

Mohnish Pabrai's Presentation and Q&A with students at the Indian School of Business on July 13, 2013

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Organizer: First off, thank all of you for turning up on this Saturday afternoon and on behalf of the CFI team and everyone else who helped organize this event. Thank you for showing up.

I'd just like to introduce Mohnish to all of you. Mohnish began his schedule with Tell Labs before he founded his own IT consulting firm. He later sold to Kurt Salmon Associates. That's when he made the switch to money management. He founded Pabrai Investment Funds in 1999. He's perhaps the best known for winning the bet of \$650,000 for a charity lunch with Warren Buffett. He's adopted Warren Buffett's value-based investing approach for his own funds. He's even authored two books on the same approach to investing today.

He works with the Dakshana Foundation, which he helped found in 2005. Dakshana Foundation focuses on eliminating poverty by helping to tutor underprivileged children and enabling them to attend some of the country's best institutes of high learning. I'd like to give you Mohnish Pabrai.

Mohnish: That was a warm introduction. It is great to be back at ISB. Thanks for having me back. Last time I was here I was kind of winging it. This time, I thought I'd do a little more prep. I think before I launch into compounding, investing, and so on I just want to share a little bit of couple of thoughts I had on ISB (before there was an ISB).

I used to live in Chicago in the 1990s, in the early to mid-'90s. Some of the professors at Northwestern University Tel School, Rajat Gupta, and such would talk about this Indian School of Business, much of it was in their heads. I think one-time I had broken bread with Rajat Gupta, I have known him for a few years. Of course, here we are today, we have an amazing institution that's thriving and doing well.

I just wanted to spend a minute or two on Rajat because I think that even if you don't get any value from the presentation I'm making, I think there's a Shakespeare value in some of the events that have transpired. My heroes Warren Buffett and Charlie Munger say that envy is one of the worst human vices that you can have.

In fact, many other human vices, envy, if you have envy towards anybody all that's going to happen is you're going to feel bad. In the case of Rajat, he was off the chart successful, but his downfall was led by two things, basic human traits and envy. He was envious of a person who was much more successful than him at least on paper, and much less capable than him, which is probably true. The second is envy and this is a very bad human trait. Also, ego is nothing but a false sense of self. All of us are ashes and dust. We came from ashes and dust, and we will be ashes and dust. It's useful to remember that.

A good friend of mine always says, "Everyone works in farms." Basically, if you were to eliminate envy in your life, and if you were to eliminate as much as you can of ego, you are very far along the path of doing quite well.

I'll go ahead and get started; we can start PowerPoint. I'm going to just talk about a very old Indian thing, most of us probably grew up with. It's a tale about the invention of the game of chess. The game of chess was invented about 1,400 years ago, 70 score and four years ago. The guy who invented the game, when he showed it to the king, the king immediately became a big chess fan and was playing all the time. He told the inventor of the game that he could ask for a reward, and it would be his. The investor says, "I want you to put one grain of rice on the first square of the chess board I want you to put two grains of rice on the second board of the chess board, I want you to put four grains on the third board and keep doubling the rice on every square. When you get to the 64th square, then that is the amount of rice I'd like/ That's all I want." Of course, the king thought that was a stupid request.

He said, "I wanted to give you such a big reward, and this is all you want, a bunch of rice?" He told his treasurer, "Measure out the rice that this guy needs and get him out of my Court." About a week went by and the guy hadn't figured it out yet. He called the treasurer back in and said, "Why are you taking so much time?" He said, "Well, it took me a while to run the calculation. It turns out that we don't have rice. Not only do we not have it in our granary, but we also don't have it in the kingdom. Not only do we not have it in the kingdom, but it also doesn't exist on planet earth."

That is the power of compounding. You took the amount of rice, which is going from 1, 2, 4, 8, 16, and so on. We have a bunch of people who are going to IIT soon. How many grains of rice on their chess board? Anyone raise their hands over here? No accidental raising, anyone with a hand, anyone? Go ahead. One to the power 64 minus one. I won't ask you to lay out the whole number. If you calculate that amount of rice in terms of present rice prices, it works out to \$300 trillion. \$300 trillion is a big number. The entire net worth of every man, woman, and child in the United States is \$70 trillion. The entire net worth of every man, woman, and child on the entire planet is just about \$300 trillion. Basically, what the guy asked for would be pretty much the entire wealth of the planet, and that is the power of compounding. That is why Einstein calls it the eighth wonder of the world.

This story of chess that I told you is something I'm sure most of you have already heard before. In fact, I heard about it when I was a kid. In 1994, I was 30 years old, and I heard about Warren Buffett for the first time. When I heard of Warren, I had really no knowledge of investments or capital allocation or any of those things. I was lucky in 1994 there were a couple of biographies of Warren Buffett that had just come out. I could look at this track record that Warren Buffett had from 1950 to 1993. It was a 44-year track record. Over that 44-year period, he had compounded money at 31% a year. If you are compounding at 31% a year, you will double your money in a little less than three years, maybe two and a half years, or 2.6 years, or something. Warren Buffett had 44-years which compounded at 31%. He was already on the 18th square of the chess board when I first heard about him because he had compounded.

I thought back to the story about chess and rice and so on. I talked about Warren, and I said, "Wow, this guy is actually playing out that chess board story." That story is very powerful because if you keep doing it, he keeps doing it, he's going to be the wealthiest person on the planet. He became the wealthiest person on the planet. It works.

Basically, in the investing world, hardly anyone followed Warren Buffett and his approach to investing in 1994 and even today. Hardly anyone had the returns that he had. The investing professionals did not follow Warren's approach to investing and did not have the results that Warren Buffett had. I thought those two facts will cause an effect. I thought that the Buffett approach was the approach to high rates of compounding. If you didn't follow that approach, you were basically not going to go anywhere. I had these thoughts, these things are related, and no one was replicating. I said, "I like this compounding. I like this 26% or 31% a year. Why don't I give it a try?"

How many of you have seen the movie, Forest Gump? We get answers in the extreme front of the room and extreme back of the room. How many people in black shirts have seen the movie, Forest Gump? When you go to IIT, on YouTube download the movie, and watch the movie. You will appreciate it. It actually won an Academy Award. It's a great movie. I'm going to play for you about one minute of the movie right now.

