

Mohnish Pabrai's Lecture on Approaches to Value Investing
at the Narsee Monjee Institute of Management Studies
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Spandan: A very good morning to everyone present here. We are delighted to have you all here for this session. Without any ado, I'll take the privilege to introduce our esteemed speaker for today. Mr. Mohnish Pabrai. Mr. Mohnish Pabrai is the owner and managing director of Pabrai Investment Fund, which is a globally recognized firm that manages a portfolio of more than \$400 million in assets and has exhibited a tremendous historical record. What makes the fund stand out is that it is one of the very few funds across the globe that does not charge a management fee. Mohnish Pabrai is also the Chairman and CEO of Dhandho Holdings, whose primary objective is to acquire high quality businesses with high quality management in place in a friendly manner. Not only this, but he has also authored a book called Dhandho Investor, which has been of great interest for all aspiring investors. Apart from his excellent trajectory in the professional field, what makes Sir all the more inspiring to us is his inclination towards philanthropy, which is reflected in his founding of Dakshana Foundation back in 2007. Dakshana Foundation has gotten over 1,146 impoverished, but brilliant students admitted to the IIT. Thank you for coming Sir, the virtual floor is all yours.

Mohnish: Thank you. Thank you for that generous introduction. I appreciate it. Anyway, Its great to be here. One of the great things about the investing business is that unlike many other endeavors, like if you play basketball or cricket or something else, you can keep getting better at this throughout your life. It's kind of an endeavor where continuous improvement and learning is possible and actually desirable, which is wonderful. What I wanted to actually kind of talk to you about today is that, when we look at this large tent called value investing, it encapsulates quite a range of approaches and focuses one could have while trying to create wealth and generate good returns and so on.

For example, buying a dollar that is trading for 50 cents would be a great way to be a value investor focusing on spinoffs, which Joel Greenblatt talked about is another way of focusing on cannibals, which is companies that are buying back their stock, looking at what I call spawners, which is businesses that are really good at creating new businesses and then spinning those off. That's another way one can go. Focusing on multibaggers is also well within the tent of value investing. One could do special situation investing, merger arbitrage. It's a long list of endeavors and initiatives, Ben Graham suggested net-net investing and so on. There are many different approaches one can take, which would all be within the tent of value investing. They say that you're old too soon and wise too late, and I've made investments over the last quarter century or more, which have covered pretty much almost all of these different ways of looking at things, we also have things like P/E of 1, things trading at low multiples or future P/E of 1 and that sort of thing as well.

What I've been able to glean when I look at all of these different initiatives or different approaches that one can take is that, across the globe there are maybe 50,000 or a hundred thousand stocks in different markets around the world. If one were to say that I only want to invest in companies that are trading at one or two times earnings, one can find those, and cast the net wide and deep. One said, I only want to buy 50 cent or 30 cent or 20 cent, you would find those as well. Pretty much, I think because the universe of prospective businesses is so wide and so large, pretty much any criteria you set could work. I think the important thing is that one is very focused in what one is looking for and has clarity of what one is looking for. I've come to the conclusion, and it's actually took me a long time to figure this out, but I think for most of you it would seem obvious. If there is such a thing as a best approach out of all of these approaches, the best approach, I think would be one where one focuses on multibaggers, businesses that can be a 10x in 10 years or less, or maybe a 100x in 20 years or less.

If one focused purely on the multibaggers, there are some advantages that come up with that approach. One of the advantages is that one doesn't have much in terms of taxes, because you'll be holding businesses for a long time under most jurisdictions around the world until the positions are sold, and unrealized gains are not taxed. Basically, it gives you an advantage and depending on the place on the planet where you practice this, sometimes the tax rates can be as high as 40, or 50%. Deferring that for decades, or let's say 10 years or more, is a huge advantage, because you get an interest-free loan from the government. There's an advantage in terms of taxes with this approach. The second advantage is that, you don't have this continuous treadmill of needing to find something undervalued, then it gets fairly valued and then you sell it, and then you go look for something else.

The multibagger approach to investing has a few quirks, and it requires us to kind of change our mindset on a few fronts. One of the changes one has to make is that, traditionally, when one looks at what Ben Graham kind of the Father of Value Investing taught us, is that you buy something for well below what it's worth, and then as it approaches fair value, you sell the position and then you go look for something else. But in the multibagger framework, what you would do is, you would actually not particularly care if a position became fully valued or even overvalued. For example, if you bought a business for 30, 40 cents on the dollar and that dollar is growing and at some point, it's worth a \$50, for example, it's gone up more than 50% or what it used to be worth, but the stock is trading at \$2.

