Mohnish Pabrai's Presentation and Q&A at the Boston College on November 19, 2013

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Mohnish: It's a pleasure to be with all of you. What I'll do is, I'm going to go through a brief monologue with a PowerPoint then we'll play a two and a half minute Bollywood video, and then we can talk about anything you want to talk about, just skip asking me about things that we own or might be buying presently and so on. But outside of that, anything is fine. Arvind, do you have the first slide up? Like I said, I'll go through a few slides. Arvind, can we go to the next slide? Are you all seeing Buffett's letter on the screen? All right. This is not a doctor document. This a real letter that Warren Buffett wrote to me in response to my application for a job with him in 1999. This was before Pabrai Investment Fund started. At the time, the only thing I had an interest in doing was learning the art and science of value investing from him. I suggested to him that he could hire me at zero cost and such. Very quickly, within about five days of me mailing the letter, I had this response back from him, which I was disappointed about at the time. Anyway, in a few weeks after that, I picked myself up with some help from my friends and decided to start Pabrai Investment funds. We started with a million dollars with eight investors, and I tried to set it up as closely as I could with the Buffett partnerships. Let's go to the next slide. Just hit next. The question that comes up when you read that letter is that "why does Warren Buffett, who's got $50, $60 billion of net worth, want to operate alone and with no analysts or associates? Then why does Charlie Munger want to do the same? Then there's a good friend of mine who's a value investor, Guy Spier he operates the same way. In fact, he used to have an analyst till he figured out that that didn't make much sense. It was actually, kind of causing him to have results that was somewhat negative in what he wanted. He went from no analyst to analyst, back to no analyst. I think he's quite happy now. Of course, I operate alone. The question comes up, as to why I would want to do that. Let's go to the next slide Arvind.

The issue in the investment business is that there are more than 50,000 publicly traded stocks around the world. Even if you have a 10-person investment team, very smart folks who are in the team, cannot look at more than a few hundred companies as a group together in a year. In fact, they'll probably get to less than that number. If you are an investment manager with this 10 person team that you're working with who's doing a lot of the research for you, first of all, a lot of your time would go to manage the team, but also you'd be reduced to just getting a Cliff Notes version of the research these folks were doing. On top of

that, you would have secondary data. You would not have a full data set the way the primary people are doing the research avid. Let's go to the next slide, Arvind. Basically, there's no way for an investment manager to be on top of thousands of businesses. That's just not possible with or without a team. What the investment manager has to do, regardless of team size, is they have to take shortcuts because the data set is just too large. The way they take shortcuts, there are many ways to take shortcuts. For example, there's a mutual fund, which is based in Minneapolis called the Mayors and Powers Fund. Some of you may have heard of it. I think the charter of the Mayors and Powers Fund is to almost exclusively invest in companies based in Minneapolis. They've shrunken their universe of public companies to look at by having a mandate to only invest in Minnesota companies, there are companies that will only invest in companies that are socially responsible and certainly value investors sort of take on all kinds of shortcuts. They might take shortcuts related to PEs or book values or cash flow multiples and those sorts of things to try to narrow the universe down. Buffett says that it is not the size of the circle of competence that you have that determines how well you do as an investment manager. It is knowing the boundaries of that circle well that are important. You don't need to know a whole lot about too many things to do quite well as an investor. There's a good friend of Charlie Munger, I think he is or was in the first 400 John Arrillaga who lives near Stanford University. All John does as an investor is, he invests in real estate, which is within a couple of miles or less of Stanford University.

His circle of competence is extremely small, just real estate around Stanford. From a standing start just doing that, he's a billionaire. Of course, Charlie Munger says that if you wanted to get rich and have a well diverse portfolio, and you lived in Peoria, Illinois, or something, what you could do is, you could own part or all of the Ford dealership in Peoria, you could own the McDonald's franchise in Peoria. You could own the best apartment building in Peoria, and you could own the highest quality office building in Peoria. If you had just those four assets, and if you just even own parts of those four assets, you don't need to own them a hundred percent, but you could have, let's say a 10% stake in McDonald's, for example then you never touch those assets, you just kept them. The odds are you would compound money at quite a spectacular rate and do quite well over time. The bottom line is that in the investment business you don't need to know everything about everything to figure out what are the best investments and such. A large team is not as helpful as what as one might think to get you to the Promised Land. Let's go to the next slide, Arvind. One of the things that happen is that when you have an analyst, the chances are that you hired this person because you, in some way, like them as humans, and they are pleasant people to be around and such. They hopefully are smart, BC grads and such. When they come up with ideas, just the nature of the investment businesses, a lot of the ideas that someone thinks are great, you might think are not great. You'd say no, and you'll keep saying no most of the time. Sometimes you're saying no to ideas, which may be good ideas. Any two

humans are going to have different circles of competence because their life experience is different. What they've learned about the world and different businesses, and such is different. Someone could come to you, your analyst could come to you with a great idea, and because it doesn't fit into your circle of competence, you might say, “Well, that doesn't work for me. We can't do that”. In fact, this has happened to me. I think in 2006 or 2007 when the first iPhone had come out, I have a smart investor in my fund who's a venture capitalist in Silicon Valley, and he called me and he said, “Mohnish, you got to invest in Apple”. I told him very quickly that, that's not happening because I don't do tech, I don't do businesses with rapid change, and so on. Then he laid out for me, why Apple made all the sense in the world to invest.

In fact, he talked about the apps, and he laid out what was likely to happen in a manner that was eerie because what unfolded over the next several years was quite similar to what he had described to me in the sense that they would transform mobile technology, they would transform just the way people, It wouldn't be a phone, it'd be a computer in your hand. The app store becomes a very high-profit margin business for Apple with very little investment and on and on. Of course, if I had bought Apple at the time, I think it's probably a 10X from when he was talking to me about it. But I was right to say no because it was indeed outside my circle of competence. If he were an analyst working for me, he would be right in bringing the idea to me. I would be right in rejecting the idea. He would rightfully be unhappy about it. The same thing happened with Amazon, some of my friends about 10 years ago were pushing Amazon because they just saw the way the company was transforming and everything. It would've been a massive home run. Again, I said, no. Circles of competence, it becomes one of the issues with having a team size greater than one. Let's go to the next slide then. When you have a team, there's this natural bias for action, like Warren as the guys are going to say, “swing you bomb”. Why aren't you swimming and swinging? If you have people who have high IQs, they're not good at grinding away endlessly without seeing results. Some smart analyst keeps coming up to you with great ideas, and you keep saying no. That's just a very difficult kind of situation to permanently be in. Just to give you kind of a real bit of data at Pabrai Investment funds, in the last almost 17 months we have had no new investment ideas, zero. It's not because I haven't looked, I've looked for, I've spent lots of time looking for good investment ideas and such, but we've never gotten to the point where something made enough sense to pull the trigger. I just had to say no to myself. But if I had analysts or partners, the natural institutional bias towards action would take over, I think it'd be unlikely we would go through such a long period without acting on ideas.

