Mohnish Pabrai's Q&A session at The University of Georgia on November 18, 2021

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Charlie: Today we have Mohnish Pabrai joining us. He started the Pabrai Investment Funds, which were inspired by the original 1950s Buffett partnerships and are close replica of the original Buffett partnership rules. Mohnish is an ardent disciple of Warren Buffett and closely follows his principles on value investing in capital allocation and from inception in 1999 through March 2021, you'll have to update our numbers, but a $100,000 investment, would've grown to 1.4 million, which equals an annualized gain of 13%. Fantastic. Mohnish was the founder and CEO of TransTech, an IT consulting firm before he started his value investing career. He loves playing duplicate bridge. Mohnish, if you want to take it from there

Mohnish: Charlie, it's a pleasure and honor to be with all of you. Just quick story. I hope Charles, do you go by Charlie or Charles?

Charlie: Charlie, usually

Mohnish: Charlie's a better way to go.

Charlie: Yeah,

Mohnish: I've known Charlie's dad for more than two decades, now. I think a wonderful guy, Larry Oberman. I met Larry many times in Omaha when he'd make the annual track in the nineties and early two thousands. One time I went to his office in Northbrook, Illinois, and he generously gave me all the annual reports for Fairfax financial, 20 years of reports. Of course, now, I have a great friendship with Prem Watsa at Fairfax. He's one of the largest donors for our foundation. We did very well actually investing in Fairfax when I was being heavily shorted during the financial crisis. I have a lot to thank Charlie's dad for, but I remember that when Charlie was born, his dad sent a picture of Charlie to Warren Buffett and said "Warren I have a new baby boy. We've named him Charlie Warren Oberman in honor of Charlie Munger and Warren Buffett". Warren buffet wrote back. He said, "when Charlie has his first stock tip, call me collect". Charlie, did your dad ever send any stock tips to Warren after that?

Charlie: I don't think so. I mean, I give my dad stock tips, but I don't think that he passes him along.

Mohnish: Make sure he knows that he owes Warren your best idea.

Charlie: I'll let him know.

Mohnish: Give him your best idea and tell him to send it to Warren because Warren's been waiting for two decades.

Charlie: I don't know if I can call and collect anymore.

Mohnish: He's got 150 billion because he's waiting for Charlie so let's not make him wait anymore. What I thought might work well is, if he could run the session maybe as a Q and A, it was really fun to get your email, after a couple of decades, how old are you now?

Charlie: I'm 21. Mostly.

Mohnish: Exactly. This is

Charlie: After 18 to 22.

Mohnish: All right. Basically, this is after 21 years that I'm hearing from Charlie Warren again, which is great, but yeah. Please take it away. We're happy to engage and other than questions on what we currently own, I think anything is fair game.

Charlie: Yeah. We had some people submit questions who are on the call. I guess to those people, we read through your questions and like, they're good to go. If you want to send them in the chat, you're good to do that. But to start off one question that we got a lot of just based on the bio that we sent out when we were trying to market the event is if you could go into a little bit more depth about your relationships with Warren Buffett and Charlie Munger and how those developed.

Mohnish: In 2007, I think our net worth at the time was around 80 odd million, almost all of it I would attribute to me using the intellectual property of Warren Buffett without paying any royalties. I had such a huge influence on my life, just like your dad and not even just investing in on other facets of life that is unrelated to investing. I felt like I owed him like a big tuition bill because I'd learned so much and Buffett runs this annual charity auction on eBay where you can bid and the highest bidder gets to have lunch with him. My thinking was that I would bid for that lunch at that time, the lunch was going for around a quarter million or so. I said, “I think this would be great. I can bid for the lunch”. I had tried a couple of times before that and not always been out bid, but 2007 I was ready. I had network had gone up and I said, okay, this time we're going to go make sure we win. I talked to my friend, Guy Spier about it. He came in with me as well. I think 650,100, we won that lunch bid. My only expectation was to just thank him. They just gave me a direct kind of one on one time. But Warren Buffett, when he runs this annual charity auction, he has a different kind of mental model. His model is that whatever people have paid for this lunch, he realizes a big deal for whoever's wanted, he wants them to believe that they got a big bargain. Now the lunch goes for like 3, 4 million and he still focuses.

When I met him with my family and with Guy and his wife in 2008 at Smith and Wollensky steakhouse in New York city, Buffett, basically, as soon as he sat down, he said, “look, I have nothing going on all afternoon. I'm here with you as long as you want to hang out with me and when you guys get sick and tired of me, you can let me know and I'll leave, but I don't have to leave. I can be here as long as you want”. He just wants to make sure that he's providing more value and such. I was addressing him as Mr. Buffett, both of my daughters were sitting on both sides of him. One was 10 and the other was 12. He said to them, look if you call me Warren, maybe the adults will learn.

