

Mohnish Pabrai's Distinguished Speaker Series, Presentation and Q&A at the MDI Gurgaon on December 26, 2014

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Sanjay: “The heads, there have been a lot of teams that don't lose much.” Those famous words, which I told you about on Tuesday, were memorably put together by Mohnish Pabrai. He is world-respected among all the value investors. Mohnish also is a well-recognized author, business, and philanthropist of the people who have benefited from Dakshana Foundation. Here is an astonishing piece of information about Mohnish's Foundation, which I'm sure has made Mohnish a very happy man. Since its inception in 2007, IITs accepted 631 Dakshana scholars, a total of 1,288. That's the hit rate of 49%. The success rate for the IIT entrance exam in 2014 was an astonishing 64%.

This is the fourth time Mohnish has come to MDI. In the past, he has enthralled your seniors with his words of wisdom. Today, he has plans to do that to you, with dots no less. As you know, Mohnish has been investing in India recently, so don't forget to ask him about that. And I assure you, you will enjoy his talk. Ladies and gentlemen, I give you Mohnish Pabrai.

Mohnish: Well, it's a pleasure to be here with you today. MDI is a very unique and unusual place. There are very few places on the planet that are enlightened enough to have a value investing program. In fact, in North America there are just two or three places you can actually go that have an MBA program that focuses on it and does a good job. I'm not aware of any in India, other than MDI.

The accolade goes to Sanjay for putting it together. Give him a round of applause. It's a field, that generally speaking in MBA programs, does not get studied as much in business schools. One of the reasons they don't get studied much is because there are no sponsors. For example, in the whole area of entrepreneurship, early-stage businesses do not get much study in business schools because GM is not going to ask to have a study done on an early stage of business. Value investing is like that in the sense that it's such a small niche activity that doesn't typically have large corporate sponsors and so on. Naturally, professors and business schools tend not to focus on it. From that vantage point, I think MDI has done a great job and it's great to be here. I'm happy to be invited back.

What I wanted to do today is go over the word called “Cloning 101.” I just want to give a few perspectives, what my evidence and empirical experience has been over the years. I started Pabrai Investment Funds about 15 and a half years

ago. Pabrai Investment Funds is a clone model. Basically, I lifted the pamphlet of what it does from the Buffett Partnerships. There's a peculiarity in humans where they don't like to copy, but I think it is obviously good.

The Buffett Partnerships were the most successful investment partnerships in the history of investing and such. When Warren Buffett finished the partnership in 1969 he terminated it. When I started Pabrai Investment Funds in 1999, 30 years later, I could not find a single example of a case where a very large hedge fund industry had cloned that model. I found it tremendously valuable for me. Things like no management fees, basically focusing on long term return, bringing a set of investors that are with you for the long run. There were a few bets, big bets, infrequent bets, all of those sorts of approaches to investing. Obviously, that was a significant advantage for me and for Pabrai Investment Funds.

Back in 2006, my wife and I started the Dakshana Foundation. Dakshana also got most of its core philosophy from Warren and Charlie. Again, in the non-profit world and in the world of philanthropy, I found that their ideas were very powerful.

When I look at the number of non-profits and NGOs who follow what I consider the laws of philanthropy, it is even rare. Very, very rare compared to value investing. I would say you would have a huge army of value investors compared to the number of people on the philanthropic side who actually act, from my vantage point, to do things the way they want to be done. Dakshana took these principles from Warren and Charlie.

The first of these principles, we will kind of quickly go through it. None of these are new ideas. None of them are my ideas. I simply lifted standards. When we are trying to deal with issues, societal problems, poverty, illiteracy, healthcare, environment, education, and so on these are very tough problems to solve. Lots of very smart people, lots of very dedicated government officials, and over many decades it has spent billions of dollars on these areas. They haven't been able to practice these problems because they're not easy problems. They're tough problems. If you're going to go at these problems with what Warren and Charlie say, you should seriously narrow your focus. If you run a portfolio, for example, eight or 10 stocks on the philanthropic side, you should put all your energies in one or two very narrowly defined columns. Extreme concentration.

The second principle is to go high risk. When we are trying to do investing, we focus very heavily on risk and migration. In fact, value investing works because we get a free lunch typically are taking low risk and typically are getting higher returns versus the risk you're taking in. When you are trying to against these problems, you need to be very bold and willing to completely fail. If you're not willing to take an approach that says, "I'm willing to completely fail." Then it's very hard to change the trajectory of mankind. To actually get a meaningful

change is hard. These areas are hard. If you are trying to be conservative and want to be careful, you should be willing to lose it all in effect.

Another principle that came from Charlie Munger is that from his perspective when you have endowments in foundations, they ought to be extremely concentrated. In fact, he doesn't see a problem with a foundation or endowment having 90% of assets in one stock, for example. The reason Charlie says to do that is that when you embark on these initiatives, you are taking a very high risk. Anyway, you are kind of part of cash, vaporize, and will be gone. What do you want to do? This is the opposite of investing; you want to pursue moonshots. If you go with 90% of assets, a single stock will put all of that in your best idea. The odds, that high risk would get a good return out of the idea versus your 14th best idea. Then to the extent that those ideas work, you can bring all that to bear all the problems they're trying to solve.

For Dakshana, I embraced all these principles. In fact, our assets are invested, very concentrated in that usually no more than three or four stocks. We've had many times close to 90% in a single position. When I started Dakshana, again, I was clueless about what to do, how to do it, and how to go about it, I assumed that for at least 10 years, whatever we would spend, we would have different initiatives that would lead to failure. I assume that 10 years or 15 years would just be wiped out in terms of money spent and not much return coming out. With the assumption of the 10 or 15 years that would happen, I wanted to start early. I had a runway and I had time. My wife and I, when our network passed \$50 million said, "Okay, we'll give away 2% of our network every year." That 2% would give us at least a million dollars a year.