I've always thought kind of the best way to set up the job description for an analyst is to hire them and give them the ground rules. The ground rules will be something like this that look, I don't want you to be in the office much at all. I would like you to pick a beach that you like to hang out on or ski hill that you like to be at, and you'll get your paycheck direct deposited into your account,

and just hang out at that beach or whatever activity you'd like to do. Never, ever call me with any investment ideas. When I need help, drilling down on a particular investment and need your brain power, I will call you. You need to keep your cell phone around at all times. When I call you, ideally, you can call me back within 30 minutes and drop what you're doing and go into full time research and analysis mode on the help I'm asking for. Then when that's done, go back to the swimming or water skiing or skiing or whatever else you want to do. Again, your paycheck's going to keep coming to your bank direct deposit till I call you the next time I need you. You can see that this sort of a job description, even though it sounds exciting, may not be that appealing to even most of you in this room. It's the difficulty setting up a situation where a person is not constantly feeding your ideas, and you're constantly saying, no, that becomes kind of hard. The compensation problem becomes also kind of a bit difficult. If someone brings me Amazon or Apple, and in my moment of brilliance, I say no in 2007 or 2003, and then it's a 10X or a 100X, and we miss that ride, and no one made that money. How do you compensate a person when things like that happen? Can we go to the next slide? Arvind?

One of the shortcuts I have taken, because again, the data set is so large, is instead of being like John Arrillaga and just doing Stanford Real Estate I said, why not be a shameless cloner? I am a low life cloner, which will soon discover in all its glory, so long live the SEC and long live the 13Fs, which are the quarterly filings that institutional investors have to make. One of the shortcuts I use quite a bit is, I look at what the other great investors are buying. If I make a list of let's say 20 great investors, Berkshire Longleaf, Seth Carmen Third Avenue, and on David Einhorn and so on you know, I have cut that universe of 50,000 stocks down to at the most, a few dozen stocks. If I especially look at what they bought in a given quarter, it might be down to maybe a dozen stocks or less. It's narrowed that huge universe down to a much narrower universe. Clearly, when people have made certain positions that top holding or that top three holdings, some great mind has processed it and gone to the point of, investing large sums into that position. Then I can look at it and say, do I want to do this or not? If I see that Berkshire Hathaway has taken a position in Exxon, which they just did, the good news is that Warren Buffett turned me down, but he doesn't realize that he is my analyst. The best part is that he's my analyst at Zero Pay. Just like I told him, I told him, Listen, just hang out in Omaha, and when I need you, I'll reach out to you. Usually, I reach out to Warren on four days of the year, on May 14th, August 14th, November 14th, and February 14th, those are the four days when Warren tells me what he's been up to. I can then look at what he's been up to.

What's even great about Warren is, I don't even have to do direct deposit paychecks or anything. He's never called to complain. The other thing that's great about him is that I keep saying no to all these things he comes up with and he never seems to mind. It's just wonderful. Then the same applies to Ted Wexler, who's also in Omaha hanging out, just like I told him too, and Todd

Coombs, and then Seth Carmen hangs out in Boston with you guys and so on, and then we've got the Longleaf guys in Memphis and all these guys are hanging out, doing exactly what I told him to do. Four times a year they pop their head and just quietly tell me what they've been up to, and then they go away. They never get disappointed or dejected if I don't take them up. In fact, as you can see, in the last 17 months, all these guys have come up with all sorts of things, and I've said no to everything. Amazingly, none of them ever mind. They are just fantastic humans. No emotional response to repeated rejections. It's fantastic. I have found that the payroll cost is zero, which is a nice number. I like that. Like the Miller commercial of sometime back, not only does it taste great, it's also less filling, it does both things at the same time. Let's go to the next slide. Besides Warren and Ted Wexler and stuff, we have several other analysts and several other tools mostly available at zero or close to zero cost that are quite exciting and quite interesting for me to use and leverage. First, I'll start with some of these things that are coming up on the screen. Let's start with Value Investors Club. How many of you in the room are familiar with Value Investors Club? If you are familiar with it just raise your hand. We have just few. Arvind, I'm deeply disappointed in what you've taught them so far. How come you kept them away from the Value Investors Club?

Oh, okay. Sorry. Maybe I'm not seeing the full classroom. Anyway, I don't know if you guys know the history of Value Investors Club but it was set up by Joel Greenland and Joel and his partner, John Petry basically, many years back, I think this is going back to the early days of the internet. They had done an analysis of some business that they were making an investment in, and I think they were on some Yahoo message boards related to that public company. On that Yahoo Message board, they saw one particular poster put up an extremely detailed analysis of the business that they were looking at. The analysis was superior to even what they had come up with. This person did not work at a hedge fund or a mutual fund. He was just an amateur investor investing for his own account. They were just surprised that out in the Transom, if you will, were these islands of incredible talent. They thought about, well, how can we tap this talent? They came up with this idea of the Value Investors Club, and what they decided is that they would invite anyone on the planet who had an interest to become a member of the club. To become a member, you had to submit an investment idea. Of course, they would review the idea, it was good enough to admit you into the club. Then once you got into the club, you were required to submit, I think, two ideas a year.

I don't think you could submit more than four ideas. They wanted to limit how much people could submit. Then every week they awarded $5,000 to the person who came up with the best idea. They basically said that for about a quarter million dollars plus the cost of running the website, they would get this amazing information flow and cut out all the nonsense that you get in Yahoo message boards. Because it's a basically curated site about what is posted or not. Actually, if you go on Value Investors Club, you will see in general that the

average write-up is quite high quality. Many of the folks who are posting write-ups and such are not professional investors. In fact, there's a person who a handle on Value Investors Club has called Charlie 479. You can do a search on Charlie 479, it'll pull up all of the ideas that he submitted. I don't know if he's been active lately, but his ideas were so good. The other thing that Joel Green Blatt and John Petry did was that if they were truly impressed with what people came up with, then they talked to them and they set them up in the investment business. They basically seeded their money to manage took a stake in the general partner and introduced them to other people who might want to invest with them. I don't know the number, but I personally know of several funds that were set up by people who originally came on the Value Investors Club just as amateur investors, if you will. Anytime I look at an investment idea, let's say in fact, like for example, in the first quarter of 2012 when the Berkshire 13F came out for the first time, they listed General Motors as a holding of theirs.

Of course, I hated the car business, it has high Capex, it's got unions, it's got all these consumer taste vagaries, and you have to make all these massive investments up front and such. For many reasons, I never had any interest in the car business. I immediately looked at the idea Berkshire bought and I rejected it. Then when the second quarter of 2012, 13 FS came out, I noticed that General Motors also a top holding of David Einhorn's. I said, why would David Einhorn and Berkshire Hathaway both take these large takes in this pathetic company called General Motors? I decided to do a drill down on the business, and usually, when I do a drill down the first thing they do, I look to see if that idea is posted on Value Investors Club. I'm not sure if I found anything there or not, but that's usually what I do is that's the first place I usually go after. I just look at Google Finance or something on the company. Of course, I did a very thorough drill draw on GM, and it dawned on me that they were a number of reasons why an investment in GM made all the sense in the world. That led me to take a position in GM. We still own that position. I don't have much to say about it except that we are up, I don't know more than a hundred to 120% so far on that position. Thank you, Berkshire, and thank you, David. You're just fantastic analysts. I might have to send you a bonus or something.

