

Mohnish Pabrai's Conversation at Schroders - The Value Perspective podcast on October 10, 2023

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Interviewer: Hi everyone, and welcome back to TVP. This week we have value investing heavyweight Mohnish Pabrai joining us. Mohnish is the founder and CIO of Pabrai Investment Funds, the founder of the Dakshana Foundation, a close friend of Warren Buffett, and a frequent bridge opponent of Charlie Munger. He joins Juan and Andy Evans on this episode to discuss how Mohnish's styles, and entrepreneurial experience shaped his understanding of risk, his commitment to leave as a pauper by giving everything away to charity through Dakshana and following the great example of Chuck Feeney, the rationale behind cloning as a strategy, while he never went for the insurance model and concentration in ergodicity. Finally, you will note some variety in the audio quality, in this episode. The joy of having guests join us from across the world also means that we are at the mercy of some fickle tech, but we hope that it does not disrupt your experience too much. Thanks for bearing with us and enjoy.

Interviewer: Mohnish Pabrai, welcome to The Value Perspective podcast. It is a pleasure to have you here. How are you?

Mohnish: It is wonderful to be here and thank you for having me. It is excellent.

Interviewer: Where do we find you today?

Mohnish: I am at my home office in Austin, Texas.

Interviewer: That is very nice, Mohnish.

Mohnish: What about you guys? Where are you at?

Interviewer: Well, we are at the very amazing Schroders recording studio now, enjoying this conversation with you. If you are a value investor, it would be very difficult for that person not to hear about you. But for those who might not know you, could you please provide them with a summary and introduction about yourself?

Mohnish: Sure. I always tell people who are introducing me that the thing that they should not skip in the introduction is that something I am very proud of is I got a lifetime ban at a casino in Vegas that told me I could never play blackjack at their casino. I told them, "I'm not counting cards because normally you ban people who are counting cards." They said, "Yes, it took us about six months to figure it out, and yes, we agree you are not counting cards, but we cannot win against your system." I asked them if they would give me a letter, a graduation certificate, and they said, "No, you are just banned." Anyway, I have been a

student of Buffett, Munger, and Graham now for almost 30 years. I heard about Warren Buffett for the first time in 1994, and it opened a big new world for me. I had never bought a stock before that never really worked in the industry, and I was intrigued and fascinated as I read the first few biographies that had come out on Buffett, then the Berkshire letters, and then the Buffett partnership letters. I just kept reading and learning and started to follow that approach in 94.

About five years later, I had some friends who asked me to manage money formally for them. The small amount, eight guys, a total of a million dollars. That is what led to the formation of Pabrai Investment Funds. I did not plan at that time for it to become a full-time vocation. I thought it would be just something on the side for me and my friends. I manage about 900 million now. It is mostly high net-worth families. The funds have been around for about 24 years. Over the years surprisingly, Warren and Charlie both became friends, which was not expected. We always think of them as icons never to be touched, met or interacted with, so that was interesting. I used to play quite a bit of bridge with Charlie on Fridays at the LA Country Club, which he does not do now because he is not so mobile. That is kind of a quick backdrop.

Interviewer: Before we get into the world of probabilities and kind of ask you about investing, we came across your Dakshana Foundation, if I have pronounced that correctly. Can you tell us a little bit about that before we go into the rest of the interview?

Mohnish: Yes, sure. Just yesterday there was news in the New York Times that Chuck Feeney had passed away. I do not know if you guys are familiar with Chuck Feeney, but there is a book called *"The Billionaire Who Wasn't"* and it is a great book to read. Chuck Feeney, over his lifetime, gave away about eight billion dollars or more to charity. He tried to do it anonymously. He went to great lengths to make sure that the recipients did not know who the person giving the money was. His objective was to die with zero. He was 92 when he passed away. A few years back, maybe three or four years back, he moved into a simple rental apartment in San Francisco. He was down to his last two million. He pretty much accomplished what he sought to do, which was to die with zero.

That is what I am trying to do; live up to the Chuck Feeney standard and die with zero. I am going to be leaving planet Earth on June 11th, 2054, about 30 years and a few months from now. One day before that, which is June 10th, 2054, I hope to be down to a hundred dollars. There is one engine, which is compounding assets and increasing wealth, and there is another engine Dakshana Foundation which is focused on giving it away.

