

## Mohnish Pabrai's Presentation and Q&A at the Boston College on October 9, 2014

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**Mohnish:** Well, it's a pleasure to be here, Arvind. A year has gone by quickly and you keep looking better and better. That's good.

**Arvind:** Well, I got to tell my wife that.

**Mohnish:** Why don't we start with the slide presentation? I would say cloning 101 and some things I've learned over the years and some things that have surprised me. Pabrai Investment Funds is a cloned fund. It's a replica of the Buffett investment partnerships. When I started it in 1999, it was 30 years after Buffett ended his partnership. You could probably say, even from then till now, it's probably one of the most successful hedge funds operations ever in the history of humanity. It was very surprising to me that when I found it in 1999, when I looked at it, I couldn't find any examples of any funds that had replicated the unusual structure of the profit partnerships. Things like no management fees, only performance fees, reporting once a year, not disclosing holdings and so on, and so forth. Really focusing on investing if you will. I cloned many of those attributes of the Buffett partnerships when I started funds and I realized only a few years later that each one of those unusual attributes gave Pabrai Investment funds quite a bit of competitive advantage. Even now, it's been more than 15 years since I started. It still tends to be true. It's not zero, but the number of funds or the percentage of funds that are willing to manage capital in this format is a rounding error. It's less than one 10th or one 100th or 1%, it's a very low number. I could count on one hand or maybe two at the most, the number of funds I know who follow that structure. It's reinforced by the belief that cloning is very powerful and such. Arvind let's go to the next slide.

If you look at the Dakshana Foundation, which is the family foundation I set up with my wife about eight years ago, it is also a cloned model. We cloned a guy in Bihar, he had a model called "Super 30" for sending kids to IIT. We went and cloned that. But beyond that, what I did is, almost everything about the way Dakshana is run is taken from Buffett and Munger principles. If I thought that no one in the hedge fund universe was smart enough to follow the Buffett partnerships, I think the nonprofit world is so much more unwilling to clone. Dakshana follows some very core principles of Buffett and Munger, and I'll just highlight some of those because that is the way nonprofits should be run. But it's not the way they are run. Again, the end result is that we look so good because they're compared to all these yoyos. It just makes Dakshana look that

much better. One of these Buffett principles or nonprofits is that, nonprofits ought to narrow their focus on one or two well-defined causes, because you're taking on, unlike making money when you're trying to kind of improve the world, it's a much more difficult challenge. To have any chance of success at all, you want to concentrate all your resources into, at the most, one or two kind of focused directions and most nonprofits are unwilling to do that, they are kind of Jack of all trades.

Then the second is that when you have endowments within nonprofits where they've got a part of money like the Ford Foundation or Rockefeller Foundation and so on, then when those assets get invested, Munger has written about that in Poor Charlie's Almanack, his belief is that those assets in our non-profit endowment should be extremely concentrated. When he means by extremely concentrated, he said that 90 plus percent of it were in one stock. That's perfectly fine. I'm not aware of any nonprofits other than, maybe a few that were set up with Founders Stock, and there was some kind of mandate from the founder that they couldn't sell it. But even then, I'm not aware of any that have to limit remained focused and concentrated in one or two securities and Munger's reason for saying that, he says that, first of all, when you embark on trying to change the world, it is a very high risk activity with a high failure rate, because the odd that you're going to be able to do that are low. Unlike investing, in the case of a nonprofit swing for the fences, you want to swing for the fences in a very major way. Part of the swinging for the fences, is, you pick a cause hopefully a tough cause. The second way you swing for the fences is, you put everything into your absolute best investment idea so that you can maximize returns. You can basically hit the ball as far out of the park as possible. The counter to that is that if it doesn't work out, let's say for example, you put all in one stock and that stock goes to zero. Let's say for example, you're trying to find a cure for Ebola or some virus like that, that's swinging for the fences, you may put tens of millions into that, and it may go to zero as well. Buffett and Munger's perspective is that you want to truly on all fronts with a nonprofit tool leasing for the fences. Pick one cause and put everything in one stock.

That's what Dakshana has done, we've identified and obviously, we've cloned someone else's model. That gave us plenty of cover. But the rest of it, I've always been willing to swing for the fences. One thing about Dakshana is that my wife and I said, we'd give up 2% of our net worth every year. If you put everything in one stock and that stock went to zero, all that would mean is that, that year we couldn't do anything more. Next year, again, we'd have 2% of assets and kind of get going again. Just the way Dakshana is set up, we think we don't have a situation where it would terminate no matter what decisions we took. Again, what I found is that today there are few cloners on the Pabrai Funds Buffett model, if you will. I have run into almost no cloners, in fact, I know a non-profit that is embracing those Buffett and Munger principles and truly swinging for the fences. They ought to, but they aren't. If you come to my latest venture "Dhandho" which is a holding company I set up a year ago, we raised

about 150 million from a number of investors in the first quarter of this year. We've agreed to acquire an insurance company, a privately held insurance company. We hope to finish that acquisition before the end of the year. Eventually, we'll make it public so that if investors want to cash out, they can sell stock, and we end up with a permanent capital vehicle, because these companies that we intend to acquire, we don't intend to ever sell them.

It's not like private equity, kind of buy and hold forever, like Berkshire or Fairfax and such. Dhandho, again, is a cloned idea. I looked at Berkshire Hathaway and I looked at Fairfax Financial, I looked at Markelle and so on. I was intrigued by the idea of being able to make investments in asset classes other than stocks, because all Pabrai Investment funds can do is invest in stocks. The idea of owning entire businesses and then replicating that aspect with the Buffett model, which is, you buy businesses, and you leave them alone, delegation to the point of application. I found that was, again, not being cloned very much. I thought that model had some legend and I thought I'd give it a try. It's dawned on me relatively recently, didn't even dawn on me when I set up Dhandho, it really dawned on me, I would say probably three or four months ago. There are about 3000 property casualty companies in the United States. Collectively, they take in about \$550 billion a year in premiums. It's a sizeable industry, but out of the 3000 companies, the number of companies that follow the Berkshire Hathaway model of running an insurance company and running Float and investing in equities and all of that whole model of running an insurance company, it was really surprising to me to find is not replicated at all. I mean, I would say once you get past the Berkshire, Markelle and Fairfax of the world, I've looked at an insurance company after the insurance company, what I find is that, if they're really good at insurance, which many of them are and many of them aren't, but the ones who are really good at insurance, they tend to have absolutely no understanding of the investment side.

Looking back, I guess it makes sense because the two disciplines are so different from each other that typically, the skills you need to be a great underwriter, a great operator on the insurance side, are not really that useful on the investment side. Typically, the companies that have great operators on the insurance side have no clue on what to do on the investment side. They tend to go institutional, or they tend to sit in treasuries or they just kind of have an in fixed income. What you really have to do, which is so hard for these companies to do, is, you have to take a non-institutional approach to asset management or investment management. That non-institutional approach means that you need to identify and find a Louis Simpson the way Geico did, then give the entire investment portfolio to Louis Simpson, and then tell him, carte blanche, do whatever you want, and no one's going to look over your shoulders. There are two or three skills needed to do that. One is, the biggest stumbling block would be the ability to identify a person like Louis Simpson, which would be very hard to do. I think Warren Buffett is extremely good at that. Most of these companies have no ability to identify Louis Simpson if he

was standing in front of them. The second is that after you identify Louis Simpson, you've got to take a non-institutional approach and give that person full freedom. Again, that's really hard to do, kind of really regulated cut-and-dry industry like insurance where you'll be hands off. When I formed Dhandho, I was thinking that we would buy private assets or make assets investments in stocks, we might even invest in real estate, et cetera.