Forest Gump is my hero. I like Forest Gump. After I decided to do this, trying to replicate Warren Buffett's compounding, I changed my license plate. I might have mentioned this to some of the Dakshana scholars last time. But maybe for the people who are not in black shirts, what does my license plate mean? Maybe the ISB crowd can take a guess. That's my real California license plate that is on my real 6 Series BMW convertible. What does the plate mean? How do you come up with that? What does it mean?

The LB means pound. It's an abbreviation for pound, so compound 26. That's my license plate. I make sure I look at it every day. In 1994, I was 30 years old, I

had just sold some assets in this business I was running. I still had the business, just sold a small portion of it and basically ended up at \$1 million in the bank. I really had no use for that money, it was the first time I had any kind of money in the bank. At the same time, I read these Buffett biographies and the chess overlaid with his 18 squares. I said, "Hey, why don't we focus on a very simple formula, 1.26^Q equals two. I can handle that math even though I didn't go to IIT. I decided to play a 30-year game. The 30-year game I decided to play was that if you compound at 26% a year, your money is going to double every three years. If it doubles every three years, then in 30 years, it's two to the power of 10. What is two to the power of 10? 1,024. Forget the 24, let's round to 1,000.

I had a million dollars; the plan was to compound at 26%. In 30 years, I should add three zeros to that because it's 1,000 times whatever you had. It becomes a billion, which is a better number than a million. I said, "Let's go for the billion." My thought was that even if I failed by 90% or 95%, or even 97%, it's still okay. All those numbers are okay.

I decided I would play this game, and of course my hero told me, just like I tell all Dakshana scholars, just take up one idea, make that idea your life. Think about it, dream of it. Live on that idea. Let every part of your body be full of that idea and just leave every other idea that is the way to success.

I think Swamiji, said that for my benefit to compound money, that's my take on him. Anyway, this is what happened. In 1995, I started putting those million dollars into work. For the next four and a half years, from 1995 middle of June or to the middle of the year in 1999, it grew at 43.4%, way above the 26%. The \$1 million became \$5.1 million. I said, "All right, man. I knew this could be done. We got it done." Then, you know, I had all these friends. I would tell them the different stocks they should buy, and they used to make a lot of money with all the stock I would give them. They came to me and said, "Listen, this stock tip business is very random. We want you to manage some money for us, you do what you want. We can have some benefit of that." July 1st of 1999, I set up Pabrai Investment Funds. It started with \$1 million from eight friends of mine. I also put in a \$100,000. From 1999 to 2007, middle of 2007, eight years, Pabrai Investment Funds compounded before fees at 37.2% a year.

Of course, I get paid outrageous fees. After fees, it was 29.4%. Both numbers are perfectly fine. More than 12 years have passed since I started this. Things were working, going well. Again, pat myself in the back, I was doing well, and then all hell broke loose. For the next 21 months, we compounded at -47.1%. I can just tell you, if you compound -47.1%, the car starts going in reverse. This happens fast. Thankfully that came to an end in 2009. The last four and a quarter year, we've been compounding back again at about 32.8%. Now it's been 18 and a half years, we have this slide wrong. It's 18.5-years and it's 25.8%. We undershot by 0.2%. We still have 11 and a half years to go. Maybe I can make that up. We'll see. It's close.

The good news with investing, unlike tennis, is the more you play the game and the older you get, the better you get. This is a game where over time you get better. That's great. All knowledge is accumulated, that's also good. Of course, the things that you own, your portfolio is very undervalued. I think it'll do well in the future. I'm excited to see how the next eleven and a half years unfold.

How does one compound at 26%? Well, you cannot compound, you cannot beat the index by trying to beat the index, you must try to do something different from what the index is doing. Basically, you make very few bets. You make very big bets and make infrequent bets. You make bets when the odds are heavily in your favor. In this business, you can be wrong a lot and still be okay. If you look at my record, I had that 21-month period where we actually had several investments go to zero, and we still look fine after that period.

Of course, this is going somewhat off topic in the sense that we could do a separate presentation on each of these things. If you focus on things like cannibals, companies that are buying, own stock, or spinoffs, or clone what other people are doing, what great investors are doing, which is what I do, a lot of things become a lot easier. Basically, the other thing is that I don't make investments unless we have at least the prospects of double or a triple of the money in two or three years. As that amount of money, the portfolio goes down, that number keeps going up. For example, with the last 5% of assets, the last 10% of assets we need at least 5x or more. That just makes sure that the money goes out during the most distressed times. Of course, after 2009 and 2008 when I got whipsawed if you will, I made some changes. One of the things I came up with was this pre-investment checklist, which has been wonderful. In fact, our error rate is almost zero since 2009. We have hardly had any loss of capital and that makes a big difference. The second is that I started having conversations with the fellow fund manager. That was actually on investment advice I got from Charlie Munger who said that he always had somebody to talk to. Until 2008, actually, I never talked to anyone about my investments. Now I always talk to this one person who is exceptional. It's worked out very well and we don't always agree. In fact, we disagree a lot of the time, but the conversations are still very helpful. That's pretty much the song and dance. You just need to take a simple idea, take it seriously, and compound it as the eighth wonder of the world.

You want to be a cloner. I have no original ideas, basically. Many, many ways, copying Warren Buffett. Of course, you must come up with your own license plate.

I'm going to now play a five-minute Bollywood video for you, to put you in a better mood. We'll play the mp4 at maximum volume and take the lights down. Thank you. We'll answer your questions.

We'll take your questions and I think we have a couple of mics. Maybe if someone can just take the mics around, we can all hear the question. You can ask things that are in the presentation, and I hope you ask things that are not in the presentation. Pretty much you can ask anything you want other than what I'm buying right now.

Student 1: My question is, you said its replica. The theory of replica if it is that easy why is everyone not doing it? Another thing, how do you do that? For example, you said like 50 to 75% of the fund is invested in the industry, which would become two weeks, two to three years. But how do you decide that?