I started the Dakshana Foundation about 17 years ago because I knew that trying to start this when I was 70 or 80 years old, I would not have much energy to do anything. We started small about 17 years ago, and the idea was to become good at giving money away. Giving money away effectively is far more difficult than making money. Dakshana Foundation has done far better than I expected. It has been very effective at giving. We identify very poor, but brilliant kids in India who come from families, which are typically making well under a hundred dollars a month; three to four dollars a day or less. Some of them make two dollars a day. What we do is we take over their education for about two years from 16 to 18, and we get them to the IITs which are like the

MIT of India or AIMS; like the Harvard Medical School of India. It does a full reset for the family and the community because their income levels go to world standards at that point. Currently, Dakshana Foundation is spending about three million dollars a year. The objective is that we just started a program of about 13 million CapEx in the next three years to increase our capacity. The idea would be that hopefully if the compounding engine works in the next three decades, then the giving engine needs to work even better because as we compound money, then I need to amp it up like Mr. Feeney. That is what Dakshana Foundation is all about. I like to play games; I like to play blackjack. Dakshana Foundation is a game. Pabrai Investment Funds is a game. Bridge is a game. I just like to play games.

Interviewer: That is nice. You have mentioned in the past that, correct me if I am wrong, when you were growing up, your dad was an entrepreneur and you would see him many times start new businesses, and those businesses not doing very well, and then he would start all over again. We thought that it would be nice to start our conversation about how that experience shaped risk for you.

Mohnish: That is a great question. My dad was exceptional at identifying offering gaps in the market. He was good at looking at what was going on around him and saying, "This product or this service does not exist, and I know that if I create this product or service, it is likely to do well." His hit rate on those was extremely high. In India, there was no ecosystem of venture capital or anything, or even bank financing for that matter. When he had a startup, he repeatedly started with zero, and he was almost always right about the opportunity. He was very good at identifying those gaps that existed. The issue he had was that he was an eternal optimist, and he was in a hurry. Once the business got going, he would want to grow it as fast as possible. These businesses typically had a very thin layer of equity and capital and as much leverage and debt as the banks would give them. He would constantly be maxing on the leverage to grow as quickly as possible, and the moment the first headwinds would show up, and there would always be headwinds, we always have headwinds in business, he would go back to square zero. These businesses just were not built to withstand, even the lightest winds because they were always levered to the hilt and they would invariably crumble and fail because the ecosystem also was not there, that you could get other financing or someone to give you equity or something like that. He would go back to square one and amazingly he would in a few months concoct a new idea and get going again. I saw him do this repeatedly. He was a very logical engineer, a kind of rational thinker.

I remember that one time when I was about 10 years old, there used to be an astrologer who used to come to our home on Sunday, wearing orange robes with all these marks on his forehead. My father would sit with him and ask him about the future. The astrologer would give my father various data points of what was going to happen. Then next Sunday, the astrologer will be back. I mustered up the courage to go up to my dad and said, "You got to know that this guy is full of shit. He does not know anything. We do not have money. Everything is gone. You give him money every week, and then he shows up the following week. Why would you want to do this?" He said, "When I give him money and ask him about the future, he gives me a very rosy forecast for what is about to happen next in my life. I suspend reality when he is talking to me like that. He is the rope. I am at the bottom of a very deep well, and I need a rope to come out of that well. He is my rope because he tells me stories about

new businesses that I am going to create, that they are going to prosper, and that things are going to be great. That is my rope to come out of that well, not be depressed, and start the next business." That was the experience.

The impact it had on me was that I was lucky that my dad was doing well when it came time for my brother and me to go to college. He wanted us to come to the US for college, and thankfully he could afford it at that time. We came to the US and I studied engineering. I planned to never, ever be an entrepreneur and never start any business because I had seen these huge durations up and down, and I just did not want that. I thought, "If I get a good engineering degree, I am going to get a good job, and I am always going to be able to have a job, and life is going to be stable. Fifteen percent is going to go into my retirement account, into index funds, and that is going to grow." My dad visited me about three years after I started working. He told me that he was disappointed and that he had all these aspirations of what I might do, and here I was, a cog in the wheel of a large company. I told him, "Do you remember my childhood? Do you remember the trauma?" He said, "That was all excitement in life. We cannot have a boring life." He was able to prevail over me, and I moved. I left my job, started my first business, and then went from there.

Interviewer: That was a great story. We have read the book *"Richer, Wiser, Happier"* by William Green, and you profiled in there. The main thing around your profile is about cloning and how you have made your career out of being a great cloner. Can you tell us a little bit about what you were doing when you were cloning and who the people of your cloning or the subjects of your cloning were?