The million dollars was treated as a kind of experimental money. We didn't have any concern if whatever we were trying to spend it on basically vaporized, didn't work, or we got cheated out of it. We were very willing to put our hope that it would be a tuition bill that we would pay. As part of the tuition bill, we would learn and then we would over time get better. Hopefully, in 10 or 12 years, we would figure out what we are doing and take it from there. That was kind of the idea behind this 2% model.

The good news was we felt that even if in one year we completely failed, everything we did next year, again, would give us some money to play with. In the third year, we'd have some money to play with. It gave us some kind of staying power to go and do this. The 2% model was copied from Buffett. He set up his as 5% a year going into the Gates Foundation. It's 5% of the balance, basically. If he lived forever, it would be tens of millions of dollars that would say forever. There were some of principles that none of these had.

Like I said, my idea or Munger's idea were all known. We lucked out in a significant way because we got traction instead of getting traction in 15 years or 10 years. We got traction in like 12 weeks. It was very fast in terms of the help to have the elements. It worked out so well. Of course, there are challenges,

but it's worked out fine. Again, I found that on the philanthropic side, Dakshana looked so good. I'm not aware of any philanthropy or charitable endeavors unless there are some of them which are like Zuckerberg or Pierre Amador, first generation guys who are going into philanthropy. They have taken a very similar approach. They're willing to fail, they're willing to make big bets, and so on. If you look at the established foundations in the US like the Ford Foundation, Rockefeller Foundation, and so on, they take a very sedate approach. They basically have taken an approach that is about the preservation of their own jobs and preservation of their capital. They are not trying to off-board it and have three different initiatives, all that stuff going on. I don't think we compete with that.

But I think that if you were benchmarking it, it would come out quite good. All of these attributes, all clone attributes. If you look at my most recent venture, which is Dhandho Holdings, I set up Dhandho about a year ago or 14 months ago. The idea was that Pabrai Investment Funds could only invest in public equities, an insurance company, property guidance. Insurance companies are privately held across my radar, and it looked like there was a possibility that they may be up for sale. We might be able to buy it. I couldn't buy it within Pabrai Investment Funds because our mandate, is only to buy stocks. I've always had an interest in having ownership and control of one or more insurance companies.

I wanted to look at other private assets because we just kind of broadened out the kinds of things we could do with it, where we could take it, and how we could run it and such. I set up Dhandho Holdings, like I said, about a year ago, and then we raised about \$150 million in the first quarter of this year. then we reached an agreement to buy the insurance company. Just yesterday, we finally got all the regulatory approvals. It's a company called Stone Trust Insurance, it's in Louisiana. They do about \$70 million a year, mostly workers comp premiums, and it's a very nice company. They're extremely good at underwriting, but they don't have much strength in investing. Insurance is highly, highly regulated. In fact, we can invest, I would say Dakshana is the extreme end. Our investing that's done, in the insurance side would be very diversified, and the loss of a fixed income. We still have some equity exposure and all that. I think that the only change Dhandho is making is the business is willing to manage the float and capital. They'll continue running the business the way they run it. In fact, we've added \$30 billion of capital to the business. That gives us some higher power to grow and such. When you look at Dhandho, what struck me was I didn't realize it could be set up until a few months back.

Dhandho is in the United States. There are about 3,000 property guidance insurance companies and about \$550 billion a year in premiums that come in to 3,000 companies. When you look at Berkshire Hathaway, it's a 50-year-old model, an extremely well-known model. I thought most insurance companies would have a very strong understanding of the model. But I found many, many insurance companies, I would say hundreds of them that I've found, have a

very, very strong discipline on the underwriting and the operations of the insurance company are very well run. Cluelessness on the investing side, absolutely no idea what to do.

First, I was very surprised. I found it remarkable that when you have these proven models out there, and these are large businesses, why wouldn't they emulate that model? Then I remembered, "Oh, yeah, the world is very bad at cloning." They can't emulate the model. You hit them over the head, and it dawned on me that the insurance business is very peculiar in the sense that if you were to actually try to replicate the Berkshire model in an insurance company, what you would need is in the leadership of that company have two very different skills. You would need strong insurance operation skills and you would need strong investment skills.

Typically, the type of person who would be good at one or the other is typically not going to be the same person. Typically, these companies have come from the insurance side. They've got strength from the insurance side. They haven't really thought about it from the investment angle. If I would say, "Let's beef up or improve the investment side", they would need to do is follow the approach that Berkshire did. They would need to identify a talented investment manager like Boosons. Then they would have to bring someone like Boosons on board. They'd have to leave him alone, he or she alone for a long time. Because then in the investment business, you can have 5, 10, 15 years. You really figure out whether a person is truly doing better than most of the crowd and so on. In insurance it is a very institutional business. You would need to do this and it would be a very non- institutional approach. You can't have a team that will give you a guide because the moment you go to your team there is a standard kind of institutional approach to investing, which will get you an average, at best.

If you want to do better than average, you'd have to bring in a talented manager and leave that manager alone. You need two skills to be able to do that. The first skill is you need the ability to identify and hire such a person. That is an extremely rare skill. I never realized this. Obviously, someone like Warren Buffett was very talented at doing this. He never made a mistake on that front you know, and Todd, who the director, anything, all of them are superstars. Most insurance company CEOs and boards would not be able to recognize a Louis Simpson if he were standing right in front of them. They have no ability to do it.

The second piece we need is to leave this person alone. This is like a full packed lunch with no real second guessing of the decision. Warren Buffett said that every month he used to get reports of all the trades that Louis Simpson had done and what his portfolio looked like. He said, every month when he got the report, he disagreed with like 90% of what he saw on the report. He did not agree with what Louis Simpson was doing, but he never once picked up the phone and told Louis what he thought about his useless picks. He just said,

okay. I have a guy who's doing his job and I will let him keep doing his job. That skill probably is very rare than the skill to hire someone like Louis Simpson in the first place. I didn't actually realize it about a year ago, I realized a few months ago.