Value Investors Club is fantastic. Sum Zero is something like that. It's another website where, again, it's a community of mostly amateurs who are posting their best ideas. Guru Focus is another good website where they've created a list of gurus. Again, they've got all kinds of data on what their top holdings are, what they're buying, what they're selling, and so on. The Manual of Ideas is not free. I think it's about $900 a year or so. But I think it's exceptional. $900 a year is a little less than what you might pay an analyst every year. What the manual idea does is, it makes my job even easier. I don't even have to go through 13Fs every quarter. John Mihaljevic, who's a good friend of mine now, who puts out the Manual of Ideas basically puts out these very nice booklets with a couple of pages on each fund, if you will, and what they've been buying and what their top holdings are, and all of that in a much easier to digest format than the 13F.

You can get the same data through 13F it just takes a little bit more work and time. That's another great tool. There's a message board called the Corner of Berkshire and Fairfax, which is also exceptional. Again, when I find ideas to research, I look at Value Investors Club. I also look at Corner Berkshire and Fairfax, and of course, Edgar Online is run by the SEC.

I pay them, I think 10 bucks a month, and that gives me access to all the filings in nice formats and such. There may be a way to get that stuff for free, but it just makes it a little bit easier. There are various newsletters like Graham and Doddsville, which is the newsletter from the students of Columbia Business School. These tools are quite valuable. I think I found them very useful. In fact, if I look at our portfolio currently, I can think of only one stock that we own that is not a cloned position which means it was not picked up from somewhere else. I should call the fund the Cloned fund. But let's try to keep this between us and let's not tell my investors about it. They might object to the outrageous fees I'm charging them. With that, why don't we do this Arvind, why don't we play that video and that's about two and a half minutes, and then we'll start Q and A and such. I hope you enjoyed my wonderful music selection. I adjusted my webcam. You can see the Charlie Munger bus behind me. Can you see that? Yeah, we need to make sure Charlie's overseeing the proceedings here. Okay. We can open up to questions, you don't need to particularly talk about what you just heard. We can talk about anything you'd like to talk about.

Question: Can you walk us through us your research process?

Mohnish: Okay. Let me just try to make sure I understood the question. You're saying that what do I do after I identify some stock through a 13 F? Okay. The investment research process, you're saying. Yeah. Basically, the first question I asked myself is, is this company within my circle of competence or not? That's the first question. A lot of things are not within my circle of competence. Typically, every time I look at set requirements, 13F, the Baopost fund. Basically, I see a lot of pharmaceutical companies on it, and I have no idea what they're all about or why those companies are even on there. They're a quick pass. Many businesses are like that, and I cannot understand much about them and such, they are immediately excluded. Usually, if a business of some interest, one of the first things I do is, I look at the quick valuation metrics. In general, the absolute lowest return I'm looking for is it, it needs to at least be 50% off intrinsic values. It needs to be at least half off. There are many investors who will buy something for $13 if it's worth 18 or $19. To me, that's an automatic pass because if I'm buying something with 13, I should be convinced that if not immediately, at least in the next couple of years, it's worth at least mid-twenties. Valuation usually are one of our most common reasons for excluding something after circle of competence. Now, if you get past the circle of competence or something as things that I think I can understand, and also something appears to be somewhat cheap then the process I use is designed to basically get to a “No” as quickly as possible.

I will spend about a minute or two looking at the businesses, looking at some metrics or quick data to try to see a clear-cut reason to say no, if I don't get to that in the first couple of minutes, then I'll give it another 15 minutes and I'll go through a little bit more data. I might open up the website of the business, look at an investor relation, public presentation or something, try to understand what the company is saying its prospects are, and so on and so forth. See if at the end of that 10 minute or 15 minute exercise, if it can safely be passed on for some good reasons. If I cannot get to that point, then the next step would obviously be to start doing a little further drill down, start printing off the annual reports, 10 Qs, 10 Ks, and I might spend a few hours looking at the business again, trying to understand why it would be good and smart to reject it. If I get past the next few hours and it's still not rejected, then I'll start doing a more thorough drill down. That might take a few days. If it's still not rejected after that, then we'll run the checklist, and see what kind of information pops up. Usually, the checklist brings up things that I don't know about the business, which is the biggest value it adds. That might lead to more research. It's a process of elimination and eventually, you hopefully get to the point where kind of seven ducks' line up in a row, it looks like a good fit and you can pull the trigger.

Yeah, actually, I'm not too focused on rapid response or anything like that. I think we've got plenty of time and basically, if I can find two or three ideas in a year, I'm in good shape. I'll give you an example. GM is a good example of that. The first time Berkshire had bought it was I don't know, like May 14th or May 15th or so. Of course, I didn't do much with it at that point. It's a few weeks after that when I noticed that Einhorn also had a position that I started to drill down. In fact, that particular drill down, I must have read at least a dozen books on the auto business, different facets of the business. I read books on Alan Mulally at Ford. I had read Sloan's book, my years at GM some years back, and I reread some parts of it. Then there was whole, GM was a company which had a very rich data set. There was a great book called Overhaul, which was written by Steve Rattner who was appointed by the Treasury to oversee the bailouts for autos. Basically, between the filings of the company and a bunch of articles and books and such, I think that that work may have taken a few weeks, maybe three, four weeks, and then we were ready to pull the trigger after that. The thing is that the number one skill that you can bring to bear to beat the market is patience. You should never be in a hurry thinking that, Oh, this talk might go up or, I might lose this opportunity or whatever else. Actually, GM became cheaper. I bought it at much lower prices than originally what Ted Wexler at Berkshire paid for it. One doesn't need to be under pressure that you have to act in some kind of rapid response manner or anything like that. Generally, you have plenty of time to do that

Question: How often do you review your position to make sure the thesis is on track?

Mohnish: The question is, how often do I come back and review the position? Well, one of the things I do just before I pull the trigger is, I'll write up a one paragraph

thesis, usually no more than six or seven sentences of why it makes sense to make an investment in that business. Part of those six or seven sentences is what that business is worth and why it's worth that. Usually, every quarter or every second quarter, three months or six months, I'll review some of the metrics that are coming out of the company to see how they line up with what I had assumed or thought might happen. As long as that is in, things don't go in a straight line as long as they generally line up and they don't seem to egregiously violate what we might have assumed then, we might update intrinsic value calculations every six months or something. But once the business gets to be worked around 90% of intrinsic value it's a candidate for sale. We know when we are going to sell before we buy, but we know under what circumstances we'll be selling. Sometimes we might sell even before that. If something gets to be a 75 or 80 cent dollar and something else shows up on the radar, that's a 40-cent dollar and we don't have cash, then we might make that switch. Those are some of the reasons that it might make sense. If I can add one more thing, there were these two professors I think one was at Ohio State, the other was at the University of Nevada. They did a study of Berkshire Hathaway for 30 years, I think, from the mid-seventies to around 2005 or 2006.

They said that, what would be your return if you bought what Warren Buffett bought after it was publicly known that he had bought the stock? They made an assumption that you would buy the same stock on the last day of the month that it was publicly known that he had bought that stock. You found the worst broker on the planet, and you paid the highest price that the stock traded at on the last day of the month. Then you started selling that stock when it was publicly known that Buffett had started selling. Again, you would sell on the last year of the month that it was probably known that he's selling, and you would look for the worst broker on the planet and sell at the lowest price that it traded on, on that last day. These guys said, if you did this for 30 years, you beat the S and P by more than 11 percentage points a year. The S and P has done around 10% or so over a long time. This would've done around 20, 21% or something over that period. If an investment manager just beats the indices after fees, they are already in like top 15 or 20% of investment managers. If they beat the indices by just three percentage points a year, they are in the top 0.5% of managers, the top one in 200 managers. When you are talking about the outperformance of 11 percentage points a year over a period like 30 years, that is such an outlier that you would probably be amongst one of the best managers out of thousands and thousands of managers.

