# Mohnish Pabrai's Keynote Address at the Nasdaq Small-cap Forum on September 23, 2022

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Dylan: Well, welcome everybody. It's Dylan James. I'm Regional Vice President here at Nasdaq based on our office in San Francisco to extend a warm welcome to all of our small cap companies joining us today for the Small-cap Forum. We have what I think will be a fun and exciting conversation today with Mohnish Pabrai of Pabrai Investment Funds. I came to know Mohnish through a book by William Green called Richer Wiser Happier. He's also the author of The Dhandho Investor and also a preeminent voice in the world of value investing. I think that's an interesting perspective given our conversations today in the virtual forum in addition to the backdrop of what's happening in the markets. Mohnish, thanks for joining us. Welcome to Nasdaq.

Mohnish: Dylan. It's a pleasure and honor to join you and I'm looking forward to the session.

Dylan: In a market environment such as where we are right now and being a value investor, is it hard not to go shopping every single day when so many things are on sale?

Mohnish: Yeah, I'm basically a bottoms-up stock picker and I always just focus on individual names. But yeah, a lot of stuff on sale, number of things that were interesting now look like they're buy range type thing. I'm ploughing through a few things right now. It looks interesting. Yes.

Dylan: I mentioned that because right off the top, the audience of who's watching today is probably going, "Hey, have I got a story for you?" But if you could unpack for us a little on your history and how you became a value investor. We would love to hear from that because some of the audience may not have that perspective.

Mohnish: Yeah, I have actually never worked in the industry. Never worked in the investment business until I went on my own. But basically, I am an engineer by training, and I was running an IT system integration company actually in Chicago in the 1990s, and in mid-nineties I heard about Buffett for the first time. I happened to read a couple of Peter Lynch books, which were interesting. I never bought a stock till then or had much interest in the markets. But I liked the Peter Lynch books that led me to Buffett because he was talking about

Buffett in reverential terms, and I was very lucky. First couple of biographies and Buffett had just come out in the early nineties and as an outsider looking into the industry, I didn't know that there's a hedge fund industry, but I knew there was a large mutual fund industry. What struck me when I read about Buffett was that he had laid down what I would call the laws of investing like the laws of physics.

It's kind of works one way, gravity works one way, whether you believe it or not, it's still going to pull you down. What I found interesting is that the laws of investing as Buffett put them down and the behavior of the mutual fund industry was night and day. There is no correlation. For example, a typical mutual fund might have 70, 80, 100% annual turnover and Buffett was going to buy and hold and think of stock as a business and you own it as if you own the whole business as a family business type of thing, even if you own a few shares. Then the number of holdings and of course some of that is required by law, but they went well beyond that. Just a frequency of creating the number of holdings and then their results reflected not following the principle. Most mutual funds kind of lagged the indices and so on because of some of this behavior and frictional fees.

I had a notion that a know-nothing-guy like me, if he followed Buffett's principles would do better than the mutual fund crowd. Theories like that don't have much meaning without execution. In the mid-nineties I had just sold a small portion of my business, I had a million dollars that I didn't really need. First time I had cash. I started my business on credit cards and so on and I said Okay, “I'll take the million, I'm going to invest it in the public markets”. As it turned out at that time with almost all Nasdaq stocks. I knew new tech well then, and the Nasdaq back 27-28 years was even more tech heavy than now. I started to make investments, 10-stock portfolio typically I would make 10% bet and I always looked at a stock as a fraction ownership of a business.

I never looked at it as a piece of paper. That's one of Buffett’s principles and it did well. I think from 1995 to 2000 was like 75% a year compounded. That million had turned into 13-14 million in about five years. I felt independently wealthy now, which was great. I was getting more and more interested in analyzing businesses than I was in running my IT Company, which was becoming a drag. It had about 170 people. My job had turned into HR herding cat job, and it wasn't as much fun as when I was trying to grow the business. In 1999, I thought the best thing to do is to go work for Buffett. I wrote a letter to him, offered to work for him for free and such, he wrote back and said "thanks, but no thanks, I work alone”.