For Dhandho, it is a significant advantage if we can. When I set up Dhandho, I thought we would be interested in a wide range of private assets and different types of assets. You kind of go everywhere. My perspective now is I'd like to hone in on insurance. I want to wonder insurance because there is a clear void, significant void. I wouldn't have expected in 2014 or 2015 that you have such a large number of these wonderful floor generating machines that have that void. Some of the folks I've talked to, I would be delighted to partner with. I hope we can consummate some more deals in the next few years and so on. I'm excited about that.

But again, what I wanted to just kind of highlight is that when you look at kind of all three of these models, Pabrai Investment Funds, Dakshana, and Dhandho, there is no original part in any of it. They are all basically looking at, well accepting ideas that exist and are just basically cloning them. I think that works out pretty well.

We'll shift gears a little bit. This is a sort of a farm in Iowa and they are just getting ready to lay down corn or soybean. This is a graph of the average value of Iowa farmland per acre. These are real prices. Prices are a little bit different from Gurgaon farmland. For example, if in 2013 you want an acre of fertile Iowa farmland, it'll set you back less than \$9,000. How much is an acre in Gurgaon, Sanjay?

Sanjay: A million dollars.

Mohnish: A million dollars? Do we have more than a million? We are looking at what a 100:1. That is a significant price difference. When you look at this chart, you can see that we've had long periods where there hasn't been much movement. We've also seen that you could have bought farmland, for example, in 1980 for about \$2,100 to \$2,150 an acre. You could have gone like 25 years and still been at \$2,150. This is not an adjustment. This is just the normal price per acre.

When you look at this Iowa Farm, I just want to show you a couple more numbers. The previous job was going over a long period. This is like 1981 to 2013 and you again can see the value per acre. It's a pretty set thing. I'm not showing over your daily values or monthly values, but basically, these are real transactions between what I would call an intelligent buyer and an intelligent seller. If a person is looking to buy farmland, and in Iowa, typically the only reason they're buying it is because they want to do corn or soybean farming. They really have nothing else that you could do with that land and such. If it is very fertile land, they have different prices for the level of fertility versus the average. Some of the things that go through the buyer's head would be, the amount of money that they would make out of a transaction. If I buy a few

hundred acres, or a thousand acres of Iowa farmland, what is the expected price of par over the next say 10 to 20 years? What is the expected price of labor? What is the expected price, Capex, things that you have to do? For example, fertilizers and other things that you have to buy. Those are basically the views on the various aspects.

How many times in the next 10 or 20 years would there be a significant destruction of crop or a significant bumper of crops because of the weather? Based on all of that, then they would come up with an assessment of what they could afford to pay for the land. When the intelligent buyer and the intelligent seller reach an agreement, then we get to this table. You can ignore the three or four columns to the right and look at the columns to your left. These are the rental rates per acre. You could buy farmland but you can also rent a farm, right? You look at the rental rates for the last five years and they are like \$200 to \$250 per acre per year. The rental calculus is a little bit easier because you don't have to go out 10 to 15 years. You can just have a view of the different factors of production looking at the next 12 months. Based on that, you would figure out whether the rent makes sense or not.

Most asset classes that we deal with in terms of real asset being sold between people and especially when we're talking about productive assets tend to be a lot of kind of detailed smart analysis that goes on with the buyer and with the seller. When both sides come to some kind of settlement or agreement, you have a deal right? You can look at that same kind of calculus and it will go. For example, a used Model T is for sale. If you have a 5-year-old Model T and you're trying to sell it, you have to have a sense of what the value is and what you are willing to sell it for. If you set a certain price range, the buyer also will have a certain perspective. Then when there's an agreement, there's a team. These are all negotiated transactions with an intelligent buyer itself.

The stock market is completely different from that. It's a unique creation that's a few hundred years old. Even most of its victims last couple of hundred years. It has dynamics which are very different from Iowa farmland. Those dynamics can work in your favor if you let it work in your favor. Of course, they work against you if you want to not appreciate kind of what the power of that model is. When we look at stock prices, it is not a negotiated transaction between an intelligent buyer and an intelligent seller. These are for the most part faceless transactions. You're not even face to face with the seller, for example. This is based on some part of its fundamental, some part of its change based on emotions and either euphoria or having a lot of concerns. A lot of things get manifested into stock markets because of all those additional auctions driven markets, which involve stock market. Auction driven markets have a whole different dynamic than negotiated transactions. The auction driven markets will tend to produce lots of bizarre behavior in terms of market price movement. As value investors, we can take advantage of some of the desirements. That thought that we're looking at a bunch of numbers, every ticker on the Bombay stock exchange.

Let's look at a five chart on this. Anyone heard of it? What do they do? It's a good company. Does anyone own it? How long have you owned it?

Speaker: Three years.

Mohnish: Why did it go down? What happened there?

Speaker 2: The stocks split.

Mohnish: Okay, so the stock split. That's fine. Basically, let's look at a one year chart on it. If you look at it on a yearly basis, you're seeing like 150 rupees to 250 rupees. Almost 60 to 70% low to high movement. I'm just trying to highlight here, that the movement you are seeing here on the stop. For example, it's quite different from what we saw on the Iowa farmland. You're seeing a lot more movement. This fertilizer company, was it a private company? For example, every month the target group got a bid on what people were going to buy, chart it, and looked at it like this. These bids wouldn't change that much month to month. Next dart, throw.

This is a real business. What does IFCI do? What kind of finance? Is it a good company? How long have you owned it, if you do?

Speaker: I think two, two and half years.

Mohnish: Has it done well? It doesn't look like it's done well.

Speaker 2: Done a lot of swings.

Mohnish: Are you up?

Speaker 2: Yeah.

Mohnish: What is your buy price?