We do respect, you wouldn't even need a BC degree. In fact, you could walk out of the class right now and set up the Berkshire Clone Fund, which just does that. In fact, every time I talk to students, I tell them this story, and I always wait for someone to, you know, first of all, leave the classroom, but secondly, start a fund that does that. After all these years, no one's left the classroom, and no one has started such a fund. That opportunity is still wide open. I just want to let you know; this is not something Arvind is going to tell you. He's going to put

your nose to the grindstone, make you do all kinds of analysis and stuff, and it's all boring stuff. This is the real way you make money and such, and you can hang out at the beach or on the ideal ski hill for 29 out of 30 days. In fact, you can hang out for 30 days. You can just take a 15-minute break on the last day just to check if Warren has done something or not. After you replicate what he's done, which will take over five minutes on your Blackberry or iPhone, you can go back to your ski and no one behold, you beat the index by 11%. In fact, in many ways what Pabrai Investment funds is doing is something similar. I haven't taken the rigor of just doing exactly what these professors said, but in effect, I'm cherry picking what some great brands have already processed and said are what they think are great ideas and then just looking at the ones that I think pass my limited circle of competence and then take it from there. Let's take the next question.

Question: Why haven't you invested in the past 17 months and what do you think about cash allocation in your fund?

Mohnish: Okay. I just want to make sure I got the question. One is, you said that I hadn't invested in 17 months, and you were asking, I guess, why that is. The second is that something about cash, about being in cash. I didn't get that part. Well alright, let's handle the cash question first. In fact, that's a wonderful question. In 2008 and 2009 I got my head handed to me in the markets. In fact, you know, the indices were down, you know, 38, 39%. I think in 2008 we were down close to like 67% or so. We were down a lot more than the market was down. Well, there's a couple of reasons. One of the reasons we were down that much is we were fully invested; we were caught very flat footed. Of course, we've made up all of that ground and then some in the last few years. But I did a lot of soul searching as to what went wrong in our process and such. I made some adjustments. I said, it's important to have cash. At times when markets are severely distressed, anything that we invested in the fourth quarter of 2008 or the first quarter of 2009 is probably a 4X or 5X from those prices until now. Very significant returns well possible at that time. But of course, I was not able to play offense because I didn't have cash to the extent I wanted to. I said, how do I ensure that when we hit these serious air pockets that we can have cash? First, in just some basic math, so let's say I have a fund that's 80% invested and 20% in cash, okay? Let's say the market drops 50%, and let's just say that my holdings also mirror the market, and they also drop 50%. Well, what would happen is that my fund would drop from being worth, let's say it was worth a hundred million before the 80 million in stocks would drop to 40 million, but the 20 million in cash would still be worth 20 million. Our 50% market drop would translate into a 40% market drop for me because of the cash pushing. The first thing cash pushing is going to do is it's likely to cushion your drop to be less than the market, which is useful. The second is that that 20% cash can now go on the offense and can get fully invested.

Like I said, in 2008, 09, if you get that sort of cushion, there were lots and lots of opportunities to get a 4X or 5X in a few years. Let's say you take that 20% and

you invest it and you get a 4X return in a few years, so the 20 million becomes 80 million, the other 40 million might come back to 80 million. Or maybe even if it doesn't come back, let's say it ends up being worth 70 million, well, you now have a fund that's worth a $150 million, 50% above what it was before the crash. On top of that, your volatility and your drop would be less than the market drop. These are all good things. What the 2008 2009 period sealed in for me is the importance of a cash cushion. The question was, how do you know when you should have a cushion and when you should be fully invested? The way I came up with taking care of that is, I said, Okay, if we have a brand new fund, let's say it's a hundred million in cash, I said that the first 75 million can get invested in ideas that are a 2 to 3X in two to three years, a double in two to three years is fine, then the next 10%, so the first 75% goes, goes invested in 2 to 3XThe next 10% we need at least a 3X. That would get you to 85%. Then the next 5%, I said, should have at least 4X return possibilities. That would get you to 90%, and the last 10% is 5X or more. Basically, if I looked at my fund for the last 17 months, we were sitting on about 10% cash for most of this period. The bar was that it could get invested if we found opportunities which were a 5X or better in two or three years with relatively muted downside. That's a high bar. It's not easy to find 5Xs. In fact, my purpose of having this talk with you today is to impress upon you that you were put on this earth to send me those 5Xs. Arvind will give you my email address, but it's also at the end of that video. When you have those 5X ideas, after you have fully satisfied your own appetite, you can send it to me and that'd be much appreciated. Basically, what that, first 75%, 2X, then 3X and 4X and 5X does is, it acts like a circuit breaker.

It prohibits me from basically getting fully invested unless either markets get distressed or some very compelling idea you are sure of. We've been floating around for the last year and a half or so with that cash cushion. In fact, I see nothing wrong with that 10% or 15% cash push cushion, even 20% cash cushion being almost permanent. That's perfectly fine. I think that the idea that markets would go through dislocations is almost a hundred percent. We will see plenty of dislocations. You will see several dislocations in your lifetime. The dislocations will happen. We don't know when they'll happen. Quite frankly, to get fully invested, you don't even need dislocations. You might get fully invested in some anomaly with businesses, in particular industries going through temporary distress. That's perfectly fine too. That's the reason why we found a lot of 2Xs and even 3Xs, but they were not enough to pull the trigger, if you will. That's why we are sitting with a push. Yeah, that's a good question. We aren't fixed income investors. Like I mentioned, the lowest bar is looking for 2X, but sometimes we found businesses where the bonds were sitting at 50 cents on the dollar, or 30 cents on the dollar. Obviously if you invested in the bonds, you're going to be higher on the capital structure. To some extent, it's a little bit easier to make those investments if you have high conviction that the business is going through temporary distress, and those bonds are likely to get to par in some reasonable timeframe. In that case, the equity might give you even more returns. Sometimes when you have bonds at 40 cents by then they

get to par, and the equity might be a 5X but the risk profile is much more muted with the bonds. Sometimes we've opted to buy distressed bonds and gone that way, and it's worked out okay, it’s just a proxy for equities.

Usually when I've done that, I've picked one or the other. I've usually, and especially if I'm convinced that the equity is above zero for almost for sure then of course the bonds are worth par. I think that the thing that Buffett says, rule number one, don't lose money. Rule number two don't forget rule number one. I think the most important thing in investing is patience, is to focus on the downside. If you truly spend plenty of time thinking about what can go wrong the upside will take care of itself, but you want to spend a lot of time on what could go wrong and what could cause the business to suffer and such so downside spending time on the downside is a good thing. Yeah, that's a question good question. I used to basically I think until 2008 if I made a bet, it was typically a 10% of assets. Typically, the top 10 or 12 positions would make up at least 80% of assets. In 2008 and 09, when we were seeing these massive drawdowns, I was also seeing lots and lots of opportunities in particular sectors and not enough time to drill down and understand each business or even understand which one was the best. For example, many different commodity businesses collapsed in late 2008. For several reasons, many of them looked great to invest in. What I did is I made a basket bet. I invested in each of these businesses at 2% of assets, and we made several different commodity type bets. In fact, we had no losers. Every single one of them was a multi-bagger and that worked out well.