Under traditional Graham approaches, you would sell that as you get past the \$50 or whatever. But in the quest for multibaggers, you would continue to keep it in your portfolio, even when it became overvalued, you would sell it if it became egregiously overvalued. One would need to distinguish between something that's overvalued and something that's egregiously overvalued. Let's look at some examples of businesses that might help explain kind of where this approach is coming from and how it might work and so on. If you look at our

business, let's say McDonald's for example, the business existed, but Ray Kroc took it over in the 1950s. I think they went public in the 1960s. It's been public for maybe almost 60 years since then. It's still growing.

The number of restaurants, revenues, profits, etc., I mean, it's gone through some ups and downs over the years, but it has grown spectacularly. I think from the time it went public till now it's north of a 10,000 bagger, every dollar you invested is worth more than \$10,000. Not a 10 bagger, a 100 bagger, like a 10,000 plus bagger. Why did McDonald's do so well? It did well because, in the early days when it got going, there were a number of initiatives, a number of innovations that McDonald's had come up with. Some of you might have seen the movie, *The Founder*, I think it's on Netflix. I'm not sure if it's on Netflix in India, but you might want to watch it, I think it's a very good movie to see.

There's also a biography that got written on McDonald's called *Grinding It Out*. It's also a good book. It's a very old book, but it's a great book to read. There's another book which was written by the first CEO of Burger King. It's called *The Burger King*, and that's actually an amazing book as well. But basically, one of the early innovations McDonald's came up with was that everything they sold could be eaten without a fork or a spoon or a knife. There was no cutlery needed to, French fries, you would just take it from your hand and so on. The other big innovation was that it was served really fast. The production time, and actually if you really study McDonald's internal processes and how it functions, it's kind of like a light manufacturing type operation. The software and engines they use internally is like what you would use in a light manufacturing operation.

For example, they were very specific about the way the French fries should be with the Russell potato. In fact, when McDonald's enters a new country like India or Russia, etc., it takes them two or three years from the time they decide to enter to the time they can open their first restaurant because it takes a couple of years to train the farmers and generate the supply chain for the right kind of potatoes and such. It takes them sometimes more than a couple of years just to open restaurants and such. But the interesting thing about something like McDonald's is that in almost all the innovations they came up with, there were a lot of copycats and there were many businesses that came up that cloned or tried to clone what they were doing.

In general, fast food became a huge industry with many players. It wasn't just burgers, we then got a big kind of growth in pizzas, chicken, KFC, a lot of different entrances came. Also, I think on the consumer side, it also changed in terms of the frequency people were looking to eat all of this stuff. But anyway, even with all of that competition, McDonald's was able to establish a brand. People knew before they went into a restaurant, any McDonald's, what to expect they can standardization and consistency, the cleanliness, the consistency and the nature of the service worked. That particular moat has been going strong for 60 years. They aren't really any signs that say that the moat is eroding and may not do so well in the future. They continue to do well, and it's a very high return on equity business.

Basically, if you think about a franchised McDonald's where an entrepreneur does a contract with the McDonald's corporation. In a franchise situation in the United States, at least, a lot of the real estate is owned by the McDonald's corporation. The rent that is charged to the franchisee is a percentage of sales like maybe around 4% of sales is the rent. If you think about the rent that McDonald's charges its franchisees, it's kind of automatically inflation indexed. It just goes up with inflation. They also charge a franchise fee for the right to use the brand, etc., which might be another 4% or so. Then the franchisees also buy a lot of the products they need from McDonald's, and usually at McDonald's, what a lot of the other franchise-type operations will do is they tend not to focus on making money on the products. They tend to focus on passing that through, but you have the two main engines of the franchise fees and the rent, which might be something like 7%, or 8% off the top line. If you look at it from the McDonald's Corporation's point of view, a typical McDonald's in the US might have something like 2 or 3 million in annual sales, and the McDonald's corporation might get something 150, 200,000 a year from that location. The capital they have to put up against that is almost non-existent because it's the entrepreneur who's paying for all the Capex and the maintenance Capex and all of that. It's a really capital light business. The three legs that we need, I think Chuck Akre called it The Three-Legged Stool.

The three legs that we need for these long multibagger is, first of all, the core economics of the business should have very high returns on invested capital, ideally without the use of debt. You basically like McDonald's doesn't need to borrow money to make a lot of money. The second is that we want very high integrity management, and we want insider ownership, a kind of alignment of interest where there's a smart entrepreneur or someone or an insider who owns it. They've got incentives. The third is that we want a very long runway where we can see that this thing can go on for a very long time. I think that if you were to pick up the annual report of, let's say Walmart for example, Walmart went public, I think in 1972 or something, it's been public for like 50 years.

