Mohnish Pabrai's Talk with Greenhaven Road Partners Fund on October 29, 2024

Mohnish: I did not want to start giving when I was in my seventies or eighties because at that point I would not have much energy. My only option at that point would be to write checks, and probably would not even be able to do that much due diligence. I wanted to start experimenting a lot earlier because I had a bias toward education; specifically, education in India. I was not going to be moving to India; I knew that it was going to be difficult and uphill to try to get something going remotely and I expected to fall flat on my face. I wanted to give myself enough time so that 5, 10, 15 years of failures kind of become like the tuition bill, and then maybe after 10 years, I would know what I am doing. I started when our net worth crossed 50 million; I started with the formula that we would give away 2% of net worth every year, and that it would give the organization at least a million dollars a year. I was not particularly concerned if the million pretty much went up in smoke for several years; I just viewed that as part of the tuition to be paid. We started when I was 42 and now I am 60, so there are 18 wonderful years of experience which have been very helpful. Of course, we did not have even 10 years or even 10 months of no traction; we were very lucky we got traction almost right away, probably in a few weeks. There was no wasted money or anything like that, which was what I was expecting. Things went I would say 10 times better than I expected. That has been the journey so far.

Scott: I want to get into that journey. I want to ask a mechanical question. I am curious to know what the mechanics are for fund managers similar to you in terms of the tax situation, LTA, and most of the money in our funds. Do you distribute securities? Do you use some sort of donor-advised fund? Do you have a family foundation? Have you figured out anything like dos or don'ts in terms of getting money from the fund to people?

Mohnish: It depends on the amounts. If you have a seven-figure number or something annually then foundation would make sense. The economics would work out; the frictional cost would be low. I started with a 501(c)(3) family foundation in the US and a charitable trust in India. They are two separate organizations. After a few years, we had other folks who wanted to contribute to Dakshana. We got public charity status from the IRS and Dakshana now has been for quite a while a public charity. One of the advantages of public charity is that when someone at Microsoft or Google or one of these places donates money, the company match can happen. These places like IBM, Google, and Microsoft will only do the match if it is a public charity; kind of a bona fide public charity in the US. That is helpful because we have quite a few donors like that who donate smaller amounts, but the company matches significant amounts. That is what we did. We set up a foundation and then in terms of the giving, you can give the foundation appreciated stock that has some tax advantages. You can give it cash; that is a pretty standard set of tools that you would use with other charities that you are giving money or stock.

Scott: I now want to get into the meat of what you have done. Can you tell us the story of Dakshana; how it started, what you guys do, some of the results, etc?

Mohnish: I will get into that in a second, but I just wanted to talk a little bit more philosophically about this concept of what I would call feedback loops. We have feedback loops in capitalism. For example, if you start a business, and let us say you start a restaurant or something, and that business at the end of the day does not make money or has difficulty and is running in loss and so on, eventually that business is going to go away. Even if you are venture-backed and you raise capital and so on, at the end of the day, eventually the business has to be profitable. If it is not profitable in some way, cash flow positive, it is going to go away. In capitalism, we have, what I would call feedback loops, which is that, if we are not productive in providing society with some useful product or service as a business, we will not exist. Because if you provide something useful, it will manifest itself in the form of profits and cash flows, and that will keep the business growing and growing and so on.

In philanthropy, we have a problem, because there is no feedback loop. What I mean by that is, let us say I am the Rockefeller Foundation, and I have a billion dollars in my endowment or nest egg. Let us say I am a stupid investor, I do not have great investing skills and I am generating something like 6% a year, invested in index and a few other things. The mandate of this foundation is to spend 5% of its assets every year. The IRS wants you to spend around 5% to keep your status. The Rockefeller Foundation would spend $50 million and would make about $60 million; every year the corpus would keep increasing. This corpus increasing means that 50 years from now, that organization will still be around, and a hundred years from now, it will still be around if those numbers hold the 5 and 6% and all that. It does not matter whether the Rockefeller Foundation does anything useful or not. If they start the year with 50 million and just make a bonfire out of it and do no good to society, it does not matter, because the following year, they will have another 50 million or more ready to go, and two years from now, they'll have another 50 plus million to go, and it would keep going. In effect, unlike a business that has to provide some positive value to society, a foundation with an endowment may or may not provide any useful value to society, and it would keep going forever. The lack of a feedback loop is a real problem in charity. Two feedback loops are missing in the nonprofit world. The first thing that is missing is that you do not need to create a profit; you make this 5, 6% by being dumb and stupid or whatever, and you will be in business forever.

