Mohnish Pabrai's Q&A at Clemson University – Wall Street South Investment Club on November 13, 2023

Mohnish: There are two ways when you are looking at making an investment that it makes no sense. Either pricing is so euphoric and so extreme "bubble-esque" type characteristics that you would kind of scratch your head. In those cases, you can just take a pass and move on. On the other hand, where the pricing and valuation are so extreme in the other direction it also makes no sense because we invest in auction-driven markets. Auction-driven markets have this peculiar characteristic that they can swing extremely in both directions. If I were looking to purchase a home in Clemson or Andersen, it would be an intelligent seller facing an intelligent buyer almost all of the time. You would come up with some kind of intelligent price in a negotiated transaction. It would be very similar if you were trying to purchase an entire business. Again, there would be an intelligent seller facing an intelligent buyer. But when you have these fractions of businesses trading on the New York Stock Exchange or the Nasdaq, the fraction of a business can be valued quite differently from the way the entire business would be valued in a negotiated transaction. When you see those kinds of extremes and if you are a heuristic, you would say that that is the only time you are going to act when you see extreme behavior or extreme situations.

In the 2005 annual meeting of Berkshire Hathaway, Warren Buffett was asked a question. He had made a relatively large investment in PetroChina. He had never invested in China before so this was his first investment in China. It was about a 400-million-dollar investment for Berkshire. A question came up in the meeting, "Why do you invest in PetroChina?" Buffett said, "At the time PetroChina was earning about 12 billion dollars a year." It is one of the largest oil companies in the world. Maybe Exxon and BP are the only ones that would have higher earnings than that. It is 90% owned by the Chinese government, while 10% is publicly traded. Against this 12 billion cash flow, the market cap of PetroChina was 35 billion US dollars. On top of that, Warren said he was grateful that their annual reports were published in English so he could read them. They had pretty much written in black and white, in the annual reports that 45% of all cash flow would be pushed out as dividends. He was buying at three times earnings. It is a pretty dominant oil company! It was something like a 15% dividend yield on what he was buying. He understands these large oil majors very well. He said, "If Exxon or BP or Chevron were available at those valuations, I would pick those because I would get U.S. governance and many things I would understand, that maybe I might not have understood a word of in China." Given the huge delta in valuations, he thought it was a no-brainer BAT. He could not find any other oil company that was trading at those types of valuations anywhere in the world. Very quickly, the stock tripled. They held it for a few years. It was a big home run. That is an example of things not making sense.

What I would say is that if we practice what I would call anomaly-based investing, weird things happen that make no sense. That is the only time we acted and even if we are not doing anomaly-based investing because we are trying to look into the future, the error rate is high. Even the best investment analyst or best investment manager, according to John Templeton, will be wrong at least one out of three times, and more likely you would be wrong at least half the time. Wrong means that you know the stock could flat line and not go anywhere, or it could decline a little bit, or go up a little bit, but it does not do what you expected it to do. We are in a business with a high error rate. If we focus on anomalies, then those become interesting. You need to have your radar up whenever anomalies show up.

Four years ago I was in Istanbul, and one of my good friends who is a value investor is based there. I told him, "Listen, I just want to visit the publicly traded companies in Turkey that you have an investment in. Do not take me to businesses that you think are great if you do not have your own fund invested in them." I visited in 2018, and then again in 2019, and he took me to a business. When we were driving over he said, "The market cap is 16 million dollars and the liquidation value is 800 million." I would call that an anomaly; something trading for 2% of liquidation value. I asked him if it was a fraud and what was going on, and he said, "No, it is a very simple business with very high-quality people. My fund has invested in it. It is a REIT. They own warehouses and are the largest warehouse operator in Turkey. If they sold all the warehouses tomorrow they would get about a billion dollars, and there would be about 200 million of debt. You would end up with about 800 million, and the market cap is 16 million." Then I thought, "Well, this will probably trade by appointment, maybe not liquid or whatever." But Turkey is an interesting place where it is just a market filled with gamblers. People want to buy at 10 AM and sell at 3 PM. The average Turkish company cycles through its entire market cap every nine days. In the US, if I look at the New York Stock Exchange, it is somewhere between one and two years. That is also high, but a lot lower than nine days. I found there was a lot of trading volume. For about eight million dollars, we ended up owning one-third of the company. The Turkish Lira has collapsed since then. In dollars, the market cap is 500 million, and that liquidation value is close to 1.5 billion now. When things hit you over the head with a 2 by 4, and they make no sense, that is when we need to act. If someone says Apple is trading at 150, and it should be between 180 and 250, then just take a pass. That is not an anomaly. If someone says Apple is worth 1000 a share and it is trading at 200 per share, we should take a look and take it from there. Because we do not have much time, let us open up for questions and see what you guys want to talk about. Thank you.