If you picked up the annual report of Walmart, let's say in 1980, for example, a few years, 7, 8 years after they went public, you would see that they've got very superior economics at the store level, that they generate high returns on equity. It's a business that does well, with very rapid turnover inventory and so on. You would also see that it was embryonic in the sense that large portions of the United States at that time, 1980, still did not have a Walmart for most people. You could not get to a Walmart within, 10, or 15 kilometers of your home. You could see that basically this business could actually, if we just looked at it in North America, there was a lot of room to grow. What we've seen with McDonald's or Walmart is that it wasn't just a US story, it was a global story.

Walmart has opened in other countries and done well. We could look at other businesses like, the Coca-Cola company, the Coca-Cola company was formed about 130 years ago, and that mode is still growing after 130 years. Again, the unit economics are extremely attractive because the Coca-Cola company typically doesn't do bottling. They sell the syrup, they have these plants which

sell, they don't even sell the syrup, they sell syrup concentrate. Basically, it's almost like a software business where, if you're spending 5 or 10 rupees on a Coke, Coca-Cola company might get like 8% of that, and they would have very little costs against that. Again, it's very similar to McDonald's in terms of economics. There are different kinds of businesses. You can look at a business like MasterCard or Visa or American Express, and they have similar attributes where you have very high returns on invested capital, you have a very long runway and you have high integrity management with inside ownership and so on.

The nature of capitalism is that everyone wants to own these kinds of businesses. Once these kinds of moats and runways are well known, the businesses get priced to perfection, and they may not be available at a cheap price. For example, if we look at a business in India, like DMart for example, DMart has a similar model to Costco and Aldi outside India, and DMart is very embryonic today. There are very few DMart stores in India relative to what could possibly be their penetrations in 10, 20 or 30 years.

But the market recognizes that. DMart trades at huge multiples. It doesn't appear optically cheap. But the interesting thing is that if the runways are really long and they actually end up being runways that go on for several decades, then even an expensive looking price can end up being a great value investment. But I think that as value investors, we have to also have a good dose of skepticism in how we approach these things. We can't always assume that everything's going to go to the moon in terms of size and growth, and the nature of capitalism is that there will be a lot of competition that will try to go up against those modes. But I think that if there's a quote from the Upanishads which goes something like this, "as is your wish, so is your will, as is your will, so is your deed and as is your deed, so is your destiny", then kind of the punchline is your deepest desire is your destiny. Going back to what I started with, If you said, I want to focus on \$50 cent bills, and that's your deepest desire, you will find those. If you say, I want \$20 cent bills, you'll find those two. If you say that I only want to invest in businesses that can go up a hundred times in value in 10, 20, or 30 years, you can find those two. It's a matter of what you choose to focus on. As long as you are willing to put in the work to sift through company after company and with the framework that you're interested in. In the case of the multibagger framework, there are just three things that matter.

Then the fourth is the price, obviously. If a business doesn't generate high returns of equity, you're done. You don't need to spend any time on that. If the business needs a lot of debt to grow and generate higher tons of equity, you could also be done. You don't even need those. If management quality or ethics is a question, you're also done. You don't need those either. Just if you look at the businesses that generate high returns in equity, that alone will wipe out large swaths of businesses. Then, you get to the runway, right. DMart will be a lot larger in 10 or 15 years than it is today. I think that's a pretty easy bet to make that statistically, I think the odds are high that DMart might do well. We could make that statement about private sector banks in India, private sector banks in

India might be like a third of the banking pie in India today, and maybe in 10 or 20 years it might be half or two thirds of the pie, for example, and the pie itself has grown.

There are things that we could hang our hat on and then kind of take it from there. Basically, I think that if you go down this path, which is the multibagger path, the interesting thing is that and all value investing, there are a couple of data points, John Templeton used to say that “the very best value investor or analyst will be the wrong one out of three times”, like 33% error rate is the lowest error rate for the very best practitioner of the art. If you were a kind of brain surgeon and you had even a 3% error rate, there might not be too many people coming to you for brain surgery. But I think in terms of value investing, you could be wrong half the time, and I think I've probably been wrong, close to half the time and still end up with a phenomenal track record.

Especially if you focus on the multibagger companies that would go up 10x or a 100x, basically in a lifetime of investing, if you ended up finding just two or three or four 100 baggers at the age that you're at right now, that's all you need. In many cases, if you just found one, that might be all you need. We have all this time and on the other end, we just need to find things just once, don't even need to find them that many times. When I started my value investing journey about 27 years ago, in 1994, 1995, in the first five years when I was not running my funds, I was just running my own money. I started with about \$1 million in 95. By the time in the first five years, I had had 200 baggers in the first five years itself.

Then I think from 2000 to 2022, now I haven't had any hundred baggers, but I think that there might be some more in the future, some that are kind of still hopefully going through their journey. You don't need very many of them. A few of them can get you to the promised land. I would say I've had, when I look back, a rather sloppy journey as an investor because I was trying all these different things. I think if in 94 or 95 I'd have done what I am telling you to do now or suggested what you should do now, I think I would've done a lot better than how I've done. If I had purely focused 10 or 100 baggers, I think the results would be vastly better.