The second is that you do not need to do anything effective to help society, and you will be around. The second problem, which is in capitalism, is that the measurement of outcomes is very precise. We all look at businesses and decide which ones we want to invest in. We know how those businesses are doing, and we have a lot of precision of what went in and what came out. Those measurements are very precise; there is no ambiguity about them. In most philanthropic ventures, even ones that have a lot of positive value to society, the measurements are really hard. In fact, I would argue that probably for like 98% of the stuff that you would do in the nonprofit world, the measurements may be almost impossible. Let us say for example, there is a big drug problem in the city of San Francisco amongst the homeless, and you set up some program to deliver free needles to all the homeless people who want it. Clearly, that may have some net positive benefit, but what is that benefit? The measurement of how good the needle program did becomes really difficult to measure. If you do not have measurements, then how do you decide what you want to increase or decrease, or what changes you want to make? In a capitalist business, it is simple. The profits and growth and all of that give you a lot of feedback on what is working and what is not working and what areas to focus on and not focus on. In general, society benefits, and everyone benefits. The nonprofit world has these two problems. One is that you would be in business forever, while you could do nothing good, and there is nothing that will take you out of that situation. The second is that the measurements are hard. Even if you have a great heart and you actually want to do a good job, the measurements are hard.

What I did at Dakshana was I inverted the problem. Like Munger says, "Invert; always invert." The inversion that I did was that I was only going to look at activities where the feedback loops or the ability to tell what output came from the input was easy to do. For most of these kinds of initiatives that you would embark on, the measurement is really difficult. Let us take the example of Gottesman who recently gave a billion dollars to the Albert Einstein School of Medicine, and there is no tuition anymore for anyone going to med school at the Albert Einstein School of Medicine. Clearly, that has positive impacts, but if someone is from a hundred million plus family going to the Albert Einstein School of Medicine, them getting tuition-free, the benefit of that to that family in terms of helping society versus another family, which really needs that free tuition for the person to become a doctor is very different. The return on invested capital in those two situations is extremely different. I do not even know if there will be any measurements done of what percent of that class needed that help and what percent did not. Even though I love the idea; I think it is a great initiative. Education in general has a huge multiplier effect. Because you can transform zeroes into heroes; that has a huge impact.

I grew up in India. I grew up with a lot of extreme poverty that I witnessed all around me. I knew that millions and millions of people were very smart and would never get a chance at a decent education. My thinking was that if we can harness these brains and provide them the tools to become very useful to society and to the family and community, then that is a very positive thing. What Dakshana did and what we have done for the last 18 years or so, is that we had an ecosystem. We had two ecosystems in India that made Dakshana extremely effective. In fact, I do not really know of any I actually did not want to set up my own operation, I did not want to actually do a nonprofit, I just wanted to write checks. I was disappointed 18 years ago when I looked because I was not able to find organizations where I thought the social return invested capital was acceptable or high.

In India, we have a somewhat unique situation where we have very elite technical institutes. The Indian Institute of Technology, which has several campuses that are from US standards is almost free to attend. They are very heavily subsidized by the government, but they are very difficult to get into. It is a strict meritocracy to get into the IIT. It does not matter if your father went there. how rich you are or what money you donate to the IITs. There is only one way to get admitted into the IITs, which is you have to clear the entrance exam. The entrance exam does not have essays or anything subjective, it is a purely quantitative and qualitative objective test. It is probably the toughest test in the world. There are about 1.3 million kids a year who try to get into the IITs every year and there are 16,000 seats. In other words, the admit rate is about 1.3% or so. Princeton would have an admit rate of about 4 or 5%, and a lot of the IVs are between 4 to 8%. Bill Gates says that if he was limited to recruiting from only one school for Microsoft when he was running Microsoft, he would only recruit from the IITs. He would not recruit from MIT, and he would not recruit from Stanford, and he would bypass all the US universities. He would only recruit from the IITs. I will get to what Dakshana does, but just wanted to explain a little bit of how it works in the IIT. When you take the test, from the number 1 to 1.3 million, you get a rank. When you are ranked one, they come and ask you which campus and which major you want and by the time you get to rank approximately 95 out of 1.3 million, IIT Bombay, Computer Science has closed. If you get ranked 96, you cannot go to IIT Bombay Computer Science.