Del: I will start with a quick question for you regarding the last six months. I wanted to know when markets turn sideways, how do you alter your investment strategy?

Mohnish: The last six months were mostly a yawn. As I said earlier, we get excited when things are at 3%, 2%, or 10% liquidation value. It did not do much for me. I generally find that in the United States, almost anything I look at is either fully priced or overpriced. One of the interesting things that happened in the last two years is that there was a very dramatic change in interest rates; a very significant upward movement of interest rates. One thing that should affect stock prices quite significantly is interest rates. When we see a huge rise in interest rates like we have seen recently, it should lead to a significant drop in the market caps and valuations of stocks. We did not see that draw which is also an anomaly, but it is an anomaly in the wrong direction. If stocks were priced to perfection a year ago or 18 months ago, they are definitely overvalued today because we have a huge change in interest rates. In the last six months, a cheapskate like me did not make much change to the way he spends his days. The other thing is that in investing, one is far better off not looking at macro events and not looking at what the market is doing and this and that. Focus on the individual business. Just focus. The first question when you look at a business is, "Is it within my circle of competence?" Focus on the businesses that you understand well and tune everything else out. We do not know what interest rates are going to do. We do not know what the economy's growth rate is going to be. We do not know many things, and there is no point in wasting time on those types of questions. What you really should focus on is individual businesses that you understand well, and specifically, within that group, the businesses that are anomalies in the right direction.

Del: You live in California now, but you went to college at Clemson. How did you make the transition from South Carolina to California?

Mohnish: I left California a little less than two years ago, and now I am in Austin, Texas. I moved from South Carolina to Chicago, where I had my first job in 86. In 2003 I moved from Chicago to California. It was Clemson, Chicago, Southern California, and now Austin. I moved to Chicago in 86, when I graduated because I was a foreign student at Clemson. My degree was in computer engineering. There were very few companies that came on campus that did not have a citizenship or permanent residence requirement. There were a lot of defense contractors, like the power company, but they all had residence requirements. I needed a company that would sponsor me for a work visa and eventually a Green Card. I was lucky I found a very good job with a wonderful telecom networking company in Chicago. I worked with them for about three years as an engineer, and then I moved to international marketing with them. I spent about five years with them. They got me my Green Card, which was great. Then I started my own company which was an IT services system integration business. I quit when that business had a little bit of traction, and I worked on that for about ten years and it did well. In the middle of all that, I heard about Warren Buffett. In 2003, my wife said, "This is not a place for humans. It is too cold. I am moving to California, whether you are or not." I replied, "Well, I will come along as well." We moved in 2003, which was a good time. The kids were young and Austin just made sense. California has the highest tax rate in the country, headed even higher. Most of my income comes as long-term gains and the state income tax was more than a third of the entire tax bill I was paying. I thought that if the one-third goes to 0 with what I think is an improvement in quality of life, it is a win-win. It is also an anomaly. We focused on the anomaly and moved to Austin. There are some really good chefs here, and I love the place. It is great, and UT Austin with the Longhorns, helps a little bit because they are not orange, but they are burnt orange, so it is close. It is not too bad. They do not have a tiger, but they have a longhorn. We have to live with that, but that is okay.

