

PABRAI • INVESTMENT • FUNDS

Welcome!

2009 Annual Meeting
Sept. 12/26, 2009

Mohnish Pabrai
Managing Partner

Agenda

- ♦ **Performance Review & Expectations**
- ♦ **Post-mortem on Past Holdings**
- ♦ **Q & A Session**

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PIF2 (US Accredited) Performance Review

	DJIA	NASDAQ	S&P 500	PIF2 (net to investors)
10/1/00 – 6/30/01	-0.2 %	-41.0 %	-14.0 %	+17.4 %
7/1/01 – 6/30/02	-10.3 %	-32.7 %	-18.0 %	+35.3 %
7/1/02 – 6/30/03	-0.5 %	+11.4 %	+0.3 %	+34.2 %
7/1/03 – 6/30/04	+18.6 %	+26.8 %	+19.1 %	+38.7 %
7/1/04 – 6/30/05	+0.7 %	+1.1 %	+6.3 %	+23.4 %
7/1/05 – 6/30/06	+11.1 %	+6.5 %	+8.6 %	+15.0 %
7/1/06 – 6/30/07	+23.0 %	+20.7 %	+20.6 %	+34.0 %
7/1/07 – 6/30/08	-13.3 %	-11.2 %	-13.1 %	-32.4 %
7/1/08 – 6/30/09	-23.0 %	-19.1 %	-26.2 %	-25.2 %
1/1/09 – 6/30/09	-2.0 %	+17.0 %	+3.2 %	+49.7 %
Annualized	-0.3 %	-7.0 %	-3.2 %	+12.7 %
Cumulative	-2.9 %	-47.2 %	-24.9 %	+184.5 %

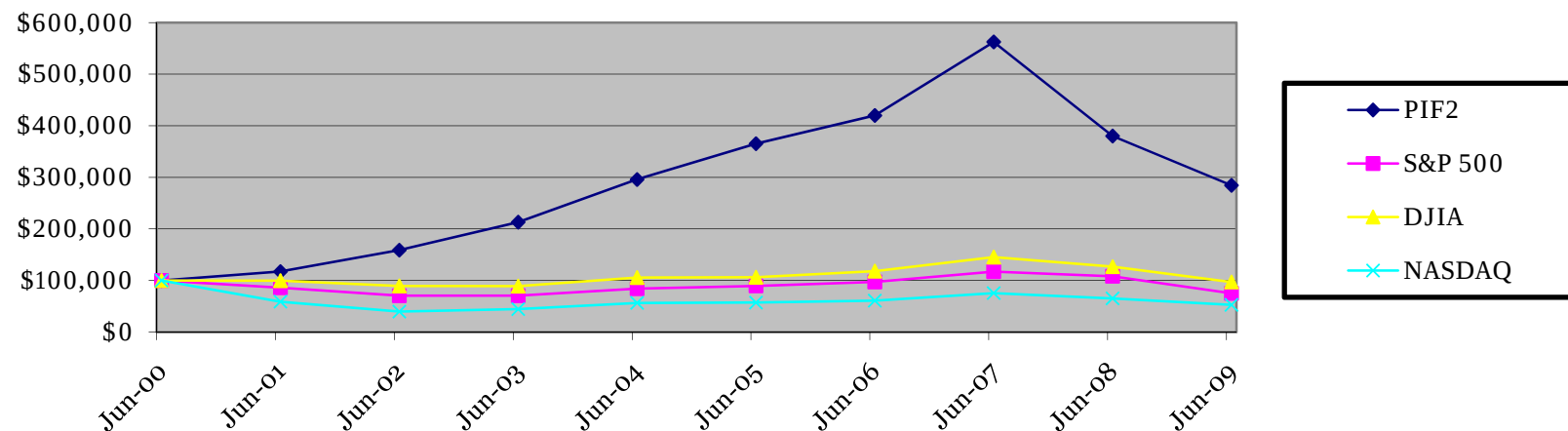
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PIF2 (US Accredited) Performance Review

Comparison of changes in value of \$100,000
invested in PIF2 vs. the Indices.

PIF2: **\$284,500**; Best Index (Dow): **\$97,100**



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PIF2 (US Accredited) Performance Review

A \$100,000 investment in PIFI at inception in 1999 (and subsequently merged with PIF2 in 2002) was worth \$398,600 on June 30, 2009. The best index (Dow) was worth \$96,100.