My thinking has actually evolved to be much more focused on the insurance industry. The reason is because there's such a large amount of assets and companies that have such a poor approach to investing that it truly add value when Dhandho acquires them, because I would leave them alone on the insurance side, and I take home managing the investments. I just wanted to illustrate that, basically, you got these three quite different operations all cloned in different ways, and all cloned from Buffett and Munger. I would say that the number of people who are willing to do value investing itself is a small number, very small number. But it is a really huge number compared to the number of insurance companies that have embarked on the Berkshire model, or the number of nonprofits that have taken a cue for Buffett and Munger. What I found is that, as I've gone deeper into the cloning on Buffett and Munger, I've found that the field is completely open. I still find, even on the investing side, is completely open, but you still, at least, have a sliver of intelligent life. I would say, in these other areas, in the non-profit world, close to zero, intelligent life. On the Dhandho side, we haven't really run into real competitors in terms of people who are truly willing to leave managements alone to run the insurance business and then run the investments and so on. I just wanted to share that. Then want to switch gears a little bit about farmland in Iowa. I think Arvind's wife is from these parts in rural Illinois, or was she from Iowa?

Arvind: Rural Illinois.

Mohnish: Rural Illinois. Close enough. This is close to what within 10 miles of her house looks like. Anyway, if we look at the average price per acre of Iowa farmland, and this is not inflation adjusted or anything from 1950 to 2013, and you see a big jump, that's actually not in one year. It was about \$5,000 an acre in 2010, and it's about \$8700 an acre in 2013. You can see long periods of hardly any movement. I mean, between 1980 and 2000, you have approximately a 10% drop in land prices. Even from 1950 to 1970, you don't see much of a rise, these are the prices per year of the value per acre. Again, you can see that 2010 is \$5,000 an acre and 2013 it was \$8700. You can see how it's evolved from 1980. If you look at these rents, if you owned a farm and you wanted to rent it out, I just wanted to focus on the left-hand side, which is the crop land rent per acre. You can see like in 2014, it's \$260 an acre, and in 2013 it's \$255 an acre, and so on. Then you can see there's one column, which is two columns over, it is rent as a percentage of value. You can see that in 2014, it is about 3% and in 2010, it's 4%. It's kind of moved between 3% and at the most, six and half percent of the value of the land. The reason I'm showing you all this is that, if someone were to buy or rent Iowa farmland, they're only doing it mainly for one reason, and

that is that they intend to farm that land, and they intend to grow either corn or soybeans and sell that corn or soybeans. The corn or soybean market is a commodity market. The buyers know what present prices of corn and soybean are. They know what the historical prices are, they know what the inputs are in terms of land, fertilizer, labor, capital, machinery, and so on. You also got variables that you don't control. You don't control the weather which can go all over the place. You also don't control supply and demand. The selling price of the crops can change. You also don't fully control the price of fertilizer, and even that can move around. When these transactions take place, when people buy Iowa Farmland or when they rent Iowa farmland, these are negotiated transactions between an intelligent buyer and an intelligent seller. Because you have a negotiated transaction between an intelligent buyer and an intelligent seller, and your underlying asset is a productive asset. These are not REM brands, and they are not Ferraris. These are productive assets being traded between an intelligent buyer and an intelligent seller. There, the buyer has to do some viewpoint over the next 10, 20, 30 years, what crop prices are going to rise, and what kind of profits he or she can make from the land.

Then based on all of that, they'll make an offer, and if the buyer and seller agree, then you have a deal and then you end up with these prices. This is quite different from the way top markets work. If I look at the rents that are being charged, you don't see much movement from year to year. I mean, you can see in 2007, it's \$150 an acre and goes to \$170, which is like about 12% or 13% or something? Then it hardly moves about 3% to \$175 and so on. Even though I'm not showing monthly prices or daily prices, if you were to chart even the monthly or daily prices, you would not see many gyrations. It would be a smooth curve in terms of how these prices move. When we get to stock markets then, stock markets don't operate this way because those are auction driven markets.

I gave Arvind a spreadsheet, which has about 13 odd thousand ticker symbols, one ticker symbol per row of the spreadsheet. Then he's going to go to a website called random.org. What we are doing here is, we are picking a random stock. I don't even know what the stock is going to be, I have no idea. We are just going to look at what the price movement on that stock has been, and this could be a stock in any part of the world.

Arvind: This stock is in the US, it's ticker PKE, P as in Paul, K as in King, E as in Elephant, and the company name is Park Electrochemical Corp.

Mohnish: Okay. I've never heard of this company. Maybe Arvind has, maybe he owns it in his portfolio. All right. Let's say I pulled up Google Finance. You can pull up whatever website you want, which you prefer. Arvind?

Arvind: We'll use the same as you.

Mohnish: Okay. I'm just looking at Google Finance, and you can see that the 52-week range on this stock is from \$19 to \$32. Okay? Maybe if one of you has a calculator, if you take the bottom to the top, it is like 50, 55% or something.

Arvind: 68%

Mohnish: Okay? Basically, if you bought at the bottom, somehow you knew that at the bottom with this random company and you sold at the top within 12 months, you'd have 68%. Then, if I look at five years, I'm looking at the five-year chart on this thing, and the lowest price seems to be around \$20. It probably is at \$19 price. The highest price seems to be \$34. We have about 70% or so movement. If you see that chart, I'm going to see the chart for all years from the beginning. Yeah. If you see the chart, this is going from 1978 onwards, you can see really from 93 or 94 onwards. It's choppy, it just goes up and down all over the place. Then you can see in probably and during that dotcom boom, this thing went from 15 bucks to 50 bucks in a few months. Let's pull up another symbol Arvind, let's run the generator again.

Arvind: Sounds great.

Mohnish: Mirror on the wall

Arvind: That translates into a company called Premier Gold Mines Limited in Toronto, ticker PG.TO.

Mohnish: Okay. Here we see a one-year range within a dollar, \$28 and \$3 and 52 cents. How high is that? What is the percentage that the high is high above the low? So it's like 226, it's almost 200% over the thing. If you've got massive swing within a year, and then if you look at a five-year range on this thing, it's all the way from \$8

Arvind: Wow.

Mohnish: To a dollar, \$45. This is not anything like Iowa farmland, and you're seeing all these wide swings. One of the big reasons you see these swings, of course, they're probably gold miner, and they're probably tied to the gold price and whatever people think is happening. But again, another part of this whole thing is that it's not negotiated transaction, it's an auction driven markets. Let's pick another one Arvind

Arvind: That translates into a company in Singapore called Communication Design International Limited, 5HT.

Mohnish: Okay. This is also a nano cap or something, but let's see what's going on here. All right, we got like one year, what's a one-year range on this?

Arvind: Market cap of \$34 million.

Mohnish: Yeah. Here you've got from 3 cents to 15 cents, a 5x delta in a year

Arvind: Right

Mohnish: If you look at five years, it's like gone up too well, it's looks close to an all-time high here, like 2 cents to 14 cents.

Arvind: According to Google, it's at eight times speed

Mohnish: It might be a great buy

Arvind: It could be

Mohnish: Maybe you can buy for your fund, Arvind

Arvind: Maybe.

Mohnish: Even if you look at the all-time range from 2006, you can see from 2 cents to like 45 cents or something and such. Anyway, I think we could do this for a long time. But the bottom line is that these picks aren't value picks. They're random picks, right? What tends to happen when you are doing value investing is, you'll tend to buy things when they're in general cheap. You might even be getting them closer to the bottom of the 52-week range because you've been looking over, if you've been looking at it for a while, it may be that it finally gets to the point that it's cheap. One of the advantages you get with value investing is that, just because of this natural wider swing in this asset class, I mean, if you were an investor and you were limited to only buying Iowa farmland and that was the only asset class you could buy and sell or do options, whatever else, you basically would be screwed because you saw what that chart looked like.

You can do fine if you're a farmer. Though people are buying today, that Iowa farmland may not do so well, might be good to rent today because you're getting it cheap if you rent it. Basically, these stock market-based assets that you're buying are really completely and uniquely different from any other asset. They're very different from buying whole businesses. They're very different from buying cars. They're very different from buying real estate. They're very different from pretty much any other asset class you can do, and it's because you're not dealing with face to face. When you do intelligent buyer, facing intelligent seller, you'll tend to get more times than not rational pricing. Sometimes you can get distortion like in 2000, late 2008, early 2009, even private assets would get undervalued because people are just freaked out or needed cash or something. But in most circumstances, you won't get that with negotiated transactions. But you can almost always find that in equity markets because of these swings that are going on, companies are going through all sorts of things. Like today, I think I didn't check, but how much was Dow down today?