Del: I am curious about what indicators you look for when trying to find an anomaly, and how you go about that.

Mohnish: That is a great question. The job description is reading and thinking. I am always reading and always looking at different things. I am always trying to make sure that if I encounter something that does not make sense, I take a pause, and look at what is going on. These anomalies show up in all kinds of places. It is kind of hard to come up with a particular pattern, but sometimes you can be proactive to cause an anomaly to show up.

In 2018, I noticed that Turkey was screening extremely cheaply as a country. The P ratios and price to book, and all of those for the entire market were screening cheap. I had a good friend in Turkey, whom I knew was a hardcore Ben Graham disciple. I am trying to move him to become more of a Charlie Munger disciple, and he is a work in progress there. He used to come to the Berkshire meetings. I thought that a good way to kind of poke around in Turkey would be to go there and look at the businesses he has invested in. The food is great there. The bluefish that they get from the Bosphorus is awesome; grilled right in front of you. I thought to myself that the lunches and dinners were going to be great, and in between that, I would get to learn about a few businesses. I had no plans to invest or anything. I just thought of it as one week of great dining and some learning from these different meetings. That is it. When I poked around, I found a few things that made no sense. That is how that happened.

I have a subscription to Value Line, and I am sure Cooper Library has a subscription to Value Line as well. Value Line publishes every week a little list of the stocks with the lowest PEs, stocks that have lost the most value in 13 weeks, and stocks with the widest discount from price to book. They have a few stocks with the highest dividend yields. I just look at those lists every week. That does not take much time; less than five minutes a week. I check to see if there is anything there that pops out.

More than 20 years ago, I noticed that two funeral services companies were showing a PE of 2. I had read an article, a long time before that, that said the lowest rate of business failure of any SIC code was funeral homes. If you wanted to go into a business with a high rate of business failure, you would open a bar to compete with Tiger Town. If you open up next to Tiger Town, you might not do so well. You might be in and out of business in six months. But if you open up a funeral home or you buy a funeral home, the odds that you would be in business even 50 years after that are high. The reason is that nobody wants to go into the funeral home business. They want to start a business that competes with Tiger Town. It is, in a way, recurring revenue. If you have a funeral home in a community, families will want to go to the same place. The other thing is that when your favorite uncle has passed away, you do not call six places trying to get the cheapest price on a casket. That is not how you treat your favorite uncle. You pretty much call the one place that you know is close and good, and you accept the pricing the way it is. There is no bargaining that goes on. Those are all characteristics of a great business. I thought, “Okay, I know that funeral homes are a great business. Why are they selling at two times earnings?” It is because it is so stable. I do not know who is going to die in Peoria, Illinois next year, but I know how many are going to die. It is a very stable business, with very predictable cash flows. I thought, “We are going to dig into funeral homes to find out what is going on.” I looked into two that were trading at two times earnings. They had done a big roll-up. They had a lot of debt. But even after looking at all of that, that two times earnings made no sense. After doing the work, I bought the stock, and I was buying at $2 a share. About a year later, it was $10 a share, and we were in and out in about a year or 18 months. In that case, it showed up from Value Line.

Another place where some of these things show up is in 13F filings. Some professional investors have over 100 million invested in the US markets and have to disclose what they own every quarter. You could look at Berkshire Hathaway's 13F, Bill Ackman's 13F, or whatever investors you admire. You can look at their 13Fs, and you can try to reverse engineer. Why did they buy that stock? Why does Bill Ackman like Chipotle? Why does he like the railroads? In many ways, it is investigative journalism, which is a lot of fun. You go down a rabbit hole to try to figure out what was the reason. Sometimes, when I see things on 13Fs, I am not interested in buying or selling, or anything. I just want to understand why that particular individual did that. When I figure out the reason why that person did that, then I can make a decision. Do I agree with that, or disagree? Is it enough of an anomaly? What is going on? Then I take it from there.