I remember in January 1995 when I had the \$1 million, I had mostly invested in the US markets, but I had an interest in the Indian markets as well, and I thought they were two or three areas where it could do well. I decided to put 20,000 out of the \$1 million, just 2% of the portfolio into India at that time. I opened a brokerage account. Just my own money opened an NRA brokerage account with Kotak. I decided to put half that money, \$10,000 in one stock, which was an IT company. I was in the IT services business at the time, so I knew this business really well. Satyam computers, which at that time actually was a pretty honest company, kind of went wayward, I think in terms of their ethics about 10, 12 years after that. But in 95, they were a clean company.

I put 10,000 in Satyam in 95, and I think by the time it was 2000, it had gone up 150x, the 10,000 had become one and a half million dollars, approximately

1.4 million or something. Then the remaining 10,000 I put into three other stocks. I bought two of the courier companies that were listed in India at the time, Blue Dart, and Sky Pack Courier, because my perspective was that the Indian Postal Service was just hosed, and if you really wanted to get a package from point A to point B in India, you really had to rely on private people to get it for you. I don't think the postal service was reliable. I thought that these businesses that were focused on that would do quite well. I was just going to make three investments, actually half in Satyam and then half in these other two.

Then at the last minute, I was also very impressed with Kotak because I was just very impressed in dealing with their people. I decided to split the other 10,000 in three ways, one about 32, 3300 in Kodak and 3300 in the other two businesses. When this 10,000 became 1.4 million or whatever, in 2000, the other three businesses had done nothing for five years. It was pretty much sitting close to what I had paid for them. Like no movement for the most part. It is not realistic to think that if you put \$20,000 in the Indian market and you get 1.4 million, something like a 70x that there's still some meat on that bone and there's still some juice to be extracted if you will. I said, this is a pretty good result, and for no really good reason, in 2000, I sold the other three stocks, and I told Kotak, "sell these stocks and just send me the money back".

I basically liquidated the entire Indian portfolio in 2000. There was no really good reason to sell Blue Dart or Sky Pack or Kotak, no particular reason that I had to do that. Kotak from 2000 to now is about a 500x, Blue Dart is about a 300x, Sky Pack went kind of backwards, I think eventually went bankrupt, but it was down like 90% or something. Basically, there were massive home runs. There were two massive home runs, which like I said, there was no reason to kind of make that decision to sell, but that's what happened. I missed those two rides. But even with the sloppy nature and kind of stupid analysis that I did in those sell decisions, the end result was fine. The remaining 980,000 that had invested in the US over the next four, five years, by 99, 2000, it was about 13 million or so.

That had gone up quite a bit because one of those bets had gone up a 100x, 100,000 became about 10 million or so. Anyway, the thing is that even with a lot of sloppy, what I'm saying is that basically when you look at that investing that took place, then just the two bets that were a hundred bagger were responsible for like 80%, 90% of the returns. It didn't matter. The rest didn't matter if it all went to zero, the results have still been great. That's the nature of this multibagger type of investing, it can tolerate a very high error rate. Of course, your objective as an analyst should be to try to keep the error rate as low as possible. In 2019, I was visiting Istanbul for the second time, and the Turkish market actually I think is the cheapest market in the world because they've got just a lot of crazy macro things going on in the country, very high inflation and weird policies, and everyone's exited and so on.

In fact, Turkey reminds me of the Indian markets may be in the early nineties or so on, and I ran into this business on my second trip in 2019 where the market

cap was \$20 million, and the liquidation value was more than 6 or 700 million. It was actually a dollar bill trading for 3 cents, which I don't think, it ever happened to me before then. In the previous 24 years of investing that never happened. I think till I leave planet earth; I don't think it'll happen again. But basically, if I look at this business which I bought at 3 cents on the dollar, like the 20 million market cap, I was surprised with the volumes. Pabrai Investment Funds owns one third of that business, and we pretty much got one third of the business for like \$8 million or something. If the business did not increase in value at all, but it got to fair value, at some point we would have a 30 or 33x return.

But now we own the business over three years. They've actually increased value of the business quite a bit in the last three years. It's run by phenomenal people, really good capital allocators, and I think they will increase the value of the business quite significantly in the years ahead. Having learned my lesson from Kotak and Blue Dart and so on, the only thing I need to do with this business is do nothing. Just sit there and spend time talking to students like you so that the time is used up and not used to sell things. Hopefully, 20 years from now, we still own that business. If that business tripled in what it's worth the value, like, a 600 billion million or something, let's say it became 2 billion, we would have a hundred bagger. I think it can triple its value in maybe 5 or 10 years, and it can keep going after that.