Speaker 2: 28

Mohnish: 28, and there's no splits or anything? 20% in how much time?

Speaker 2: Two years. Exit Summit 45.

Mohnish: Pardon?

Speaker 2: I got to sell Summit 45.

Mohnish: This is a pretty wide swing on this, right? If you look at it, even 52 weeks, it's like more than 100% almost, right? more than a 100% movement. Why do you think we see the movement? Way it is going up or down?

Speaker 2: I mean other than the standard business, there's been a lot of problem with the upper management, internal sites, and things like that.

Mohnish: Again, we have like 100% range in the last. Anyone own this? We could keep doing this all day long. But thank you, Ashish. I just wanted to illustrate to you is that you can see that there's a pretty wide range no matter what spot we look at. One of the things, in general, is likely to happen is when you are a value investor, you are likely to make these investments on the lower end of that range. I mean, you don't know what the 52 weeks will be in the next two weeks, but because you are looking at so many stocks and you're trying to pick the ones that are in one way or another from some metrics undervalue, you're likely to catch it on the lower end of that swing range. One of the advantages you can gain is just the typical kind of exaggeration, the volatility that you see in stocks because the nature of the auction driven market. This gives you an advantage. You might see a 30, 40, 50, 70, or 100% range on the stock over a year or two just based on the dilations and emotions of people who are market players. That gives you an added advantage, right? We didn't even look at stocks that are undervalued. We just looked at a random set of stocks.

When you actually overlay and look at undervalued situations, one of the things which all of you I think do as a natural exercise is, when you actually look at a stock you actually study the pieces you look at in terms of recent price history. You generally will feel better about buying it, especially for a value investor. If it's on the lower end of that in recent price history, that gives you some advantage. A small advantage in your arsenal in terms of superior returns and I have seen that in my own portfolio. When can act actually in hindsight been wrong on the stuff but made decent gains on it. It is simply because I happen to buy it at one of those low points and just the natural kind of up and flow of the stock sometimes got me 50, 60% by the time we exited. I'm perfectly happy with if you give me 50 to 60% every couple of years in these things. That's no problem. We'll take that all day long.

With that, what I'd like to do is if we could maybe open it up to questions and that is the more interesting thing for me is to learn about what's from your mind and what you'd like to talk about. We can take it from there. If you can introduce yourself, if you're a student and where, that's be great. Go ahead.

Student: My first question is, a lot of people teach us how to buy. I would like to know your philosophy on how to sell or when do you sell it? We've been taught to buy things in the shop, we've never been told to go and sell something. It's very difficult. The second question is that very few people are lucky to have the float of an insurance company like you and Mr. Buffett have. In India, a lot of capital misallocations keep happening at the promoter's end, which does not permit you to all the stock forever kind, like the buy and hold strategy that Mr. Buffett always tells us to do. There's always this challenge in our minds, whether we have to always look into that sense. Would you still say in the Indian context, that buy, and hold is the right strategy, or you have to keep churning for the cash flows and for other compulsions of the market?

Mohnish: Sure. Those are great questions. Well, I would say that selling is more difficult than buying. It's usually easy to get into things. It's a little harder to get out. Just a few things that I do and most of this is naturally obvious to most of you is that when you are operating your circle of competence, then you understand the business. If you understand the business, you understand what it's worth, and you would have a good idea. For us, creating at 50 rupees and other market caps at 200 crores, you want to spend the business and thing it is worth 500 crores. It's a set of metrics that clearly are in your head. I usually write up in a paragraph what my perspective is on the stock and what I think the intrinsic value is and why I think it's worth that and usually in very simple English terms. I do that before I buy. Usually, I'm looking to sell about 90% of what I think is perceived intrinsic value. Usually, I go back every three months or six months to update my parts and perspective because the company may have had some development. At least, once you get a year or multiple years intrinsic value may have changed. Hopefully, it has increased. You can accordingly update the terms and values accordingly to the update that you think the sale price should be. If it gets down to the basics of Graham, which is you're not buying a stock, you're buying a business.

Some basic things just to keep in mind, that you always approach it from the perspective of buying the entire business. Apple has a market cap of \$700 billion. You ask yourself the question if your family had \$1.5 trillion in wealth for example, would you be willing to buy the entire company, Apple, at 700? If the answer is yes, then invest in this stock, If the answer is no, then you should buy \$100 with the average stock. this is the mind-set of looking at it as an asset versus a stock. This is important.

If you understand what the intrinsic value is, then you are also there. Of course, there are mistakes in investing and mistakes actually are quite numerous, even amongst great investments. It is obvious to you that you have made a mistake. At that point, you re-evaluate. As a circuit breaker for myself just to make sure that I'm not kind trigger happy, it is usually when we have self-doubt about stock. This is when it declines in price after we buy it. My own history is most things I buy proceed to decline immediately after I buy them. Has this every happened to you? Just you, nobody else?

What I do is when the counter urges to take instruction from the market on value, I just use a rule that if I'm an unwilling seller of a stock at a loss until it is two years or at least two years since I bought it, the present intrinsic value has to be below present stock price. It has to be very clear. There is a significant amount of time that has passed. You've kind of shaken out any kind of market driven psychology that maybe driving.

The second part is, buy versus hold. Trade in and out? I think a market like India's is a market where there is a possibility of having very long runways. There is possibility of finding relatively small businesses that have long runways, high returns of capital, good management, and high payment. The very best

investments would not be investments that are cheap from a quantitative perspective. But rather the ones that have types of dynamics.

There's a runway with business could be worth 10 or 20 or 30x in revenue in five or 10 years. If I were in India, that would be my primary focus. I would try to find markets that are very different from the US markets in the sense that it's to some extent heavily like a private equity investment. You have to do a lot more work in terms of understanding the nature of management and ownership and so on. But to the extent that you can identify those long runway opportunities that you can identify them at prices that are quite reasonable then I think that's the way to go. The buying and selling is also perfectly fine, but I would say do it within the context of you own the business and you think of it as owning a business versus owning a stock. You're buying and selling the entire business, whether the price that you're buying is rational, both ways. Other questions?