About five minutes, you feel like you're having lunch with your grandfather. It puts you at ease. You forget that you're with this amazing historical figure and such. During the lunch I told Warren that my wife Harina, she's a huge fan of Charlie Munger, a lot bigger fan of Charlie Munger than Warren, I told him, “look, Harina's happy to be here. But her true love in life is Charlie”. Warren is very competitive. He says, “Charlie is an extremely old and boring guy. I'm the one who's really interesting and exciting. Not Charlie. He's just this curmudgeon, you don't want to spend time with him, always pessimistic and so on”. He told us, he said, “look, just to make sure you guys understand who is the better lunch date I'm going to have you guys meet Charlie for lunch. Then after that you'll know who's a better company”. I thought he was joking because Charlie doesn't do these lunch auctions. You can bribe Buffett and have lunch. You cannot bribe Charlie and have lunch. Okay. There's no platform to do that. But the following week, I got an email from Warren's assistant going to Charlie's assistant, basically saying I met this couple in California. They're really fun. I think you'll enjoy meeting them. They seem to have the misconception that you are more interesting than me, but once they meet you, they'll know that I'm the guy. It was buy one, get one free. We got the one lunch and then the second lunch with Charlie was free. I actually enjoyed the Charlie lunch more than the Warren lunch because he's just so candid and so open. Warren is also very candid and open, but there's a Veneer of diplomacy, which is not there with Charlie, which is better. The lunch with Charlie led to a nice friendship with Charlie because we were in the same geography. I started meeting him periodically. Then a few years later, I started playing bridge with him at the LA country club. Usually Friday afternoons from like noon to five or six o'clock. We first meet for lunch for an hour or two. Then we play three, four hours of cards. Now, Charlie, doesn't go to the club anymore. He's going to be 98 in January. Those experiences and Rick Guerin used to join for those lunches as well, which is great. The Warren lunch led to a very nice friendship with Charlie, but, like the Ginsu knife commercials would wait, Warren has this party every year on Sunday, it's a brunch where he invites all the managers of Berkshire Hathaway and the board members and his close friends like Bill Gates is there. Sometimes Bono shows up, there's always some Hollywood celebrities there and whatnot.

And he invites all the past lunch winners to that brunch. Guy and I started getting invited after 2008 and we used to always look at each other and say, we are the only two low life in this room. Everyone else is happening. Sometimes, we'd be at the brunch and I'd tell Guy; right behind us is Bill Gates talking to Bono. There'd be NFL players there. Then the founder of banks, you just meet all these amazing that NFL player, the big guy last name, Sue Naga, Sue something. I anyway, such a gentle guy. Then I see him on the field. He's not at all gentle, but in person, he is so gentle and so nice. Those lunches have continued. I got to know Warren's assistant through the lunch and I asked her if she would meet Guy and me for lunch. She said, oh yeah, she'd love to do that. We started having lunch with Debbie on the Thursday, before the Berkshire meeting, she said, normally Friday is crazy in the office, but if you come on Thursday, I'm free on Thursday. Every Thursday, once a year in May, we'd go to lunch with Debbie. I found the lunches with Debbie were better than the lunch at Warren or Charlie, because I'd always tell Debbie, Debbie, listen between us girls. Can we talk, okay? She said, "what do you want to know Mohnish? tell me, I'll tell you anything". This was before we knew whether Warren had a cell phone, in 2010, 2011. I asked Debbie, I said, "Debbie, does he have a cell phone?" She'd laugh and said, "well, he has a cell phone. It's a little flip phone, but it sits in my desk". She said, "he doesn't know how to use it. When he goes on a trip, I charge it and give it to him. The only thing he knows how to do with it is, when it rings to open it an answer. He knows how to call me because I put myself on speed dial. If he has to call someone, he calls me and then I have that person call them. There's nothing else. He knows how to do with that phone". Okay. Anyway, there were a lot of interesting things I found out about how Warren kind of operated and how he spent his day and different things. We'd go to Omaha, to Berkshire headquarters. Some years Warren would be there. I think one time he gave us a tour of the headquarters and then I exchanged some letters with him. I sent him some stock tips, since you're not sending stock tips, someone's got to send us stock tips. I'll send them stock tips once in a while. Kind of a little bit surreal for me because we are not as human supposed to live in the time of Einstein or at the time of Newton or at the time of Gandhi or anything like that, but here we are actually living at the time of what I think will end up being two historical figures. That'll go down in history and even a hundred years from now, people (50 years from now) will be talking about them and such. The fact that they are in the flesh with us and the fact that, by accident, I got to interact and got to know them. It's been a lot of fun.

Charlie: That's great. I guess, switching gears more to like your process. The question that we've had come up a lot throughout the semester, especially with it being a lot of undergraduate students in the club is developing a circle of competence when we don't really know that much. I've mentioned in the club, about John Arrillaga, which I think is one of your favorite examples. But I was hoping that you could expand on that and just help us figure out where we can look to expand our circle of competence.

Mohnish: Yeah. Like the Arrillaga example, the size of the circle doesn't matter. You can have a really small circle of competence, but what is very important is staying within the circle, not even going to the edges, stay in the epicenter. To ask the question is to answer it. If you are wondering if something is in your circle of competence or not, the answer is it's not in your circle of competence. Probably, I think at your ages, what is likely the most probable to be within your circle of competence are products and services that you use regularly. Generally speaking, I think a good way to kind of begin your journey in terms of understanding what businesses to look at is to just look at all the products and services you consume. You go on YouTube, you go on Facebook, and you use Google. Do you use an apple iPhone? You use an Android phone. What brand of clothing do you wear? What kind of toothpaste you use, just all your daily habits, what kind of drinks do you like to drink food you like to eat? That's, I think a starting point, because generally speaking, for a brand to come through and be something that you would trust and use is a very high bar. Usually you have to have some very special attributes and characteristics for the business to get there. I think that's probably the simplest way to start tackling the circle of competence issue. Also, I think it's not that hard to figure out what is a good business and what is not a good business. It's relatively easy to start segregating those. If you are familiar in a consumer of products, which then you can tell whether they're a good business or not, then once you know that there's a few products you use or few services you use that are good businesses then from then on, I think you can start trying to figure out whether an investment makes sense and diving deep and figuring it out and so on.