Dakshana had a scholar, a very poor kid, who grew up in a slum in Hyderabad. His parents were under 50 bucks a month in monthly income. Sometimes they did not even have food to eat and went to sleep hungry. This kid got accepted by IIT with a rank of 63, which is the best rank we have ever produced at Dakshana in 18 years. He goes to IIT Bombay Computer Science. The IIT Bombay Computer Science class has horsepower in that class; it has no parallel anywhere in the world. There is no computer science classroom in the United States or anywhere else in the world with the brain power that the IIT Bombay Computer Science class has, because you have people who are ranked 90. Now, just to tell you about how hard that test is. If you score about 33% on that test, you will get a seat at IIT. You just have to score 33%. These kids who are in the top 96 have something like a 90-plus percent score; 92% score on that test.

Anyway, Ashok goes to IIT Bombay Computer Science. He has never seen a test in his life that he was not number one; it has never happened to him. In every class he was in Dakshana or any place else he was always number one. In the first computer science test in the first class he took, his rank was like 80 out of 90 or whatever number of kids in the class. He said, “I got a score of like 27 out of 100 on that test. I studied really hard for it. I spent about half an hour just looking at the paper. It never, ever happened to me that I am not in the top 1% or top 5% or 10%. There were kids in that class who had topped that test. They got a hundred on it, and they were goofing off the previous night. They were not even studying; they were like playing around.” He went back from that test and he said, “Ashok, find another gear. Whatever you have done in the past, you are not in Kansas anymore.” He really busted his ass. He is a very competitive guy who works really hard. He graduated probably in the top 15% of his class. He grew up in a slum in Hyderabad, and India's Microsoft headquarter was right there;

you could see it every day. For him, it was aspirational to go to work for Microsoft, and he applied to Microsoft, and he got a job. I said, "Listen why don't you send an email to hr@google.com and you just send them your resume, but in the email, I just want you to tell them your IITG rank of 63 and your GPA when you are graduating from IIT Bombay Computer Science." Within about seven hours of him sending that email, Google set up Skype interviews with him. They never met him. Three guys talked to him for about 20 minutes each. He had a job offer from Google and he moved to Mountain View. Ashok is now level seven and makes over a million dollars a year. He has moved up quite a bit. He has a large team that works for him. Anyway, what Dakshana does is we identify extremely poor kids who have very high horsepower. The IITs have a 1.3% admit rate, we have about a 70% admit rate of our kids going to IIT, and then we have expanded to med school. We take now about a thousand kids a year, and about 7 or 800 of them end up at very good schools and almost all of them go to some decent college. Currently, Dakshana spends about 3 million a year and we are just embarking on about 10 million of CapEx and then we will probably be able to take about 1500 kids a year. We have our own campus now; 109 acres and such. That is what we do. The input-output ratio at Dakshana is very easy to measure. We know it costs us about $3,000 to support a kid for one or two years. In Ashok's case, the family used to make 50 bucks a month and they make now 80,000 a month. The transformation from 50 bucks to 80,000 was $3,000. That is kind of what we do.

Scott: Just for folks, the $3,000 you are housing kids for a year, and educating them. From an American mindset, it is hard to get your head around how much is done for those kids in that year. Can you just elaborate a little bit on what was done in that year for the kids to make the transformation happen? It seems like you get a lot out of $3,000.