Mohnish: Yes. Charlie Munger talks about these mental models, and cloning is a very powerful mental model. One of the weird, unusual things about humans, and I still do not know why this is the case with humans, is that most humans have a strong aversion to cloning. I am not sure where that comes from in evolution, but they think it is beneath them. They almost think it is like copying. Moreover, a lot of humans will believe that, for example, Starbucks is such a great idea, but it has already been done or, SoulCycle is a great idea, but it has been done. There is room for many Starbucks and there is room for many versions of the same business. That is the other thing that humans have a false mental model where they see that someone has done something innovative, and they think that it has been done and there is no opportunity there. We run into some humans, for example, if you look at a company like Microsoft, they spent so many billions of dollars a year on R&D, they have got Microsoft Research, which in several decades, more than four decades has produced nothing. They just keep having these very smart Ph.D.s funded. Nothing comes out of that lab. But what has worked for Microsoft is they saw WordPerfect and they cloned it and created Word. They saw Lotus 1, 2, and 3 and created Excel. They saw Netscape and, created Microsoft Explorer and now Edge. They created Bing. You know what Bing stands for, but it is not Google. All the successes Microsoft has had, have come from being an intense cloner. Apple invented the mouse Apple copied the mouse from Xerox PARC Labs. Microsoft wanted to make the mouse work in the MS-DOS and Windows world, which was a big challenge because of a very different architecture, and they were just dogged about it. Finally, the engineers were able to do it; they created Windows. Microsoft is not even a great clone. Windows took 15, or 20 versions before humans could use it, and they still complain. It is not as good as that. Even not being that great a cloner gives you a huge advantage.

Sam Walton with Walmart, for the first 15 years or 20 years of Walmart's existence, there was absolutely nothing new that Walmart came up with. It was a completely cloned model taken from Kmart and Sears. Sam Walton spent an incredible amount of time in his competitive stores. Whenever he was traveling anywhere to see any Walmart new locations, he was always going into the retail stores of even small, mom-and-pop competitors. He did not care if they were big or small or successful or not successful. Even from a failing retailer, he would find something that they were doing that he could copy from them. Walmart built on that. Even a company like Starbucks, Howard Schultz looks at the cafes in Italy and says, "This can play in Peoria, Illinois." He clones it, and it does play. Then he went upscale with Starbucks Reserve and all of that. What I have found over the decades is that number one, most humans for whatever reason, think cloning is beneath them, and number two, that if you do not follow that bar, it is going to give you a huge leg up in life.

Dakshana Foundation is a cloned model. I found a guy who was doing something smart. I wanted to fund him but he did not want to scale. Then I asked him, "Do you mind if I copy your model?" He said, "No, not at all. I would help you."

Pabrai Investment Funds was cloned from the Buffett partnerships. The Buffett partnerships had these unusual rules from 1956 to 1970. He had the greatest record. When I was starting Pabrai Investment Funds in 1999, it was three decades after Buffett had shut down. In three decades after he shut down what is arguably the most successful hedge fund ever, no one had cloned his model; no one had cloned his fee structure. Nobody wanted to do it that way. I was surprised. I told myself, "Do not be surprised, Mohnish. This is the way humans are. They want to leave all these opportunities for you because they do not want to clone." I have so many investors who will not invest in a fund, which charges a one or two percent management fee. We charge no management fee, and I did not come up with that. I have copied that from Warren. You latch onto a demographic that wants that; they want the aligned interest of the investment manager, and it works. I have found in the investments that I have done well; many of those have been cloned. Business models have been cloned; the charity has been cloned. I have no original ideas. I am just a shameless cloner.

Interviewer: I got a follow-up to that. In terms of cloning, can you ever get to the point where there are too many cloners? Let us take Berkshire Hathaway for example. Back in 1979, there were 20 people, or 20 potential cloners who sat there listening to Charlie and Warren. Then in 2015, there were 44,000 potential cloners. Does it ever get too competitive, or, is it quite a difficult thing to do? Not everyone can be as successful as you have been with cloning for whatever reason.

Mohnish: Now the Berkshire annual meetings are online. Millions of people listen to those. All the past meetings are online on buffett.cnbc.com. It has been in the public domain for a long time. How many companies do we have that have cloned the Berkshire mark? Almost zero, because the thing is that cloning does not work unless you are fanatical about it. Sam Walton was a fanatic. Bill Gates is a fanatic. It is the fanatics who can make this happen, not the people who say, "I think this is going to work. Let me give this a go." If you have that type of approach you got to go all in. Again, for whatever reason, very few humans are

willing to go all in. It is the intensity of the pursuit. I am not concerned that cloning is going to stop working because the cat is out of the bag, or because I am doing this podcast. It is going to be alive because many humans have an aversion to it. The ones who do not have aversion are not fanatical about it. The other piece is that there are so many areas available for cloning. Even if one area becomes somewhat competitive, you have so many other greenfield areas you can go into.

Interviewer: Mohnish, correct us if we are wrong. When you started your career with the very big influence of Warren and Charlie, and this even comes across in your first book, *"The Dhandho Investor,"* you were leaning more toward the Benjamin Graham side of value investing. However, as your career progressed, you seem to have leaned more toward the way that Charlie and Warren think about the world. Has your perception of risk changed because you have become more experienced or because it has been influenced by the way that they look at the world?