Mohnish: Let me start with your first question. That's a very deep question. I said it's not replicable, but no one is replicating. It took me a long time to figure this out, and I'm just about getting close to figuring it out. There is something strange in the human genome, something strange that makes people. The good news is we sometimes can give you an expanded answer that makes people very much opposed to being intense copycats. Most humans do not want to do cloning because they can consider it beneath themselves. Of course, low life people like me, do not consider cloning to be beneath me. I'm willing to do it. To give you an example, if you look at a company like Microsoft, Microsoft isn't even that great of a cloner because anything they work on takes them three or five or seven versions to get it right.

Sorry, Ashok, maybe you can make it better for them. It takes them a long time. But the bottom line is that most of Microsoft's revenue comes from Windows, which was cloned. It comes from the office. PowerPoint was bought from another company. Word was from Word Perfect. Excel was from Lotus, and so on and so forth. Even SQL Server was lifted from Oracle, and it just goes on and on. You can look at Microsoft money, you can look at Paint coming from Google, and so on. The bottom line is that Microsoft isn't even that great a cloner but it's one of the largest and most successful companies out there.

You look at another company, this is something that really perplexes me. It's called Walmart. Sam Walton, the founder of Walmart, would not call him a brilliant man. He was not someone who would've been blowing of IQ tests. Most of the people in this room would've had a higher IQ than Sam Walton. But Sam Walton, if he was alive today, he would've had a network of about \$150 billion. He'd be the richest person on the planet. For the first 20 years of its existence, Walmart did not come up with any innovation. All Walmart did was look at Kmart model and the Sears model and replicated them. In fact, what I find funny is in India we have this big debate going on about letting digress for a second foreign retailers to make things more efficient. If they talk about Walmart coming in, there is nothing in Walmart's business model that anyone can look at by walking into a Walmart and replicating it.

India does not need Walmart to come in, for retail to become efficient. India just needs an entrepreneur to look at that model and replicate it. That's it. There's nothing else needed. There's nothing special about Walmart's model. There's nothing special about Microsoft's model. This list goes on and on. McDonald's for example, they have a whole army of people, whole departments, which spend all their time trying to figure out which is the next location they should put the next McDonald's in. They do a lot of studies and analysis to figure out demographics and all that. In the United States, Burger King, which competes with McDonald's, has two people figuring out locations. All they do is look at where McDonald's is putting their locations. It's a very powerful strategy. They look at how McDonald's is opening in Peoria, I don't know, at this corner. They say, "We'll take the next corner and open there too. They've done all the work, so they must be working well for them."

The thing is, Walmart's of the world, the Burger Kings of the world, and Microsoft's of the world are rare. Most people do not want to do cloning because they think it's low. In fact, even when I looked at Buffett's model, I set up my own investment partnership. I replicated the Buffett partnership. He closed his partnership in 1969. I opened my partnership in 1999, 30 years later. In 30 years, I could not find one example of a single fund anywhere in the world that had replicated the Buffett model, which was the most successful hedge fund ever created. Nobody replicates the model that ran from 1956 to 1969. There were books published, the books I read, and the books had sold millions of copies printed in many languages. The model was very simple. There's nothing special about the model. Even today, forget 1999, today is 2013. I've been running Pabrai Investment Funds for about 14 years.

I've spoken at so many business schools and so many different places, and I've answered questions as you asked. I've told the business school students that there's no point in paying fees to ISB. I'm sorry, have they already collected full in advance, but half, so you can still save half. Sorry, I'm sorry. There's not an ad, but you can still save half. What you can do is, you don't need to even listen to the rest of the board in Q&A. You can walk out right now and start replicating. Every time I say this, nobody walks out. They want to keep paying tuition.

First of all, the only thing I can figure out is there's something in the human genome that makes cloning very attractive to maybe one or 2% of the population, if that, probably less than that. For some reason it makes it very attractive.

I have adopted cloning in a very serious manner. In fact, on my gravestone, they will write, and I hope they will write, "He was a cloner. That's it." In fact, if you look at Dakshana, our model that works so well, it's not the model I came up with. I could never come with such a good model. I'm too stupid to come up with a model like Dakshana. It was lifted from Super 30. Anand Kumar, a great guy came up with a great model, just like Kmart came up with a great

model, and McDonalds does a great job. All we had to do was ask Anand Kumar, "Hey, do you have a problem if we clone your model?" He said, "No, I'll help you." So, I said, "Okay, great." Now I can clone, and the guy wants to help me. It's great. That was the first question. What was the second question?

Student 1: How do you do it? For example, you said, 75% of the stock is invested.

Mohnish: Yeah. That's the crux, the real question.

I don't have a newspaper in front of me. I should have brought one. In fact, I'll do it maybe in my next presentation sometime. I want to take the *Economic Times* or *Wall Street Journal* or whatever, and I want to create a dartboard out of all the stock board pages. Create a dartboard, maybe I'll actually create a real dartboard, have some unpaid interns do that. I want to take a dart and throw it at the dartboard. Whatever stock it lands on, I want to take that stock and just give you the statistics. Let's say, a company in the US, like General Motors, a huge car company, I know close to \$200 billion in sales, \$150 billion to \$200 billion in sales. If you look at the 52-week range on GM and General Motors, you can do the same thing with Infosys. You can do it with Tata Motors. You can do it with any company by just throwing the dart basically. What you find is that in 52 weeks, which is in one year of time that it takes the earth going around once, General Motors was at one time being valued at \$18 a share. In fact, just yesterday, it hit a 52-week high. It's over \$36 a year. In one year, this one stock, you have basically 50% movement. You double the market cap from a year ago or whatever. The underlying business has not changed that much. If I look at Infosys, I don't know you guys, what are the price of Infosys right now? 2,000, 2,800 rupees. What is a 52 low on it? The 52-week high?

Student 1: I guess it's high, I'm not wrong.

Mohnish: It's 2,200 to 2,800. You have a range of like 30% or so. Now if you look at any other asset class, let's say I have a three-year-old model T car, okay? The price I could get for that car a year ago, three-years ago, and the price today is within 5 or 10% of each other. Even for the most part real estate movement is low. Stock markets are different creatures. The reason they're different creatures is because they are auction driven markets. In the case of a car, you have an intelligent buyer facing an intelligent seller. Between the intelligent buyer and seller, they arrive at a price of the car that makes sense. If they don't arrive at an intelligent price, there'll be no transaction. Both sides have to agree.