Mohnish: We have two programs. One is a two-year program and the other is a one-year program. I will just go over the one-year program for simplicity. They drop out a year after high school. They finish 12th grade and drop one year or prep for the IIT exam. We move them to our campus in Pune. Room, board, coaching, books; everything is covered. They do not pay for anything. We have a very high-end faculty. We have some faculty members that in India make about 60, 70, $80,000 a year which is equivalent to making about half a million dollars in the US. We have some rich kids trying to get into the Dakshana program because we have better coaching at Dakshana than the for-profit world does in India. We have a problem where we have to have a lot of gates up. We get a lot of offers from very wealthy parents, offering us even 20, $30,000 a year to take their kid. Of course, we do not take any of the kids at any price; it is free or nothing. That is kind of how we do things at Dakshana.

Scott: That is great. I will give you a chance to brag for a second. The stats on the medical school program are perhaps even more impressive. Do you remember what they are? You wrote about them in your annual report.

Mohnish: There is a set of medical colleges, which is like the IITs called the All-Indian Institutes of Medical Sciences. They have a ridiculously low acceptance rate, and they have much fewer seats. When I was in high school in India, there used to be only 36 seats for AIIMS, and there were like 50,000 kids applying for those 36 seats. It was insane trying to get a seat. Probably some of the very top-end Indian doctors in the US are AIIMS graduates. Some of these guys have gotten Nobel Prizes. The admit rate at AIIMS in India is like 0.1% and at Dakshana, we do not try to get into AIIMS; we just have them take the test and try to get them into med school. About 15% of the kids we take on go to AIIMS, whereas in the national population, it is 0.1%. It is insanely hard. Our numbers on the AIIMS side are even better.

Scott: That is awesome. I am going to let folks come up to the computer and ask you a couple of questions.

Interviewer 1: Hi, Mohnish, thanks for doing this. I am curious how the 3000 per student has evolved as you guys have scaled. Did it used to be 5,000 a student, and as you have scaled, the price came down? Also, if your $3 million a year operating budget went up to $10 million a year, $20 million a year, could you still scale the organization and achieve similar success rates at similar costs?

Mohnish: When we started, it was an outsourced model, so we did not have our own campus. We just wrote checks. We identified the kids, and then we sent them to, for-profit coaching locations and paid for everything. We paid for the room and board and paid for the coaching and all that. Over time we brought it completely in-house, vertically integrated, and in fact, now a lot of the faculty is our alums. A lot of the kids who graduated through our program went to IIT, and they have come back. Those guys are fantastic because they have gone through our program. The cost used to be around 5,000, and of course, there has been inflation in the last 18 years. It used to be about 5,000, about 17, 18 years ago and now it has come down to about 3000. But if you consider the inflation in the last 18 years, it has probably come down even more, because of what money was then versus now. We do have limits in terms of how far this can go. We think that we can get to spend about 7 or 8 million a year, and then we would max out because we would run out of IIT seats. We are already taking approximately 3, 4% of the IIT seats; 1 in 20 or 1 in 25, kids on that campus are coming from Dakshana. I do not think we can ever get to more than 1 in 8. That is a lot taking 12% of the seats, because you have to understand the rich kids; they have a lot of resources, and they are trying everything under the sun. In fact, a lot of them start coaching in 6th grade. Our coaching starts after 12th grade for one year. A lot of rich kids are going through coaching for like six years, for example, to try to get in. It is an insane situation; you are starting a kid at 12 to try to get into IIT at 18. Once we get to about 7, 8 million in spending, we will run out of seats. We will probably get to that in a few years. We are just adding capacity, which will take about three years with all the construction and all that, but it will go to about 5 million a year in about three years, and then the next step from that would be to max it to about 8 million. I would say in probably five, or six years, we will be maxed out.

Interviewer 2: Thank you so much Mohnish, and congrats on the successes so far. I would like to ask two related questions. You talked about pursuing high-risk, high-reward investments in your charities. Can you talk a little bit about some failures that you have learned some lessons from and what those lessons are? Relatedly, now that you have found something that works so phenomenally, do you try to create a feedback loop where all your incremental and charitable investments flow into compounding what you have already built and adjacencies related to it? Or are you planting other seeds to try to do something maybe perhaps in an entirely different domain?