Mohnish: Ben Graham's framework is like bedrock. All of us need that bedrock. The ideas that the stock is not a piece of paper, ownership's stake in a business, and the concept of margin of safety, those ideas permeate across, whether you are doing pure Graham investing or going with the Buffett or Munger approach of the great businesses, they all use this underlying bedrock. The reality of the situation is that we will make a lot more money by having ownership stakes in businesses that grow dramatically in value over time. If I bought a business for 40 cents on the dollar and that dollar never grew, or it grew at a low rate, I might make two or three times more, but if I even paid 60 or 70 cents on the dollar for a business that was growing, 10, 15, or 20% a year, and I did not pay that much of a premium for that, clearly that is going to be a vastly superior approach, not to mention far more tax efficient, because you are not each time paying Uncle Sam when you sell and want to look for buying again.

The other piece is that there are only so many great ideas one is going to find over a lifetime. The idea that Ben Graham had is that you sell a business when it gets at or near its perceived intrinsic value is at odds with the theories of Phil Fisher, for example, whose perspective was that a great business may surprise you about its real intrinsic value. Intrinsic value is a very difficult thing to figure out for most businesses. The odds that you may be wrong about an assessment of intrinsic value can be extremely expensive. The model of giving a great business a lot of rope, which is holding it beyond the point at which you think it has passed, its intrinsic value would be blasphemy in the world of Ben Graham. However, that approach is extremely important for true wealth creation over long periods. Ben Graham himself made most of his money from owning one business for many decades, which was GEICO. The GEICO ownership violated the core principles that he was espousing and teaching. He just felt like he could not teach the approach to finding or holding a GEICO as easily as he could teach a quantitative approach to investing. Even in Graham's case, half his net worth when he passed away was GEICO, and it had trounced the S&P by seven, 8% a year over the long holding period. A Swiss Army Knife approach to investing is probably best. There are times that we are going to find anomalies where some grow that much but are cheap and are very stable and could give us a great return for some time when we do not have a great business that is obvious to buy. If we are in the fortunate situation of finding a great business with a great runway, then we want to hold onto those for dear

life. This is a big mistake I made for many years where I was buying well below intrinsic value and selling right at intrinsic value.

Interviewer: Mohnish, you brought up GEICO there. That takes us to the subject of insurance. One element of the Berkshire model is insurance and having some insurance to have a flow to invest. At one point in time, you did have an insurance company, but you chose not to take that on in terms of copying the Berkshire model. Can you talk a little bit more about owning an insurance company and why you did not decide to take that on?

Mohnish: That is a good question. Warren has repeatedly said that insurance is a commodity business. It is very difficult. There are some pockets within the large insurance industry where one can have a sustainable competitor advantage, but by and large, the bulk of the industry operates in a commodity-like manner. If I am a small business and I am looking for workers' compensation insurance, for example, I am going to take the low bid. I may take the low bid amongst A-rated or B-plus-rated carriers, but once a carrier or insurance company is A-rated the lowest price wins. Most insurance companies do not have pricing power. Warren has also said that the average insurance company is a terrible business. What I realized almost right after I acquired Stone Trust Insurance was that at the first board meeting, it became clear to me that this was not the place I wanted to be. It was a very commodity business. They were a price taker, and their dumbest competitor was selling price. I felt that rather than go deeper and deeper, getting more and more pregnant with this situation, I wanted to put the toothpaste back in the tube, so to speak, which is not always easy to do. Toothpaste is only designed to come out of the tube, not go back in. I decided I was going to reverse a course, and we decided to sell the insurance company. We were able to sell it for just about what we bought it for, which I thought was a very good outcome. We were able to return most of the capital that we had raised back to the investors. The person who bought the insurance company from me is extremely happy with Stone Trust. The difference is that he is a vastly superior operator than I am. I remember that when we sold the company to him many years ago, the premiums we were collecting every year were about 65 million dollars a year. We sold the business maybe six or seven years ago. The premiums last year were 50 million dollars. It is down 30%, but the combined ratio of that business is 62% unheard of in the insurance business. Francis Chu, who bought the business from me, is an unbelievably great operator. He has got decades of experience. I would never have been able to do what he did. It was a win-win for everyone. It gave Francis a platform to build the insurance side. The interesting thing I learned, and this goes back to the concept of great businesses and then the mistakes in investing, is that investing is a very forgiving business. Even the best investor is probably not going to be right more than half the time. You are going to have a 50% error rate. I realized that when we had bought the insurance company, that was a mistake. I thought, "Can we reverse because it is going to consume a lot of brain cells in an activity that I do not want to particularly be focusing on." That is what ended up happening. I learned quite a bit. I am very grateful for the experience. Being able to see the insurance company from the inside, they were very good people. To be able to see the claims at an individual claim level and, kind of seeing how the sausage is made, if you will, has been a great experience for me. It taught me a lot and I am sure it can help in the future. Even in the case of Berkshire Hathaway, Charlie Munger said a few years back that in the very distant future, insurance may be a small business at Berkshire. It would not

surprise me that when Ajit Jain is no longer running things they may elect to run off that business because I have not heard of them having a second Ajit. A lot of that business only works because there is an Ajit, just like Stone Trust only works. After all, there is Francis Chu. These unusual insurance operators are very rare. It is a difficult field.