What I did is after the 08, 09 timeframe, I basically came up with three thresholds. An investment could be at 2% of assets, or 5% of assets are up to 10% of assets. Typically, 2% would be something which is either got kind of asymmetric risk reward possibilities, but the risk is somewhat elevated. It's not as muted as we'd like, what the rewards are outlier rewards, if you will. I mean, as we had exited that position, but we had taken a position in Freddie and Fanny Preferred, and several different investors have recently taken those positions and such. Those preferred by Freddy and Fanny got knocked down 95%, even more at the bottom. I think they were down 97, 98% from par. Very significant. If they went to par and you were buying at the absolute bottom tick in some cases you had a 40 50 x return possibility. Of course, I didn't get in at those prices, but we were buying in the still single digits, seven, eight, 9% of par. Of course, in the end, we exited the position, we exited at a slight loss because we had other opportunities that looked more interesting at the time. I wasn't fully, and I'm still not fully convinced on whether that will work out or not. But those preferred to have moved up quite a bit since then. In fact, recently people, parquets was talking about making some audacious proposal to the US Treasury that he and some fellow investors would take over Freddy in Fannies part of their business and those preferred go to par part of that package. That was an example of something that if we took a 2% position of that, we would not have done more than that because it has had a bunch of

hairy becomes possibility, but also had huge rewards as well. 2% it could be the basket or some things unusual 5% might be some normal type of opportunity, and 10%, if we are quite convinced about the prospects and such.

Question: How does one expand their circle of competence?

Mohnish: If you are in the investment business, it helps to be a curious person. It helps to be a person who's a voracious reader, and it helps to be a person who's very interested in businesses in general, and very curious about how different businesses run and make money and all of that. If those types of traits are present in you, then by definition your circle is going to expand over time. But I don't think you need to particularly focus efforts towards expanding the circle. It'll happen naturally.

But also, it's important to remember that we have the genres of the world who have a single asset class. That's all they've invested in, and they've done extremely well with that. Of course, it's useful to have larger circles, but it's not that important. I think that this is a business where you're better off being an inch wide and a mile deep versus a mile wide and an inch deep. If you start off being an inch wide and 200 feet deep, then I would say put more energy behind going deeper versus going wider first.

Question: How do you think about the tradeoff between valuation and growth?

Mohnish: Well, I think it depends on the business, but in general it's a function of growth. Growth and stability of cash enter that equation. But if you have a business that has, let's say, absolutely zero growth, it's just going to sit at the same level of cash flows, but it has very high stability on those cash flows, kind of like a utility and almost guaranteed to come in then I would say a business like that is worth at least 10%. I mean, at least 10 times cash flow, you might go a little bit higher in a very low interest, environ might make it 12 or 13 or even 14 times. I would say that a business like that is worth let's say 10 to 14 times cash flow.

If you can get it at five- or six-times cash flow the odds are good that you'll get a double out of it. Now, if you get a business that has stability of cash flows, but the odds are high that they might grow up at some small rate, let's say five to 10% a year, then that's worth quite more than that'd be at least 15 times in my book. Sometimes you get to business, I like one of those talks in my portfolio right now is a company called Horse Head. The ticker symbol is zinc. I'm not saying this to talk about the business, but they have kind of two facets to their cash flows. One facet of their cash flows is somewhat independent of the price of zinc. If zinc prices stay where they are today which is low right now, these guys may produce somewhere between 130 to 170 million in cash per year from that business. If zinc prices stay where they are with, and that might start coming up in a year or 12, they finish some investments that they're finishing off. It's a company that has a market cap of 700 million.

On the low end if you look at their, you know, low hundreds type cash flow, let's say 120 million or something, or hundred 30 million, it's at like six times cash or something. But zinc prices could collapse like they did, in which case cash flows would go down. But also, the flip side is that for every ten-cent increase in the price per pound of zinc their cash flow increased by 25 million. They're very highly levered to the price of zinc. Zinc is, for example, currently at about 85 cents a pound, and the historic range the last few years, the historic range on zinc is like 50 cents to $2, for example, and 50 cents is the price when the world shuts down, kind of like financial prices when no one is using anything. I think it's unlikely to go below where it's right now, but it's not out outside the realm that in the next few years, zinc prices might be a dollar 30 or a dollar 50 or even $2 that could happen.

You have this kind of low end, you can say 120, 130 million of cash flow and extreme high end, you have like 280 million of cash flow, right? What's a business like that worth? Well, I don't know what it's worth, but I think it's worth more than whatever it's sitting at right now. You would look at those sorts of, in effect, what a business like zinc is giving you is giving you a free option. I'm not paying for those zinc prices going to a dollar 50 or dollar 30 or whatever. If that were to happen almost for sure, that stock would move in a very significant way. I like free options where you have upside without downside. I think it depends, I think when you're looking at these cash flows inside, how stable are they, how variable are they? In fact, in businesses which have high variability of cash flows you can get wider gyrations from intrinsic value, which creates the opportunity to do something with it.

Question: When you are looking at buying a business, what do you think about leverage?

Mohnish: Yeah. When I made the checklist, the biggest number of questions on the checklist related to leverage, and which means that the most failures that most people had in their investments were because something went wrong with leverage. In general, you need to pay a lot of attention to how businesses are financed and how conservative they are on that financing. Yeah, I think that in my case, what would happen is that the checklist would throw up all sorts of red flags in the case of a business that's highly levered. What matters is, with leverage, is it recourse? Is it non-recourse? Is it at the plant level or corporate level? How stable are the cash flows versus the leverage? What kind of multiples do you have on those cash flows versus your interest payments and all that? All those things matter. I think being a good credit analyst is a huge advantage. I think you need to pay attention. Ideally, you want to look for businesses which generate large cash flows with virtually no leverage.

Question: What are some of the big buckets on your checklist?

Mohnish: Yeah. Just to take a step back on the checklist one of the things I did not want to do, the checklist was to just blue sky. Think about things that are good to think about as an investor when you're making an investment. I did not want to

create a checklist in that way. What I wanted to do with a checklist was to create it based on real losses that some great investors had because they missed something elementary. Every investor, no matter how good they are, it's plenty of mistakes they're going to make. In fact, John Templeton says that if you're right, two out of three times in the investing business, you're going to hit the ball way out of the park. The good news about this business is you can have a very healthy error rate and still do quite well.

That's one thing to keep in mind. What I had done when we were creating the checklist was to look at permanent losses of capital that had occurred amongst investors whom I had a great deal of respect for, and then try to reverse engineer why those losses might have incurred occurred. The easiest ones to do on that front will be Buffett and Charlie Munger, because they talk so much about their mistakes, and many of the investors don't talk about their mistakes at all, and some fall in the middle. In some cases, I had to kind of reverse engineer what I thought the mistake may have been. But in other cases, like with Berkshire, you know, when I looked at Dexter shoes or us there, or them buying Berkshire mills and all these different investments they made, or Net Jets, for example, the nature of the mistake was obvious, and therefore coming up with a checklist question was easy.