Kaushik: Hello sir, Kaushik Narayan. One of the things that you picked up from the Buffett partnership was single person team, as far as investments are concerned. Don't you think having a devil educate sort of helps in certain situations?

Mohnish: Yeah, that's a great question. I had a conversation a few years back with Charlie Munger and he mentioned that he always had someone to talk to about the investments. He said, "Well, it wasn't always Warren, but I've always had someone to talk to." In fact, at the Daily Journal meeting, he said that even Einstein needed someone to talk to. I think that each human brain processes the information differently. To the extent that you can find someone who's thoughtful and is not processing data similar to you would be useful to have these conversations. There are incentives and the dynamics of that exchange that are very different from having a peer where there is no vested interest of any kind Two people having conversations about stock.

I think for most of history, I operated making decisions on my own. I have a good friend, Guy Spier. He and I usually talk about things that either he's looking at or I am looking at. Many times, we don't agree. And many times, I'll buy things that he wouldn't buy and vice versa.

If we look at our portfolios that are way different than each other, I have found it very useful to have a conversation. Guy runs the fund on his own. Neither of us have any economic interest in the other part. We don't gain or lose anything by what happens. I'm confident that he's confident that we are candid in sharing our beliefs and perspectives. That's useful. I think that it is valuable to having that type of relationship. It doesn't need to be an off the chart person. Just having someone else to talk to is important. One of the things that happened this year actually in Omaha is that I had brunch with Charlie Munger. He was sitting there and there was nobody next to him. I decided to help the guy out and give him some company and just so he doesn't get bored, and I

took Guy with me. I said, "Charlie this is the person I talked to about my investments." And Charlie immediately got very interested in he is kind of checking Guy out. Then Guy says, "I don't know why Mohnish cares to talk to me because I really have nothing to add to anything he duly comes up there." Charlie said that "Well the process of going through a process, the process of going through talking to someone else about your ideas requires you to put them together in a certain kind of format and manner that can be articulated to that person. That process is useful in seeing some flaw in argument. Then guys said to Charlie that yeah, Mohnish could actually just do that with a monkey, you could just articulate. Charlie usually says, "Yes, but the problem is Mohnish would know it's a monkey. It wouldn't work."

Charlie, actually, I saw in that interaction that I've talked to him to put a huge amount of weight on the notion of a person bouncing things off. I actually don't move on anything now. I haven't moved on anything until I have that, at least one conversation. We have many conversations. We may not agree, but you know exactly what Charlie said. It forces me to kind of put my thoughts in an organized manner and here are some perspectives, maybe different inside. It's a huge advantage, but I think you have to set it up in a manner in which there is no vested interest. There's an axe to grind. It's a trusted relationship and then that works.

Ashish: Ashish. Sir, we are here in notifying market business in India saying that they're holding onto blue chips like ITC the oracle just because their historical cost get more than the historical cost. In terms of elements of historical cost and margin safety, is it a positive bias that allows you to hold on to such blue chips or is that element allow us to buy a share?

Mohnish: Yeah. Well, that's a good question. I would say that please have a seat. if you have a company like, Hero Motors, it's changed. It's called Hero Motor Corp. So, if you held it, let's say 20 years or something, what would you return on investment be? It is like 45x to 50x.

Speaker 4: Including all the dividends.

Mohnish: Okay, 100x maybe. Obviously one of the things that happen in terms of human psychology is that if you own something, you should look around long runways, right? If you look at a company like Hero, where so many advantages, you know, motorcycles are better in rural areas than scooters are, and they have all the distribution networks. They've got this huge installed base. They've got all the brand equity and all that. For someone else to uproot that, it's not easy. There are all these follows too, like capitalism is ruthless. Like the nature of capitalism is aspiring to take their moats away and such. I think that if a person is holding onto Hero Honda because of the past, it may not be as robust as holding on to it to some view of the future.

The future has a way of unfolding differently from past. If you are able to understand the business within your certain competence, then you can look

out 5, 10, 15 years from now and see that those aspects of the moat are going to intact what valuation of the business would be. What is the Hero market cap? 60,000 crores? Okay. \$10 million. The question I would ask someone who is buying the stock today is, how does it get to 120,000 crores and how long does it take? How long does it take to get to 200 crores or 200,000 crores? What are the circumstances and does the company, Heros, get there? It is going to get there. All of the natural payments and so on, I would say are holding on to it. The dividend is more than the cost base, that is irrelevant. The cost base is irrelevant. I think the thing is that you look at it as if there are advantages.

Of course, in India, you don't have the same dynamic. With the US we have significant tax issues, long term gains. You have no tax implications and that's a beautiful place to be. If you have a view that is a business and that is going to double, triple, or quad value in the next five to 10 years, it's a great place to be and should be there. If you have a view that for whatever reason may not be the case or the odds are low, then you want to look at something else. I would say just identifying those long runways and being non-emotional about how you go about looking at them long term is a good way to go about it.

Student: Sir, I have one question for you. It's regarding your recent investments in some of the banking stocks in India, the J&K bank and South Indian bank. What is the rationale behind these two universities? There is largely an unbanked country that has a scope for the next 10, 20, 30 years. Also, with respect to the valuations compared to you this is one question. The other is, don't you think there are issues with J&K Bank with the recent Black Swan Event in Jammu and Kashmir?

Mohnish: Okay, good questions. But we cannot talk about our portfolio until we exit these positions. In the next few years, I mean, when we no longer own the positions, we can talk about. I think the thing is, Buffett and Munger talk about if they own tops, I must have a fair review of them. I will share those favor reviews in the public when evidence comes out that doesn't support the views. I now, say I have I mentioned these things and can sell these things that make me look stupid. I'd rather look stupid in front of it, but at some point, we own stocks and when we don't own the, we can talk about them.