Arvind: Over \$300

Mohnish: The over \$300 points and all kinds of businesses got marked down. I used to give the example, in fact, I'll look here. There's a company called Service Corp.

You could see that Service Corp, if Arvind pulled it up, it dropped 2% in price today. This is the company that buries dead people and they're in the funeral services business. Whatever caused the market to go down, Arvind, what caused the market to go down?

Arvind: I have no idea.

Mohnish: Anyone else want to take a crack at what happened? What happened that caused the market to go down today? You know how these commentators have a one sentence answer, I heard earlier today on CNBC that, and maybe, I don't know if this was a reason why, I just caught a soundbite where they were concerned about Mario Draghi, and they said that people are concerned that the emperor has no clothes. Maybe they are questioning his ability to actually do things in Europe. I don't know what happened, but something jolted in the market, I have no idea what happened, but whatever jolted the market, it did not increase human life expectancy. Did it increase human life expectancy today?

Arvind: Doubtful

Mohnish: Any of you can answer. Did we have any change in the way humans take care of their death today?

Student 1: Maybe fewer people have died. I don't know

Mohnish: Fewer people died.

Student 1: Yeah.

Mohnish: You think fewer people died? Arvind, do we have Ebola on the screen or not on the TV nowadays? Basically, you look at something like Service Corp. Whenever you have these big ups and downs in the Dow, if Service Corp were a private business and they were negotiating to sell the business and they've been negotiating, and yesterday they're agreed to some surprise. Then today the buyer comes and said, listen, the Dow dropped 300 points, so I need to drop your price by 2%. The seller would tell them go take a hike. They're not concerned at all about that. You can see that you have these swings taking place, and today's a good example where everything gets marked down. Service Corp is just an extreme example of a company which is just burying dead people or cremating dead people. What a wonderful business to be in and why should they have any impact whatsoever on their business valuation cause of today? But it did. In fact, even if you look at Service Corp, I'll just pull up the, like, the one-year range on this thing. If you look at the one-year range on this, it's like from 17 to \$23, again, that's a fairly large range for a company that is doing something as benign as burying dead people. If you look at it over 10 years, this thing has gone from like \$2 or \$3 all the way up to \$23. In fact, the funny thing is it went down a lot during the financial crisis. You see that chart during the financial crisis in 2008

Arvind: Yes.

Mohnish: And 2009. Okay, did people stop dying then? Did they have more heart attacks at that time or less heart attacks? Like the human mortality change at that time? What happened then? Nothing happened, and neither did they have margins or anything else. You can see kind of what's happening. This would not be the chart. If we had a chart of private transactions of buying and selling of funeral homes, this would not be the chart that would show up. There'd be a completely different chart. Those are my kind of remarks I wanted to make. We can talk about anything you have in mind now Arvind.

Question: What were your learnings from your lunch with Warren?

Mohnish: Yeah, I think that's a good question. I think that I had exit interviewed everyone who was at that lunch after lunch, we didn't have any recording devices and none of us took any notes while we were at the lunch. I wanted to capture as much of it as I could. I made some notes after talking to everyone. We covered about 54 different topics, a wide range of topics over three hours. With Warren, there isn't much that's not in the public domain, and I don't think he told us much that we couldn't have found somewhere else. But what the lunch did for me, it helped me calibrate and understand better what is important to him, and the kind of way he thinks about it. A few things that kind of stood out are, one, this discussion that we had with him about the inner scorecard was without a scorecard. He mentioned at lunch that it wasn't out then, but it was about to be released in Alice Schroeder's biography. If you read her biography, you can find a bit of a write up on that front. He said, "would you like to be the greatest lover in the world, but known as the worst or the worst lover in the world known as the greatest?" He said, "If you know how to answer that question, you've got to make, what became clear is that Warren clearly marches to his own drummer, and to a very large extent, he does not care what the world thinks. He is very willing to take a stand that is unconventional, which is even unpopular, and he doesn't really care what the impacts are. Just one example would be, he is a guy in the Midwest, but he has a wife and a mistress for decades. He's in the public eye and it's an irrelevant data point for him as to what people would think of it or make of it. That is a person who's in a scorecard. I think in investing, it is very important because you want to have independence of thought. Typically, when you're making investments, they will tend to be as a value investor, they tend to be cheap. Usually, they tend to be cheap for a particular reason.

That reason is probably believed by lots of people. In fact, taking a contrarian view. You need to have conviction in those contrarian views. That was one thing. The second is that, when we talked to him, I asked him a question about Rick Guerin, because, at that time, I hadn't heard about Rick Guerin in several decades after the seventies. I knew that Buffett, Warren, and Rick were close, and there was only the two of them who were partners. I just asked Warren, "Hey, what happened to Rick Guerin?" He converted almost any question into a

learning opportunity. The way he answered the question was that, he explained how Rick was levered going into the big downturn in stock prices in 1973, 1974. Because he was levered, he got margin calls and such, and he got squeezed and he actually was forced to sell his blue-chip stamp and Berkshire shares to Sequoia Front and Buffett at the prices at that time, which were nothing. I think he sold Berkshire's stock at \$40 a share to Warren or something like that. Then Warren went one step further. He said that, "Charlie and I always knew that we were going to get very rich, but we weren't in a hurry. Rick was in a hurry". He went in one step further than that. He said that "if you are even a slightly above average investor and you spend less than you earn, you cannot help but get wealthy over a lifetime". You can clearly see that this is front and center, very important to Warren. Warren is not interested in swinging for the fences on the investing side. He wants to make sure the downside is well protected. He definitely does not want to use a lot of debt and such. We know that all those things about Warren on the public domain, but what seared it in for me is that, he could have run Berkshire in a manner that would've ended up with a stock price even two or three times where it's today. But that isn't the important thing for him. The important thing for him is to finish first, you have to first finish. he took the patient steady route, and that's a very important lesson for investors is to take very patient and steady route.

I just wanted to highlight that in the context of something I ran into recently. Arvind will know this, but Fidelity recently did a study of which brokerage accounts at Fidelity performed the best. Maybe Arvind has more color on it, but they started all the different brokerage accounts and there were these two people who were talking about it, James and Sheldon, Sheldon asked another guy and then the other guy was joking. Yeah, it was the people who were dead whose accounts perform the best. Then James said, "no, that's close. It was the people who had forgotten that they had accounts at Fidelity". When they looked at the performance of these different brokerage accounts that had stocks in them, the ones that performed the best were the ones that had absolutely no activity for a very long period of time.

This means they were people who had picked a few stocks and then these guys just forgot they even had their account. In the end, those accounts perform the best. That just shows you how good brain power does for you in investing. There's a tremendous lesson in what Buffett is saying, and a tremendous lesson in that Fidelity study. The number one skill that you can bring to bear in investing is patience, extreme patience. Even if you go back and look at stocks you bought five years ago or 10 years ago, and you have sold them, just look at how they've done. Many of them would've done vastly better than you would've thought. They've probably done well even after you sold them and so on. Those are some of the lessons that stand out.

Question: What are your inner score card metrics for your portfolio and life, respectively?

Mohnish: Well, I think that in investing, first of all, every company is different, you can't use the same kind of yardstick for different companies. But in general, I would say that, once I make an investment, I usually have some thesis around what that company is worth and likely to be worth in the next few years and why it's likely to be there. Probably every few months, I'll just look at what's happening in terms of what's transpired, maybe 36 months or year or so. How it lines up with the original thesis and such. Then you take it from there. Like when I invested in the money center banks, they were trading well below tangible book value. Tangible book value is a value of a bank, which is liquidated. The book value is real that they could shut their doors and return the capital, and that's what you ought to get back. Solvent bank with correct reserves and so on, to trade below book value, and in fact, it should trade at some premium to book value because it's a going concern. What premium depends on what they make on assets and so on. What their spreads and all that interest rates and so on. I would say, when you look at money center banks, probably the most optimistic scenario might be that, at some point, two times book value be probably the extreme end of what it might be worth if you were drinking all the Kool-Aid and everything. But one time book value is probably understating it and probably reality guys somewhere in between. We look at different metrics, and you look at it based on what you think is appropriate not based on what price the market is set for the security. In other facets of life. I think that there's a big influence. Another book I read a long time back, I probably read this 15, 16 years ago, called Power vs. Force it is written by a guy named David Hawkins, and he has a kind of controversial approach. But the thesis of his book is that, if I lie to you and in your conscious state, you don't know I'm lying to you. In your subconscious state, you do. For most humans, the pipe between the subconscious and the conscious is mostly clogged but it's not fully clogged. What will happen is that if I'm lying to you, you'll get a feeling that you don't have a lot of interest in being around me, but you won't be able to tell why that is.