Some of the other ones took a little bit more work, but we were able to get there, like before the financial crisis, Longleaf Partners had invested in General Motors, and they of course, eventually GM and bankrupt. Of course, they lost a lot of money on their investment. Ironically, now I have an investment in GM but it's not your father's GM anymore. I had an intern who helped me do that. The checklist questions came out of real failures that I had in investments that had gone south for Pabrai Investing funds and other great investors had. We ended up with a list of 90 odd questions. I wasn't particularly planning that the checklist should go in one direction or the other.

It was driven by the mistakes and what those questions were. Then when I re-categorized, I reordered the checklist by category, what surprised me is that how beautifully they fell into a few different categories. There's a significant number of questions, maybe 25 questions, which relate to various types of leverage and failures relate to leverage things. Then there's another section that relates to moats and competitive advantage shrinking moats or non-existent moats or, mistakes made in thinking about the moat and such. There's a lot of questions around that, like Dexter shoes in Berkshire's case was, Warren made a mistake about that moat. Then there's another section that is on management and ownership. What percentage of the companies with management own, how are they compensated? How aligned are their interests?

All these questions related to management and ownership, and then we get to some miscellaneous areas like unions, organized labor, environmental issues and things like that. But the top three or four categories basically took up most

of those questions, and those are the most important things you would think about. You would think about leverage, you would spend a lot of time thinking about moats and competitive advantage, and you definitely want to spend a lot of time thinking about the folks who were running the show and what types of people in history and such that they had. To me it was surprising how most of the mistakes were in those areas.

Question: When evaluating your own mistakes, can you describe your process to analyze the mistake? How do you avoid hindsight bias?

Mohnish: Yeah, I think the question I tried to ask myself is that was it obvious before the investment was made that this was a possible failure point and a significant failure point and not something obscure, just headlights front and center and, if you look at Dexter shoes, can the business be decimated by cheap foreign competition? That's a question on the checklist. When I looked at Longleaf Partners and their investment in GM, they had a lot of commentary when they owned the stock at the time when they're bullish on the stock, and they were bullish because the big three automakers in the US-dominated a truck business, and they still do. They dominated it at a time. Longleaf owned it, and they still dominate a truck.

In fact, they dominated it in a very incredible way. Those trucks are just cash cows. I think these guys are making like $10,000 a truck. It's very high profit margins on those trucks. That's a great franchise, and Longleaf focused on the power of the franchise, and they were right, the trucks have a great franchise, but there's other layers in that business. The unions, the labor relations, the high Capex nature, and those should have been major red flags. Of course, one of the things that happened with GM post-bankruptcy is that Detroit used to be one of the worst places on the planet to build a car in, let's say 2003 to 2007, very high labor costs and all these very highly inflexible labors.

In fact, labor was not a variable input into manufacturing in US autos. It was a fixed cost. If GM and Ford did not need a worker, the UAW contracts required them to pay them full pay while they sat at home and full pay with benefits approaching 60, $70 an hour. How do you compete against people who are making $5 a day with those sorts of labor costs? In the case of long leave to meet with obvious that the main thing you should have focused on there, or they should have focused on there, would've been the issues related to labor and capital intensity and such. Of course, then the big three had other problems with quality and other things with their non-truck offerings. I don't want to beat up on longleaf.

I just using that as an example, I think the exceptional investors. But these are just some examples that stood out. In many cases, when investors made mistakes we couldn't tell, I couldn't tell what the failure point was. Just like when Baopost makes an investment in some pharmaceutical company, I can't figure out why. If they lose money, I also can't figure out why, and that's fine.

You don't need to know all of them. When we were doing the checklist, we needed to just understand enough to build a decent list.

Question: How do you evaluate commodity-based businesses?

Mohnish: That's a very good question. In fact, I did not understand that much about commodity-based businesses till late 2008. It dawned on me at that time when I was looking at some of these businesses that commodity-based businesses can have incredible moats. For them to have incredible moats, they need to be low-cost producers. Most commodities, they talk about which quartile of cost they're in. Let's take not the company with the ticker symbol zinc, but let's take the commodity zinc, for example. If you look at the commodity zinc, the lowest cost producers in the world who have the lowest cost mines the bottom 25% of production may have a cost of, let's say 40 or 50 cents a pound.

The next quartile, which is the 25 to 50% producers may have a cost of production of let's say 60, 70 cents a pound. Then the third quartile, you might get to 70, 80 cents a pound. In the fourth quartile, you might get to maybe close to 85, 90 cents a pound. If zinc is trading like it's trading right now at about 85 cents a pound, and of course there are zinc producers who have a cost of a dollar a pound. There are zinc producers who have a cost of a dollar, 25 a pound, a dollar 50 a pound, you know, it just goes on. You can have parts of the earth where you can produce zinc, but it's very expensive. Of course, all those guys who have costs above 80, 90 cents a pound, unless their marginal costs pro producing zinc, are very low, they much have shut down production at present prices they're not able to produce because they would lose money on every pound they produce.

Those minds are mothballed if you will. If zinc demand increases, the price might go up to a dollar or five dollars, 10 a pound, and more production may come online. The person who has the greatest moat in that business is mine that's producing at 40 or 50 cents a pound. That mine is going to make money day in and day out. They're going to make money no matter much what the state of the world economy is because, even if production drops, even if China goes into a tailspin, all kinds of things happen. It is still unlikely you get to less than 50 cents a pound. If you own a commodity business where you are the low-cost producer, and you have some significant volumes you can bring on it that low cost, that is a fantastic business.

That is a business that has as much of a moat as Coca-Cola or Geico has, for example, it is an enduring durable competitor, brand-age. When I look at commodity businesses, one of the first things I look for is what quartile they are in their production. Of course, you also have to look at long continuums of where commodity prices are. For example, in 2008 when we were making these commodity investments, most of the investments we made were in businesses that were first quartile producers. In fact, prices had come down to the point where they were barely making money. But it was clear to me that at

some point the economies would start functioning again. The world would go from a standing, completely stalled economy situation to a working economy globally.

As soon as you got to working economies globally, those prices would rise. Then these low-cost producers go from making very little money to making gobs of money. Of course, when they got to making very little money, their stock prices absolutely collapsed. I mean, they collapsed to the point, like in there was a company Teck Cominco in Canada, blue chip minor, like the IBM of mining, their stock price went from $50 to $4 in about four months because of they had some specific dynamics with leverage that was causing stress for them, but also commodity prices that come down a lot. But they had some of the lowest cost mines in the world, and so they had incredible assets and in fact, so we invested at those four or $5 prices and eventually the business went up to 40 and $50 and not that long a period.

Yes, I think that you know, when we were talking about expanding the circle of competence, I did not understand commodities very well before 2008. I got a lot, much better understanding, and I do feel that I've got some, let's say, tools in the arsenal now, which helped me understand commodity businesses, which I didn't in 2003 or 2005. That is somewhat helpful in the future and such. The same with, when I studied these autos, like GM and such, I understood some dynamics about the auto business that I never understood before, which, hopefully, will give me some advantage over time.