In the case of the stock market, you are basically faceless. Buyers are faceless and so are sellers. You are auction driven with this mechanism for setting pricing. Auction driven mechanisms, by their very nature, are set up to create distortions. Warren Buffett has benefited big time from those distortions. If there was no stock market, Buffett could not have done what he did. Let's say Warren Buffett was restricted from 1950 until today to only buy private

companies from intelligent sellers. No way anywhere close to what the record is today. We have this mechanism of this auction driven market that we have this distortion.

If I went to buy GM a year back and I went to them today, the price would not change a 100%. It would be 5%. In the case of Infosys, you go to buy the whole company and they give you a price today and you go to them six months from now, the price will not change that much. Bottom line is that it is the auction driven nature of these markets that causes these wide distortions.

The second is that especially when there is extreme fear or extreme greed, you will get attenuation of that distortion. Infosys is something, for example, which is a breach company. But what if I pick something that is an obscure company? Let's say I pick regional Jute producer in Calcutta; 100 pro market cap type and it will have a wilder distortion. But the same company, if you go do a private transaction to buy is going to have less distortions. The stock market is set up for clones like me to have a field day with. The same thing you see in the public market.

Facebook comes public, everyone's excited about Facebook, the stock price goes up like crazy. Then a few months later, no one was interested. That goes on all the time. Markets are constantly overshooting sometimes where they are significantly valuable. The companies all are significantly undershooting where they're significantly undervalued. Because of the significant over and undershooting you can sit there. The bottom line is that if you have that much of a swing, 50% to 100% type of a swing in a year, it means that there are enough companies out there that are not correctly priced at any given time. They're either underpriced or overpriced. Especially if you are overly on top of that distress, temporary situation that affects that business that will cause even more attenuation of the pricing.

The other thing that's happening in public markets is that in any company, typically in about two years, sometimes in one year, sometimes six months, the entire shareholder base changes. People aren't even holding the stocks that long. All of these things basically mean that some yoyo like me can sit there, spend most of my time talking to you guys or hanging out with Dakshana scholars, and every once in a while, I see distortions of an extreme nature. When I see distortions of an extreme nature, then I act precisely, and I don't even need to be right all the time. I can be, in fact, John Templeton, who was a great investor said, "There is no investor who's right more than two out of three times." You can be wrong plenty of times and you can still do fine.

These distortions take place all the time. If you understand the business, what it's really about, and the first most important thing is circle of competence stick within things that you understand really well. If you understand things really well, you know what they're worth. When the world is valuing it much below what it should be worth, that's when you act to buy. When the world is

valuing it significantly above what is worth, and you sell it, you're done. Nothing has to be done. Maybe you have two or three buys in a year, two or three sales in a year, and you move on from there.

Student 2: My doubt was basically in, like you said, that evaluating potential buy by throwing a dart.

Mohnish: You're putting words in my mouth. Did I say that? I said, by throwing a dart, I can demonstrate to you the wide distortions that take place in stock prices. That's not how I pick stocks.

Student 2: What would the metrics you use be like? What would you use for validating the potential?

Mohnish: Number one, I do not throw darts to pitch, in case I was not clear. I don't do that.

Let me give you some data points that might be useful. There were a couple of professors in the US, one guy is at the University of Nevada, and another guy is at Ohio State. They wrote a paper where they looked at every stock Warren Buffett bought for 30 years from 1975 to 2005. A 30-year period. They did an analysis. They said, "If you bought what Buffett bought, and you bought it after it was publicly known that he had bought it, and you bought it on the last day of the month that it was publicly known that he had bought it, you bought it at the high price of the last year of the month." The highest price it traded on, which means that you go and find the worst possible broker on the planet and say, "Please give me the worst possible price you can get and I want to buy it at that price." Then you hold it until Buffett started selling the stock. It was known publicly that he was selling it and you sold it on the last day of the month that it was public. The price you got when you sold it was the lowest price on that last day of the month. You did this for every stock that he bought and sold for 30 years. If you did that, you beat the index, the S&P 500 by 11.5% a year on average. The S&P had done about 10% historically. You were doing about 21.5% a year with no ISB degree required. Again, you can walk out of the room right now and you can put this strategy to work. I've told so many business school students about the strategy and so far nobody has set up a fund to do this.

Why are they not replicating? It's still not too late. You can start a fund tomorrow which does this. You can take a villa and go on vacation every day. Then the last day of the month, you come back from the swimming pool and just look, "Okay, has Buffett bought anything?" "He bought IBM. Okay, we'll buy it." Then you go back to your ocean surfing, swimming, whatever else you're doing until the end of the next month. You are done.

The bottom line is that cloning, which I talked about, is a very powerful notion. Unfortunately, no business school professor has ever written any books on cloning that I'm aware of are any good. There are a few books on

cloning, but they miss the point, I think. The bottom line is if you did what Buffett did, what these professors said you should do, what Buffett did, you are already meeting the S&P by 11% points, 11% a year. Now most of what Pabrai Investment Funds has done, at least in the last several years is in fact, if I look at my portfolio, almost everything that we own was copied from some other great investor. Please don't tell anyone. Keep this our secret. We just keep it for internal use. Don't put it on the web. We only want ISB to have an edge.

Basically, what I am doing, you can say is a slight tweak to the paper that these professors wrote where basically if you set up a fund, and clone the ideas of great investors, it only layers or adds to what you can do. I don't buy everything that the other greats are buying. I look at what they are buying and then I look at the ones that I can understand and the ones that I can understand and figure out. Yes, if they are undervalued, and it's right, I will buy. Those are the ones that I'm buying and that's it. Basically, limiting it to two or three decisions a year. Not much else is required.

Balachandra: I just wanted to understand the relevance of putting the topic of investing and philanthropies. This is a topic we are here to see of you. We are yet to hear about philanthropy.

Mohnish: If you ask me, we can go there. Do you have a question on philanthropy?

Speaker 3: No, we just wanted to hear some thoughts on philanthropy also.

Balachandra: We just heard about the investing issues, compounding, and all.