Then a few friends of mine who used to get stock tips from me, basically asked me to manage money from there instead of just this random stock tip business. I never thought of it as a business. I set up Pabrai Investment Funds with a million dollars. There were eight of us that put like a hundred thousand, some two hundred thousand. I thought of it really like a hobby as opposed to a real

fund. But then about a year later, fund had about two and a half million with 70% year in the first year, which was nice. I said I shouldn't treat this like a stepchild. I should really treat the fund like a real business. I had left my IT Company, I brought in a CEO to run it and then subsequently someone came and bought it. I said "okay, let's focus on Pabrai Investment Funds." The Fund was set up with the same rules as the Buffett partnership. So we didn't have any management fees and we only got paid when we made money with a 6% hurdle high watermarks. That Fund started to scale gradually and here we are, talking to you.

Dylan: Are there from those early days or could you remember any of those names that are in the small and microcap realm that were part of that early-stage portfolio?

Mohnish: Oh yeah. I had a number of software companies as such in the portfolio. Well, I've had 200 baggers in my history. One of them actually was a dotcom that eventually went bust but it was a spawner, creating other companies called CMGI and CMGI went up. Basically, when I bought the business it was trading below cash. It was like people didn't really like it, and I was looking my side stepped the entire bubble because I was in tech, I actually saw the bubble building in 1999 and so I had actually changed my approach quite heavily by the time the Fund started into a more very basic Ben Graham type-stocks. CMGI was basically spawning all these dotcoms. Some of them were going public and it was getting massive crazy valuation. I think I must have sold within 10, 15% of the top and moved on.

Then there were some businesses like PeopleSoft and Business Objects where the multiples were really high, these companies were growing fast but they had a big services component like when they sold the software they were all the services that came with it. One of the cues I used is, I said "Okay, let's assume the market is efficient and let's say if some software company is trading at 70 times or 80 times trading earnings, the market actually knows what it's doing and what that means is its future revenues and profits are going to be a lot higher than the past, and usually the services piece is a multiple because it's so much more". My IT Company was specializing in services. What I did is, I looked at the ones with the highest trailing PEs and I built practices in those businesses.

I still remember I loved PeopleSoft, but it was so expensive. Instead of buying the stock, I hired a PeopleSoft practice director, which is probably the highest return investment I ever had because basically I think it was a couple of hundred bucks spent on the ad, and before this guy came onboard, I was going to pay him about 300,000 a year. We had him build out at $400-$500 an hour and then he helped me hire a team of 20 people that went in after him. Like literally if I just look at the investment we made and the revenues and cash flow, they were just astronomical. Sometimes what I did is I did not buy the stock. I

just used the market data to go more in building the services. It was a mix of the two, which was fun.

Dylan: That's really interesting. Could we go back to your history with Warren, which did not end with that letter.

Mohnish: The funny thing is, I grew up in the suburbs of Mumbai and who would have thought that we are friends, but it's surreal. But yeah, I think I had done well, basically using Buffett's intellectual property. All his intellectual property is basically public domain. He just gives it away. Buffett says that when he passes away, what he would like on his gravestone is to say that he was a great teacher and so he's had this great wonderful approach to teaching us all and he runs this annual charity lunch auction on eBay. In fact, this year was the last one. I think in 2007 I must have made like 70 million or more off his intellectual property and I never paid a tuition bill. I think that the tuition bill is due, and I'd like to meet him and thank him. He was doing this charity lunch.

I said, “Okay, we'll bid on this lunch on eBay, and we win it”. Two or three years in a row I bid on that, and I kept losing. Then finally in 2007 I won the lunch and then I met him in 2008. Actually, I didn't expect it, but a nice friendship developed from there and it was wonderful. Then he introduced me to Charlie Munger who's become very close. I played a lot of Bridge with Charlie Munger on Friday afternoons with him and his friends and had dinner several times at his home and so on. It's been wonderful.

Dylan: Would you have anticipated the letter and then the lunch would end up being actually friends with them. You are learning a lot from Charlie Munger and in addition Li Lu and then how does that probably just adds to the further benefit of cloning and they using their thinking cap on how they view the world in addition to your own expertise?