I mean, the two people running it, they're not that old. I think they could keep compounding for a while. When I look at kind of that particular business, and it's a small part of the portfolio today, it's gone up, I think in the last three years it's gone up like five, 6x or so. It's gradually moving towards its value and so on. But I'm just saying that the nature of these hundred baggers is that this one business could become bigger than everything else in the portfolio, even though we made such a small bet with it. With that, I think I'll stop there. Would love to hear what you have on your mind. We can talk about what I just talked about or stuff that isn't related. Thank you.

Renil Shah: Thank you Sir for the insightful session. It was so interesting to listen to you. Now we'll open the floor for questions from the audience. Those who want to ask the question can raise their hand. Okay, Samuel you may go first.

Samuel: Okay. Thank you for this insightful session. Today we listen a lot that value investing is dead in the modern world. What is your opinion on this?

Mohnish: Well, all intelligent investing is value investing, because we have so many stocks around the world, and because there are so many things going on with different companies around the world, like this news anchor Jim Cramer says, "there's always a bull market somewhere". I think that if one is an investment analyst and picks through stuff, one will find that there are some parts of the market and some parts of the ecosystem that appears very overvalued. But you'll also find that there are lots of things that are hated and unloved. For example, Turkey is hated and unloved. It's in the nature of auction driven markets that they will overshoot and undershoot. I mean, one simple data point you can look

at is look at the price of any stock on the NSE or BSE and look at the 52-week range on that stock.

It might be 50 to 150 or 100 to 200 or 500 to 1000. It's a like a 50%, 100% swing in one year for almost every stock, like all 5,000 stocks. But if you look at the cost of an apartment in Mumbai, an apartment in Bandra or Juhu or someplace, and you have a friend who's a broker or agent, and you go to him every day and say, what is my flat worth? He'll say, your flat is worth three crores. Then you go to him the next day and say, what is my flat worth? Now you'll say it's still three crores. Then you go to him after one week and you ask him again, what is my flat worth? He'll say, listen, idiot, it's still three grows and you keep bothering this guy every day. Then maybe after three months he might say, it's actually 3.1 crores. It has moved a little bit. It's 3.1 crores. Now I can get you 3.1 crores. Then maybe in six months or eight months, if you keep bothering him and he's still your friend, every day maybe it becomes 3.3 crores in a year or something. Possibly maybe three and a half crores or might go to two and a half crores, the fluctuation rate of that flat is not going to range between three and six crores in a year. It's going to be like 2.7 to 3.3 crore, be in a very tight band because that price is not being set in an auction format. It is being set with an intelligent buyer facing an intelligent seller. When you have intelligent buyers facing intelligent sellers, you get great price discovery. But when you have these auction driven markets, which is the NSE or BSE or New York Stock Exchange, you will get much wider swings. If you are in the business of investing where you are dealing with auction driven markets, just this phenomenon of the 50% swing means at some point the stock is mispriced. It has to be either underpriced at some point or overpriced at some point overpriced, because the real value of the business cannot change 50% in a year for most businesses. Hence, we have proved that there is always value in investments and markets.

Renil Shah: Thank you, Sir. Okay, Veer you can ask your questions.

Veer: Thanks. Mohnish, my question is specifically to India. We have a lot of corporate governance issues within India. When you are picking companies, how are you filtering out these companies which have significant corporate governance issues, which are now or later, for example, Satyam had massive issues later on. What kind of filters do you use when you're investing or picking?

Mohnish: Yeah, I think your filters need to be stronger investing in India than I would have in the US. I think that if I were to invest only in the New York Stock Exchange type businesses, the odds that I would lose money because of fraud approach is zero. I would say if I make 10 investments all in the New York Stock Exchange and I have a lifetime of investing, I do just in that market, maybe out of 50 investments I make in a 40, 50 year period at the most, one might be fraudulent, something like that. It would be pretty low number. In India if I did the same thing, I think the number would be higher. But I think given that we already know that the ethos levels of let's say managers or managements

in India, may be somewhat lower than the ethos level of a typical NYSE listed company, we can adjust for that.

There are plenty of businesses in India where one can reach a fairly decent conclusion that the ethics and ethos of the business and the owners is high. There may be a lot of businesses where we may not be able to make that determination. If we either know that ethics is low or governance has issues, or we are not able to figure it out, you could just take a pass on those businesses and just like you would take a pass on a low return equity business, it could be very ethical, but return equity is low, because there's 5,000 listed company, you would still end up at a decent universe to look at. I think, if you set up rigorous filters for ethics, it may not be foolproof, but you can reduce the error rate.

Renil Shah: Okay, Paridhi, you can ask your question.

Paridhi: Thank you for a great session. My question is that what is your strategy in identifying and valuing a company and how do you identify whether your first stock is overvalued or undervalued?