A good example is like, if you're talking to a used car dealer and he's giving you his pitch on why that Ford Pinto is such a great car, you may not realize or understand what part of what he's telling you is a lie, but you generally get the feeling that you want to get as far away from him as quickly as possible. That's because you can tell that there's some things that he's saying that are probably not true. Whereas if you are hanging around with the Dalai Lama and he's talking, you probably want to increase that type of interaction as much as you can. The thesis of the book is basically, humans don't particularly care how bad the truth is, but what they care about is that you're telling the truth. To give you an example let's say my wife and I are about to go out to see a movie and have dinner and so on. Let's say she gets dressed and she asked me how the dress looks, and let's say I have a perspective that the dress doesn't look that great. Since I read the book, I changed my answers and I encouraged them to try this. When I was asked by her, how the dress looked or this and that, I give an absolutely candid answer, even though I know that in the near term, it may lead

to us missing the movie or the date getting canceled or various other negative effects. But the long-term impact of that is that she has a very high degree of trust that when I'm saying something to her, it is the truth. That long term has huge positive impacts on the relationship. I would say that in 2008, for example, our funds were down like 67%. I very candidly communicated with my investors, obviously first of all, they got the numbers, which showed them what was going on, but I also clearly told them that it wasn't just the financial crisis that was causing these issues, that we took zeros on some investments. Those zeros were not entirely because there was a financial crisis, though they were partially, but a lot of it was my own mistakes. Quite frankly, our withdrawals and redemptions were pretty benign at that period. Investors basically had trust. I think that it takes a lifetime to build that trust. It takes a lifetime to always say the truth. But I would say that's a very important thing not to say the small lies because the small lies add up and they erode trust. As you go through your life, when you run into situations where you have a choice between truth and diplomacy, you should choose the truth, even if there's near-term pain. If you repeatedly choose the truth, then long term the paybacks are exponential. To some extent, that is exactly what Buffett does. Buffett is all about candor and he always starts his annual reports with mistakes and with bad news. He always tells his managers, "Give me the bad news first". I think that's the way you want to live your life, you want to give people the bad news first, and you want to be candid about the bad news.

**Question:** Do you think you could be too patient in your approach and miss opportunities as a result?

**Mohnish:** I'm trying to be like those Fidelity account holders who've forgotten they have an account because I actually think I'm not patient enough. I actually look at my portfolio and I truly think that if I just went away for 10 years and took no actions on any of it, I think we'd be just doing incredibly well. I think one of the negatives in me is that, unfortunately, over the next 10 years, I know I will sell stuff that I should not sell, and I know I will buy stuff that I should not have bought. The very best thing I could do is to just take a sabbatical and go bike riding with Guy Spier for the next 10 years and just forget about the fund and everything and then take it from that. I think the problem is the other way around. I'm trying to become better at the patience game. I think Warren is really good at it. The big issue and big problem in the investing world is if you turn on CNBC and you see all those sticker symbols flashing by, or you open up Bloomberg terminal and you see all those red and green lights and all that, all of that is telling you that you need to act now. The world is passing you by, you need to act now. The reality is that real business change happens over years and years, it doesn't happen over days or weeks or even months. It takes several years for that business change and business evolution to happen. Just to tell you how impatient I am, I think there's only one stock in my portfolio that is more than three years old. To me, that does not sound like ultra-patient behavior. Do you think that's patient? I didn't get a response, Arvind

Arvind: I see people shaking their head, they don't think you are patient.

Mohnish: Yeah, exactly. Basically, I think the lesson I'm trying to get better and better at is one of being more patient. One thing I like about Dhandho, especially when you buy these wholly owned businesses is, we'll never sell them. I think probably the best thing we could possibly do is never sell them. I mean, I have businesses in my portfolio that it would not surprise me that in 10 years they're trading at 8 times, 10 times where they're trading today. I hope I'm smart enough not to sell them before that time, but I don't have the confidence that I'm that smart

Question: Guy Spier has spoken a lot about building the right environment and cultivating patience. How do you cultivate patience and set yourself up to succeed?

Mohnish: Yeah, I think Guy's way of taking care of patients, from an office point of view, is just never going to the office, have you checked when's the last time he was in the office?

Arvind: He's been on a little bit of a book tour.

Mohnish: Yeah, he's always on some tour. That's probably the best thing he can do for his portfolio. In fact, I told him that I sent him that article about the Fidelity study. I said, "I'm hesitating to send this to you because what little time you spend, the office is going to go very soon to zero". His response was that he's just installed a very high-end espresso machine. He's going to be going in for that. That's refined. Well, I think it's a challenge, but the way I've tried to set up the environment is, first of all, things have to be at a total no brainer level for me to take the action of making a change. When I go into the office, I don't go in with any interest or perspective that I'm going to make changes. Are we doing okay Arvind?

Arvind: We're doing great.

Mohnish: Okay. Basically, I don't go in with the idea that we're going to buy some stocks today or sell some stocks or any of that. I just don't have that. In fact, normally when I'm putting trades and I put them in after-hours so that the market's being open has very little impact. Then the second is that I have many other activities that I'm involved in outside of buying and selling stocks. I mean I don't run the foundation, but I do have some time that the foundation takes, I believe Dhandho takes some time. I spend about four or five hours a week playing bridge which is also, I think, a great activity that I strongly recommend, and I play racquetball and go biking and so on. I like to read, and I read all kinds of things that have nothing to do with investing. I would say that I enjoy learning about businesses, and I enjoy understanding what they're worth, and so on so forth. But the thing is that to get to the point of making investments, usually they have to hit you between the eyes to no brainer, because I have to sell something to make room and so on. That's generally how I manage it. The other way to manage the environment is to not have a team. If you are in a structure

where there are other partners or analysts or associates, then everyone's going to come to work with the idea that we're going to do something today and we're going to change the world today and all of those things. I think that would be a negative. I don't have a blue book terminal. I just try to keep the environment as much away from getting you to be active. I don't talk about the positions much. There's not much frequent communication with the investors. When I'm communicating with investors, I do not talk about what we presently own or presently buying. Because again, if I got questions on those, then I'd start defending why I bought them and then that leads to a commitment and consistency bias, which means that even if I'm wrong, I'll say, "Oh, I told them all these things so I can't sell it, because then they'll think I'm stupid or something". Then that starts violating in a scorecard. It starts violating power scores and so on. You have to do things in a manner that make you kind of in alignment and also make it easy to do what you're trying to do. That's the way to do it.

**Question:** How was running a fund help you make investment decisions?

**Mohnish:** Well, I would say the investment business you are talking about Pabrai funds.

**Arvind:** Yes. Yeah.

**Mohnish:** Yeah. I would say the investment business is a little bit different than a typical operating business. I mean, it does have some elements of that, but it is on a simpler and smaller scale. I mean, you don't have large scale HR issues, large scale Capex issues. You have some elements of running business. I think that when I ran my IT services company, I probably learned a lot more about running businesses from that than I did from running Pabrai Investment funds. In Pabrai Investment funds, I think what I am proud of in terms of the way it has run, how efficiently it's run. The entire workforce, excluding me, is part-time stay-at-home moms and basically the world miss prices and misjudges the talent capability of stay-at-home moms. They are not in a position or interested in taking up full-time careers, but to think that all of them can only lick stamps is ridiculous. But that is what the world does, they think that all they can do is do a \$10 an hour part-time job or something. I have people in the office who have very high-flying careers in different areas and now we are able to give them lots of challenging work, and they are pretty much running the operation on all facets of it, including SCC compliance and so on and so forth. We do it on a payroll that would shock most people. I think that Pabrai Investment funds part of it probably runs under a hundred thousand dollars a year in payroll, excluding me on assets of 700 million. You can learn a few things on running a business from a fund running a fund, but I think you can learn a little bit more if you have experience in operating a business, which is a little more size. But I think it all applies. I think that if you ran a lemonade stand when you were a teenager and had a paper out or any of those things, all of those things help and add up. But if you get a little more size and scale to what you are doing, then that is even more helpful. It is very helpful to then understand how CEOs of large companies

might be running the businesses and what they keep front and center in front of them, and what is likely the important factors to focus on.