Mohnish: Actually, what you will find, and I'll maybe digress for a few minutes and not even digress, but I'll go into it for a few minutes. What you'll find is, it's the same as investing. There's really no difference. My personal biases of philanthropy which I get to play out in Dakshana are very simple. Basically, first of all, I feel that my father used to say, "We come to this world naked. We are going to leave the world naked." Since we are leaving the world naked, then the question comes up that if you end up with more assets than you need, what do you do with them? Probably a lot of, because of Warren Buffett's influence, for most people, the best thing to do is to recycle it back to society.

If you decide that you want to recycle assets back to society, then the question becomes how do you do that? And what do you, what do you focus on? Some basic principles, number one which comes straight to investing, is that if you were looking at two different charitable endeavors, endeavor A and endeavor B, you ought to be able to figure out which one delivers a higher return to society. If you really understand that, and once you figure out which one delivers a higher return to society, what you ought to do is put all of it into the higher return endeavor. The first thing about philanthropy, my

philosophy is you do not do sprinkling. You do not say, I'll give some money here and I'll give some money here. I'll give some money here.

No, because that is not going to maximize and optimize what society's benefit is. The first thing is it has to go through single calls, and it has to go to the cause that has the highest possible returns. In my case, it will very easily conclude that is likely with investments in education towards alleviation of poverty. Education has a huge multiplier effect. Then you get to the point of saying, "Okay, I want to invest in education. Instead of giving a person a fish and you feed them for a day, you teach a person to fish, and you feed them for a lifetime." Then the question comes up, do you want to teach fishing? What type of fishermen does you want to create?

The model Dakshana has adopted is a very high ROI model because we have a partnership with the government of India. They do most of the heavy lifting. We get to add on top of a great model. The returns we get on the funds that we invest are off the charts. In fact, to demonstrate that maybe I can have Ashok come up. Ashok, can you come up for a second?

Ashok Kumar is a Dakshana scholar who is an IIT Bombay student. You finish two years or three years? He's finished three from IIT Bombay, he's actually from Gachibowli. He grew up here, right? And in fact, I visited his home in Gachibowli with my daughter a couple of years back, I think two years back. Ashok's father is a tailor and I think it's a lower-class area where he practices the profession.

Very, very modest dwelling. In fact, when I went to this home, my daughter and I could sit down on two chairs. The rest of the family had no chairs to sit on. We were served tea on a very small stool, which could probably hold maybe just two cups of tea and some snacks. Basically, Ashok went to the Jawahar Navodaya Vidyalaya in Gachibowli, he got picked by us in 10th grade because he cleared our selection test. We worked with him for two years on IIT prep. Then after two years, he took the IIT entrance exam in 2010. His India rank was 63. Half a million kids take the exam. It's a single generation transformation in my mind from zero to here of that family. In terms of what we invested; we could never do that for the family if we were not riding on a great platform. Ashok is now interning at Microsoft also in Gachibowli. Basically, I think the future of his family is going to look very different very soon.

Ashok, maybe you can answer this question. What do you think of the Dakshana model? What do you think we're doing in this?

Ashok: Well, I am Ashok Kumar. I am staying in Chanda Nagar here. In my 10th class, I took my Dakshana entrance test, and got selected for Dakshana. It's an organization that helps the poor students who cannot afford IIT coaching and they help to get it free of cost. I come from a poor background. I don't think my parents would've given me coaching at that price. I would've continued

my studies without any coaching, and I would land up in some local college here. But really, it's because of Dakshana, I am in this position now, and I'm proud of it. I'll be completing my fourth year. I'll be graduating next year from IIT Bombay in the computer science department. I recently interned at Microsoft. My last job was an internship there.

Tom: I had a question on the back on the investing side. My name is Tom Highland. I am an ISB alum, and I manage an early-stage venture capital fund focused on nuts-and-bolts businesses here in India. I just had a question. You put up a slide earlier around your fee structure and there's something 800, 900 basis one difference between your net fees and your return.

Mohnish: Yes.

Tom: I'm curious as to how that works?

Mohnish: My investors love my fee structure. In fact, if the entire fund industry adopted my fee structure, the industry would disappear. My fee structure, which is copied straight from Warren Buffett, is there are zero management fees. I don't get paid anything for assets in the management. The first 6% of returns go to the investors. Above 6%, I get one fourth and they get three fourths. If you're up 10%, I get 1%. It's subject to high water marks. If you are up 5%, we get nothing. If you are down, we get nothing. If the industry adopted that fee structure, which I would love them to do, they would just disappear.

Tom: The second part related to that is not everyone is a natural stock picker or a cloner. For those that want to build wealth and perhaps just buy into the S&P, do you just buy DF, buy a fund with a very low load and kind of sell it in another go?

Mohnish: Let's say you had a 70 IQ and you say that, "Hey, I want to do the best I can." I would say, "Okay, you know, 70 IQ you can buy an index fund." Then someone comes and says, "Hey, you know, I have an 85 IQ. I'm better than 70 IQ guy. Can you do better than that?" I say, "Yeah, of course. You can buy Berkshire Hathaway stock and just hold it. High property will be better than the index." Then someone says, "Well, I'm a 100 IQ, can I do better than 85 IQ?" I say, "Of course you can." Then I say, "Just read the paper by those two professors and replicate that." Then someone says, "I have 120 IQ." Then I would say, "Why don't you just do what I'm doing?"

Raj: Hi, my name is Raj. I'm an ISB alum, 2007. My question, you guys analyzed what happened in 2009, what went wrong? What immense went after that?

Mohnish: What went wrong?

Raj: Yeah, what went wrong and when?

Mohnish: Sure, sure. That's a very good question. Well, we don't learn anything from success. It's really when we stumble that we learn a lot. In fact, I'm very

grateful. Every time in my life when I've stumbled it has led to growth and led to learning and stuff. I think that period from 2007 to 2009 was a wonderful period from a growth and learning perspective. In fact, I'm reaping a lot of the rewards of some of the lessons already. I think one of the things that went wrong was hubris. I had gone from literally from, I mean, the entire period, the funds ran from 1999 to 2007. We never had a down year. Not only did we do 37.2%, but we also never had negative returns in any single year, including the period of popping the NASDAQ bubble and all that.