Mohnish: Yeah, think if a business is within your circle of competence, I mean, let's take the example of a business like DMart for example. Let's say I have not looked at DMart recently, but let's say, for example, a trailing PE basis is trading at a hundred times earnings, which it used to trade at or maybe still trading at something like that. If one understood the business and had a good view of what the cash flows of the business are over the next 10 or 20 years, one can discount those cash flows back, and then that would tell you whether the business is overvalued or undervalue. It would just be a straight math exercise. If you are not able to estimate those cash flows, then I think there's no basis on which you could make an investment like that. You would take a pass in that particular case.

The first question to ask yourself is, do I understand the business, and is the business within my circle of competence? If you understand the business and the business is within your circle of competence, then by definition with some boundaries, what the future of the business is likely to look like and what the trajectory is likely to look at, what the cash flows are likely to look like. I think if you can put some boundaries around that, then you have a basis to make an investment. In 2015, an Indian guy living in Vancouver Canada name is Parry Pasricha. I didn't know him. He sent me a writeup of a company based in Hyderabad called Rain Industries. Basically, at that time it was an extremely well written writeup, like 20-page PDF, I think that writeup is floating on the internet. If you just Google like Parry Pasricha Rain Industry, probably that PDF will pull up. There's another guy, Luca Franca, who had done a report on Rain, I think that's also on the internet somewhere. That was done before Parry did his report. But basically, the situation that Perry was bringing up in that report was that Rain was trading at I think 35 rupees a share, at that time about 170- or 180-million-dollar market cap at that time with about \$2 billion in revenue. It was trading at about one-tenth of sales. The price-to-sales ratio was 0.1. It seemed very likely that in the next four or five years in a single year Rain's

earnings would be over 35 rupees a share. When I looked at Rain, it's a very cyclical business. It has a lot of gyrations, and a lot of issues with it, but it was extremely cheap.

In effect, it was trading at a future P/E of 1. I couldn't find anything wrong with it. I made a bet on Rain Industries and as a foreign investor, we could only buy 9.99%. We bought 9.99% of the business for I think \$20 million. By less than three years after we bought in early 2018, late 2017, it was trading at over 400 rupees a share. My thesis when I originally invested was that I just want to own this business when the earnings are 35 rupees, and I just want to see what the market would do with the price of the stock when the earnings are 35 rupees a share. I just want to see if it actually sits at 35 rupees at that point, and which I didn't think was possible, but I just wanted to see what happened.

This was just a pure math game. I think the earnings were coming to close to 10 rupees a quarter when they were approaching 9 or 10 rupees a quarter, the stock went to like 440 rupees. Of course, by that time I had fallen madly in love with Rain and its great management, and they're very high ethics and very honest and competent operators. I said, no, this is a far better business than I thought it is. We shouldn't get off the bus so quickly, most of the time my problem had been going to get off the bus too quickly. Rain went from 35 rupees in 2015 to 440 rupees in early 2018 to 60 rupees in March 2020 when covid hit to about 160 or 170 rupees currently.

Okay. We still own it. But even if you take the current situation, with a 160 or something in rupees, it's like a 4x in seven years, for example. We think it'll do better and be worth more in the future. I think in that case, as I said, I still don't have a crystal ball on Rain of what next 10 years of cash flows would be. That's, I think, impossible to estimate, but I think the fact that we would make money on that investment was very high probability.

Renil Shah: Certain interest of time. Can we take two or three more questions?

Mohnish: Sure, sure.

Renil Shah: Yeah.

Mohnish: Keep going.

Renil: Yeah. Rajat, you may ask your question first.

Rajat: Thank you, Sir for your wisdom on value investing in public auction markets. My question is for the private markets venture capital in particular, I want to understand, what parameters will you employ for investing in early-stage startups from a value investing lens in the context of A, where price discovery, as you mentioned, is ambiguous, B given the current news of funding winter and the capital drying up?

Mohnish: Yeah, I think that I'm probably not the right person to ask that question to. I think the closer you go towards the formation date of a business and then try to extrapolate the future of that business, the murkier it becomes. The venture

capital game is a very different game in the sense that you are expecting most of your returns to come from one or two bets in the fund, for example. You're expecting 80%, 90% of the fund, a lot of those investments may go by the wayside or may not do much long term. Basically, it's a very different game. I think it's very hard to get downside protection in the venture game, and I think it's very hard to do these future cash flow projections and all of that because we just don't have the trademarks, we don't have the historical trademarks.

It's not something that I think I have expertise. The other thing about the venture business is that if we look at the statistics, in Silicon Valley, which has had a very long history of venture capital, the venture funds that have, let's say the top 10%, their analyzed returns and the top 10% of venture funds, their returns are multiples of. The top quartile funds have done much better than the bottom quarter funds. If we do the same thing with bond funds, for example, the difference between a top quartile bond fund and a bottom quartile bond fund may be almost non-existent, might be like 100 basis points or 200 basis points would be a very small difference. What I'm saying is that the ability to add alpha in a bond fund is very limited.