**Question:** How do you decide what to read?

**Mohnish:** Yeah. My study state assumption is that I am a gentleman of leisure. I was surprised, but someone asked one of my daughters recently, what does your dad do? Her response was, "well, he sleeps, and he is on Facebook and that is it". That was her definition of what I did, you know sleeping and being on Facebook. I do take afternoon naps, which are really good. In fact, I had a nice nap just before we got started today. Thank you, Arvind, for starting at a time, which allowed for my nap. That was good.

**Arvind:** My pleasure.

**Mohnish:** Oh, sure. Thank you. The 7:00 PM in East Coast and 4:00 PM here works out well, I assume I am a general leisure, I will tend to read whatever I enjoy, I probably have at least 50 books sitting here, that I have not read yet. Many of them are not worth reading, and I will find that out soon. I may read 10, 20 pages and decide this is useless and give up on them. I will pick up different books depending on my interest at the time. I was telling Arvind that there is a stock that is shown up on the radar that looks quite interesting. Recently, I pushed all the books aside, and recently I have been reading and chewing on the business, and just trying to get an understanding of whether I am not even sure it is within my circle of competence or not, but it looks interesting, and I am enjoying the research so far, and so that is what I am doing. But basically, there is no strategic plan, it is just "go the way the wind blows" study stages, keep reading. I have subscriptions to three newspapers a day. I read those. I have subscriptions to several different magazines, Forbes, Fortune Business week and Economists and so on. I read those and I have manual of ideas, subscription and value line subscription and different subscriptions. I read those and some message boards, I look at what is happening, I will go to Value Investors Club occasionally. Obviously, there is a website, like DATAROMA which does a nice job of condensing what the new 13F update is on different investors, and I look at that too. Between all of that, I can usually find enough things to keep me busy on a reading perspective.

**Question:** What value investing models do you tend to use most often, and can you share any examples of models that you have used in the past?

**Mohnish:** Yeah, that is kind of a little difficult question to answer because some things are being processed almost at a subconscious level, in the sense that I may not myself even articulate clearly to myself what things going to, but in general, when I'm looking at a stock, I am looking for reason to say no, not a reason to say yes. I am looking for reason to say no as soon as possible so that I can go back to other things of more interest. When people bring up a stock to me, or when I look at a 13F, or DATAROMA or something, I will ask myself, Okay, first of all, is it written circle of competence and if it is clearly out, then good, I am

done with it. Then if it is within circle of competence, then I ask myself the second question, is it super cheap? Nowadays, with the way the US markets are, I don't think markets are overvalued, but I don't think they are nothing like 2009. In fact, I found a couple of things to do, which are, in the US it is kind of very low liquidity and volumes, I am just nibbling every day as much as we can get. But for the most part, we haven't found anything in the US for a while. Even the idea I am looking at now, which looks interesting, is outside the US. Those are the first two models, competence and evaluation. That bit blows out large portions of it. Then if it looks like something within Circle of Competence, and then it looks like it is cheap, then I will spend maybe a half an hour or something. Again, the idea is to find something that is going to be a showstopper, which is telling me, aha, I got why I would not want to be interested in buying this. Then if I don't find it in half hour, then I will invest some more time. I pick a hour or two, again, digging a little deeper, and again, with the ideas to find a reason to stop looking and moving on. If I continue to look, then that means that there are a few aspects of the business that I am finding very attractive, and at least to that point, I have not found anything, which is telling me to stop looking. I don't know if that helps on the model side. One of the things in investing is that, the data set is too large. Like that spreadsheet I sent, Arvind has like 13 or 14,000 stocks, and that is not even all the stocks in the world, all the stocks in the world, maybe \$50,000 or \$25,000 to \$50,000, something in that range. Just looking at one business could take you two, three weeks. You spend even a week on a business, you couldn't look at more than 50 businesses in a year. In the US that would be like 1% or something of the public companies. The key is that you have to take shortcuts, which help you eliminate large portions of the universe in a very short period of time. It leaves a wide-open portion of time for the things that do look like it is a promising kind of data set to prove it to. That, I think is more art than science. But you have got a way. If you, for example, did cloning and did 13Fs, that is a great way to cull the data set. If you just said, okay, I am only going to look at what other great investors have bought, then you might be down to maybe less than a hundred stocks a year that you would look at. Then within the hundred, you again look at which one that is cheap by your definition, and within circle of competence by your definition then again, that a hundred is going to go down quite dramatically. You may not need to look at that niche stocks in a year, and then the number becomes quite manageable.

Arvind: I mean, just on that in the Google talk, you discussed IPSCO and the funeral services business, how you thought about different ideas at the moment in time when you made the investment. Could you discuss similar ideas that you had made that you have since exited that were successful investments and how you thought about it at that moment in time for us?

Mohnish: Well, let me think about funding that trying, I'm to think of what past names might be worth thinking about.

Arvind: You can come back to the question if you want. I can ask another.

Mohnish: Yeah, I haven't had many exits for a few years.

Arvind: It could be very old.

Mohnish: I think this was probably the first investment the fund made, and it was in a company called Silicon Valley Bank. Silicon Valley Bank is an interesting bank. I think they are still around; I don't know if someone bought them or not, but they basically were headquartered in Silicon Valley, and they are pretty well-run bank. What they would do is, they basically focus on venture backed startups, which means they already had a bunch of money in the bank and so on. Then they would focus on kind of conservative lending, usually asset-based lending and so on, do these companies. What they would also do was, when they would make the loans, they would also take warrants from these private companies in addition to what they were getting on the regular loan term. Like in the middle of 99, the funds started, the dot com boom was more and more fuel was being added to that fire, and it was raging. Silicon Valley Bank was sitting on this very large number. You could say a basket of warrants of a bunch of these dot com venture backed startups. But when I looked at the valuation of bank, it was very modest. It was just a small premium overbooks. There wasn't a lot of disclosure on these warrants in the filings, but you knew that they would talk about little bit saying that this kind of basket of warrants and you could look at the companies that they were doing business with. I actually believed at the time that the internet would be transformational. I just wasn't willing to pay a hundred times earnings for Pets.com, and so my take was that, if I bought stock in the bank, then I have downside protection because it is a sensibly run place, but it has got a moonshot built in if those warrants kind of come in, and if this madness kind of continued. I think in a very short period of time, we had a double on the stock and other people started to realize that these warrants had value such, and then we exited. That wasn't a holding relatively long, but the thesis was, okay, we have got this basket there, which is giving us a kind of an unknown upside without downside. Unknown upside without downside is a really good mental burden in general. In general, markets are very bad at pricing uncertainty properly. There was no way for the equity markets to properly price that unknown basket awards. I mean, if they had done a disclosure, we said, Okay, look, here is the 200 companies that we have warrants on, and here is the N number of warrants and here is the strike price and all that. Then you could take 10 of them or 20 of them or something. Where most of the value was and ascribes of value to them, which is probably the way it was, where probably a lot of the value was sitting in a few of the companies that they had. That mental model that was used to make that investment was completely different than the model I might have used, let us say, to make the IPSCO investment, right. They were different. You basically look at you look at different situations and you can come up with kind of different perspectives. Like if you look at the 3G guys, for example the ones Buffett's partnered with, and you look at kind of what they have done at Burger King and at AB InBev, and probably what they are likely do at Craft. Now with this Tim Horton

acquisition, these guys can squeeze blood out of a rock. If someone were to make an investment in one of the things that they are into, you can probably assume that, whatever historic margins they were, they will probably figure out a way to get some more out of it. If the top line is stagnant or growing little bit, they probably get little more juice out of it. If you understood that about the manager then you could say, okay, if something that looks fully priced may not actually be fully priced because you are not taking into account the new manager and what you can do. Those are different examples of models you can use.