Through all that period, that helped us because there were all these other stocks that were undervalued. I think there was hubris in the sense that I think there was maybe a bit of a build-up of thinking that I couldn't do anything wrong. The second was that I never at all saw the housing bubble. I completely missed seeing that. There were investments that I had made, which in hindsight were very dependent on a functioning financial system. Basically, what happened in 2008 and 2009 was that the financial system in the US basically was out of oxygen. It just couldn't breathe. I had companies that were dependent in my portfolio, who were dependent on access to capital markets, access to financing, access to all that.

When you just cut that off, they just went on a tailspin. Of course, I run a quantitative portfolio. Like in one case, a company called Delta Financial, we took a \$65 million loss, \$65 million to zero. Another case we took almost a \$40 million loss. On the one hand we had permanent losses in some cases, which took us down. In other cases, what happened is the entire market fell. Things get overvalued and undervalued. We had things that were solid, solid businesses. They were just knocked down in price. The big problem I had at that time was that we were fully invested, and we had no ability to be offensive to actually go and buy the best thing at that time that we would've been able to go and buy. We had no cash.

Not only did I not have cash, but I had redemptions from investors. I had to raise cash to redeem people, and I'm basically exiting them in my exiting positions, which are pennies on the dollar. That compounded the problem.

One basic lesson, cash or skin. One of the reasons I put in those rules where returns need to be at least 5x or greater for the last 10% of cash, is that it is hard to find. That's not easy to find. That means you're basically riding with a cushion. Most of last year we were sitting on more than 20% of cash, for example. In fact, even now I'm sitting on just around 10% of cash. That's a big change from basically the time I started in 1995 until 2007. There were very few periods where we actually had held cash. We always were almost fully invested.

One change we made is a very healthy appreciation for holding cash. The other two changes I made were where I came up with this investment checklist, which is a whole different presentation. But basically, it's very

powerful. It's looking at the mistakes that other great investors have made and why they made them, and whether those mistakes would have been obvious to spot at the time the investment was made. In many cases, someone makes the investment you can make right up front and there is no problem. The checklist has been very useful in catching those. I started having a conversation with another investment manager, which has been very useful. Then the cash approach was useful. I'll just digress a little bit.

When one of the biographies of Warren Buffett came out, *Snowball*, which was written by Alice Schroeder, she said that when Warren Buffett was a child, he used to walk in a strange way. He used to walk with his knees kind of somewhat bent and then walk. the reason he did that was to absolutely take out any probability of him falling. Very careful kid, not trying to fall. In fact, the way Warren Buffett picks stocks are the same. He extremely spent most of his time on the downside, he looks at, "How can I lose money?" He spends all his time and energy, not how much money can he make. He looks at, "What will cause me to lose money? How will I fall? What will cause me to call?"

There's a bunch of great appreciation since 2007 or 2009 on the downside. I just spend a lot of money on the checklist of those forces.

Madhusudan: Hi, Mohnish, this is Madhusudan. I have two questions. You scan almost globally in different countries and different companies in various sectors. In one of your interviews quoted, "I have invested in only two companies in India, and I don't do it because of regulatory hazards or whatever there." If there are a few companies who generally pop up on your radar, like a few big bets and frequent bets, even if you don't invest, can you just go over companies generally pop up on your radar?

Mohnish: Sure. The Indian market, you know, for me as a US investor, that's just cumbersome. I think the second the Indian markets are quite different from the US markets. One sense, I hardly ever see, basically never see managements. I hardly ever visit businesses. You can call me an armchair investor. I am not interested in going and understanding the people, meeting them, and all of that.

In India, if I were to follow the approach I do in the US, I think I'd get my head handed to me. If I were an investor who focused on India, I would focus on businesses that had major growth ahead of them. You know, businesses that can do a 10x or 20x in five years or 10 years, significant growth.

It almost becomes like private equity investing or venture capital investing if you want to do that. In fact, if I were investing in India, I would not want to be restricted to public banking. I would want to have a fund that would allow me to do all of the above, private, public, real estate, anything that I wanted to do. I would set up a different structure. If I wanted to do that structure, I could not do armchair investing. I would have to be able to handicap the nature of management and all of that. I'm able to do that in the US because the

businesses I invested in have very long histories and the managements have very long histories. In the United States, I can make an almost definitive statement. The probability that I will lose money on investment because of fraud is pretty close to zero. In fact, I can't think of a single case in the past 18 years as an investor that I lost money on investment because of fraud. I had lost money on investment because of my stupidity, but not because of fraud.

In India, I could not make that statement. There are plenty of very high-quality entrepreneurs. There are plenty of low-quality entrepreneurs and you'd have to sift them out. My biases are that I like to just sit in an armchair and my wife will tell you, he doesn't work at all. I have no interest in kicking the tires and going and meeting businesses and trying to figure out the venture capital approaches you have to forecast ahead without too many tread marks behind you. That's just not a game that I either would be good at playing or even have an interest in playing.

I think that the Indian markets, I'd have to move here to do that. I'd have to do it with it being the only thing that I do. They'd just be several structural changes that I'd have to make that aren't that exciting for me to make. Those are the reasons. I have no Indian stock for you because I really do not follow the Indian markets. But what I would suggest is you can do the same thing, which is to the extent that Indian markets require disclosure you should find out who the good investors are and look at what they're doing. I can tell you some names of people I admire in India. I think Chetan Parikh is very good. I think Amitabh Singhi in Delhi is very good. If you track some of these and they probably have many more of them, then that might be a good place to see what they're doing and then figure it out.

Madhusudan: Thanks, Mohnish. My next question is in one of your interviews, you said in one of your funds, you invested almost 60% of it in one stock, and you would even stretch to 90% provided you had the funds. Can you share the sector if you are not comfortable with sharing the company?

Mohnish: I don't think I ever said that. Which magazine was that in?

Madhusudan: I don't remember. I was just googling and reading all your interviews.