PIFI / PIF2 Annualized Return: +14.8 %

Best Index (Dow): -1.6 %

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Performance Comparison PIFI / PIF2 vs. The Best Index

	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>Life of Fund (10 years)</u>
PIFI / PIF2	-25.2 %	-12.1 %	-0.8 %	+14.8 %
Best Index	-19.1 % (Nasdaq)	-4.6 % (Nasdaq)	-1.4 % (Nasdaq)	-1.6 % (Dow)

(Annualized; As of 6/30/09)

PIF3 (Offshore / IRA) Performance Review

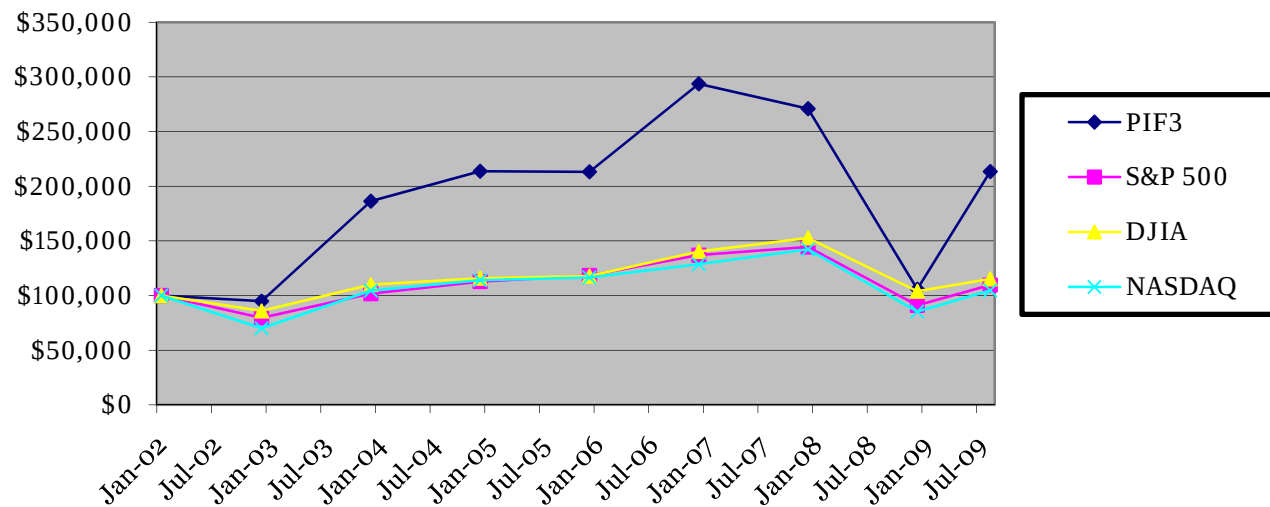
	<u>DJIA</u>	<u>NASDAQ</u>	<u>S&P 500</u>	<u>PIF3</u> (net to investors)
2/1/02 – 12/31/02	-14.1 %	-29.9 %	-20.4 %	-5.2 %
1/1/03 – 12/31/03	+28.3 %	+50.8 %	+28.7 %	+96.5 %
1/1/04 – 12/31/04	+5.3 %	+9.2 %	+10.9 %	+14.7 %
1/1/05 – 12/31/05	+1.7 %	+2.1 %	+4.9 %	-0.2 %
1/1/06 – 12/31/06	+19.0 %	+10.4 %	+15.8 %	+37.8 %
1/1/07 – 12/31/07	+8.9 %	+10.7 %	+5.5 %	-7.8 %
1/1/08 – 12/31/08	-31.9 %	-39.9 %	-37.0 %	-60.9 %
1/1/09 – 8/31/09	+10.8 %	+28.3 %	+15.0 %	+101.5 %
Annualized	+1.9 %	+1.2 %	+0.6 %	+10.5 %
Cumulative	+15.2 %	+9.6 %	+4.7 %	+113.0 %

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PIF3 (Offshore/IRA) Performance Review

Comparison of Changes in Value of \$100,000
invested in PIF3 vs. the Indices.
PIF3: **\$213,000**; Best Index (Dow): **\$115,200**



PIF3 (Offshore / IRA) Performance Review

A \$100,000 investment in PIF3 at inception in 2002 was worth **\$213,000** on Aug. 31, 2009. The best index (Dow) was worth **\$115,200**.