Speaker 5: I'm Chandra working with Axis Bank at present, and a retail investor by side. I have one question, would you advice somebody to wait for five years and then no matter how long the wait be in a highly defensive business like TNT, Electric and Nestle, and wait for 10, 20 years, whatever the horizon. Do you think it's the right category for an initiative a or b?

Mohnish: Yeah, that's a good question. Let's say, your one lakh rupees, and I'll put the comma the way they do it in the US. Let's say you have one lakh rupees, and this is 2014. You can't find anything of interest. You sit on it and let's say now it's 2020, and now something shows up of interest, which is deeply undervalued and long runway and all that. You make the investment. Invest a hundred

thousand over here. And then this thing, let's say is growing at 20% from this point on. Let's say in 2025, this would be like 20%, and in 3.5 years it would double, right? Let's make the math simple. 2027, for example, you've got two doubles. You are at 400,000. What is the return from here to here? In 13 years, if you get a 4x what's the analyze return on that? 11%. I'm not calculating, does that sound right to you? Let's say 11%. It is very hard to make up lost years in investment. If you have an investment, it does nothing for five years, nothing for 10 years, and then it starts moving at even quite an aggressive rate. It would take a long time for to analyze this investment over the entire period to have that rate. To get too close to 20% of this, you'd have to go many, many more years, for quite a while,

Student: If you are willing to go for 20 years in the future, hold the stock for 20 years, do you think it would be a good decision?

Mohnish: No, because I think at least the way Buffett and Munger would do it is from that point of view, opportunity cost. Now, the caveat, what is your best option today? Is the risk of permanent loss of loan, and it's the best of all the various options you have? The returns you are better off doing that versus sitting there endlessly. I think, sitting there endlessly.

First of all, if you are an individual investor and you're sitting in India on the exchange, and I find it hard to believe that you couldn't come up with something that is low risk and decent return probability. The best approach, I think, is what are your best options today? Now, sometimes the options are really bad, and in that case your cash is not a problem. But planning to hold cash for some long period of time and then planning to have a runway for 20 years or something, the thing is the moats. Moats have a way of evaporating, and they have a way of changing. The thing is, you are making an assumption that even a Unilever or P&G would have unaffected moats for 20 years. Whereas in the US for example, we have seen significant erosion of P&G moat because of the Walmart and Costco. They've taken away a lot of their pricing power and so on. I think moats are elusive. Moats can shrink and it compounds the problem. If you say, I'm going to wait 10 years to get a 20 year moat, that is a very difficult proposition to be right for 30 years. You need to be right for 30 years. It is kind of hard to look at businesses today and know where they will be in 20 years. They are very few businesses that can actually make. I'm not even confident that a company like Hero Honda can make a 20 year claim. I mean, it may work out well. But it will be difficult to say that you have a steady situation for that long. I would say that it's probably better to look at your best options today.

Rohit: Hi my name is Rohit. Related to your question about investing in India, I'm not going to specifically ask your portfolio, but what changed your mind? Because I read somewhere a while back that you were sort of aversive. Not recently, but sometime back. What changed your mind about investing in India?

Mohnish: Well, I think the Indian markets for the most part are outside my circle of competence. The reason they are outside of the circle of competence is that I am not here. The type of work I would need to do to really understand many businesses would be similar to private equity investing in the US. You really have to get to know management and get to know a lot of the uniqueness on the ground. You need to get to know a lot more, I would say a deeper understanding of things.

A few things seemed within the circle of competence. It's hard to know exactly how the future unfolds. But India has had, I would say, a 67 year history, more than a 67 history of leaders who had a social event, or leaders who had four governments, or both. Even when they were capitalists, they were not a whole capitalist. We have a leader in Modi where there is a chance for very significant change. I've always felt that in India, for example, the government if they did just two things, two or three things. One is they get out of the way. The government in many, many places build out great infrastructure, build out great schools that will be a tremendous model. The way they focus on things in the government are meant to do that. There's some chance that may happen, right? If we actually end up with those dynamics then you could see significant GDP growth and significant growth in corporate profits, and even revenues and so on. You get lot of tail winds in that case.

We've made a few bets where we think downside is very muted. I mean most of the bets we have are in banking in general. Banks will grow at multiple of GDP. The GDP growth is coming in and that will help for sure. India has large population. There's lots of work on that front. Those are some of the reasons and we'll see how it works out.

The approach I took with Dakshana was that, I'm a guy sitting in shorts in California and I don't have much I didn't understand about India and so on. When I had understood at that point in Dakshana was that I was familiar with the Super 30 model. Both Super 30 and Anand Kumar. I'm going to see him later today. I was familiar with Super 30.

I obviously was familiar with the IIT. I'm also familiar with the fact that the IIT is a strict meritocracy, where basically if you do well on the test, you get in. It doesn't matter if you're a prime minister's son or Ambani's son. If you don't do well, you're not getting in. It's a very clean system. I was also aware that if you get into the IITs there is a very high subsidy by the government. I have no control over that, but I think it's a stupid policy where the government subsidizes that. I have no ability to pay full fare. The government gives me the same deal as some poor farmer's son. In effect, that is a misguided public policy. That's a topic for another day. I did see the Super 30 model and the power of this model. I saw that the hiccup would be that ITTs were meant to be taking the best talent of the country and producing engineers.

But what happened is it became taking the best talent amongst middle class or higher from urban areas, and then reducing engineers in that pool. It ignored large portions of the population, ignored the poor, it ignored rural, and so on. I felt if we are able to get kids with very small amounts of money, you can actually lift family for power. For example, I'll give you a simple situation Dakshana spends about and I'll get you a question of what we see the first 12 weeks. I just want to give context of where we're coming from. Dakshana spends about, let's say one lakh to 1.25 lakh per scholar we take on to get them prepped for IIT. Typically we are now getting about 60 to 70% of them in and even the rest of them, the 30% who don't get in are going to NIT's and other almost a 100% are going to engineering schools.