Charlie: That's great. A lot of people are asking about a combination of your process when you're like reading articles or books, listening to podcasts, and then also where you're sourcing those from. If you can go into that for a little bit.

Mohnish: Well, I think that the best way to approach this is kind of like as if you're a gentleman or lady of leisure, I'm curious about a lot of things. I'm very curious about a lot of different businesses and how they work. I'm always trying to read autobiographies or biographies. I was just listening to a podcast, I'm in the middle of it right now, which is between Reid Hoffman and John Elkann on Reid Hoffman's broad podcast, and John Elkann is the chairman of Fiat Chrysler, we'd made that investment maybe nine years ago. I'm still learning stuff about the company from that podcast. Even though I used to own the stock and I've known John for so many years, I read a few newspapers every day, the physical papers you could do it digitally. If you run across interesting books or interesting people to understand them. I think what you're looking for is something that hits you like a two by four aha moment, where some company or some business you may be a customer of, but you've then studied it. Then you come up with some major, I would say, insight into the business that most other market participants probably don't understand and, or don't appreciate. If that insight is meaningful and valid, that becomes a big edge and you don't need that to happen even more than once a year. The reading is just something to enjoy and broaden your horizons, but through all of that, once in a while you get these aha moments.

Charlie: Great. Then next question was, somebody was curious about when you go through periods of underperformance, how you handle that, especially with outside investors, possibly losing confidence, or you might need to reassure some people and how that works.

Mohnish: Yeah. I think the business I'm in, all of the assets could leave every year. People can redeem, I mean, basically in effect, the entire asset base can be pulled. It's a temporary pool of capital and people have a variety of reasons why they would redeem assets. There's only one reason why people give you assets, but there's many reasons why they could want to take assets. Only a few of them relate to performance, etc. It could be life circumstances or whatever else is going on with the individual or family. My take is that, that's just part of the game. Part of the way the nature of that business is. If I were left with no outside capital and just had to work with my own capital, I would still think it's a blessed life. I wouldn't really have many regrets about it. I accidentally went into the investment business. I just kind of stumbled into it. There was no plan to do that. The plan was to just invest my own money. I think that it's not something worth worrying about. I think you do the best you can. People will leave for a variety of reasons. They'll join for a variety of reasons. There's a constant kind of assets coming in assets going on. That's all happening, but it's not something I really spent time dwelling a lot into, hi,

Monish: Hi. I'm Monish. Thank you for joining us today. I'm reading through some of the responses as well. One of the things that our members really wanted to hear ideally, was a lot about leverage and how it affects, whether your valuation or how you kind of determine if that's the right thing for you. How can you tell if the business is using leverage optimally? Or how can you tell if the debt situation's kind of out of control, if they have it in control, what are some of the things that you look at specifically would leverage?

Mohnish: Yeah. I think with leverage, first of all, on a personal level, yourself as an investor, it's best to minimize or eliminate it. I mean, I think it's perfectly fine. If you have a mortgage, it's perfectly fine. If your cars have loans on them. In fact, I think it's a good idea for all your depreciating assets to be financed and your home to be financed. I think those are reasonable things to do, but I don't think you should have margin debt in a brokerage account, et cetera. I think that's not a good idea and also not to play around much with options, and on a personal level I think that's also not a good idea, but when you get past all that, and you're looking at different businesses, I think it's pretty apparent whether a business is levered or not. I think it's pretty easy to tell on the balance sheet. Sometimes there are some liabilities which are off balance sheet, like leases, et cetera. But if you read the annual reports and such, I think it would become pretty obvious what their obligations are. The ideal great business is one that generates very high returns on equity without any use of borrowed money or leverage. We have a company in the US called Fair Isaacs. It's based in Bozeman. They're the ones who have all the FICO scores. Each time some financial institution gives you your FICO score. They get one penny or something. It's a great business. Basically that business is very profitable. They don't really need any leverage and a large portion of the revenue goes to the bottom line, but in investing, every situation has an exception and they can be really good investments. One can make on in businesses, which are levered. Sometimes the leverage can be nonrecourse or sometimes the terms can be such that the market is misreading it, it's causing distress on the equity for not very good reasons and so on. I think sometimes the presence of leverage can create great investment opportunities, but to keep it simple, if you just set to yourself, I would not invest in businesses which were levered. You could live a very blissful and profitable life.

Monish: Awesome. Kind of related to that too. I know a lot of people are expecting rates to rise in the next few months or even years. Is that going to have any effect on how we look at leverage or the amount of leverage some companies take on now that these rates are rising or how's that going to affect stock prices? Do you think going forward?

Mohnish: Yeah. I mean, if a business is levered and they're having difficulties or the interest is a very significant part of their earnings at low interest rates, and that's a very serious concern because you could easily get to a situation when the upside down or the tripping components and so on. I think it's very important to look at the gearing ratios and how likely the business is to be able to withstand meaningful changes in interest rates. In general, capitalism is brutal. Most businesses do not survive for more than a few decades, even though we're very successful ones. The ones that have leverage are going to be significantly less likely to be able to survive for multiple decades of time, because you're just adding a layer where you could have a very significant business downturn at the same time when rates go up and you are kind of upside down and then your lenders start to turn the screws on you. Those are not good situations to find yourself in.