Mohnish: Let me correct that. I think when I invested Dakshana's assets, we were very concentrated in the manner that we did this. Not the funds, but the Dakshana foundation. The foundation is willing to absolutely place a single stock as the whole pie. We have no problem doing that, of course I should just correct that. The thing is, we have different pools of money, and one of the pools is money that comes from outside my family. Money that comes from outside my family just sits in the money market. It doesn't get invested. The money that my own family puts into Dakshana, we want to maximize returns. There is one stock that the foundation has a big stake in. I think it'll do very well, and it should go nameless. I can't tell you much more about it.

Madhusudan: It's a US or an Indian stock?

Mohnish: It's not an Indian stock based on my earlier comments. And it's not even a US stock. There you go. We have what, a hundred odd countries you can think about?

Chaitanya: Hi, my name is Chaitanya. I have a question regarding investment. One of the central themes of Warren Buffett investing is the presence of moat around companies that he looks at. But your concept of cloning, as I understand it, might conflict with that moat. Or could you just please clarify that? Is there a difference between the cloning part and the presence of a moat? The presence of a moat means there is very less competition than good returns on the capital. But cloning essentially, like I'm copying another guy in a business, so my returns reduced.

Mohnish: Well, Buffett is a multidimensional investor. I would say dozens of investments, if not 50 plus, 100 investments he has made were not moat based. To give you an example, I think maybe around 10 years back, he bought the debt of Finova Capital. Finova is like a subprime lender in the US that was going bankrupt. He bought the debt, and he bought a lot of the debt. He basically got into a position where he could participate in the restructuring of the business. That business is not much of moat. They had a portfolio and there were certain statistics of loss that you would have in that portfolio.

He wanted to run that portfolio, which means getting the loans paid off, etc. Just to keep the residue. There are dozens of investments Buffett has made and continues to make that are not based on moats. In fact, he's done lots and lots of arbitrage deals. In fact, he used to do a lot of things in 50s and 60s.

I would say that Buffett prefers to buy moats. I think now with the size of the capital he has; the odds are heavy that he would go mostly moat based. But that's not all he does. He does all sorts of things that are non-moat based and so it's not in conflict. I think the cloning thing is, let's say you picked four or five investors that you thought were exceptional, and let's say that I'm going to pick the best of their ideas, which I can understand within my circle of competence, maybe even the ones that have more, etc. You put some criteria on that. You can skip the ones that don't have moats, you can skip the ones that you don't understand. So cloning is not in conflict with moats. You can actually do extremely well investing in a business that is unquote a shallow moat if you pay next to nothing for it. Of course, the ideal situation is to buy a business with a great moat at a great price or even a fair price.

As someone looking at the portfolio, the outside would say, this is not diversified, it's all in the same geography. That's true, it's the same geography, but the odds are very, very high. If a person bought those four assets and he bought them at reasonable prices and he never touched them in terms of selling them or anything over a lifetime, he'll do extremely well. If you look at the competent circle of competence of an investor like that, it's this small.

They invested in something just in their geography in just four asset classes and very basic asset classes. You don't need to do ESO sort of things to do well as an investor. I think simplicity is very powerful and keeping it simple is really, really, I think important.

Mohnish: Any questions from Dakshana scholars?

Student: I want to replicate what you have done and are still doing. How should I proceed?

Mohnish: I'm sorry, you must repeat. I couldn't fully understand.

Student: I want to replicate what you have done.

Mohnish: You want to replicate, great. You want to be a cloner.

Mohnish: You want to replicate what I've done?

Student: Yeah, but sir, I have no money in my hand. But I want to replicate you. How to proceed?

Mohnish: Very simple. First of all, when did you join Dakshana, this year or last year?

Student: Last year.

Mohnish: Last year. Okay. Are you going to join IIT?

Student: Yes, sir.

Mohnish: Okay. What is your rank going to be?

Student: Below thousand.

Mohnish: Pardon?

Student: Below thousand.

Mohnish: Okay. All right, very good. I have another talk I give and will give the abbreviated version. It's called the secret, the secret to becoming very wealthy. That's what you want, right? Okay, so here's the secret. How many hours are there in a week?

Student: 168 hours.

Mohnish: 168 hours. When you start working full time, let's say you finish your degree in IIT and you join Infosys or something. How many hours a week are you required to work? Ashok, how many hours?

Ashok: 40.

Mohnish: 40, 45. The US is 40 hours, let's say 45 hours. Let's say 50 hours. We want to work hard for our employer. 50 hours, how many hours are left? So even if you

take out time for sleeping and other things, what you will find is that you are basically left with at least another 30 or 40 hours that you could do something else, okay? You can spend it with your friends and watching movies and enjoy yourself, or you can spend it in your Swami Vivekananda's under single minded pursuit of maximum wealth. What do you want to spend it on with friends or to maximize wealth?

Ashok: Maximize wealth.

Mohnish: Maximize wealth? Okay. Basically, when I graduated with a degree in engineering, I took a job, and they required me to work 40 hours a week. After three years of working, I had an idea of something I wanted to do. I used to get very good reviews from my employer. I no longer care about the review, how good I'm doing, that's irrelevant. My objective was, once I knew what I wanted to do, my idea of my business was to not get fired. They should not tell me you lost your job because I need the cash. I just did enough to make sure that I'm not fired. What I used to do is from seven in the morning till about 8:30 in the morning before I went to work, I used to work on my business.

And then about six o'clock or so, I would come home until about midnight, I would work on the business. Then all weekend I would work on the business. Anytime I had planned meetings or anything like that, I took a vacation meeting. I could even take half a day vacation. I had vacation built up. The paycheck is coming in, someone is paying me, right? And this business I was trying to do, if it did not work, you know, there would not be much cost because I still have a job. I was working from my home. It took me about 10 months from the time I started this focused activity. I was 24 years old until the time I got my first client. 10 months I was just continuing to do different things.