1.25 lakh that we have spent in effect forces the government to spend like 25 to 30 lakhs on that day. Once he gets into IIT, that is a sub six, eight lakhs a year, what is costing the government? I'm happy to spend one lakh with the government spending 35 or 30, that's a good number for me.

We had a kid who joined Dakshana in 2010. His father is a very poor tailor in a slum in outskirts of Hyderabad making less than Rs. 4,000 a month. We prepped the kid for two years from 2008 to 2010. Then he took the IIT entrance exam. He got a rank of 63 out of 500,000, our best performing guy. Then he went to IIT Bombay Computer Science. He finished this year, 2014. Google interviewed him by Skype Mountain View, and they hired him. Then they had Visa issues. They moved him to London. I think his starting salary is a \$100,000 a year. The first month, he moved his parents out of that place where they were living. Second month, they've put a down payment on the house they are going to own. They move to a rental, they move to a house now, and the third month, he is getting his father from working as a tailor for someone to being on his own. They own a tailoring shop, right? You are going from like \$80 a month to \$8,000 a month. The whole thing cost \$2,000. It is a great model. I knew that model is good, but I had no understanding of how to execute the model. What happened the first 12 weeks, I contacted some friends I knew in the US who were IIT grads because I'm not an IIT grad. But I have friends who are grads. I told them, "Hey, you know, I basically want to find poor kids."

There was an industry in India where I can pay coaching industry in Kota, one or two lakhs, and they will train them right. All I needed to do was find bright poor kids and send them to Kota. This was the original model I had in my mind, send them to Kota, and pay room, board, and everything. Then, two years they will take the exam and we will see what the returns are. Over time, we are ready to improve money for 15 years. Over time, we'll improve the model and such. I only had this model in mind, but I had no one in India. I wasn't going to move to India, none of that.

I talked to some of my IIT friends and I said, "Look, I would like to find someone in India who can be a consultant or be a helper for me. Who can help me starting to put some of these pieces together." I've had a lot of experience with start-

ups. One of my friends was IIT Madras. He said, "Okay, write up something. I'll put it on some IIT Madras alum message board there. This NGO wants this and that." I wrote up some blurb of what I wanted to do, and he put it on the message board. One person responded. This guy was about 67 years old. He was a retired guy and he had graduated from IIT Madras. He said, "I like your cause and I'm in Bangalore. I'm idle and tell me what to do. I'll do it." I told him, "Okay, here's what we'll do. I want you to be a consultant." As a consultant to Dakshana, I already formed the Foundation in the US. "As a consultant and every day work for Dakshana, I would pay 5,000 rupees. Every hour you work for Dakshana, I'll pay you 800 rupees. If you work three hours, you just keep track of your time. At end of the month, we'll send the money." he didn't really care about the money. He said, "Fine, no problem. That sounds fair to me." I told him about the problem that I wanted to solve and what I wanted to figure out to help the poor kids who are smart. I had one or two ideas. One idea I have is that there must be kids showing up at these coaching institutes who want to get admitted but cannot pay the fees, right?

All expenses are paid and if you're traveling or flying anywhere, whatever, all paid. I got him a credit card, which was a Dakshana credit card. I said, direct builder, you're taking a flight, whatever, eat. You have no risk of an invoice being unpaid. It was a direct bill. He started, he became a traveling salesman. He was going around. I said, "Go to Kota, meet all the coaching institutes. Tell them we want to do this. Ask them about their kids that they run into whatever." He started having a number of meetings with the coaching institutes. He was saying, "Look, if you find people who cannot pay, we can pay." It's helpful to you because you'll get better students and all that. And these guys listened to us. We actually got our first scholar from Bansal classes.

We met Mr. Bansal and the coaching institute in a short period. Just that afternoon, a family showed up and they had no money and all that. They were crying in front of them. Ramesh met these people and said, they seem very poor. The kid has qualified for the test. We are not concerned about risk. I said, "Support him." Tell him we'll pay for everything and admit him and all that. He became our first scholar. We admitted him to a bunch of classes. We got him set up in dorm over there. He got home. This guy was greeted more and more people. The name of the school system, Jawaharlal Navodaya Vidyalaya started coming up in multiple conversations. Multiple people told him, you should look at JNV. He had never heard of JNV. When the third guy told him that, he took a note and did some research. He found that there's a school system in India called Jawaharlal Navodaya Vidyalaya you might know. Are there Dakshana scholars here? Yeah.

Dakshana scholars: JNV Nadiya, JNV Bihar, JNV Chhattisgarh.

Mohnish: There are 550 JNV's in the country and they're in every district, almost every district in India. And basically, these schools are phenomenal. I mean, I would

say that if you visit a JNV you would find it hard to believe that the government of India actually executed such a phenomenal system. The schools are fantastic. They are a magnet system. 2 million kids, 20 lakh kids a year and fifth standard take a language and independent IQ test. The IIT, the testing is absolutely corruption free. All the results get tableted in Delhi and they admit the top 2% of the kids. Out of 2 million, 40,000 kids get admitted into five 50 JNV's across the country. You have to be from that district to go to that JNV. that is the district in Jaipur. How many kids take the test every year in fifth standard?

Dakshana
Scholar 1:

More than a thousand.

Mohnish:

More than a thousand. And that's a low number. And what about you?

Dakshana
Scholar 2:

Nearly 8,000 to 13,000.

Mohnish:

Okay. Which district did you send you from?

Dakshana
Scholar 2:

Western Champaran district.