Interviewer: Can I ask about that? If Francis was fantastic on the underwriting side, was there any chance for you to partner and you be on the investment side, and he would be on the insurance side in a similar way that they have a Berkshire?

Mohnish: Well, we are old too soon and wise too late. When Francis was buying the business from me, he begged me to keep a stake. He said, "Mohnish, I want you to keep 20%, 25%, whatever you want. Let us do this together." Because I had seen this business up close, I probably underestimated what Francis was all about. If he made that offer to me again, I would take it. At the time, he repeatedly kept asking me, because there were earnouts. We had our future payments based on how the business performed. Each time, he made an earn-out payment to us because the business performed extremely well. Again, he asked me, "Do you want to roll this into a stake?" and I kept saying "No." Francis is an exceptional underwriter and operator and a good investor, but he is an example of a guy who has always stayed with Graham. He is a classic Graham investor. In a situation where Francis is the operator on the insurance side and someone like me is on the investment side, we would do even better. It would do very well. That would be a good marriage. Part of the reason it would be a good marriage is because he is such a great guy. In terms of trust chemistry and competence, we would have a lot of fun with that. We are both young. It might happen at some point.

Interviewer: I would have thought that the reason why you at the time thought that it was not going to work out was more related to how regulation has changed over the decades. That might limit your capacity to do that great business in the way that they were able to do it with Berkshire. Is that a misunderstanding?

Mohnish: Well, Berkshire has some very subtle aspects of its insurance business that are not available to most other insurance companies. Insurance is regulated by the state in the US. The regulatory framework for insurers based in Nebraska is vastly superior to most other states. One of the things I had almost finished doing before France had bought the business was that I had redomiciled. We had started the effort to redomicile the business in Nebraska because I realized once I was in the business, and I looked at the different state laws, that it was an advantage to be domiciled in Nebraska, even if you were not writing a lot of business in Nebraska. There are reciprocal arrangements that the different states have which give Nebraska insurers some advantage. I do not know whether that advantage came about because Warren was able to work with the regulators to change some of the frameworks over the years. The first is that the state of Nebraska has a better regime for insurers who are good at the investing side. The second big advantage that Berkshire has, which people do not understand, is the insurance companies Berkshire has, are heavily overcapitalized. If a regulator says that if you are writing 100 dollars of premium, I want to see a 100 dollars of equity. In many cases in those businesses, Berkshire has 500 dollars of equity. When you have 500-dollar equity and you are writing a hundred dollars of premium, this is the same situation that now Francis finds himself in at Stone Trust because their

premium volumes have dropped so much, and their surplus has increased so much. The regulator is going to give you a lot of leeway. To give you an example, when Berkshire bought the Burlington Northern Railroad, normally just at the highest level, what regulators want in terms of an insurance framework is they want to float invested very conservatively into fixed income because that is going to be used to pay people in the future. They do not have a problem with the surplus being invested in equities, because that is kind of the backup for the insurance. In the case of Berkshire, the regulators in Nebraska have given them the freedom to even invest the float in equities. When Berkshire went to them and said, "Look, we are going to buy this railroad and this railroad. You need to think about it like a bond. If you think about the way the railroad operates and look at the long history of the railroad, it is producing 5 to 10 billion dollars a year in cash flow. It is a bond with a variable, and we are going to put this railroad inside the insurance company. When you think about the way the float is allocated and the surplus allocated, please think of the railroad portion being part of the float." The Nebraska regulators accepted that. What happened is that they paid about 40 billion dollars or so for the railroad. If they were to sell the railroad today, my guess is it would sell for something north of 120 or 130 billion dollars. Its value has more than tripled, excluding all the huge dividends it has paid out over the years. Now, the Nebraska regulators love the whole railroad sitting inside because they can see the value compared to the publicly traded railroads. Recently, interestingly, just in the last few weeks, Berkshire did a filing where they showed that they have moved the railroad out of the insurance company. I know that would have been a fun conversation with the regulator because the regulator said, "No, no, we like the insurer. We like the railroad," and Berkshire would have said, "Well, look, I got 700 dollars of equity or a 100 dollars of premium. I am still going to be 400 dollars of equity or 400 dollars of premium. It is still like four times what anyone else has. Do you have any concerns?" One of the things that Buffett did a long time ago in the eighties; they had a lot of trouble with some insurance operations. Some of these things were horrendous. One hundred and thirty percent combined ratios, or 140% combined ratio. They were upside down. These companies were eventually liquidated. They did terribly. They could never fix them. They liquidated them. What Berkshire did at the time when they liquidated these companies is that the parent company stood behind the claims, which they did not need to do; they had no obligation. These companies were in real trouble; horrendous combined ratios. They were going to be liquidated. Their business model did not work. Berkshire at the parent level did not have an obligation to pay off all claims. It was non-recourse. The claims are only to be paid to the extent that those companies had capital, but those companies ran out of capital. What Berkshire at the parent company did is they stood behind those claims and they paid every single one of them. The regulators believe that in the case of Berkshire, there is an implicit guarantee on these claims. It is not an explicit guarantee; it is an implicit guarantee. That is kind of like Freddie Mac and Fannie Mae, being implicit guarantees of the US government. The regulators will always look very favorably upon Berkshire Hathaway because of that history. Other insurance companies do not have that type of reputation with the regulators.