**Arvind:** That is great. Silicon Valley Bank, how did you stumble across that idea? How does one screen for something like that? What triggered your initial interest to take a look at that one?

**Mohnish:** I am not sure exactly how it crossed my radar. It may have been on a list of some companies or something that sometimes, they put up these lists of, I am not exactly sure how it came up on the radar.

The thing is, at the time, I had made another investment in 95, which is about five years before the fund on another dotcom type stock which was called CMGI. Eventually it went past, actually, their offices in Massachusetts and CMGI had kind of investments in like a hundred plus internet companies. When I originally invested in them, it was very modestly priced. It was priced that just a small premium to cash. Again, it was like Silicon Valley Bank in the sense that they had all these different investments, but you weren't really paying a lot. This was in 1995, so it was many years before the market went crazy and we made a hundred x on CMGI. This is before the funds and such. I was lucky, I got most of it out before things crashed and burned. In hindsight, that was a mistake because I should have sold at even at 5x, because at that point it was already bubbles. But at that time in 1999, I was looking to find vehicles like that but I wanted to get more safety. I wanted the downside protected. I think that is when Silicon Valley came up with the radar and I looked at it in more detail, I kicked the tires quite a bit on that, because I was always concerned about lending activity to these tech companies because, how do you get your money out because they don't have many intangible assets. But on that front, what they did is, they only stuck to venture backed startups, which were already pretty high quality. Then they made sure that enough protection on hard assets and such, I think that worked out pretty well. But I would love to find something like that now, that would be nice, the moonshot is always good if you can get them with no downside

**Question:** In the Dhandho investor, you talk about mispriced probabilities reflected in a stock price. How do you go about determining the probabilities ascribed to different outcomes?

**Mohnish:** Just ignore the book because the book is stupid. What you want is very simple. You want as close to a hundred percent probability of at least 2x in two years

as close to a zero probability of anything else. Or if it is a 90% probability of a 2x in two years, then the other 10% could be above 1x, which means you don't lose money and losing money should be very infinitesimal. When you look at it, you should have confidence that the odds that you would actually end up with a permanent loss of capital are as close to zero as you can get. I would say that if you are looking at probabilities, then the curve should look at something like 1% or lower probability of a permanent decline, or less than, let us say 20, let us say losing between zero and 30% should be under 1%. Losing more than 30% should approach zero. Then anything less than a double between 1x and 2x maybe is under 10%, and above 2x is the of it. Those probabilities sound good to me.

**Question:** How do you determine what is in your circle of competence?

**Mohnish:** Well, to ask the question is to answer it. If you are questioning whether something is in your circle of competence, trust me, it is not in your circle of competence. Because what Buffett says is that the most important thing is to operate within your circle of competence. Ideally you don't want to operate near the edges, you want to operate dead centered. It should be obvious that something is within that circle. Like I gave the example in that Google talk about that billionaire John Arrillaga, who only buys real estate within two miles of Stanford. I think anytime he looks at something in about three seconds, he has answered the question of whether it is in circle of competence. Once he gets five miles from the center, he knows he is outside the circle.

**Question:** How have you built your circle of competence over time? At what point in taking on new sub-industry do you feel it is in your circle of competence?

**Mohnish:** Yeah, that is a good question. In fact, the idea I am researching now that is a question that is twirling in my head in the sense that there are some aspects of the business that I understand and some aspects I am trying to understand. There is enough there that is prompting me not to give up, but I would say that I would not make the investment if I cannot, within three sentences, nailed down exactly kind of what the bottom line is. What is going to happen here and what type of money we are likely to make and what timeframe and all of that and so on. I think the good news of the circle of competence is that, unlike being a basketball player or something where after 30 or something you're going to start declining, you are in investing, you are going to keep improving over your whole lifetime and over your whole lifetime that circle is gradually going to increase in size just by default, and it will especially increase in size each time you lose money because that will really teach you a whole bunch of stuff. The key is not to focus on trying to increase the size of the circle. That will happen by osmosis, but the key is to work very hard to always stay well within the service.

**Question:** How do you think about your geographic circle of competence and separately, currency risk?

Mohnish: Yeah. I actually ignore currencies because I don't really have a view on it and hedging and such can become expensive.

Arvind: Okay, sure.

Mohnish: I don't mess around with trying to hedge currencies or any of that. I just assume that if the business ideas work out, even if we have some currency movement against us, it should still be fine.

Arvind: Sure.

Mohnish: The currencies may move in our favor. We don't know that. What was your second part of the question about? Yeah, I think about different parts of the world. Well, I am learning more and more about different parts of the world, and I definitely feel that the closer you are to home, the more you understand and the better off you are. I definitely feel it takes more effort and even then you may miss some obvious things which may be obvious to locals. Clearly there are risks involved when you go global. But at the same time, if in spite of those risks, if things are looking like no brainers, then you can look at that.

Question: Besides leverage, what are common mistakes investors make?

Mohnish: Well, I would say that patience is a big part of the equation. I think that you can be right about all your analysis stock, but just not keep it long enough. You can study this, right? Like stocks have done average about nine or 10% a year, but if you study the long history of stocks, it is not coming in like clockwork. It is very lumpy. You can have large movements in short periods of time and no movement for long period of time and all of that, so patience is a big part of it. I think sticking within circle of competence is a big part of it. One of the reasons why cloning is such a good idea is because it is already made it through the filters in one brain. If you admire that brain and if things have already made it through that brain, the important thing of cloning is that you should focus on cloning the ideas that are the biggest positions of the people who made those bets. Like the top three or four, if you were looking at the top three or four or five bets that a person has made rather than the 30th bet he has made, the 30th bet is not going to help you that much. But the interesting thing about cloning is that if you look at our top five positions of David Einhorn and top five position of Bill Ackman, top five position of Carl Icahn, top five position of Warren Buffett, top five position of Seth Klarman, and so on, then you know that is a really good pond to go fishing yet because it is already been through one filter. When you start looking at some things that have already been through one filter and you only look at that pool then that is a big advantage. That is when you go to a bowling alley and if the objective is to get the highest score when you are bowling, how many of you have bowled before, can you raise your hand? Looks like we got some bowling affection outs in your class. Maybe you can take them bowling Arvind.

Arvind: I will go with bumpers.

**Mohnish:** Yeah, there you go. When you go bowling, if the idea is that you have to get the best score, then you can bowl two ways, with bumpers or without bumpers. If you could bowl with bumpers or without bumpers, which would you choose

**Arvind:** With bumpers that students are saying,

**Mohnish:** Would anyone choose without bumpers, bowling with bumpers is basically like doing cloning of 13Fs because it has already been through one idea. The odds that you will have a gutter ball just go down dramatically. I mean, you may still end up with the ball going off to the side when it gets close to the bins, but the odds are very low. I think those are the important things as you avoid leverage, you be patience, stick to circle of competence, go away for a long time after you have made your portfolio, ball with bumpers. Those are all good things to this.