Charlie: I sort of have a follow up to that. I was curious how much you think about macro events when you're investing, or if it's really focused company specific. That's something that's sort of like really at the end. Where that comes up in your process?

Mohnish: I think investing is difficult enough if you're just trying to understand a business and how it works. I think when you start overlaying and trying to make assumptions, okay, here's what I think will happen to interest rates or unemployment or recession in this year that year, all of those things, most people are wrong about everything. I thought that would happen with COVID in March 2020, turned out to be wrong. I mean, I would've never guessed that now we'd be sitting at all-time highs on the stock market after more than half a million people died in the US. We had all these lockdowns and stores and everything shut down and businesses, people working remote. I also wouldn't have thought that remote work would've led to a more productive workforce, not a less productive workforce. These are all counterintuitive. I think that the best thing to do is not to give too much weight and not to think too much about the macro, because it's a lot harder and it may not have an effect in the end at all.

Charlie: I have another question. I interned at capital group this past summer that was online, but I remember hearing about the best ideas fund. I remember you talking about that. I couldn't find anything about it, but I'm curious what your checklist is to sort of keep yourself honest, make sure that you're not pounding something into your head that might be incorrect just because you've been looking at it for a while.

Mohnish: I think this is a Buffett quote. He says that a, a horse that can count from one to 10 is a smart horse, not a smart mathematician. If you are looking at a business that is the best in its industry, that may simply be the smartest horse, but what you want is the smartest mathematician. Fair Isaac might be better than the best steel company, or the best oil and gas refining company, for example. I think that the interesting thing about capitalism is that, there are some businesses which are so easy to run, which have such strong comparative positions, which have pricing power. There are others which are so hard to run, no pricing power, lots of competition, on and on. As investors, we have the choice to choose where to go, be patient and try to look for the businesses who have a natural advantage, not just the bun, that's the best in the industry.

Charlie: Mohnish. I have another question. You're talking about picking the best, not just the best in industry, but picking the best mathematician. A lot of our members kind of want to hear more about the moat aspect from the value investing principles. How can you kind of tell what a good moat is or if a company even has a moat?

Mohnish: I think for the most part, it can be quite obvious if you just spent some time thinking about it, let's say, for example, you use Instagram or Facebook. You can form some opinion about the stickiness and how long those businesses could thrive and what would it take to unseat them? I mean, these are classic network effect businesses. They can be unseated if they're going to lose their weight and such, else some disruptor comes in with a better mouse trap, but it's not so easy to do that. They would need to be completely sleeping at the wheel for a long time to allow something like that to happen. I think it's something that you can start to put your arms around when you look at different businesses. If you look at a business, like 7up, for example, how does Sprite affect it? How do the other soft drinks affect it? How do other non-carbonated drinks affect it? What kind of pricing power does it have and how do consumers think about it versus the substitutes and so on. Those will start answering your question about the nature of the Moat and how wide and deep it is. I think that if you cannot get to a point where something is a no brainer, where you have been able to convince yourself that this is amazing, it just pass because even if you make one decision a year or two decisions a year or one decision every two years, that's perfectly fine,

Charlie: Kind of a follow up to that, is the moat the only competitive advantage that you're looking for or are there other competitive advantages that you kind of see from an annual report or somewhere else that you kind of factor into your decision to invest as well?

Mohnish: Well, the moat is kind of all encompassing. I mean, that's why Warren and Charlie used the term, because it's kind of, if you look at Porter's five forces, for example, it's a lot more complex kind of description of what is a moat, but the moat encapsulates things like a low cost producer. Sometimes the moat can be that you are just cheaper than anyone else in producing. Sometimes the moat is all about that. You don't need to have as much mark-up as someone else, like kind of a Costco, they're always going to be under everyone else's price. That gives them a strong moat. The moat, I think, is a very broad kind of shorthand for what gives a business in enduring competitive advantage. The enduring advantage can come from a number of different places. Sometimes the enduring advantage is hidden. You can see it in the numbers like the profits are great, or the growth is great, but why it's great may be hidden. Then you kind of have a treasure hunt, treasure hunter, how to figure it out.

Charlie: We did a question in the chat that I'm actually going to make slightly more specific than it's written, but it's asking how do you evaluate the quality of management when you're looking at a business? I guess I'll add onto that, as students, when we can't interact with management. Because I know that you could probably meet with the managers of the companies that you're looking into.

Mohnish: Yeah. I think it's actually an advantage if you can't meet the management because you are unlikely to be sold, which is a good thing. The simple way to evaluate management is simply look at the track record. What they have done over the last 10 or 20 years versus what they said 10 or 20 years ago, and that's pretty easily available. Warren and Charlie don't care so much about the projections of businesses making or projections of managers making. What they care a lot about is, what is a track record of that manager or management team. It's fun to go back into a business, go back 10 years, 15 years, look at the nature of the business, look at what the manager was saying. Then look at what transpired, did they under promise and over deliver? Did they over promise and under deliver, are they competent or incompetent? I think these things start becoming very apparent in most cases, when you start looking at those things from a long perspective.

Charlie: Yeah. we had another question that was submitted. A lot of the people on the call are obviously interested in finance and investment management. Some people were curious about what it is about the investment profession that you find most rewarding or most challenging or most tedious.