Mohnish: Yeah, I had no expectations from the lunch. I just wanted to thank Warren, he's like a larger-than-life figure to all of us. The fact that we could even reach out and touch him was surprising to me and the fact that he turned around and then wanted to be friends was very surprising and yeah, it's been a wonderful journey. I have no complaints. My ex-wife, but my wife at the time when I was telling her I'm going to bid for this lunch and so on, she thought it was weird and strange, but she said whatever. Then after that she said, “other than marrying me, that’s probably the best thing you ever did”. It had a lot of side effects and I almost feel like it'll be buy one and get infinite free. This is kind of still paying dividends, it’s wonderful.

Dylan: You had the annual meeting for Pabrai Investment Funds fairly recently. Now are you zipping around on a golf cart? Is this a tent pole type of event? Does the cloning extend to that degree or what's it like?

Mohnish: No, I think it's a much more sedate affair. I just moved to Austin so we had our first and we couldn't have live meetings for a couple of years. We just had our

first live meeting, which was really nice to see the investors. I had a lot of investors in Texas that I hadn't actually met before. It was nice to meet them all as well. That was great.

Dylan: What prompted the move to Texas from Orange County?

Mohnish: We had some pretty bad fires, and the air quality was really bad. I didn't think that was going to stop. Almost all my income is long term capital gains, and the state of California really doesn't care what your income source is, everything is 13.3%. My state income tax bill would always be like a third of the total tax bill. It was a significant portion. I said I can do this from anywhere. The kids had left the nest. I looked at tax-free states and Austin looked actually very nice and in hindsight I think I would've liked to move here even if there were no benefits of taxes. It's a nice place.

Dylan: It's a great place. It's a magical area. A lot of people share that, but then once you're there and you experience, you're like, "wow, it's as cool as everybody says it is". From what you mentioned on the annual meeting and the return to in person, just tangential to that, when you are making investment decisions, is there a large component of that meeting and talking to the company and can you talk about that as part of your investment decision? Is that interaction a lot? Is it a little, do you meet a lot? Do you like to meet lots of people at companies before you make an investment decision?

Mohnish: Yeah. Buffett's teacher: Ben Graham, basically wanted to come up with methods for investing, which the common investor could pursue. He didn't act, he wasn't a proponent of meeting management team because he felt that Joe Public couldn't do that and such. The second is that there is a danger in interacting, especially with the CEOs because they're very accomplished people. But the one skill they have in common across the board is, they're amazing at sales. They wouldn't have gotten the job if they weren't great at sales. If you're talking to a great salesman about a subject that they know everything about but you're still trying to learn, the odds that you get swayed and get distorted are quite high. Buffett actually says that what is a better method than meeting management teams is to look at the long history of the business and look at the long history of the manager.

Go back and look at what were they saying 5 or 10 years ago and what transpired in the subsequent 5 or 10 years. Did they under promise and over deliver or did they overpromise and under deliver? I think the track record is far more important. In fact, one should pay almost no attention to projections and such that managements are making. I think the track record is far more important. For the longest time when I was investing on my own for my own account and even when I started for Pabrai Investment Funds, probably for the first 15 years or so, I didn't really care to interact with management or even with IR teams because there's a internet, scuttlebutt and there's such a large body

of information available that you can generally form good opinions. I then started investing outside the US and there I have to meet them.

The odds of losing money in the United States from outright fraud, while it's above zero, it approximates zero. You're a 100X more likely to lose money on an investment because you made some dumb decision than if someone defrauded. The cases where you have these fraudulent financials, whatever else are, they get a lot of press, but they're very few and far between. There's a lot of checks and balances in the system. Basically, if you can get all the data you need from studying the long histories and then extrapolating that and talking to competitors and talking to customers and so on, then that's a richer better way to go about it.

Dylan: From what you were mentioning on Buffett and the look back it brings to mind, the story that he tells quite frequently of how he got involved in investing in the Washington Post, which is very accessible to all of us. It was extremely depressive at the time because of the Pentagon Papers and yet President Nixon and Baby Rose putting pressure on the business. Appreciate that explanation and those thoughts there. Could we pivot to the current environment and some of your thoughts on the environment that we've been living in currently in the markets post Covid?