It's a good question, when you're looking at commodity businesses, I think you must understand cost curves. You must understand where they are on the cost curve. You must have some understanding of kind of what normalized commodity prices and some commodity prices under different scenarios are. I think you must understand those facets of macro. But you don't need to understand a whole lot beyond that. I think that, in my investment in zinc, for example, I understand cost curves well, and I have some understanding of what drives zinc prices and such, but I don't have a very good understanding of that. I think that there is a decent chance in the next few years that we might get significant movement upward in zinc prices. But the thesis doesn't rest on that. If that happens, we will make out quite well, but I think our investment probably works out, even if that doesn't happen, and that was fine. The more you depend on and rise in prices, the better your understanding needs to be on why that is absolutely assured to happen.

Question: What are your thoughts on shorting?

Mohnish: Pause the question that thoughts on shorting and why I don't short? Well, it's a stupid bet because, and maybe Bill Ackman can educate you why it's a stupid bet, but the maximum upside is double, and your maximum downside is bankruptcy. Charlie Munger has a saying, he says that “I don't want to go back in the game Monopoly”. He says, “I don't want to go back to go. I've been at go

at one time in my life. I know what that feels like, and I don't want to go back there again". If you're doing a straight short, then there is no limit to how high stock prices can go. Eventually you may be right. In fact, both Buffett and Munger say that they've many times identified great short candidates.

Of course, they've never pulled a trigger, but they said that they were almost always wrong at the timing if they had gone ahead and done it. Because you may eventually be right, but in the meanwhile, you may have to withdraw the bet and not get to play your hand out, or you can flat-out be wrong. I mean, the thing is that the average business and the average CEO and employees and all of those who go to work, they go to work to add value, they don't go to work to help the short seller and subtract value every day. You have many forces working against you. Sometimes, you can get irrational pricing, and exuberant pricing. You might say that Twitter has a ridiculous price. Many of these dot coms that have gone public have ridiculous prices.

But they can get much more ridiculous before they get to valuations that you and I might consider sane. When they go home from ridiculous to more ridiculous and you are short, that is a very painful experience. The other thing is that once you short a stock, you have an umbilical cord link to a code machine that cannot be broken while markets are open. You constantly must look at what a stock is doing. I am usually drooling on my pillow till almost half the trading day is done in the morning. Shorting just wouldn't work very well for me because by the time I rise my slumber, all hell would've broken loose. It just doesn't work for me. Why short when it's so easy to make money on the long side, especially by being a shameless cloner?

Question: What advice would you give to students passionate about value investing?

Mohnish: Okay, yeah, that's a good question. The first thing I would do is to start creating what can be an auditable track record. What you need to start doing if you're not already doing this, is set up a separate brokerage account, hopefully, one from where you're not writing checks for your groceries and such. It doesn't matter what amount you put in. You could have 5,000 or $10,000 in that account, for example. You trade on that account the way you would trade a million-dollar or a hundred-million-dollar portfolio, for example. It'll give you a couple of data points. One is don't do this on paper. It needs to be real money with a real broker. The first thing is you will get data on how good an investor you are.

After a few years, after three years, or five years or seven years, you will know whether you are meaningfully better than most investors or not, because the data will start pointing you in a particular direction. Also, you learn a lot, which is great, and that can go on while you have another day job and such. You can start building that today while you're a student and such. The second thing that you can do is to the extent that it doesn't have a conflict with your employer, and you've got some years that you spent investing your own money and done

well with it, then what you can do is you can go to friends, family, and fools, and especially the fools. They're the most important. Try to convince them to give you some money to manage and start building a record now with more than just your own money.

You can do both things when you have a day job, if your day job is not managing money, or if your employer doesn't object to these types of activities. Over time, if you do well. Like I said, even small outperformance versus the market is rare on a long-term basis. If you are outperforming the market by 3% or 5%, or any numbers like that you know, Buffett says that you can be in the middle of the Atlantic and potential investors will swim to you in shark-infested waters in the middle of the Atlantic to invest with you if you are doing well as an investor. If you do well, then your existing investors are likely to give you more money to manage, and they're likely to introduce you to other people and such that they know. The assets and the management will probably grow.

Question: How do you think about your investment time horizon?

Mohnish: That's a good question. Usually, I am expecting the convergence to intrinsic value to happen over two or three years. I feel that you should be patient and give it at least that much time. It can get to convergence a lot faster. It can get there in a year, which is great. But two or three years is fine. We've held positions. I mean, Pabrai Investment Funds has about a 15 year, almost 14-and-a-half-year history now. I think there's been a few times when we held positions for five or six or seven years, but not that often. It happens occasionally. I mean, our position in horse head is about five years old now for example.

Question: How do you go about your sell decision?

Mohnish: When it gets to 90% of intrinsic value, or if it's below 90, maybe might be 80 or 70% or something, and something else is much cheaper maybe a 40 cent or 50 cent dollars, and we don't have cash, we might make that swap. I also want to, as much as possible for our US funds to have long term gains. In general, not a big fan of selling for less than a year and such, unless it's getting well above intrinsic value and all of that.

Question: How do you think about diversification across industries in your portfolio?

Mohnish: Right. I think that if we have things that are in maybe four or five different buckets that's a decent number. If we had, let's say, a couple of positions which were in the same industry we don't have a problem with that. I'm not looking to have 15 different industries that we invested in at all times. If we find that, that's fine, but it can be four or five different industries.

Question: What books have you read recently that you would recommend?

Mohnish: Yeah, let me just think of a few recent ones. There's a book that just came out recently. It’s called The Frackers and I think it's a New York Times Colonist Greg

Zuckerberg, I think is the author. It's basically tracking the whole fracking and horizontal drilling industries. Those have some very significant transformational impacts for decades for the United States and probably for other countries in the world as well. I think it's just a good book to understand. It's playing out in front of us in the sense that just as recently as five or six years back, almost everyone was very concerned about becoming any energy independent and huge dependencies on Middle Eastern Oil and all of that. I think the United States is well on its way to basically fairly quickly becoming a net exporter of energy.

That's an important development. There's another book which is in a completely unrelated wane, which I liked a lot. It's called Give and Take, and I think the name of the author is Adam Grant. I think that's what his name is. That's an interesting book. He divides the world into three types of people. People who are givers, who are takers and who are matchers. Matchers are people like, if I do something for you or if you do something for me, I'll do something somewhat like you. He just shows the kind of amazing returns the givers get, people who are doing all sorts of things for all kinds of people without trying to keep score. I think that's another great book. These are some books I enjoyed recently, and there might be some others, I'll think about some others that you might find interesting.

Question: How often do you read a new book?

Mohnish: Actually, I don't read, people think I read a lot. I don't read that much. Sometimes when I find a book that's interesting, then I like to pound through it. I would guess that I'm probably reading, I don't know, 50, 60 books a year. My guess is that book a week type thing is my guess. One of the things I do is I don't hesitate to abandon books. Most books could be summarized into five pages. I'm deeply disappointed that these authors don't do that. Many times, you're going through the book and you're trying to find nuggets and if I'm 40 pages into it and I can't try to figure out where the nugget is I might give up, and because there's an opportunity cost. Then, I have good close friends who will never, ever abandon a book till it's finished, no matter how useless it is. You have people in full range of kind of spectrum on that front. But my take is that, if it's not somehow grabbing me or delivering value in the first 40, 50 pages, then it continues to do that, then it's probably going to lose me.