Mohnish: Yeah. I don't find it tedious. I find it permanently, thrilling, and amazing. Investing is one of the broadest disciplines. It's cuts across many different disciplines, especially depending on the business you're looking at. I gave a talk a few years back, it's on YouTube, about Coca-Cola at UC Irvine. Coca-Cola is in many ways a pretty simple business. Almost all of us are consumers of, if not Coca-Cola, one of the products. They've got a hundred brands or something, and we can very quickly, can I get an understanding of the nature of the business, but the kinds of things that affect Coke from a psychology perspective, the association tendency, celebrity giving Coke and endorsement or being used in the ad, the impact it has on us, or, just when we see the brand in different places and how it works. Coke can get really complicated as you start to overlay how it works in different settings and geographies and such. Investing, even in a simple business like Coke, requires you to be open to multidisciplinary thinking. That is the case with a lot of businesses you look at. The factors that affect a business are so wide ranging that you want to make sure you've honed in on the stuff that is likely to happen and understand what the likely impacts of that are. That will cut across many disciplines.

Charlie: We have a couple kids in the club that are involved on campus and like the entrepreneurship scene. They were curious on how you think being a founder of TransTech has helped you identify compounds and just helped you in your value investing career, like how that all ties together.

Mohnish: Well, there's this Buffett quote. He says, "what is it to walk on land? If you try to explain to a fish what it is like to walk on land, one day walking on land is worth more than a thousand years of trying to explain to a fish what it's like to walk on land". It's the same way with running a business versus reading about a business. I think that when you run a business, met payroll, made sales, lost customers, had good customer service, had bad customer service, employee turnover and challenges in hiring and all these other myriad things that you run into. Those teach you a lot about the way the world works and that experience that you get running a business gives you a better understanding of the challenges any business faces, running it is facing it. It is dangerous to look at a business through some spreadsheets. That's not a good way to look at a business. I think a better way to look at a business is to kick the tires, to really put yourself in the driver's seat of the CEO. Think about what three or four variables would affect most of the outcome and think about whether you can handicap, how those three of are variable would play out.

Charlie: I was supposed to actually have a presentation today about incentives for a finance class, but it got pushed back, but I was hoping that you could explain, some of the people on the call might not be familiar with how the Buffett partnership was structured. I guess why you picked that structure from an incentive standpoint, and then I'm curious if you could start the Pabrai

Investment funds over again from scratch, if there's anything about that structure that you would change.

Mohnish: Yeah. I would not change that structure if I were starting again. I think when I first encountered a Buffett partnership structure, basically Buffett had a number of different arrangements with different investors, but then the early 1960s, he made it all uniform, brought them all into a single partnership. He said, “look, the first 6% every year that I make is going to go to the investors and above that, I'll take one fold and the investors get three folds. If I have a down year, I first have to make it up. If I minus 10% in a year, I have to come up to base plus 6% annualized from that base”. After that on a fee. Everything about that appeal to me, I think it made a lot of sense. It seemed to be a win-win for everyone. It definitely aligned the interest of the investor with the investment manager. I think it gives a lot of incentive to the investment. It's quite a lucrative scheme. If you are a really good investor. I mean, if you're going to bang out 20% a year, you're going to get three and a half percent on other people's money every year. That is quite a handle. The creepier take is quite large. It can work well. At the same time, your investors don't mind you getting that because they're also getting 16.5% after fees, which is also really good.

Charlie: I have another question and it's kind of more on the informational side of things before you're getting ready to actually make that investment. I know that you can probably never have all the information before you go into a decision, but how do you find that stopping point where you say, “I think I have enough information that I feel comfortable making this trade”.

Mohnish: Yeah, that's a great question. I'll take a tangent and come back to your question. Many years back, I was talking to Charlie and he encouraged me to discuss my investments, not so much with an analyst who might work for me, but with a peer investor who cared about me and was a good investor. He said, “I always had someone to talk to, Mohnish, and it's a big advantage because sometimes, we as investors, have blind spots”. I told him “in your case Charlie, for example, you have Warren to bounce investment ideas off”. He says, “well, it wasn't always Warren, but it's very helpful to have somebody who you can discuss your ideas with”. We all have our circle of competence. We all have our blind spots. One thing that is useful is to generally bring your ideas to some person who you trust and who cares deeply about you and is also a good investor. That's an important thing. But I think beyond that, you obviously want to get to an aha moment, which is telling you here's all the reasons why this investment is a no brainer and the world doesn't get it, but eventually there will. Here's why it makes sense. What I have found in 25 plus years of investing is, the greed portion of our brain can sometimes mislead us. It’s really important to have circuit breakers on that greed. One of the circuit breakers I have is, I have a pre-investment checklist. It has like 160 or 170 questions on it. I run any investment through those questions before I invest. The big value the checklist adds is that, the first time I run it, it'll pop up maybe 10 or 20 questions where I don't know the answer. What that says to me is “listen dummy, you are not done with the work. You can't even answer these questions, first go and figure out the answer". Figuring out that answer might take several weeks of work, which is fine, or might take several days. Once you can answer all the questions intelligently, the checklist has done its job. It's going to highlight things that are likely possible failure points in the investment. Every single company, you can come up with scenarios where that business is going to have struggles in the future. The question you're trying to answer is, what are the likelihood probabilities that happens or doesn't happen in that business versus what you think are the good things that could happen in the business? I think the circuit breakers is important, talking to somebody you trust is important. Being patient and thinking through why something would not work or what are the issues that could cause a permanent loss of capital, that's where the focus needs to be. The upside will take care of itself. I think your aha moment is already probably showing an upside question of how do you protect the outside?

