, or another thing going on in the markets is to understand how it is that the market is behaving today and to adjust one's investments accordingly. We find ourselves in an interesting situation at present. I started investing actively in 1993, and in all that time I cannot remember an environment existing that is more conducive to active investing than the one we are in now. The very fact that a smaller and smaller percentage of investors are trying at all to invest actively is very beneficial, and as an active investor I like that very much. At the same time, however, the market today has a behavioral characteristic that it has never had in the more than three decades that I can remember. This needs to be understood and respected, and it is likewise crucial to adjust both investing itself and one's own expectations accordingly. *Hidden Investment Treasures* is about that, too.

The book's introduction and conclusion are devoted to a description of the stock markets today. Again, you will probably not be surprised by anything here, as you are familiar with our views from our various forms of previous and ongoing communications with you. You know that we have been pointing out the dramatically changing nature of the stock markets already since 2018 and that in the spring of 2020 we completely adapted our stock selection and portfolio composition correspondingly. The larger format that a book offers, however, affords me an opportunity to describe and explain everything much better than, for example, in short letters to shareholders or in our presentations. I hope and believe that you will find *Hidden Investment Treasures* interesting and that it will serve as a wide-open window into our investment considerations. Investing in stocks is above all about buying ownership stakes in the businesses of individual companies. Proceeding company by company, the book's individual chapters describe almost our entire portfolio. Taken together, they will give you an even better grasp than heretofore of the companies within which we have collectively invested our money and the potential in each of them. I hope that you will enjoy reading this book as much as I enjoyed writing it.

Book link: https://shorturl.at/u4ULv

Changes in the portfolio

In the quarter just ended, we added to the portfolio two new companies from the technology sector: Applied Materials and Lam Research. Both are in the same industry as is another of our investments that we have held for some time, KLA Corporation. This industry is termed semiconductor devices and materials. One chapter in Hidden Investment Treasures is devoted to investing in technology companies and, among other things, the controversy over what really constitutes a technology company. As investors, we try to view technology companies not according to the industry into which they are formally classified but by whether the technologies and technological processes used in the production of their products and services are an essential element in value creation or if they are a source of long-term, sustainable competitive advantage. Among the companies that are formally categorized as technology-based and fall into either the Information Technology or the Communications Services sector, we find some that can be said to be just that but also others for which this classification is at least debatable. Similarly, among companies that do not formally belong to these two sectors, we find many that clearly are built to a large extent on technology and base their market positions and competitiveness on it. In the cases of Applied Materials and Lam Research, there can be no doubt that these are technology companies not only as a formality but also in fact.

Dozens of companies are directly or indirectly involved in the production of semiconductors. Within this broad group of companies, there are several without which it would not be possible to produce advanced types of semiconductors in the world today. These include a group of five very well-known companies, each of which has a dominant global position in its particular field, and which together operate more or less as oligopolies. These are Lam Research, Applied Materials, KLA Corporation, ASML, and Tokyo Electron. At the end of the year, we benefited from a significant correction in the share prices of Applied Materials and Lam Research, and, together with KLA Corporation, we now own three of them. We view these as one collective investment into a critical point within a very important segment of the global economy that is growing and will continue to grow over the long term.

Lam Research manufactures wafer fabrication equipment for the semiconductor industry and also provides related services. The company is a market leader in plasma etching, thin film deposition platforms, photoresist systems, as well as wet and plasma-based cleaning products for individual wafers. Its main customers are the four major semiconductor manufacturers Micron, Samsung, SK Hynix, and Taiwan Semiconductors. Lam Research is a business with net margins of around 27% and ROCE of about 30%. Capital outlays are relatively small. The company has good capital allocation with a preponderance of share buybacks.

Applied Materials provides manufacturing equipment, services, and software for the semiconductor, display, and related industries. Its principal business activities are semiconductor systems and Applied Global Services. Its largest customers are Samsung and Taiwan Semiconductors, but its overall clientele is more diversified than is that of Lam Research. At first glance, it would appear that Applied Materials has a somewhat less tangible and definable competitive advantage compared to KLA Corporation and Lam Research, but the numbers do not support such a view. Net margins likewise in the neighborhood of 27% and ROCE around 30% are outstanding. Basically, it can be said that all three companies we own have very similar underlying profitability metrics. Even their valuations, growth, and potential are similar. All have strong free cash flow and strong balance sheets, and they are regularly buying back their own shares over the long term and in large volumes.

The businesses of Lam Research, Applied Materials, and KLA Corporation each depend upon capital spending by semiconductor producers and on demand for products using semiconductors. This is cyclical, albeit somewhat less so than is semiconductor manufacturing itself. Nevertheless, cyclicality must be taken into account and an imbalance between supply and demand in the semiconductor market can sometimes bring very dramatic fluctuations. Moreover, risk also lies in the very nature of the businesses these companies pursue. Failure to develop new products and technologies on a timely basis in response to changing market conditions could impact their financial performance. Paradoxically, it is here, too, where lies part of their competitive advantage. The competitors of these three market leaders are exposed to the same risk, but, because they have much smaller market shares, they also are in poorer positions from the get-go and have fewer resources and incentives to invest into development. The longer I follow KLA Corporation, Lam Research, and Applied Materials the more I get the impression that the nature of their know-how and technological maturity is highly cumulative. Much more so than in other industries, this can be a very important source of competitive advantage. It is an advantage tending to grow especially among the leaders in the field.

Every advanced chip today can be said to be manufactured using equipment from Lam Research, Applied Materials, and KLA Corporation. These companies have been in our sights for a very long time, but during most of that time their stock prices had seemed too high. In recent weeks, however, they have become acceptable and we are pleased to have this trio of exceptional companies in our portfolio. The sector has very high barriers to entry, and these companies are likely to maintain their high returns on capital for a long time to come. As opportunity presents itself, we intend to build further our positions in all three of these companies.

Other transactions in our portfolio include sale of the majority of Williams-Sonoma shares. Their price has more than tripled since the summer of 2023 and we therefore decided to take away a large profit. Thanks to this sale, we also have cash ready to invest into other investment opportunities that this year will bring. Our cash position is in fact even larger than it would appear when looking at our portfolio if one adds in also the large amount of cash held inside our biggest long-term position, that of Berkshire Hathaway. It constitutes about 30% of the company’s total assets. At the same time, it reduces this investment’s risk and increases the capacity to take advantage of good investment opportunities during market downturns. We like this combination very much.

It is now 16 years since our fund switched from its original to its current investment strategy. The average annual return of the fund over this entire period is 12% per annum.

Daniel Gladiš, January 2025

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