If we look at a fund like Sequoia Fund or Andre Horowitz or Y Combinator, etc., they have multiple advantages, but one of the big advantages they have is deal flow. I have some friends, and some of my investors are venture capitalists in Silicon Valley. They say to me that if we had access to the trash can of Sequoia, our returns would be 3x what they are. He said, if we could just look at every deal that Sequoia turned out, we would do 3x better, because they said, we just don't get to see, so deal flow. One of the things about the public markets is the small investor actually has a huge advantage over the institutional investor. An institutional investor with hundreds to millions or billions of dollars cannot look at small investments.

They have to put large amounts of money to work at a time. A small investor having five crores to invest or 50 lakhs to invest, 10 lakhs to invest, can look at everything, can look at nano caps, can look at everything. Their universe is much wider, and they could be a lot more picky in terms of where they put their money. In the public markets, the small investor has a huge advantage. In the venture market a small investor or an unknown investor with no access to real deal flow is at a huge disadvantage. My conclusion when I look at all of that is, it's not a game where the odds are in my favor. I have chosen not to play in that area. I think the kinds of questions you are asking; I think are very difficult questions to answer.

Rajat: Understood, Sir. Thank you.

Renil: In the interest of time, we will take only the last two questions. Priyanshi, you can go first.

Mohnish: I don't know if the others can hear you or not, but I can barely hear you.

Priyanshi: Okay.

Mohnish: Go ahead. We'll try.

Priyanshi: I'll put my question in the chat box, if not been heard.

Mohnish: Yeah, I think for a know nothing investor passive index investing is a great way to go, especially if you have many decades of time and you're young and so on. I think index investing does well. The frictional costs are low and such. If you have a view and you understand certain businesses, you understand they're undervalued and so on, then I think you could actually pick stocks and so on. But I would say starting baseline, being a passive investor is certainly a great way to go for most people.

Renil: Vaibhav, you can ask your question next.

Vaibhav: Sure. Thank you. Thank you, Sir, for an insightful session. My question is very simple. When we look at value investing, which was being propagated by say the likes of a bank, we did not have the modern situation, right, and of negative really for a longer period of time, but liquidity both absolute and relative. Do you think that probably sticking to that value investing may result in risking probably figuring out who the future winners could be or simply put probably what would you change in value investing, which has been taught or which has been learned to something which would be more relevant in our current context?

Mohnish: Yeah, I think it's a good question. I think that most investors would be better off completely ignoring everything macro. For example, if I had a viewpoint of kind of what would happen to Starbucks 20 years ago, it really doesn't matter what the rates are and what the Fed is doing and what financial crisis is happening or whatever else is happening. At the core, the Starbucks business is such that when they open a store in the US, they get their money back in two years, 35% return on capital. They don't franchise any stores. When they open a store in China, they get their money back in 15 months, something like 70% return on capital. For example, if they have one store in Manhattan in a particular intersection and they put another store diagonal from that store, it doesn't even cannibalize the first store when the second store is so close.

It's an incredible business. I think that if one focuses on understanding the business and is able to identify great businesses, that should be where the focus is. When I made the investment in Turkey in this business, it was completely irrelevant to me what was happening on the macro front. I mean, Turkey inflation rates are crazy and the way they deal with the currency is crazy. But I could look at that business and see that these things would not really matter in terms of our returns. Basically, when I made the investment in that business, \$1 was five lira, five lira could get you \$1. Now it is almost 18 liras to get \$1. I have suffered incredible devaluation, but in dollar terms, we are up for 5x, in lira terms, we are up infinite x, but who cares about that?

What I'm saying is that we had extreme macro headwinds when we went in, didn't care about it and it didn't matter. I think it's very important to be right on the business. If you were early on McDonald's and Walmart or any of these, you know, MasterCard, Visa, whatever Coke and so on. I think the thing is that some

of these long runways, they'll transcend everything. The key is can you find these great businesses. Can you find them early enough? Can you buy them at decent prices? Can you be patient through thick and thin?

Vaibhav: Sure. That's very useful. Thank you.

Mohnish: There's an investment bank in Nariman point, Enam. Most of you will be familiar with Enam. They took Infosys public and when they took Infosys public, they were having difficulty placing the stock. They were the underwriter; they were left with stock that nobody was willing to buy. Enam kept the stock for themselves until pretty recently they kept most of those shares. I think they may have reduced or eliminated the position now, or it's a much smaller position. But basically, it doesn't matter what else Enam did in the last 30 years, it's irrelevant what they did in the last 30 years. 90% of the value of that firm was based on whether or not they kept that Infosys stock that nobody wanted. It's a good business, they're great people and they're smart people, but one decision trumps all the other decisions. If they had sold Infosys or they had found a lot of people willing to buy it, I think Enam would be a shadow of itself where it is today. It's just small things like that create huge deltas in where things end up.