Mohnish: Well, I am a big believer in focus, so for us right now, our focus is to get to the 7 or 8 million and max out the model. Maybe we will try to take it to 10, 12 million and see. I want to hit a brick wall and just see where that wall is. We will push as much as we can to see what the limits of that wall are and where that ends up. If you think about it from a net worth point of view, I would say if Dakshana was spending something like 10 million a year and if my net worth were, let us say around 200 million, that would be about a 5% type of annual number if there were no outside donors. My net worth got cut in half because I got divorced a few years back. Thankfully it was still over 50 after the divorce, so we could still keep it going, but we are not at 200 million yet. With some luck, maybe next year; we will see. I always want to have feedback loops. I do not mind taking risks. When we started this model that is working very well it was not expected to work. I was a guy in shorts in California doing something remote in India, and people took advantage of us. We paid companies to coach our kids. They sell third-rate faculty. They sometimes never sent anyone. They just took the money and nobody showed up so we had a lot of issues. For example, in the very first batch, our success rate of getting kids into IIT was about 10%; just 10% of the kids got in. It was the same quality of kids as we have today, but it was an eight-to-one, seven-to-one differential in success. It was very clear to me that what we had given in terms of quality to the kids of coaching was pathetic. It was terrible. I knew that this was just like any business. We just have to block and tackle and make tomorrow better than today. We fired some of the coaching places that screwed us. As the saying goes, "Fool me once, shame on you. Fool me twice, shame on me." We got rid of all the yo-yos who were screwing with us. The next year was around 20% and I knew it could keep going higher, and we just kept working at it. We need to find some other models in a few years. I know that the return will go down and that we will never find anything like this. We just lucked out and it is very extreme, but it will not be anything like this, and that is okay. It can be a much lower return and still be quite good.

Interviewer 3: Mohnish thanks for doing this. I have a quick question. In the beginning, you mentioned some of the failures of charities at large, and I am wondering, have you seen anything interesting in terms of people who are employing other methods to kind of fix some of those failings outside of what you are specifically doing?

Mohnish: I am really impressed with some of the charities I have run into since then. For example, some of you might be familiar with Success Academy, which is Joel Greenblatt's initiative in New York City with all the charter schools. I think they have done a wonderful job. In general, charter schools, if they run well, and that is a US model, which is easier to get you guys' arms around, is that because you are getting base-level funding in terms of public dollars from the government, and then you are overlaying that with private funds, the return on those private funds is very high. In Joel's case, the Success Academy, a lot of the teachers are Ivy League educated, and a lot of the students are inner-city minorities. It is kind of two worlds that do not normally meet. They have done a great job. Well-run charter schools can work well, because of the public funding that is coming through. We have a lot of waste of public funding in the public school system in most cases around the country, so that can be a good model. I found some very good models in India as well. Some are in education, sometimes some are kind of adjacencies. If you look at it from the lens of input-output, you will find it very easy, because that is what you guys do for a living. When you look at the Gottesman Program at Albert Einstein, and let us say you were going to compare it to Success Academy, I am nothing against the Gottesman, but to me, Joel's program has a higher return.

Interviewer 4: Hi, thanks for doing this. I just had a brief question. Has your philanthropy been exclusively focused on this education and if not, have you invested in or donated to regions that have experienced natural disasters or anything with shorter-term time horizons? The reason I ask is, because I live in Asheville, which as you may know, has recently been hit pretty hard by hurricanes, and I am in charge of a team that is trying to allocate a couple of million dollars to disaster recovery. If so, I am just wondering if there are any general lessons that you have observed from that, and if you do not have any experience, that is totally okay.