Interviewer: That is interesting. I am going to change topics a little bit here. You have been gifted with a mind that is very well suited for math and thinking in terms of probabilities and that probably has helped your career in the way that you have made decisions over time. For those who do not have that inclination or who

have been educated to think probabilities, what would be the best way for that person to learn to adopt probabilistic thinking?

Mohnish: Probabilistic thinking is very important for investing because everything is probability. Being a good bridge player is a great way to build that probability muscle so you can have fun. Bridge is a very fun game. It is a very easy game to learn. It probably will not take more than 30 minutes to learn the game, and one cannot master it even in a lifetime. It is a great game to continuously keep learning. Buffett and Munger have gained a lot from playing games like bridge. I came to play bridge separately from investing. I played bridge for many years before I became an investor. It was a coincidence for me that I was playing and love bridge, but that can help the probabilistic thinking. Even when one is studying businesses and studying histories of businesses and trying to extrapolate where they are going to go and what they are going to be, one is going to see a range of outcomes. That is just the nature of the way the world works. If one is just good at that type of thinking which games like bridge or blackjack can give you then you are that much ahead.

Interviewer: This probably ties in with one of our final questions, which is about the way that you run your portfolios. Mohnish, you famously run very concentrated funds. If we can go back to the topic that we started with, which was around risk, how do you arrive at that decision to run with those concentrated funds?

Mohnish: Well, if you study the subject, the amount of benefit you get in terms of diversification and reduction of risk starts to go down quickly as you add more positions. If you had a single stock portfolio, that is at the end of the risk curve. But once you are in about four or five positions in different industries, you are already quite diversified. Once you take that number up to ten, that is a significant, diversified portfolio. But when you take it from 10 to 20 or 30 or 50 now you are hurting yourself because the minimal benefits you would get from diversification would be more than offset by the lack of knowledge of those businesses. When we stay very narrow, we are going to be at the epicenter of our circle of competence. We understand those businesses well. As you start layering on more things and more companies there is going to be a variance in terms of how well you know the businesses. Not knowing the businesses well enough, even in a highly diversified portfolio, is risky. From my point of view, once we get past a few names, the risk profile does go down.

Interviewer: One thing that has come up on the podcast several times is the idea of ergodicity. The idea is that there is a difference between your time-weighted returns and just an ensemble average. That has implications for the chance of ruin over time. Something that is on an expected value basis looks like a good trade to make. If there is a chance of ruin, then that may not be as appealing as you think. If you run with a concentrated number of holdings in your portfolio, there is an increased risk that you have that chance brewing. How have you thought about managing that risk through your concentrated portfolios?

Mohnish: Any number multiplied by zero, no matter how big is zero. We do not want to go there. It is equity investing that a few of the decisions that you are going to make are going to generate outsize returns. For example, if I were to look at the Walton family owning stock in Walmart, Sam Walton during his lifetime, and Walmart was not very valuable. He distributed the stock to his kids and he passed away. There have been no Waltons running the business for several