Charlie: Could you go through an example, not a current holding, but maybe a former holding that either worked really well or worked not so well. You learned a lesson from, just to sort of put some of this into practice.

Mohnish: Yeah I think that we don't really learn much for the businesses that we do well with, those just feel great, like, "well done Mohnish" that's all about it. That's all you're going to get out of those investments. It's the failures. It's the same thing as when you're in school, the classes that are easy A's don't teach you much the classes that you have to struggle and you maybe get a B or you're, you know, C level, a C average, trying to pull a B out or whatever. Those are the ones that really teach you a lot in investing. That's why it's always important to have a real portfolio, real brokerage account, do not do this through a spreadsheet because you need to feel the pain. You need to feel the pain because you will lose money. It's guaranteed. John Templeton said "we're going to be wrong when we invest, at least one out of three times". I think that failures teach you a lot. In 2008, for example, I had an investment in a subprime mortgage lender, Delta financial went to zero. That was painful because we had a concentrated portfolio. We at 60, 70 million invested in it and it all went to zero. I've had a number of difficulties over the years with investments in finance and banking company. I've come to the conclusion that I don't need to go there. Generally speaking, if a bank comes up on the radar, I don't even bother to look anymore. I just say it's a pass. Okay. Now, if you look at someone like Warren Buffett, in his entire career he's, (I believe) never been wrong on a banking investment. He used to have an investment in a bank in Illinois Forrest Rockford in the 1960s. It was one of the first acquisitions Berkshire had done. I have a friend who used to be an intern at Forrest Rockford at that time. He'd say that Warren would show up once a month to visit Forrest Rockford from Omaha. He travelled there and he said the whole place would be frenzy for several days before Warren showed up, because they knew he never forgets a number. He's asking a bunch of questions, but that particular bank was probably one of the best run banks in the country, their write offs or bad debts for decades approach zero. It was a single branch bank in Rockford. The founder knew all the major business owners and the founder was very deeply involved in all the underwriting decisions. Pretty much every loan and he had to approve it and he wasn't going to approve loans to dead beats. They had an exceptional track record in terms of how they with the loans and Buffett is a really good banking analyst. He had investments in Wells Fargo, JPMorgan bank of America, M and T bank, on and on every one of them has been a home run and it's worked out really well for him. On the other hand, if you look at his track record with retailers, it's been terrible and he doesn't talk about it much because he doesn't like to discourage his managers. But I would say that almost all of the retail investments that Berkshire Hathaway has made, which have been dozens of retail investments, only a couple of them have done really well. Nebraska Furniture Mart and Bosche have done well. Almost every other jeweler they bought has done terribly. Almost every other furniture operation they bought has done terribly and almost every other retail operation they bought has done terribly because in general, retail is just so hard. It's so hard to do well that even Warren Buffett struggles. There are SIC codes where Warren excels and there are SIC codes where Warren does poorly. That's the situation with all of us. The earlier you figure out what you're good at and what to avoid, like I've figured out. I took a lot of painful arrows in the back. I wish I knew this 25 years ago. But I don't really want to own banks or finance companies. I repeatedly get holes with those. I've done enough for a lifetime. On the other hand, I've done very well in other areas where, like in a lot of commodity businesses, which are low cost, those have worked really well, low-cost producers and a number of different kinds of businesses, which I've been able to handicap well have worked out well.

Charlie: How do you determine what price you'll pay for a business? How do you calculate the intrinsic value of a business?

Mohnish: When you go back to circle of competence, if a business is within your circle of competence, by definition what their businesses were, and you don't need to do this precisely. Okay. I mean, let's say I take a business like Coca-Cola. What is Coca-Cola worth? I would say that it's likely that Coca-Cola's intrinsic value is probably more than 15 times trailing earnings. It might even be more than 20 times trailing earnings. Maybe it's even 25 or 30 times trailing earnings, such a high quality business, but let's stick to 15 times trailing earnings where that's a no brainer. We know it's worth more than 15 times trailing earnings. If Coke is offered to you at five times trailing earnings, it's a no brainer. It's an aha moment. If it's offered to you at 12 times trading earnings, we don't know. Once we get to what we don't know, we can take a pass. This is a game with no call strikes. We can let a thousand balls go by, not just three. Coke comes to you at 12 or 13 times earnings. Yeah. Not really let it go. Then Facebook shows up at 12 times earnings, let's swing at that one. You just keep doing that all day. You basically keep saying no to almost everything. What happens is that, once in a while, there are these aha moments. I think the key is that it has to hit you between the head with like a two by four where you just cannot ignore it. Like

I've mentioned in some of my previous talks, I was visiting Turkey and I ran into this company. That is the number one warehouse operator in Turkey. It was really simple to figure out what, their warehouse is the 99% least, the least like Amazon, Carrefour, Ikea, very high-quality tenants, long term leases, 10 years, whatever. It's really easy to figure out what the cost of a warehouse is, 30, $40 a square foot for the land. 35, $40 a square foot for construction costs like 70, $80 a square foot. They had 12 million square feet. It may be worth 900 million to a billion, something like that, may be 800 million to a billion somewhere in that range. There was a couple of hundred million of debt. The thing is worth about, let's say 600 to 800 million. The market cap was 20 million. If you see a cow or a bull which is huge, you don't need to know the weight to know that it's big. I didn't need to know whether the liquidation value of racers was 800 million, a billion, 600 million, 500 million. All of those answers were fine. Even 200 million was fine. I'm paying 20 million. Okay. The only question left was, am I dealing with a bunch of crooks? Are they honest? Like what's going on here. I poked a lot at that, and I met the father and son, and I asked people I trusted. They said, there's nothing we've ever heard, which is untoward about them. They came across as pretty straightforward, smart people and hardworking people. They had built themselves from scratch. I mean, they worked hard at it, so it was a no-brainer. I think what you're looking for is these absolute no-brainers and they do show up from time to time. When they show up, then you step up to the plate.