Mohnish: Oh yeah, sure. I think that investors always think that whatever bloom and gloom is going on presently is at its worst ever. They think, “oh this is terrible, worse than what we've had in the past”. The reality is there are always things going on. There is always good news and bad news when you look around the world and inside and the one thing that's always been true is “this too shall pass”. The most important thing is to not fixate on macro and not try to project what the world looks after like six months or a year. I have no idea what interest rates would be. I really don't care. It's really not a relevant data point. What matters is when you get down to looking at what a specific business is, what is the likely trajectory of that business within a range of different scenarios.

For example, if I'm looking at a business like funeral homes, let's say, there are a few large funeral homes, there are revenues that are unaffected by interest rates or anything else going on. We don't know who's going to die in Peoria next year, but we know how many are going to die, one of the most predictable businesses, right? If you're looking at a business like that, what you'd be concerned with is, okay what’s the population of the United States or cooperation in driving distance to their funeral homes and what's the expected annual kind of death rate and so on and so forth. That drives our revenues and everything else. Those are the factors you need to focus on, right? Then look at what are the cash flows versus what you'd be paying for the business. Let's say I look at a business like Starbucks.

Businesses like Starbucks are going to have more variance than a business like a funeral home business. But even a business like Starbucks, you can start

putting boundaries around and then if the business is in your circle of competence, you would have some viewpoint on. What's important about the business in Starbucks is that when they open a store in the US for example, they get all the money back in two years, unlevered 35% return on capital. It's a great business when they open a store in China, they get the money back in 15 to 18 months. It's even faster. It used to be that we don't go in Starbucks and put on our laptops and spend half the day there or whatever. Now people use technology in the dash in and out and they still charge the same amount for the coffee.

Their margins actually just went up. It's actually interesting for me. Starbucks and Chipotle have really become technology business. They're really not food businesses, they're tech powered businesses. I think when you're looking at businesses like that and you're really looking 5 years or 10 years out, it's really the micro factors around the business that are going to drive your long-term results as an investor. It isn't going to be, "oh we might be going to a recession or interest rates are going up" or whatever else is happening. I think the thing that matters is they've got 5,000 stores in China in five years. Do they have 10,000 or 7,000 stores? That makes a difference. I think it's always better to focus on the micro factors around the business and then focus on the businesses where you are able to look deeply into the future with a relatively narrow band of outcomes or at least a worst-case outcome that looks good to you and then take it from there.

Dylan: This too shall pass.

Mohnish: Absolutely

Dylan: Appreciate that. Your daughter is now running her own investment fund. That's got to be gratifying. Something that you're doing over the years is seeding and she's seeing her own success. Talk about that where the legacy continues.

Mohnish: Yeah, I have two daughters and I never, as far as I know, encouraged them to go into the investment business. I've never actually had any conversation along those lines. What I always encourage them to do and part of it my daughters knew relatively early when they were 12 or 13 years old, I actually talked to them and said, "look, most of our assets will go get recycled back to society. Sorry to disappoint you but it's not coming to you". But what we used to do is, we used to put the maximum amount allowed under the gift laws in a UGMA account for them, used to be $10,000 a year or so. My wife and me put about $20,000 and then it became about $15,000 or so. Basically, what I liked about those accounts was that at 18 they got full control and I manage those accounts; I still manage them actually because they gave me power of attorney even though they became adults.

But usually, it was just invested in three or four stocks. Those accounts did really well and I told them, "listen, when you turn 18 and you pick your career path or what you going to study in college and what career you want to pursue, please

don’t base it on what pays the most, base it on what you are most passionate about”. When I examined how they went about their choices, I was really pleased. I think exactly what I mean, they could have gone and bought Ferrari and drugs with the money and whatever else, but that never happened thankfully. But the choices they made for their careers and the path they took widely exceeded my expectations. My older daughter started the fund and a lot of the stuff in the investment business is not teachable. A lot of it is temperament.