Mohnish: Dakshana has done very little outside of its core model. One time I gave 10,000 to Joel to have lunch with him with a donation to Success Academy. I had lunch with Buffett and that was a donation as well to the Glide Foundation. When there was a Turkey earthquake, we made some contributions, because we have investments in Turkey, and I did not feel like we should just be taking without giving. But in general, I say no almost 99% of the time and I do not look at other causes. It is important in philanthropy to be focused. In your Asheville situation, the important thing there would be to drill down to see what the best way is to help that community with those limited resources, and that is not an easy problem to get your arms around. You can certainly limit yourself to Asheville, but you can still optimize within that. Because charity is so hard, my advice for all of you would be to stay very narrow, to say no a lot, and to not sprinkle all over the place. I do not think that would work very well.

Interviewer 5: Hey Mohnish, I know you do not really like talking about your existing stocks, so I am not going to ask you about that. Buffett has been selling Bank of America, Apple, and the S&P at a pretty high PE ratio, and even within that, it is being driven by massive macro trends like AI. I am curious about your macro view in terms of valuation, opportunity, availability, and the future for small-cap stock picking, I know sort of earlier in your career you did more small cap. I know you do stuff in India. I am curious about your thoughts on high-level macro and what you think is the future for small-cap stock picking in the US domestic markets. Do you think that because of ETFs, there is just less and less active management? What are your thoughts on that?

Mohnish: I really enjoyed a recent letter by David Einhorn where he was talking about how Buffett always says that he is not a market timer; he is never focused on market timing. David made the point that he is the best market-timer. He knows that there is no better market timer than Warren. He closed the partnership in 69 and Charlie and everyone else took it on the chin, but Warren did not. If you track the history of what Warren has done, it turns out that he was very smart and impeccable, like, for example, his Gen repurchase with overvalued stock Berkshire stock. He has been very smart about it. Berkshire probably may have some views that things are a little frothy, but they may get a chance to put a hundred billion or more into working on something. He commented that market dislocation will happen. He said he does not know where it will happen next year, but he thinks the odds in 10 years are high. From my point of view, I am a stock picker, so I do not particularly care where the S&P is at, because I am not buying the S&P and I am not buying the magnificent seven, and so on. But, in a world with 50,000 stocks and all these individual things going on to individual companies, there are always going to be exceptional opportunities. If someone is willing to dig even in the frothiest markets, there would be opportunities especially now we have this kind of barbell-type market where a lot of it has been left behind and a few things are kind of raging on. I do not find a lot of things, but I find enough things to be invested in. We do not have too many buckets. If I look at our billion or so under management, it is the weirdest allocation we have; 70% or something is sitting in Turkey and another 20% or 25% is sitting in coal. We are at 95% now, and then the 5% does not really matter. It is not really relevant. Within Turkey, the 70% is in three stocks. That is the allocation we have right now, and I would not want it any other way.

Scott: Let us take one last question.

Interviewer 6: Hello, and thank you for taking the time. I have a quick question. In *The Dhandho Investor*, you had written that if you own a stock and after two or three years it is not working, it is probably time to move on. I am curious if you still feel that way broadly, and then more specifically how you might think about something like a factor being out of fashion, which explains why the stock is not working, even if the business is executing.

Mohnish: The good news about investing is that one can do really well, even with a high error rate. The best of us will be wrong one out of three times in what we think about something the company is going to do. Many of us would be wrong half the time, or more than half the time. The stock could flatline, it could decline, it does not get to where we think it is, where it should be valued. There are many reasons for the error rate being as high as it is. If you have invested in something and after three years is still sitting where you invested or is lower than where you invested, there is a decent probability that your assessment was wrong. It is not a hundred percent probability, but you need to do a holistic analysis of what might be going on. It may be still undervalued, or the market may take longer and so on. That is fine, but a decent possibility at that point is that there may be some factors that you may not be understanding that are affecting intrinsic value.

Scott: Thank you so much for your time. I do not know what the social return will be on this hour that you spent, but there is a fair amount of capital in the room and minds and hopefully, you have influenced some of the thinking. These ripples will be felt over time. We really appreciate it. Thank you.

Mohnish: Well, Scott, I want to say that I have a lot of respect for you and what you do, and that is why when you cold approached me, it was a no-brainer for me to participate. I really enjoyed the interaction, so thank you so much.

Scott: Great. I appreciate that. Thank you, Mohnish

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