For example, if you look at Value Line, or even if you look at some of the 13F filings, you will find that some national car dealerships in the United States trade at extremely low multiples. Currently, in the overvalued market, car dealerships trade very cheaply. Companies like AutoNation, Asbury, and Lithia are furiously buying back their shares. AutoNation has no dividend. It just buys back a lot of shares. The same applies to Asbury. A car dealership is relatively easy to understand. Some of you might have even visited a car dealership or two. If you have seen the movie Fargo which I would describe as a dark comedy, there is a scene where this guy goes into a used car dealership. He is trying to buy a car. When the guy is trying to negotiate, the salesman says he needs to talk to his manager about this. He disappears to talk to the manager, and in the movie, what happens is he goes over to the other office, and they discuss football scores or what happened that weekend, and then he comes back after five minutes. There was no discussion about anything; the back and forth was all a charade. If you look at a car dealership, it is three or four businesses in one. There is the new cars business. New cars are extremely easy to compare and shop for. We have many websites like TrueCar which will help you understand the invoice price and other things. Car dealerships make almost no money on new cars because it is so competitive. People know what they want to pay and what options they want. They might not even make 500 dollars on a new car. That business is like a loss leader. But when you go to buy a new car, they almost always get involved in financing it. They make a lot of money from financing, insurance, and warranties. Used cars, especially certified pre-driven, have significant margins because you cannot do an apples-to-apples comparison. For example, if there is a red Honda Civic that is two years old and 10,000 miles, there will not be another one that is the same, especially if the dealer is a Honda dealer that is giving you a Honda warranty on a used Honda. Used cars have better margins. The best margins are parts and services. If you look at a car dealership, parts and services are around 10 or 15% of the revenue, but almost 40% of the overall profits. It is extremely profitable because where are you going to go? They know they got you. They know that you got them when you come to buy a new car, but with everything else, they got you. In the US, the franchise laws are such that the car manufacturers are not allowed to sell cars directly. Moreover, they cannot shut you down or anything. These are almost monopolies. If I have a BMW dealership in a certain area, BMW is not going to put three dealerships within three miles. In that geography, you have got like a monopoly. Car dealerships are a great business. But then, there is this looming threat of EVs, where people think that there will be a lot of EVs that may not need a lot of parts and services. But the EV stuff is a little far out, and given what the three OEMs are doing, it might be even further out. If Tesla makes a 10% margin, then all the GM, Ford, and Stellantis will never make a dime on any EVs because their costs are going to be 10% more than Tesla's, so they will want to delay. They are delaying the transitions as long as possible. If they were smart, they would just run the business and runoff, which is not investing in EVs. Here is one of the anomalies to pay attention to. We have an anomaly called Elon Musk. When you encounter someone like Elon Musk, there are a few things you should do. The first thing you do is you do not compete with Elon. It is not good for your health or your wealth. We have an anomaly there. If I was GM, Ford, or Stellantis, I would just take my ball and go home. I would not play that game. But what they are going to do is they are all going to play the game. They will all lose a lot of money and in the end, they will all cease to exist, and you heard it first here at Clemson. That is just the way it is. But in the meantime, car manufacturing is a terrible business. Car dealerships are a great business, but the market does not get it. That is a little bit of an anomaly. That is how we go about it.

Del: You were talking about some of the anomalies for success. On the other hand, are there any strong indicators throughout your career on what to look forward to, when to not buy a stock for a company, and your way to know when to avoid going into a certain industry or company on its own?

Mohnish: Well, there are 50,000 or so stocks around the world. Ninety-nine-plus percent of them are either ones that you cannot understand or are too expensive. They are not anomalies in the right direction. Our main job is to just say "No," to everything, except when every once in a while, something shows up that you should look at, and then maybe after doing the work, if it makes sense, you say "Yes." If I can find two stocks a year I can say "Yes" to, life is awesome. That is all I am trying to do. Even one stock a year would be just fine. If I can find one a year, I am doing good. I focus on talking to the wonderful students at Clemson and avoid saying "Yes" to stocks to buy because most things just do not make sense to buy.