One of the biggest things that is almost impossible to teach is the inactivity gene. If you are a hyperactive person who needs action all the time, value investing is not your calling and that's probably not going to work too well. My older daughter's natural tendencies, which are actually better than mine, are that she looks for very high quality in the businesses, whereas I'm actually more of a bargain hunter, and then she never wants to touch them. I think both those traits are really good. I was just talking to her the other day, I said, “look, I think the only tweak I would make is that you want to buy the great businesses, but Buffett says you want to buy them when they're on the operation, there's something going on that's causing temporary distress because in investing it is really easy to tell what a great business is”.

That's pretty easy to tell. If you gave me a list of a hundred companies, I'd pretty quickly be able to tell you which ones are great businesses because you can look at the histories, you can look at the return on equity, you can look at whether there is any leverage or not. You can look at the names of the companies, and I'll just tell you. I look at a business like Fair Isaac and Company in Berkeley, licensed to print money. Every time someone gets a FICO score, they ring the register and then their brother wants to give me my FICO score every week now. A monopoly business, I don’t know 95, 98% market share and extremely low cost to every one of their clients. If you look at a business like Coke, you can tell it's a great business, AMEX and so on. Then NASDAQ for example, incredible business, you don't even need to look at the financials to know that. Knowing what a great business is a relatively straightforward exercise. Knowing what a great investment is, is not such a straightforward exercise. You have to overlay a few things. But at a first cut, if you start with a bunch of great business and then sift through within that group, I think you are halfway home.

Dylan: You gave an interview recently on William Green's podcast where you talked about the percentage of success as an investor or a percentage of success that you need to be comfortable with just for the education of the audience because they may not have listened to that. Can you talk some about that?

Mohnish: If you're a brain surgeon and you had a 5% error rate, that wouldn't really work very well, you lost one out of every 20 patients on a regular basis just from carelessness or whatever, that wouldn't work so well. In the investment business even the very best investor, even when we look at Warren Buffett,

John Templeton's said that, “the minimum error rate is going to be one out of three”. If you pick 10 stocks, three or four are probably not going to work, maybe even five are not going to work. That's just part of the most interesting thing about the investment business that even with the 50% error rate, you can transfer the hell out of the market. The quirk with the stock market is if you go back and look, if you look at the S&P 500 for example, or the Nasdaq end season and long term, 9, 10% analyzed rate of returns including evidence and so on over many decades, if you parse that number further, what you'd find is that most of that return is coming from 5% of stocks.

Most companies are not delivering the bacon. Most companies are not generating 10% a year on average over the long term. But there is a small sliver of business that are generating 20, 25% for a very long time. The reasons the index is so hard to deal is because it doesn't know it owns Microsoft, it doesn't know it owns Starbucks and it's too dumb to sell Starbucks and it's too dumb to sell Microsoft too dumb to sell Fair Isaac. The reasons we have a hard time versus the index is we got to pick the one out of 20. It's only a sliver of the businesses that really will get you to the promised land long term. A high error rate is nothing to be afraid of. If you look at Berkshire Hathaway, Warren Buffett's probably bought maybe 80 or 90 companies and I would say at least 30 or 35 of them have just been outright money, and this is Warren Buffett and he's the best. Because we are trying to look into the future, it's going to be in high error type of exercise. But that's perfectly fine. There was a guy recently who was a very successful individual investor in India. He borrowed about $20,000 when he first started at 18% interest. Someone vented to him taking the stocks he bought at security and when he passed away, he never managed outside money. He had about $4 billion and he passed away at 62. He wasn't very old. He made one investment in an Indian company, The Titan industry, a jewelry manufacturer with about 4% of his capital. When he passed away, it was half his net worth and through thick and thin, he held that for 25 years and it compounded like crazy. In his case, he could've been completely wrong with the other 96%. The other 96% could've gone to zero, but he'd still have $2 billion. It's a very forgiving business. The important thing is that when you find yourself in the happy place of a fractional ownership of a great business, don't let it go. Even if it looks overpriced, don't let it go.