Vaibhav: Thank you. Thank you so much.

Renil: Can we take up one last question by Praveen if time permits you?

Mohnish: Of course.

Renil: Yes. Praveen you can ask your question.

Praveen: Thank you so much Sir and thanks a lot for your wisdom today. My question is regarding multibagger as we discussed, so during our holding period of say 10, 15, 20, 40 years, we see drawdowns of or north of like 50%, sometimes even 90% during the investment tenure. How do you deal with that situation? Rate often arises when you're holding for a long period of time, especially for multibaggers?

Mohnish: Yeah, so the conviction is really important. How do you get a conviction? I think you get a conviction because you have a very strong understanding of the business. If I go back to the business in Turkey for example, basically, that business has a number of different business lines, but the one that has the most value today is they have 12 million square feet of prime warehouse space in Turkey, and it's mostly in Istanbul. Those 12 million square feet has a value today of, you could go to a broker, he will tell you that you can sell the whole thing and you'll probably get a billion dollars for it, something like that. Billion, two billion or something. There's only about a 100 million or 80 million of debt. If you just liquidate that entire position, you'll get about maybe \$900 million or something.

What is a warehouse? Warehouse is land, concrete, steel, some 20% is refrigerated, you have some refrigerated units and all that. All of these things are going to increase in value if you have inflation. Steel price is going to go up,

because it's going to track international steel prices, concrete and cement prices will track international concrete and cement prices. Land also has prime land and a prime major city in the world has a value. When I invested, the value per square foot was about \$80 a square foot for land and improvements.

I don't think that \$80 going anywhere, it may be 200 a square foot at some point, but it will not go to 30 a square foot. That won't happen. I don't care about anything else that's going on. That is the piece that is the most important. It's 99% lease, it's 10 years inflation index leases and all of that. Conviction is really important, right. If you invested in Starbucks, you would have two or three things that you understand. You would understand the unit economics that when they open a store, they get their money back in one or two years. You would understand that. If that certainly changed where it was taking 5 years or 10 years to get your money back, when you open a new store, something has changed, right. That's a significant change.

If that looks like a secular permanent change, the thesis has changed. But if it continues to be very high returns on capital, the second is you would've had some perspective on the runway where you say, okay, it has 5,000 stores around the world, for example. It probably has more than that right now, but at 20 years from now, I think it can easily be 25,000 stores, for example. If you have conviction on that, then you know that two pieces that really matter are what are the unit economics and what is the store count, and those are really the pieces that matter. When you make an investment in a stock, you should be able to explain the thesis of that investment in 5 or 10 sentences to a 10-year-old without a spreadsheet and without anything, *“ki bhaiya ye business ka ye value hai”* and this is why this makes sense.

That gives you the conviction. If you have to go look at a spreadsheet or go look at something when price drop 50% to understand what is going on, you have not done your homework. It needs to get down when you've done all the work to simplicity, it can take a long time to get to the essence of these businesses, but it needs to get to the essence of those businesses. You have to get to understand why this business is resilient. Why will it be around 10 years from now, and why will the economics and the return on equity and all of that still be high? Why will all those things be true? We aren't particularly concerned with price movements. We are concerned with the expansion or shrinkage of the moat. If the moat goes through a secular decline, we have a problem. The quoted price change is not relevant.

Parveen: Got it, Sir. Thank you so much.

Renil: Thank you so much, Sir, for your insights. Before we conclude this amazing session, SBM NMIMS would like to extend heartfelt thanks to Mr. Mohnish Pabrai for sparing his valuable time to grace this event and enlighten us with some really practical and usable words of wisdom. We would also like to extend our gratitude to all the attendees for their unabated attention to our event and for some really good questions. We definitely have something to take back home. What was more intriguing for us was how you identify stocks, whether it is

through Chuck Akre's three-legged stool, which can become multibagger, McDonald's, Coca-Cola, etc. I'm very sure if we replicate this approach, we can make money for ourselves. If knowledge is power, then curiosity is the muscle. Let's keep up this curiosity forever. On that note, we reach the end of the session. Have a great day everyone. Thank you, Sir.

Mohnish: Yeah, I would just like to say that I think you guys are the cream of the crop of India. You are the future of India. You're at a great institution and you guys will do really well in the decades ahead, in whatever becomes your eventual career pursuit. I think you already kind of won the lottery if you will. The world is your oyster. Congratulations.

Renil: Thank you, Sir.

Mohnish: All right.