Question: You have bought baskets of commodity-based companies and Japanese stocks previously. Do you often buy baskets of stocks around larger themes?

Mohnish: Yeah, I basically just clone that from Warren and Charlie. It's a subset of what they do, so I think they would be a better reference for you. But I subscribe to three newspapers, daily newspapers New York Times, Wall Street Journal and Financial Times. I read those three newspapers every day. Then I subscribe to a bunch of magazines, and they are like, Forbes, Fortune Business Week, and The Economist, for example. These are like four magazines that are showing up.

Then we have subscriptions like the Manual of Ideas, and I have a subscription to Outstanding Investor Digest, but I haven't seen an issue and I don't know how many years. I think it's been a couple of years since I saw an issue, but I would love to read that when that shows up. Then beyond that, there are the books that I'm reading and then the investment research that is coming up and such. I think that much of the reading is in that sphere.

Yeah. Our Japanese investment idea, first of all, there was one of my non cloned ideas. It was an original thought, God forbid, which came from my brain. And it did not work. It reinforced me not to come up with my own ideas because they all suck royally. The Japanese basket, I think we ended up with like a two and a half percent return, and it took a lot of work to buy all those different names and then sell all those different names. The good news was, we didn't lose money, we didn't make money. As long as we don't lose money, I think I'm fairly happy. We were in and out with slightly above money market returns.

That was okay. Yeah, I think my preference is not to do these baskets and things of that is to hone in on a particular business and understand the dynamics of the business and different competitors in the industry and pick the one that I think has the best prospects in terms of returns and such. I think the baskets have been kind of few and far between in our history. They are mostly anomalies, and want to focus much more on, I think sometimes we get to the point where we get some aha moments, like in 2008 with commodities, the aha moment was that cost curves matter, and there were a whole bunch of first quartile cost curve companies available at throwaway prices.

I said, Okay, we can just go into all of them and that worked. The second aha moment was in Japan was the net-net capital of the world. It was all these cheap below cash companies. That aha moment didn't work because the only way I could invest in business is because I couldn't understand them. Most of the filing were in Japanese and so on was to just do a basket the way Ben Graham did a basket. That didn't work. One of the reasons it didn't work is, what Graham says is that “the ideal time to buy these net-nets is not when the markets are cheap or when markets are expensive”. He said that markets are cheap.

If you buy net-nets, the good businesses will end up doing a lot better versus these cheap net-nets. When I bought the net-net basket in Japan, the Japanese market was the Japanese market, rather the multi-decade low. The market did rally, but our stocks didn't move that much. If I had held a basket of Japanese blue chips instead of the net nets, which would've been more expensive I would've had fantastic returns. Of course, I probably would never have paid up for those and bought that sort of basket. That wouldn't have happened.

Question: How do you think your experiences before starting Pabrai Investment Funds have helped you as an investor?

Mohnish: Yeah, that's a good question. Before I was in the IT industry, when I was growing up my father was an entrepreneur, and he was kind of an entrepreneur on steroids in the sense that he must have started bankrupted, sold and grown at least 15 different businesses and 15 different industries over his career. The common theme in all his businesses was that they all started with much zero capital. He was personally bankrupt many times in his life. Many times, I saw him reach out with nothing in completely new industries. Of course, from the age of like 13 or so, my brother and I were like his defector board director, he didn't have anyone else to talk to. But when these businesses were in serious trouble, he used to sit down with us with the numbers and we had to try to figure out how to get past the next day, how to give the business life for one more day.

Then we'd get past the one day and again, sit down in the evening to try to figure out how do we get past one more day? After I was about 16 or 17 years old, many times when he travelled, my brother and I used to run the operation and such. I didn't realize it at a time, but later when I started working, I realized that I had finished many MBAs before I was 18. It was just by accident. That's the way it happened. Today, when I'm running the funds and doing what I do, I think the experience I had during my teenage years was probably the most important in terms of giving me the skills that I use in the business today. In fact, the human brain is ideally set up to specialize during our teenage years.

It is optimized to go into a particular field from the age of like 13 or 14 till about 18 or 19. Of course, what happens in the way education systems in the US and almost anywhere else in the world are set up is in that age band, we are forced to become generalists. The education system does not encourage specialization during that period. When you look at some humans like Bill Gates or Warren Buffett, Warren Buffett bought his first stock when he was 11, and he had run several different businesses as a teenager significant size business. By the time he was 18 or 19, he had made all these stock investments, run all these businesses and probably spend more than 10 or 15,000 hours on them.

The same for Bill Gates. He used to sneak out of his parent's home at night when he was in high school, and he would go to the one computer in the high school that he was in Lakeside, and he would work on it till about five in the morning, and then he would sneak back into bed and go back to school the next day. He did that through his teen years. Of course, by the time Gates was 19 or 20, he probably had 15,000 hours of programming experience, which hardly anyone who was even 10 years older than him had at that time. The thing is that it was not only the number of hours of experience that the Gates and Buffett and Leonard DaVinci or Michael Angelo and all these guys had at that time, but it's also that intense activity that took place during that window of time when the brain is specializing.

If you've tried to do the same thing in your twenties or thirties, the brain is past the time that it is optimized to specialize in. One of the interesting things I feel

is that when you look at a country like Germany, it's interesting that Germany does well, even in manufacturing when it has one of the highest labour costs on the planet. The reason is that the German school system starts segregating kids into different tracks when they're like 11 or 12 years old. If you are going to go into a track, which is going to be manufacturing, vocational and that sort of thing, then, besides going to school, you'll start working in a factory at the age of 13 or 14.

If you're going to become a mathematician or something, then you're going to be in a different kind of magnet school and that sort of structure. They start segregating the kids. German manufacturing, I think is exceptional because those people who are running those manufacturing shops and managing those started when they were 12 or 13 on the shop floor. The country is probably one of the best in the world at high tech manufacturing, high precision manufacturing, high value add manufacturing and all of that. Quite frankly, they've been unaffected by low-cost competition from China and such to the extent that we can learn, I think the one thing we can learn in terms of the, hopefully in the US system, is to maybe try to see if middle schools and high schools can be changed so that in those periods of time we start identifying kids who are clearly showing directions in where they are likely to be headed. Not everyone will show that, but I think the ones that show that I think that the education system needs to be set up to allow that. I got there by accident because of my dad. I think Gates and Buffett also got there by accident because they just had this interest and pursued it. I think that they probably had no understanding that their brains were optimized to do what they were doing at that age. That's a huge advantage.

Arvind: Mohnish, thank you for being so generous with your time. Any concluding thoughts you would like to share with us?

Mohnish: I thought, Arvind, we decided we'd go all night, but you'd disappoint me so much. Maybe we can do that next year. Okay. Maybe people can bring their sleeping bags and such. But no, it's been a pleasure. I think like I said, you guys are very lucky to have a person like Arvind leading all of you. I think he's exceptional and loves what he's doing. I just think that this whole area of investing and value investing is so much fun because it's one of the broadest disciplines. When you understand businesses and especially particular businesses and what drives them, you are pulling from multiple disciplines. You're pulling from behavioral economics and you're pulling from human psychology and finance and so many different areas, macro and so on, that's what makes it so much fun. But this was fun and a pleasure and look forward to next year again. Thank you.

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