Mohnish:

Bihar, right. If you look at the Champaran district, let's say 10,000 kids from that district who are taking this test in fifth standard. They can take it in one of 14 languages. They are only admitting 80 of those groups. You have to be super, super smart to be admitted. Which college did you go to?

Dakshana
Scholar 2:

Now I'm in NIT.

Mohnish:

Okay. And what about you?

Dakshana
Scholar 1:

IIT Bombay.

Mohnish:

Okay, where are you at now?

Dakshana
Scholar 1:

Bank of America.

Mohnish:

Congratulations. Basically, once we found the JNVs, and once this guy found out the system, so he said, "Look, this system is in rural India. It's an on God has taken places. Nowhere near any civilizations. And it is only attractive for people who are rural India who don't have that much money or because they're not going to send. It's an integrated system there, schedule cast, schedule tribe." We had cast based issues. Kids will be sleeping next to a schedule tribe or schedule cast kid, all of that is fully integrated. Its not an attractive school

system for affluent people to send their kids, but it's a very good school system for poor people to send their kids. The government does a pretty decent job. The features, hiccup miss, but great talent. Once we found JNV, Ramesh was on his 5,00 rupees a day. He went to Delhi and we were lucky. We met two guys who were senior, one of the commissioners of JNV system, and the other was head of academics. We had a startup unknown, right? I got our business card, which says, be a consultant, right on Dakshana. He said, "Look, we want to do this and can we work with your school system and can we test your kids and then find them and so on." They listened to him and the JNVs had a problem. The problem they had is they had all these very bright, they knew that kids were very bright, but after 12th standard, there was nothing. The kids finished after and they're in the middle of nowhere. How far is the closest coaching center?

JNV student: 400 kilometers.

Mohnish: Okay, so there you go. You have these 10,080 kids, there is no chance, even if you had the money to get any IIT coaching, right? They knew that problem. What they said to us is, "Okay we'll do an MOU with the unknown Dakshana and we will set up like one school in each region. There were eight regions in India and we will test. We'll have you test the best kids in each region, and then we'll take 40 kids in each region, move them to that one school. Dakshana will provide the faculty and all of that to run the program." That's how we started in 2007. We had no expertise.

By this time, about 9 or 10 weeks had passed. I think maybe 60,000 rupees or 80,000 rupees been spent in terms. Ramesh came to me after about 10 weeks and said, "We have to bring this monthly or the daily billing to an end because I can't keep track of the hours and all. It is taking too much time. I need to go full time. I switched him to one lakh a month. I said, Full time, fine, you full time. And I told him, "Move to Kota." I still was focused on the Kota thing. He moved with his wife to Kota and we got the MOU done with the JNV system.

March of 2007, we had started Dakshana's operations. By June we had the first call, and by September we had 320 kids we had selected from the JNVs. We had moved them to the eight schools. What we had done in Kota is we had signed contracts with all these coaching institutes to provide faculty at these locations. Basically, we took the pieces and just needed check writing ability. I had check writing ability. I didn't have any ability beyond that. We could write checks and we were up and running. What happened is that lots of lots of these coaching institutes did a very poor job. They sent bad faculty. They could not find what we were doing in coaching. Assam for example, yes, yes, I'll do all this stuff and discipline. But they would take money and send us invoices and then be useless facilities. What we ended up doing, for example, with Assam, we had 40 kids and only about, I think six kids first, first time made it to IIT, but in other regions, it was a little bit better.

I think first batch, 22% of that batch went to, I knew that we had seen a lot of problems to get even to 22. I knew that if we had better faculty and better things going on, it would improve. My take is that any business or anything I'm running is all I care about is that the next year is better than this year. We just started to chop some wood and go on. We became lucky. The first 12 weeks I found this guy honest guy, simple guy. He was doing his thing and we got the MOU, one with the government and we got the scholars. One of the things that works and I'm sure, what year did you guys finish your coaching with Dakshana?

Dakshana
Scholars:

2012. 2014, 2009.

Mohnish:

So how many of your batch mates went to IIT?

Dakshana
Scholar:

That year? Very few. Four or five.

Mohnish:

There you go. Smart kids, good batch. What we did is we basically just then worked on the model, to improve the model. We knew the talent was there. We knew that all of the pieces were there. Then we just worked on, now let's just keep improving the yield and all that and worked on. That is always better to be lucky and to be good.

Student 3:

Just ask you a simple question, how did value invest in your personal level?

Mohnish:

How did value investing impact on a personal level?

Student 3:

You said you make value list that impact you personally speaking that you would've as advice.

Mohnish:

Okay, well that's a good question. I might have to think about it for a second. I mean, I would say that let me put it this way. I would say that value investing led me to Warren Buffett and Charlie Munger. I picked up a whole bunch of values which had nothing to do with investing from these guys, right? I saw, especially in actually both their cases that they really didn't care about the money they were making. I mean, I think it's a way of score for them, especially Warren. But it has very little impact on the life that they are not really spending the money, they are going to give it away and all those sorts of things. Some of that has rubbed off on me, probably not to the extent that it's with them.

I think it grounds you. I think some of those, if you pursue value investing, you cannot pursue it without understanding Warren Buffett and Charlie Munger. If you understand them as people and as humans, they're as high quality as you can possibly get. If you emulate their qualities, which are unrelated to investing the only thing that can happen is it can improve your life. For me personally, they would not have been, not been a Dakshana, if I were not influenced by Warren Buffett. That is not one Buffett, the value investor, that's the Warren Buffett of the planet. I wouldn't have had the values of the fallacy of having

large inheritance. My kids are not interested in large inheritances either. That has come through because of the influence of Warren and Charlie. I think there are many, many things that I've picked up from that that either I've paid attention to or never thought about. That is very useful. With that, thank you very much."

Sanjay: I hope we have your time next year. It was really wonderful to have you over as always. I think the discussion on Dakshana was the most impactful, much more than the value investment part. Thank you.

Mohnish: Okay. Thank you.

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