Charlie: I'm curious your idea of being a shameless clone, or if you've had to make any updates to that over the years, or if you think that that's like a timeless thing and it's going to stay perfect the way that it is

Mohnish: Well, I think it's a big advantage to be able to leverage what other people have already figured out. I think that if you look at something like DATAROMA, which lists the top holdings of a number of prominent investors for something to make it, the portfolio of Chuck Akre or Bill Ackman or any of those people, it's gone through a bunch of filters. I mean, Bill runs a concentrated portfolio. He might have one or two new positions, he's got a team, they look at hundreds of things, right? If something has made it through, it's worth checking out and trying to reverse engineer why it means. I think it's a big advantage to use as your universe to dig into what other people have already figured out. Instead of starting with here's 50,000 stocks globally, let me go figure this out. That's a really tough job. But if you take that skill set, that data set down to here's 50 stocks, which are the top holdings of 10 or 15 investors that are really in mind or here's 20 stocks that are in that group. It's really relatively easy to go through the list and say, okay, which ones can I understand? That'll throw out a bunch of them and which ones are great businesses. That'll again out a bunch of not so great businesses. Then the ones that are great that you can understand, you can look at the valuations and go from there. Pretty simple.

Charlie: That's all the questions I had. I don't know if anybody else has anything that they want to ask. Before we wrap up, Warren Buffett has said that he wants to buy businesses that are going to return on capital employed for a very long time. How do you know if a business is able to employ capital at high rates of return over long periods of time?

Mohnish: It's a great question. Munger would say, “why should it be easy to get rich?” The ability to answer that question has the possibilities to make you insanely wealthy. If you know how to answer that properly. But it's not easy to answer that properly. Let's take a business like Geico, Geico is a direct writer of auto insurance. Unlike State farm, if a policy pass through state farm, state farm pays 10% or so off that premium to the agent who, independently owned agent, which is bring that policy in Geico uses a call center. It has approximately maybe, eight to 10, 12% advantage over State pharma in all state, and that's a secular advantage. That advantage has allowed Geico to go from nothing to, it used to be two, 3% of the auto market. Now it's eight, 10, 12% and they're to grow, but progressive, which is also a direct writer of policies, has run circles around Geico. Progressive invested very early in telemetry technology, which gave them a lot more data about how the cars were being driven by these drivers and that allowed them to have a much better understanding of the risk. They were willing to, there were, certain drivers you could offer even lower premiums than Geico, bring them in, and they'd still be profitable where Geico will look at the driver and say, I really can't take this guy below certain premium because they were missing some data points. That's an example of how, and Berkshire's now trying to fix that. They're behind the eight-ball trying to help Geico catch up to Progressive. My two senses is that Progressive is really good at technology. They've had a long head start. They're continuing to jam on this. I think Geico is going to have a hard time. They might get there five years, 10 years, they might get there. They still have the advantage against the other player, but they're not the best. They were the best 10 years ago but they're not the best today. One would not have been able to predict 10 or 15 years ago that we'd have this kind of issue come up with Geico, right? We'd just look at Geico and say, oh, Berkshire Hathaway, they've got this advantage. They just keep chewing through and getting more market share. They've got great customer service, who doesn't like the Geico, on and on. You guys might not remember this, but there were these series of ads Geico had for the caveman. You remember the caveman ads. The caveman ads were hot and heavy when we met Warren for lunch. My daughter asked Warren, have you met the caveman? and Warren said, “I'm sorry, I haven't met the caveman. Can you tell the caveman we'd really like him?” It's so funny anyway. If you look at Coke and the sugar issue, and where does that go? 10, 20, 30 years from now, is it an issue with a nonissue? Is most of the portfolio, non-sugar carbonated versus non-carbonated whatever. I think that if you look at visa and MasterCard, incredible businesses, what do those businesses look like 10 or 20, 30 years from now? There's so much happening in payments, American Express so much happening in payments. It may not be easy to figure those things out. This question, we can clearly tell which businesses generate high returns on employed capital that's black and white it's in the balance sheet. We can tell income statement.