Kerry: Mr. Pabrai, this is Kerry McMillan with Wall Street South. You always send me great notes, and I think the students would like to hear about your association with Warren Buffett and the Berkshire Hathaway.

Mohnish: Well, I do not have any official affiliation with Berkshire or Warren. Both Warren and Charlie are friends and it is kind of weird that the Indian guy who was a foreign student at Clemson is friends with Warren and Charlie. But, weird things happen in this world. That is another anomaly. We live in kind of interesting times because we live in the time of Warren Buffett and Charlie Munger. I found that interesting, that they are alive while I am alive. I discovered about 16-17 years ago that Warren Buffett would meet you for lunch if you bribed him. I thought, "Oh, this is great! I can try to bribe him." When I was at Clemson, I got my degree in computer engineering. I tried to take as many classes as I could in the business school. I spent a lot of time in Serene Hall, but now those business schools have moved to where Clemson House used to be. I spent a year living in Clemson House, which was pretty nice but Serene Hall was where I used to take my classes, and I enjoyed it. At that time, I took a few investment classes, but almost everything I learned, I learned from reading about Berkshire Hathaway, Warren, and Charlie, and all their writings and annual meetings. In 2007 my net worth was 84 million. A very large portion of that was because of using the intellectual property of Warren and Charlie without paying them for it. I felt like there was a huge tuition bill due, and then I saw that he was willing to take bribes. I thought to myself, "Well, if someone makes you tens of millions of dollars, and you want to say thank you to them, how much should you be willing to pay them for tuition?" I thought at that time that two million was an appropriate number. If someone makes you 80 million, you can give them two million. It is okay. That is a good cheap deal; two and a half percent. I decided I was going to bid for Buffett's annual lunch. You can bring seven people to the lunch. I was going to go with my family and there were still three seats empty. I talked to my friend Guy Spier. I told him, "Hey, I am going to bid for Buffett's lunch. Do you want to come with your wife?" He said, "Oh, I would love to. That would be great." I then said, "Look, there are going to be two of you and four of us. You can be one-third of the total, and I can be two-thirds. I am okay to go up to 2 million. With you, we could go to 3 million." He said, "Wait, wait, wait. That is too much. I cannot handle more than a quarter of a million." I told Guy, "OK, listen. You are capped at a quarter of a million. Anything above that, I'll take care of if the one-third is more than a quarter of a million." I bid for it, knowing that we had a three-million-dollar war chest. The bidding capped out at 650,000. What a deal. Guy wired me 200,000 and some change and then we wired the money to this wonderful church in San Francisco GLIDE, which takes care of the homeless. The movie, *The Pursuit of Happiness* with Will Smith was about that church and that homeless shelter. That is where the money went. We met Warren for lunch, and I thought, "My only objective for the lunch was to look him in the eye and thank him for his wonderful intellectual property and then go on my way from there." The lunch went on for about three hours. He said, "I will stay as long as you want because I have got nothing going on all afternoon." After three hours, we had no more questions. We were exhausted. But what I did not expect was that the lunch led to a wonderful friendship. Warren then introduced us to Charlie. I told Warren that my wife Arena was a big fan of his, but her real love in life is Charlie Munger, and Warren kind of got competitive and said, "Charlie is an extremely boring guy. I am the interesting one. But I am going to arrange for you guys to meet Charlie for lunch because he is in LA and you guys are in California.

After you meet Charlie, you will know that he is utterly boring. Then I am the guy." I thought he was joking, but then I got an email from his assistant and we got lunch set up with Charlie Munger. I enjoyed the Munger lunch way more than the Buffett lunch. It was great. Charlie, you cannot even bribe. He does not take bribes to have lunch. That led to a great friendship with Charlie. Until recently, I used to play bridge with him on Fridays at the LA Country Club. Now he is too old and immobile to go there, so those bridge games came to an end. But I just had dinner with Charlie two weeks ago and we had a great time. He is going to be 100 years old on January 1 and he is doing well. It was an accidental thing that happened. I did not expect to have a friendship with them.