**Question:** How will you think about your hurdle (e.g., 2x in 2 years) within the context of Dhandho holdings?

**Mohnish:** That is a great question. These are all negotiated transactions with people who I think are smarter than me who are focused on full price or better. Usually, they want more than a full price. I think the interesting thing is that I am looking at a business that unfortunately, I think I will only be able to get a minority positioned because the founder is not looking to sell much of what he has, and we might put in some growth capital and so on and we will pay a very full price for that if we do it. But the nature of that business and such is such that, I think that almost for sure we will make like 5 to 10 times our money in five years or seven years. One of the advantages of these private deals is that one of these small businesses tend not to be in the public markets. I mean, in general, I think if you are looking at businesses with market caps less than 50 million or 25 million in the public markets, one of the problems in public markets is that market cap level, you have got so much overhead for being a public company and such that the economics, I think, don't work out. Those types of businesses are kind of zombie businesses that they may be good businesses at one point or something, but they run into some issue which has caused the market cap to go where it is gone. Whereas some of the businesses I am looking at are kind of still growing on upswing, but they are just small. I think that the interesting thing about these insurance companies, one is that I can add some value with the portfolio. What can look like a full price based on the business before Dhandho steps in can look a little more attractive once we are part of the equation because of doing a little better job of the investments and the other thing is that, today actually, the pricing for insurance companies is lower than historical and maybe even in future because interest rates are so low. If I am looking at an insurance company that has everything in fixed income, and there are some insurance companies like that, then, the investment portfolio is not doing anything. When you look at valuation, the premium to book or multiples and different things, it will take that into account. If interest rates were 12% or something, then those businesses will be worked and be sold for different

prices. To some extent, this is a good time to go hunting. But anytime you are getting to negotiated transactions, facing intelligence sellers and especially the people I would like to buy these businesses, which we are not intending to sell, I don't want to buy them from stupid people. I would be disappointed if they didn't get full price.

**Question:** In the past you have owned companies like Berkshire, Fairfax, and Leucadia. What is the rationale for buying them and separately for selling them?

**Mohnish:** Well, I think we won Berkshire a few times, and I think sometimes it has gotten cheaper than other times. For example, I may not have all my facts straight on that, but there is an emerging young investor called Allan Mecham, and maybe Arvind you could have him come and speak to your class. I think he is in Utah or someplace. Arlington Capital Management or something is the name of the fund. I think they have a few hundred billion under management. He had and probably still has, I think, a pretty large position at Berkshire. I seem to recall it was more than 50% of the fund. What he had done is, he had levered that portfolio borrowed against him to produce the returns, and he basically levered it because he, in effect, thought that, with Berkshire, there was a floor where Warren had said that below 1.2 times book, he will buy back stock. In effect, before that was 1.15, 1.1 and whenever Buffett said that the stock basically never went below those floors, or if it went below the floor, it just came right back up because that is the time when Warren was buying. He bought his position basically right at or slightly above that floor with the assumption that it will do reasonably well over the future. Then he levered it on top of that to choose the returns, and he did quite well. Now, I looked at that and to me, the perspective was, I remembered Buffett's story about Rick Guerin and the thing is that there are circumstances under which Buffett would not exercise that put. For example, if you bought 2009 type pricing rather than buying Berkshire stock, he would be looking to buy other things and he wouldn't care Berkshire went do. It is very unlikely. But in those types of scenarios, Allan might get margin calls and it didn't happen during the period that he owned it. In general, I would say, with Berkshire, you would do reasonably well, but I think it is just so large that you ought to be able to find things that will do better unless it gets close to that floor level pricing. Leucadia is a different animal now because the two founders are gone and there is another guy running it, so you have to handicap how well that guy does. Fairfax, actually they have a stated objective of delivering 15% of more long-term returns to investors. If you agree with that and you think they will do that and that's your objective, then that would be a good stock to own for that. But I think that if you are working with small amounts of capital, you ought to be able to do better than any of those things.

**Mohnish:** Question to class, what is your largest position?

**Student:** I am an index guy Mohnish, and I used to work for Vanguard several years ago, I have got a pretty large position in the Vanguard 500 index.

Mohnish: Okay. Vanguard Index 500?

Student: Yeah. I have about 40% of my portfolio due to mathematical calculations on my part in Jammu and Kashmir Bank in India.

Mohnish: Jammu and Kashmir Bank

Student: Yeah.

Mohnish: Okay, sounds good. Next

Student: Yeah. Mosaic Corp, Potash mining

Mohnish: Okay. Anymore?

Student: CVS

Mohnish: DDS?

Student: No, CVS like Rite Aid.

Mohnish: Oh, CVS pharmacy, okay good. A cloner. Any others?

Student: Yeah, Consolidated-Tomoka a real estate company in Florida.

Mohnish: Sure. Wintergreen Funds

Student: Yes.

Mohnish: Okay, good. In case I am twiddling my thumbs, I have a few things to look at. How much more time do we have Arvind, are we out of time?

Arvind: Well, last year you said we were going to rage and then you made fun of us.

Mohnish: We can go as long as you want. No problem. I already had my nap

Arvind: Oh, exactly. Wonderful.

Question: How do you see the evolution of Pabrai investment funds and manager change going forward?

Mohnish: Yeah, Pabrai Funds, if I were not managing it, I would return the capital and I think the investors would want the capital returned if there was a change along those lines. I don't really think of it as work. It is fun. It is amazing. I get paid for it, which is great. Yeah, it is not any different from running my own money, own portfolio, I don't really consider it any kind of burden. There are no plans to make any changes. There is no long-term strategic plan. The long strategic plan is to just avoid making stupid decisions and make as few decisions as possible.

Question: Do you measure how many pages you read daily?

**Mohnish:** Yeah. I saw some talk, I think with Todd Combs, he was saying that Buffet had talked at Columbia and said that he was reading like 500 pages a day. 500 pages a day is quite a bit of reading. I haven't ever measured how much I am reading every day and I don't know how you would put newspaper reading or scanning into that. I don't think I am anywhere near 500 pages in a day. My guess would be, I am maybe at a hundred page of the day or something. I think my guess is something like that. Sometimes when I am reading a book, I will do more than a hundred pages a day. It might be 150 pages.

**Question:** How do you quantify the intrinsic value of an investment?

**Mohnish:** Well, there is a guy in your group who mentioned that they own Jammu and Kashmir Bank. Right. What is the PE ratio of Jammu and Kashmir Bank?

**Student:** Six times earnings

**Mohnish:** Is that cheap?

**Student:** I think so

**Arvind:** Yes. Definitive. Yes, he is saying.

**Mohnish:** Okay. What should be the multiple of Jammu and Kashmir Bank?

**Student:** Maybe closer to 10 to 12.

**Arvind:** 10 to 12 times maybe more he is saying?

**Mohnish:** I mean if you look at a bank in India, generally speaking, what happens with, and this is in India, probably elsewhere too, but I think probably truer in India is, a bank in India, reasonably well run bank ought to grow at a multiple of GDP. Did you consider that in your thesis?

**Student:** Yeah. I took into account state population growth.

**Mohnish:** Okay. Like, what is India's recent GDP growth?

**Student:** It is about 5 to 7%.

**Mohnish:** That is pre-Modi.

**Student:** Right

**Mohnish:** What do you expect India's GDP growth to be, let us say in the next few years?

**Student:** Hopefully about 8 or 9.

**Mohnish:** Okay. Typically, I would say that a decently run bank in India should be growing at something like two times GDP. 8 or 9 may get aggressive but let us say we don't even put anything much of a Modi factor in there. I mean, it would not be

surprising if something like Jammu and Kashmir Bank is growing earnings at like 15% a year, right? I didn't hear a yes.

Student: Right, yes.

Mohnish: Okay. If we have a business that is earning, let us say a hundred dollars a share or a hundred dollars a year, let us say it is earning a hundred million a year, for example, and let us say that a hundred million a year is increasing at 15% a year what multiple should we put on that business?

Student: Yes. 10 to 15 times, maybe a little higher.

Mohnish: Okay. Let us say that Jammu and Kashmir Bank, let us pull some numbers out of the air. Okay? Let us say it has a market cap of 600 million and let us say they are earning a hundred million. Are there six times earnings?

Student: Yeah.

Mohnish: Let us say they are earning a hundred million. Let us say the market cap is \$600 million, and some of you guys have calculators. Let us go five years. At a 15% increase in earnings every year, what is the earnings in year five? Is it \$200 Arvind approximately?

Student: Yes. You don't need a calculator.

Mohnish: Okay. It is 200. Okay. If you put a 15 multiple on 200, that would be 3 billion.

Arvind: Yes.

Mohnish: If you put a 20 multiple, it would be 4 billion. Are those numbers higher than 600 million?