decades. There might be one Walton on the board, but I am not even sure if that is true anymore. They have all held the stock and it probably makes up 90, 95% of their total assets. When you look at it from the outside, you will say, "Oh, this is terrible. It is so non-diversified." They probably know Walmart better than anything else. If we step away from the public market for a second and look at founders who create a lot of wealth with successful businesses, most of them are not diversified. In many cases, the companies may not even be public. They may have 90, 95%, or more of their net worth in a single stock, even when the company is public. They may have a significant portion in a single stock. Of course, they can be hurt, and we have plenty of cases where they can be hurt. But the other side of the coin is that great investment opportunities are rare, like when you find yourself in the happy position of owning a great business that is not overpriced. That is a big sin if you start trimming because it is more than 25% of the pie. I face this issue in real-time. We invested in a business in Turkey Reysas, which was around 3% of the liquidation value when we invested. The market cap was around 20 million dollars or so. The liquidation value was 600 to 800 million dollars. Of course, it was a no-brainer investment, and I was surprised we were able to get a lot of stock. We ended up getting about a third of the company for about 8 million dollars. Reysas now is valued at about 500-600 million dollars, and it used to be until a few weeks ago, close to 800 million. The value of business today is even higher because they have done a few things in the last few years. The liquidation value of that business is well beyond a billion. If I look at intrinsic value and not liquidation value, it goes well beyond that. It makes up a significant portion of some of our funds. Every quarter when I write to my investors, they will let them know we have got this issue, and I tell them, "Listen if you are uncomfortable, you should get off the bus because we are not going to lighten up." I cannot justify lightning up Reysas when it is undervalued when it has great management and a lot of great tailwinds, and that comes with risk. But we are not going to find a Reysas every two years. That is just not going to happen. Anything I replace it with, first, there will be a big tax bill, but then anything I replace it with is likely to be inferior. The other thing that has happened is in the last four years of owning it, we have gotten to know the business a lot better than we knew it before we invested. Even though I am not a founder or a person in the management of Reysas, I consider it like a business my family owns. If there is a business like Walmart that your family owns, it is probably not the best decision to start looking at, let me diversify and this and that. It is a double-edged sword. It does come with risks, but one of the things about investing is that if I look at my friend Nick Sleep in the UK, he was very early in investing in Amazon. Amazon became a big part of the portfolio for him, and the UK regulators were giving him some grief about that. He and his partner looked at each other and said, "We have hundreds of millions of dollars each, we never thought we would have this, even anything close to this. Why should we let other people tell us what to do? What if we returned everyone's money, and just managed our own money? Then whatever Amazon becomes is nobody's business; whatever percentage of the portfolio. Nick returns everyone's money. When he returned the money, he put everything in three stocks. He put a third into Berkshire, a third into Costco, and a third into Amazon. Of course, what happened is Amazon kept going like the Energizer bunny; it never stops. It again became a very large portion of the portfolio that he was running. It became more than 50 to 60% of the pie. At that point, he got a little antsy about that and sold off half the Amazon position. He bought a company called ASOS, also in the UK, which between us is not a good business. It will never be a good business. From my perspective, it is a mistake

for Nick to be investing in ASOS, and that is a greater risk than a business like Amazon going to zero. If I look at a business like Amazon, it is multiple businesses. It is not a single business. If you look at people like Jeff Bezos or Andrew Jassy, what percentage of their net worth is in Amazon? My perspective, if I were to be so bold as to critique that effort with Nick is he had a very well-diversified portfolio with those three stocks. Each one of those three companies is exceptional. Even if one of the three survived, he would not be in the poor house. He would still be fine. If I were him, I would just leave them all alone; let them all be. If Amazon becomes 80%, so be it. That is okay. That is a good thing.

Interviewer: That is interesting. Thank you very much. Mohnish, given the levels of concentration that you feel comfortable running as per what you just explained, would it not be better for you to run a vehicle with permanent capital rather than the current structure that you have?

Mohnish: What happens with all of us if we become very successful is the vehicles eventually become permanent. If I look at Nick Sleep again, it is a permanent vehicle because it is his own money now. The same thing happened in many ways to Warren Buffett with Berkshire Hathaway. He was such a large portion of the pie. I'm not particularly concerned about this; I do not get a lot of sleepless nights thinking about permanent versus non-permanent capital. At the back of my mind, I always feel that if everybody took all the capital away, I still have a decent amount of my capital, and if I never managed anyone else's money, I would still have a happy existence. It is possible at some point I could involuntarily be turned into a permanent capital vehicle. If that happened, no problem. If the investors choose not to have the confidence in having some of their hard-earned assets with you, it is a choice they have and they can continue with their choice, and that is perfectly okay. I do not see a big compelling need or reason to change things from the way I am doing things right now. I like the families that have invested with me. I like that most of our assets are first-generation entrepreneurs who are still building wealth. Few of them have retired and such. But it is a great mix. If that mix continues for a while, that is okay, and if it comes to an end, it will not be the end of the world. Either way is fine.

Interviewer: If I may ask a follow-up question on the Turkish example that you provided before, when you are investing outside of the US in places like a marine market, you are running a risk, which is not only the business risk itself, but you are also exposed to the currency. Turkey has been going through a rough time over the last two to three years. How do you think about that in the context of what you were explaining and this subject of ergodicity?

Mohnish: Reysas is a good example to study from a currency point of view. Before we invested, I fully expected that the Turkish Lira would get decimated. I expected absolute clobbering of the Lira, and it had no impact on the investment decision because I said, "If I have a warehouse in a prime location in Istanbul with a long-term inflation index lease with Amazon, Carrefour, or IKEA, that has a global value and that value will prevail. Cement has a global value, and steel has a global value. Prime real estate in a place like Istanbul has a global value. My take was that even in extreme scenarios of currency decimation, we should be okay. What happened is that when we invested in Reysas, it was five Liras to the dollar. Today it is more than 28 Liras to the dollar. That is an 80-plus percent