Warren used to have this brunch every Sunday in Omaha after the Berkshire meeting. I have been going to the Berkshire meeting for 26-27 years. But on Sundays, he used to invite us to a brunch where the managers of the different businesses, the board of directors, and some of his friends joined. When Guy and I went to those lunches, we would feel that we were the only two low-life people in the room; everybody else was somebody, and we were nobody. We always felt this would be the last year we would be invited because they would figure out that these guys are useless. Sometimes I would tell Guy, "Do not turn around and look, but right behind us, Bill Gates and Bono are having a conversation." It was just a surreal experience because there would be football players from the NFL, Hollywood actors and actresses, and all these different celebrities, and we would be the only yo-yos. That was great. Life is peculiar. Life has anomalies, and we end up with a weird anomaly of the Indian guy with a friendship with these two guys. Life is great.

Student: How do you go about thinking about diversification versus betting large on just a few high-quality names you believe in?

Mohnish: That is a great question. Charlie Munger says that if you owned, partially or completely the Ford dealership in Peoria, Illinois, the McDonald's franchise in Peoria, Illinois, and the best apartment building in Peoria, Illinois, and those were the only three assets you had, and you had one-third in each of them, he would consider that an extremely well-diversified good portfolio that would likely do well for you. If you think of a portfolio like that, it is all in a single geography; in a small town, and three businesses. If you were going to look at a portfolio of stocks, once you get past about ten stocks in a portfolio, there are diminishing returns. You are probably going to hurt yourself more than you are going to help yourself when you buy the 11th business. That is because the 11th business will not be as well-understood by you as the number two business in that portfolio. When you go from ten stocks to 50 stocks, for example, you do not gain that much with the diversification. What I have always tried to do in my funds is set an upper limit from a cost point of view of 10% in a single position. But I do not trim the position if it grows. For example, when we were buying the REIT in Turkey, we put the eight million in and that became 150 million or something. It has not been trimmed because even if it was valued by the market at 150 million, it is worth about 400-450 million based on the current liquidation value of the business. If I look at intrinsic value, which liquidation value would be even higher than that, in one of my funds, for example, we have had 3 Turkish bets. They probably make up 65, 70% of the pie. We own the dominant Coke bottler in Turkey, and they bottle Coke in about 12 different countries. If you own a Coke bottler or a Pepsi bottler in most geographies around the world, it is a license to print money. It is highly unlikely that you would not do well with that. We own an airport operator in Turkey. They operate about 15 different airports. That is another monopoly type. Business is extremely well. I look at that as the three businesses in Peoria, and that is kind of how we go about looking at things.

Del: You said you used to hang out at Los Angeles Country Club. What is the best golf round you ever had out there?

Mohnish: When I went to the LA Country Club, I was not a golfer. We used to play bridge. I do not have many regrets, but one of the big regrets I have is I should have focused on golf much earlier. I took up golf after I moved to Austin. I joined a nice club that was ten minutes from my home. I do not even know if I have a handicap at this point. I do not think it is measurable. But, I have a good time with it. I go to the driving range quite a bit. Maybe if we talk in a year or two, I might be able to tell you that I have a 30 handicap or something. We might get there, we will see. I am enjoying it. The LA Country Club hosted the PGA this year. It is a marvelous facility. Charlie used to play two or three times a week, and that would have been a lot of fun if I had been smart enough to take up golf earlier. If I was really smart, I would have taken it up when I was a Clemson. But we are old too soon, and wise too late, and that is the way life goes. I had a great time, and I would say that you guys have a wonderful jumping-off point into your careers being a Clemson. I got a very fine education but I never appreciated what a beautiful part of the country I was in till I moved to the other not-so-beautiful parts of the country. It was wonderful! I made some lifelong friendships. Some of my best friends are the folks I met at Clemson at that time. It has been great, and I encourage you to make the most of it and start golf as early as possible and go from there.

Thank you very much.

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