Finally, the first client arrived, and then after about two weeks, the second client arrived. But I had the first two clients, I had more money coming up and I explained to him that, "Hey, you know, I've started my own business and it seems to be taking off. And now I'm going to go do my business." They tried very hard for me not to leave. They told me, my boss and his boss, they called me and they said we could not understand. You are doing so well. And then, for the last 10 months, you were not doing so bad that we want to fire you. But it was not what we used to see before. I said, "Exactly, that's what I was trying to do is not get fired, just barely, you know, stay above firing level." And so, then they told me that, "When your business fails, come back here. Much higher salary." They offered to pay me a lot more. They said, "Anytime the business fails, come back. We'd love to have you." I said, "This is fantastic." I have my four months from this client, full efforts behind it to get more clients. And if it fails, no need to even look for a job, just go back to higher pay. Because of the secret, you basically have the time to do two jobs, and everyone thinks you should only do one job. What you do is your second job

fails, no problem. Start something new. Fails, no problem. Just keep going. Something will hit. As you keep doing things, you learn more things than you'll just keep going from there. So that's how I started my first IT company TransTech. That grew and did well. I left that to start Pabrai Investment Funds. And here we are. So great question.

Student: How to fund upfront means that how you started to fund your power of fund?

Student: What is the procedure of making a fund? What was the procedure for Pabrai Investment Funds?

Mohnish: Yeah, so I just copied what Warren Buffett did. There was a Buffett partnership in 1950s. There was a book written which had a chapter on exactly what that fund did. I copied a chapter. I went to a lawyer, I said, "Copy this." And he created the fund. That's it.

It cost \$8,000 and we were in business. Before I spent the \$8,000, my friends already told me they want to put \$1 million to start the fund. The thing is if there are things that you don't understand, and any time you do things, there are things that you don't understand. In fact, even when Dakshana started, there were lots of things we did not understand. The first thing we did not understand is how to find scholars. So, we copied Anand Kumar's model. But Anand Kumar, every year has 10,000 people who show up at his doorstep? Tomorrow is his test, right? Tomorrow is a selection test. There are probably 5,000 or 10,000 taking that test. Then he'd pick the 30 kids and go from there. When Dakshana started, and if you hold some tests, nobody will show, because nobody knows us.

One question, I was trying to figure out how we will find any scholars and how will they find us? It was an important question. We did not know the answer. This is what I did, I started Dakshana and I hired an Indian consultant. This guy was an IIT Madras grad. He was like 64 years old. I told him, "I want you to just do research on Dakshana and things like this." For example, how do we go meet anyone who's willing to meet you? Go meet all the coaching schools. And I told him, for example, we can tell the coaching institute that if somebody comes to them, they don't have money, send them to us. Many things like that. I told him that every day he works for us, he'll get paid 5,000 rupees.

I said, "If you spend one day on us, 5,000 rupees. If you spend less than a day, 500 rupees an hour. Just bill, whatever time you spent, send me the bill. I'll pay you. You just keep doing research. He started going and meeting people. I think three or four times when he met people, they told him, you should look at J&B. He had never heard of JNV before. After the third person told him, look at JNV, he decided to look at JNV. Then we found JNV, and now you are here.

Whenever you start a business, you don't know the answers. You don't know all the answers, which is okay. You need to know a few answers, and you need to make sure you reduce your risk. That guy was paying 500 or 5,000 rupees a day. If he works full time for one month, it'll be one lakh rupees. If he worked full time for three months, three lakh rupees, no problem. Three lakh rupees gone it's not going to be a problem.

They don't have a model today that makes money, but they'll figure it out. You don't need to figure out everything on day one. You figure it out. Even with Sam Walton at Walmart, just kept learning as he went along and that's how you do it. Something to understand when you start a business is you need to have passion, you need to have the drive. You do not need money, but passion and drive are important.

Student: Sir, how to get rid of the ego and envy in you, I mean, what is your view about this?

Mohnish: How to get rid of envy? Envy, ego, envy. Envy basically, it's related to being jealous. I would say that do not be envious. What can I learn from others? How can I improve myself but not be envious of others? Not having ill thoughts.

Buffett says that, Charlie Munger says that in Juda, when they came up with the 10 Commandments, Moses came up with the 10 Commandments. All the 10 commandments have to do with the basic sins of humanity. Thou shall not steal, thou shall not covet thy neighbor's wife, thou shall not covet thy neighbor's farm, etc. All related.

Basically, the most very important trait is not to be envious. There will always be people who do better than you. There will be a lot more people who do worse than you. The important thing is to focus on what you can do to improve yourself, but do not carry envy. In fact, we saw Rajat Gupta rather successful people for a very simple reason. I mean, he has money that he could have ever spent in his life, and he lost a reputation that took a lifetime to build that probably will never come back. Everyone who knows him will tell you that he is a first-class person. Envy is a very dangerous thing in my opinion.

Student: I'm not much aware of so-called business and then God, you talk today. I prefer one thing that I think you're not too interested in, Indians from Indian firms. What problem is there in Indian firms that you are not interested in?

Mohnish: Good question. Well, I'm going to have a seat. I think the reason I gave that one of the big stumbling blocks in investing with Indian firms is I need to be in India and the way my life is set up, I'm not in India. It's really, really, hard for me to get an advantage versus other investors who are based here if I try to do it from sitting in California. I think you need to be closer to these markets and a lot closer to the CEOs and principles of the companies if you are going to try to do a good job. Just the way my life is set up, I can't do that. It doesn't

mean there's no opportunity. Lots of opportunities in India, lots of opportunities to do well. Lots of firms that one can do very well. But not a place where I can necessarily do well. I must play a game that I know I can do well at. And if I were to sit in Irvine, California and try to invest in Indian stock market or Indian companies I'm probably not going to do very well at it.

Student: Because there are so many Indians who want to do means, very well in business sector. But if they want to serve India, they must stay here. Is there a better opportunity in India also?

Mohnish: Absolutely. I think in fact, it's questionable whether many of you do better if you went outside India. I think if you stay here there's plenty of opportunity.

Student: India has served us for many years.

Mohnish: We are counting on you to do that. I hope you do that. Okay.

Organizer: Okay. Thanks Mohnish. It was really a thought-provoking session. It's great to see a lot of youngsters learning the way of investing and I would say the ways of life. We should not envy; we should not have ego. Hopefully some of us specialize. The students will try to successfully copy, cloning, and then like make us successful investment managers. Wish you all the best in your next eleven and a half years. Thanks.

We have an announcement that you come tomorrow for the session that we are having on Philanthropy. Thanks a lot.

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