devaluation. In dollars we are up by 20 or 30 X and in Lira we are up by infinite X, but who cares about that? There are two other investments I made in Turkey. One was a Coke bottler and the other was an airport operator. In the case of the airport operator, it was very simple because all their revenues are contractually in Euros. Very little of TAB Airports' revenue is in local Lira. A lot of the expenses like staff salaries are in Liras. In that case, a decimating currency would give them tailwinds because their costs would go down while their revenues would stay intact, which is exactly what has happened. One of the things that markets do is stereotype, and they use broad brush strokes. Turkey was considered uninvestible; it was considered very investor unfriendly. Any place you go to where the currency has a problem, most investments are not going to work well. What I noticed is that the baby got thrown out of the bathwater. When I sifted through, I met with maybe 60 or 70 listed Turkish businesses over the last few years. Most of those companies are not invested. They would face real headwinds in this environment, but there were a few that the baby got thrown out irrationally. That is what we are looking for. We are looking for irrational behavior amongst market participants. I am not so concerned about the overweight risk of emerging markets or the overweighting risk of currencies. What one needs is to be a rational investor and accurately weigh those risks, not be paranoid about those situations. In the case of the Coke bottler, around 70% of their revenue is not even from Turkey. It comes from a dozen other countries. The same with TAB Airport. Even though their currency is Euros, a large portion of revenues are coming from outside Turkey. That was excellent because now it is a business listed in Istanbul facing all the negative perceptions of investors leading to ridiculous and irrational undervaluation. The second thing I noticed is that these three businesses, each one of them had off-the-charts management, off-the-charts owners, and just incredible capital allocation; better than what I would find in a lot of developed markets. The quality of the people was extremely high, the competence of the people was very high, and the integrity of the people was very high. A rational investor should weigh all of these factors in making a decision. I have a lot of comfort in the investment we made. The funny thing is that in the last four years, the clouds over Turkey have not lifted. There are still a lot of big clouds over Turkey. It did not stop Reysas from going up 20 times in dollars. It still got there somehow. I do not know how it got there, but somehow it got there. That is kind of how I see it.

Interviewer: Thanks very much, Mohnish. I can see from your background and for listeners who cannot see it, you have got a wonderful library behind you. The signature question that we ask all our guests is whether you have a book recommendation. I have high hopes for your book recommendation.

Mohnish The book I read this year that I enjoyed a lot is called *"What I Learned About Investing from Darwin."* It was written by Pulak Prasad, from Singapore. It is an exceptionally well-written book. He is an exceptional investor. I read it twice because I enjoyed it so much and I felt like maybe I missed a few things. Pulak has got a good sense of humor, so it is a page-turner; it will keep you occupied. I made some changes to the way I invest after reading the book. There were a lot of take-home values, so I recommend that.

Interviewer: What sort of changes did you make to your process after reading that book?

Mohnish One of the things that Pulak brought up is that in the investments he makes, one of his rules is that the companies cannot have any leverage. His perspective on leverage needs to be zero. It is an extreme view. His logic for that is that he feels that all companies are going to face tough times. Times are good, and times are bad. That is the nature of business. When times are bad and the business has no leverage, it can play offense. Whereas a highly levered company, when times get tough, which I saw with my dad, you are just trying to survive and you are trying to keep the wolves at bay. If you are looking at companies that you want to be around for a long time, to finish first, you must first finish, then reducing leverage or eliminating leverage is going to give you a lot of levers that you can pull. Now, I have not gone a hundred percent down the Pulak path, and of course, the portfolio takes time to change, but it is a very important consideration. Much more important than it was before, where in the past I would say, "Okay, the market cap is 5 billion and they have got 400 or 500 million debts. That is fine. Just move on." I would not ask myself the question, "Can this business be run without debt? Can they just eliminate dividends for a couple of years and why is that debt out? Why aren't they doing that? How do they think about it?" If you look at companies like Berkshire Hathaway and the great businesses around, they have built themselves around that. If you lever up a business, you are going to juice the returns, but you also take away the resilience. This is just one of the points he makes. He has many other points. Another interesting point, which I also adopted, is he does not project. He has no projections for the future of what the earnings or cash flows of any of his portfolio companies are going to be. That might sound like blasphemy; how can you run a portfolio without peering into the future? He answers that it is an exercise in futility because we are making assumptions. If each assumption is off by 20%, what you have in the end is garbage. You have four or five assumptions and each one is off by some small number, which is going to create a big error rate. Pulak's approach is to buy and hold forever. He views any sell decision as a mistake. If you go on his website, they have listed the entire portfolio. They run a hedge fund, but it is closed. They do not take new money, but they have listed the entire portfolio, including every exit. The whole thing is public. Their perspective is that "When we are going to go into business and invest in a business, the holding period is forever. If the holding period is forever, why are we messing around with DCFs and all that? It is irrelevant." It is a good food for thought. I hope you enjoy the book.

Interviewer: Interesting Mohnish Pabrai. Thank you very much for coming to The Value Perspective podcast.

Mohnish: It was my pleasure. Thank you very much.

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