Dylan: That's awesome. In the time we have left, I want to be conscious of your time, but this has been a really awesome discussion. Can you talk some about your foundation and the work that you're doing there?

Mohnish: Yeah, I realized a while back that if I continued to do well delivered above market returns and especially getting fees on other people's money, there would be a nice pile of cash pile and inheritance is large. Inheritances do a lot of disservice. They don't really help you. Gene pool, they do more harm than good. Small inheritances are okay. I knew I wanted to recycle it back to society, but I grew up blank. I was very disappointed when I looked at different charities and foundations that I could give the money to. Generally, what I found is well-

meaning people with great hearts but no business mind. I think if you run a charity well you have to have capital allocation skill and the two kind of run at odds with each other. Usually, the great hearts and capital allocation don't go together.

What ends up happening is a lot of charities do what feels good, but it's very suboptimal. In terms of a holistic measure, what is the return on social return invested capital and so on and so forth, they don't even know what that means. I was reluctantly pushed into setting up our own foundation. We identify poor gifted kids in India and then we help them get into the very elite institutes in India like the MITs and Harvard of India. Those institutes are almost free to attend because they're so heavily subsidized by the government, but it's very hard to get in and there's a big prep industry that's really expensive. We make the prep free and most of the kids we take, the parents are illiterate, they haven't finished college, they're usually farmers or laborers. There's a massive trajectory change because we have a very high success rate getting kids into these elite institutions, usually 70, 80% a year. It worked out really well. We've had several thousand kids go through our program and now a lot of the alums are in the US and they're working at some of their top tech firms here and so on. It's been very fulfilling and growing. It's so wonderful.

Dylan: That's great. We all applaud you for the work that you're doing there. That has a big impact. I will wind down with maybe a fun question for you. One thing that I take aways from what you shared about Warren and Charlie is that there's this adage of “never meet your heroes”, but you met your heroes, and you developed a relationship with them. Expanding on that a little bit, is there a Mohnish Pabrai philosophy of life?

Mohnish: The Mohnish Pabrai philosophy of life is just an amalgamation from a bunch of other giants who shoulder them standing on, I have no original thoughts. Basically, I call myself the shameless cloner. I think everything I can think of, was lifted from somewhere. Actually cloning as a model is really powerful. For some reason, humans have an aversion to cloning. They think it's beneath them, but we have a number of really top-end companies in the US where the cornerstone was cloned. Walmart probably for the first 20 years of its existence had absolutely no innovations. Every single thing that Sam Walton did was lifted from an existing competitor. In fact, he spent an inordinate amount of time in other people's stores continuously lifting ideas from them. Microsoft Bing, it's not Google but it came from Google and this goes on. Cloning I have found has been a really great mental model to have.

When I see other people doing smart things, I force myself to incorporate those. In terms of the heroes, I think the advantage of the dead heroes is that they can't disappoint. It is what it is. The record is set. But I think with Warren and Charlie, I think they will stand just fine. They legacies will be fine, even 5,000, 200 years from now. They'll be okay. Yeah, I think what’s interesting about Warren and Charlie is that one does not need to know them to learn from them.

In fact, I think most of the stuff I learned from them has been through their writings. Very little has come from talking to them. They're open books, they've actually written great stuff and it's wonderful that it's available to us.

Dylan: I've got probably 10 more questions for you, including ESG and all kinds of other things, but I'll close the discussion with, “hey, we get to Austin periodically, would welcome the chance to buy a chai, latte or whatever works”. I want to thank you again and also shout out to your book The Dhandho Investor. I think you wrote a really wonderful evergreen book that is extremely accessible and also very insightful. Thanks so much for the conversation this morning and sharing some of your thoughts and knowledge with our community of small and micro-cap companies. Really appreciate it and look forward to doing it again.

Mohnish: Yeah, and Dylan, I think you'll enjoy spending time in Austin. I think it's a wonderful city with some very great musicians, some great chefs. It's just a great place to be.

Dylan: Certainly. Appreciate it everybody, Mohnish Pabrai with Pabrai Investment Funds and we'll get back to the program.

Mohnish: Thank you. Bye.

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