Arvind: Yes.

Mohnish: Does it matter what multiple we put on it?

Arvind: No,

Mohnish: What I am saying, it doesn't matter if it trades in 15 times earnings or 20 times earnings in five years?

Arvind: No, it doesn't matter.

Mohnish: What if the multiple is 10 times earnings

Arvind: Still agreed with earning

Mohnish: 2 billion market caps,

Arvind: Right?

Mohnish: 2 billion, 3 billion, 4 billion. Are they all acceptable answers?

Arvind: Yes. I am assuming that the assumptions play out the way that you expect them to be

Mohnish: Yeah. What I am saying is, at least we don't need to rack our brains on what the multiple will be or should be or ought to be. We can just say that if those numbers play out, if it goes from a \$100 million in earnings to \$200 million earnings and it goes steadily up like that, the odds are very high that the market cap is between \$2 and \$4 billion. Right? Of course, we don't know whether earnings will do that, and they could be a choppy or they could be a better, I mean, the thing is in the sense that, it is possible Modi really kicks in and the bank is doing 20% a year. So 15%, for example or Modi doesn't kick in, and the bank is doing 12%. You can run those same numbers at 12%, and even then, you would still end up. The thing is, where you would kind of lose money is what is the book value of the bank, do you know what the book value is? What multiple books does it trade at?

Arvind: He says to us, it is close to one. Close to one, or he is saying close to one, but maybe low

Mohnish: Right, basically if their loan book is good, if their reserves are good, and in fact they don't even need to be that good, if their future earnings can absorb any hiccups they have on their books, if you will. That is the kind of bet that is very well worked making, and I am so grateful that you brought it to my attention.

Question: Why do you think one is able to get Jammu and Kashmir bank at a discount?

Mohnish: Well, the guy sitting behind you probably has better answers than me, but I would say that first, it is not a private bank. It is an unusual bank because it is majority owned by the state government of Jammu and Kashmir. I think a 53% stake or something?

Student: Yeah, it is about half

Mohnish: Right, so it is not like HDFC or ICICI bank, which is purely privately held. This is like a public sector bank, but it is actually interesting public sector bank because it behaves like a private sector bank. The second is that the state of Jammu and Kashmir, especially nowadays, when the two sides are lobbying grenades with each other and all of that India and Pakistan, it is a very heavily militarized area. Generally speaking, investors are a little leery of the prospects of a financial institution. Recently, there were floods in very significant floods in Srinagar and around, and I think probably a lot of the bank's branches got affected, and it is possible that their loan book got affected and such because those people that took loans may be in other states and so on. They may have real pain from those recent floods. We will have to see. But in general, the flip side is that India, I think has issued like one or two banking licenses in 10 years. I think about 70% of assets are with these probably run public-sector state-owned banks, which are owned by the central government, which are gradually going down in value or in percent of the pie. I think that half the country doesn't

have a bank account, and that is front and center for Modi. He actually has that particular metric directly in his sites, and he wants to, in his five years, dramatically change the number of people who are bank accounts. It is possible that banking gets significant deals.

Arvind: Right. Other questions?

Mohnish: My take would be, the biggest issue would be with this Jammu and Kashmir bank, today is October 9th, 2014. If you can avoid selling it till at least October 8th, 2024, can you do that?

Student: Yeah, I will do that.

Mohnish: If you get an urge to sell before then call me collect, I will talk to you in the lunch

Question: A lot of what you have said today pertains to companies that are both very high growth and very cheap. This approach seems very different from traditional impressions of value investing.

Mohnish: Well, I think the best investment you can make is a company that is very cheap and that has good gross prospects and generates high returns on capital. In other words, Jammu and Kashmir Bank, I don't know why you didn't have him run the class Arvind

Arvind: That is a second half of the semester

Mohnish: Okay, all right good. I might sit in on that lecture. Okay, all right, that is good

Question: How can a young person train their brain to invest in Dhandho type situations?

Mohnish: I think the main thing is that, you have to have a temperament, which says on a daily basis that you do nothing, and that you only act when there is no spreadsheet required when it is hitting you between the eyes with a two by four. It is total no brainer. When those things come about, that is when you pull the trigger. In other words, Jammu and Kashmir Bank.

Question: How do you disentangle operations destroying value even if there is asset value? E.G Sears

Mohnish: Yeah, that is a good question. I will just digress for a second before I answer that. If you look at Buffett's different investments, and you put them in different categories like banks or media, insurance companies, retailers and so on, it is batting average, for example, on investing in banks is a thousand. I am not aware of any banking investment that Warren has made, and he is being investing in banks since 1969. He used to own a bank completely for Rockford in Illinois, and he actually used to go to Rockford in Illinois once a month, look at the books and so on. He still has a subscription to American Banker, which is a daily newspaper. I don't believe there is a banking analyst on the planet that

is better than Buffett on banking. I think the guy has never been wrong on a bank. But again, if you take the same Warren Buffett and you look at his batting average on retailers, it is horrible. Mistake after mistake. I mean, most of Berkshire's retail operations are useless. He is too diplomatic to say it in the annual report because that would make the CEOs of the companies look bad, but most of those jewelry operations they bought, most of those furniture operations they bought, I think Nebraska Furniture Mart is fine, probably Morshabs is fine, but most of those other ones are useless. They haven't delivered anywhere near, in fact, most of them probably have not delivered anywhere near what he has paid for them and so on. But also again, if you look at Buffett in media, almost a thousand batting average, almost always been right on media. First, I think that if you are buying a business that is in secular decline that has similar attributes to shorting a stock, they are not as bad. I would generally stay away from these businesses. I used to own Sears and I got my head handed to me, and I learned the difficult way that Sears basically will, no matter how many IQ points you add to Eddie Lampert, Eddie Lampert is a third rate retailer. He may be a first-grade investor, but being a great investor has nothing to do with running a retail operation and knowing how to run a great retail operation. There two completely different skills. His CEO is at Sears. That is just a revolving door, they just come and go and they will keep coming and going. Now it is himself. I guess he won't fire himself. How many of you shop at Sears?

Arvind: No one here shops at Shear

Mohnish: Did they not hear the question, I don't see any hands. How many of you shop @sears.com?

Arvind: No one.

Mohnish: How many of you know there is a sears.com. How about Sears your way? How many of you have heard of Sears your way? The guy who asked a question on Sears, he must have heard of Sears Your Way, because that is all Eddie talks about.

Arvind: No

Mohnish: Even he denies having heard of it. There is your answer. The people who shop at Sears are dying every day, unfortunately, service flap is bearing them and the people being born today will never ever shop at Sears. They have secular guaranteed decline. One thing about business is that you have to understand there are businesses that are recurring revenue. Recurring revenue is an amazing, amazing concept that you cannot give enough weight to when you are making the investments. I mean going back to our favorite stock, Jammu and Kashmir Bank that is a recurring revenue business. When you get banking clients, people don't switch bank accounts every three months or six months. When they have loan with you, they are paying you for a while. I mean, those relationships just stay forever. When you are a retailer, every time a consumer's

going to buy something, they have a choice as to who they buy from. You can get stickiness like Amazon. Amazon has a lot of stickiness. Sears at one point had stickiness, but when that stickiness is in decline, reversing that is almost impossible. In fact, Buffett said that he knows of no examples of successful retailer turnarounds. Zero. I think that there is no way out for this collapse.

Arvind: Well, Mohnish, thank you. Thank you once again for being so generous with your time and so forthright with your learnings. It really means a lot to everyone in this room, and I am sure it will mean a lot to everyone who sees the video.

Mohnish: Well, my pleasure. What we will do, Arvind, is when we meet every year, we will look at the Jammu and Kashmir stock price.

Arvind: We will do that.

Mohnish: Yeah. Once a year. Can we make sure that our Jammu and Kashmir analyst joins us every year?

Arvind: We can do that. We can do it in Omaha or in Boston it will be great.

Mohnish: Okay. That sounds great.

Arvind: Okay.

Mohnish: All right. Well thank you very much, it was a lot of fun.

Arvind: Thank you Mohnish.

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