It's easy. The nature of how long that can continue, becomes a much harder question. That's why we want a margin of safety. That's why we want these aha moments. But if we can figure that out, in some cases, I'll give you an example, which is going on right now in my portfolio. I'll talk a little bit about one of the portfolio holdings. There's a company in India that I invested in about three years ago called Indian energy exchange. It is a network effects business that basically has 95, 98% market share where electricity on the sport market is bought and sold through their servers, and whatever is bought and sold through their servers, they keep 1% of the transacted amount. When I first invested in the business, there's a company called American tower and American tower basically owns tens of thousands of these cell phone towers. It's a great business because by the time you get the second tenant on that tower, anything incremental coming in is like almost a hundred percent margin. Then when you go from 3G to 4G, to 5G, each one of those is adding more complexity and such. Once ATT architects, its network and has towers in certain positions. If you take out one tower, it affects one, what I'm saying is that you can't take out one tower and put another one a mile away. It affects the whole network. In effect, the owner of that tower has an advantage where a AT and T's probably going to keep paying rent well beyond the least term because their network topography would change so much if they had to redo these things every time. For a number of reasons, American power is an incredibly great business. It's been a great business for a very long time. One of my friends used to be a fund manager at a large fund house and they had an invest investment in American tower. They had like an investor day, so they invited all these fund managers to their headquarters. They were going to have some meetings and presentations and then play golf in the afternoon. My friend showed up a little bit early and he went to the CFO's office. He knew the CFO, and he saw the CFO just sitting there with his feet on his desk. He asked him, “Hey, you don’t look like you got anything to do”. He said, “yeah, I don't have much to do”. He says, “don't, you need to do deals? You guys keep buying new towers, don't you need to do new tower deals? You’re just sitting with your feet on”. He said, “look, everyone has my number, anyone who has a tower for sale knows how to reach me. They also know exactly what I'm going to pay”. He said, “there's no voodoo or work involved. The call comes in. We tell them, yes, here's the terms. Here's where you sign. We wire the money we move on. My feet are still on my desk. I don't need to go have a root canal about this”. That's the definition of a great business. When you look at something like American tower, it's likely that's going to endure for a long period of time. Now there could be a disruptor. Elan could put everything in satellites, for example. At that point, he's not going to have his feet on this desk. His feet are going to be shaking under the desk, but who knows how far and what the odds are and whatever else. I think that when I look at a business like IEX that we invested in, 3% of India's electricity was flowing through their servers when we invested three years ago. Now it is north of 7%. It's become 7 1/2%. It's grown a lot. India's per capita usage or electricity is going up as well. The government of announcing policy changes where it's probably going to get to 20 to 25% of the total electricity. It might even go higher, might be 30, 35%. It's huge to take a country, the size of India, where the per capital electricity usage is so small. Then you collect. The way that business works, 75% of revenue is net income. Okay. When I visited their offices, I visited the offices in New Delhi a few times. It reminded me of Chuck Akre and my friend with American tower. I saw this country club relaxed place. Nobody's really stressed. They got about 40 software guys who don't seem to have much to do. They got a 30, 40 other people who also don't seem to have much to do. Everything's running through like two or three servers they have, and the money's flowing. Everyone pays them in advance. They have no bad debts, nothing, and whatever comes in, they have no expenses. Okay. It's a bunch of bits running around on a server and they collect 1%. They got no expenses. They just pay for the software people. As their revenue grows like this, 80 person company might become, if it becomes 10 times the size in revenue, it might go to one 20 people, 50% increase in people for 10 X extra revenue. The 72% might become 82%. Okay. Now the question is, how long can this continue? I don't know. We've had so far 5X or 6X returned since we invested, (well done Mohnish) like I said, we learn nothing. IEX teaches us nothing. It just feels good. But I don't know how long it can go on. It could go on for 20 years. If it goes on for 20 years, hallelujah. God loves me. It might also, may be be in three years, some policy changes come in and something happens or whatever upsets the apple cart. We don't know it, some of these things are kind of hard to figure out, but my best guess is let it ride. We have an India fund where IEX is now like 40% of the pie and we are like saying, it's okay. We just keep our investors informed. I said when it gets to 95%, which it might with the way it's going, as long as we can just let everyone know, "listen, guys, 95% of your money is in one stock, like, disclose that properly". If you don't like this, you can exit whatever else I think we are. But you don't get many opportunities like that. I made a mistake with IEX. I used to own 5% of the business which was the most we could buy and then COVID hit and I was concerned. It always looked expensive. That's the thing. When you look at Fair Isaac, like if I look at IEX today trailing earnings, it might be trading at 80 or a hundred times earnings because it's a spectacular business that's growing like crazy. It's never going to be at eight times earnings. Anyway, I think that question is a great question. It's a great question to think about, and you only need to figure it out once you only need to find one IEX or one American tower. If you are right about that runway for 30 or 40 years, just sit there and let it rip and you're done. That's it.

Charlie: Thank you so much for your time today. This is great.

Mohnish: You look a lot like your dad. Tell him I said, Hi!

Charlie: Is that a compliment or an insult?

Mohnish: That's a compliment. He's a good-looking guy.

Charlie: Yeah. I'll let him know.

Charlie: All right.Thank you so much.

Mohnish: Like I said, I enjoyed interaction with both of your parents, they're both wonderful people. It was great to say hi. Do you guys play Clemson often?

Charlie: I was looking at it with my roommates. I think we have a home and home scheduled with them in the next couple years, but yeah, we played them at the beginning of this year. I went to that game. That was pretty fun.

Mohnish: Clemson lose that one?

Charlie: Yeah. Clemson lost. Yeah.

Mohnish: I remember, that was not expected.

Charlie: Yeah. A lot of people are saying that Clemson's not as good this year, but my roommates and I were saying that Georgia broke Clemson that, like we did it to them. That's how we're trying to justify it.

Mohnish: All right. That sounds good. Well, you probably know that the orange in my room yeah. Is because I'm lead orange when I cut my wrist or whatever. But anyway, go bulldogs and go tigers

Charlie: Go dogs.

Mohnish: Yeah. Thank you so much. Thank you.

Charlie: Bye.

Mohnish: Okay. Bye.