PIF3 Annualized Return: +10.5%

Best Index (Dow): +1.9%

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Performance Comparison PIF3 vs. The Best Index

	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>Life of Fund (~7.6 years)</u>
PIF3	+19.0 %	-3.6 %	+3.0 %	+10.5 %
Best Index	-14.2 % (Nasdaq)	-1.9 % (Nasdaq)	+2.6 % (Nasdaq)	+1.9 % (Dow)

(Annualized; As of 8/31/09)

PIF4 (US Qualified) Performance Review

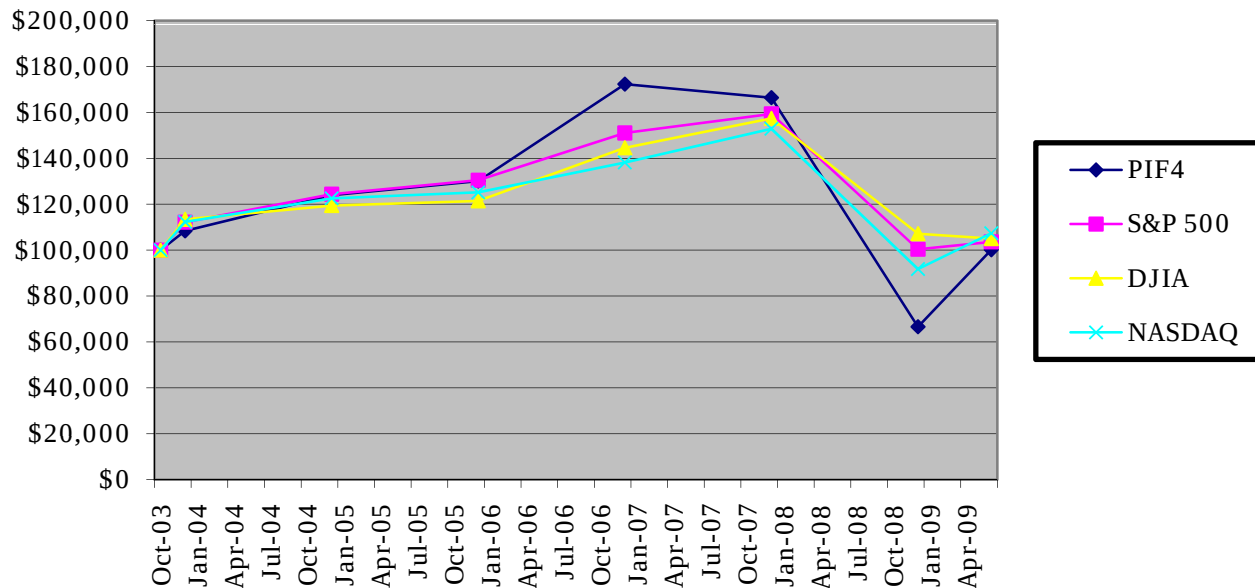
	<u>DJIA</u>	<u>NASDAQ</u>	<u>S&P 500</u>	<u>PIF4</u> (net to investors)
10/1/03 – 12/31/03	+13.4 %	+12.3 %	+12.2 %	+8.4 %
1/1/04 – 12/31/04	+5.3 %	+9.2 %	+10.9 %	+14.4 %
1/1/05 – 12/31/05	+1.7 %	+2.1 %	+4.9 %	+4.9 %
1/1/06 – 12/31/06	+19.0 %	+10.4 %	+15.8 %	+32.4 %
1/1/07 – 12/31/07	+8.9 %	+10.7 %	+5.5 %	-3.4 %
1/1/08 – 12/31/08	-31.9 %	-39.9 %	-37.0 %	-60.0 %
1/1/09 – 6/30/09	-2.0 %	+17.0 %	+3.2 %	+50.4 %
Annualized	+0.9 %	+1.2 %	+0.6 %	+0.0 %
Cumulative	+5.0 %	+7.4 %	+3.6 %	+0.0 %

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PIF4 (US Qualified) Performance Review

Comparison in Changes in Value of \$100,000
invested in PIF4 vs. the Indices.
PIF4: **\$100,100**; Best Index (Nasdaq): **\$107,400**



PIF4 (US Qualified) Performance Review

A \$100,000 investment in PIF4 at inception in 2003 was worth **\$100,100** on June 30, 2009. The best index (Nasdaq) was worth **\$107,400**.

PIF4 Annualized Return: +0.0 %

Best Index (Nasdaq): +1.2 %

A Tale of Two Periods

➤ PIFI / PIF2 Performance from 7/1/99 to 6/30/07

- 29.4 % Annualized vs. 4.6 % for Dow

➤ PIF3 Performance from 2/1/02 to 6/30/07

- 22.0 % Annualized vs. 7.9 % for Dow

➤ PIF4 Performance from 10/1/03 to 6/30/07

- 20.2 % Annualized vs. 13.7 % for S&P 500

➤ From inception to 6/30/07, the results are more than acceptable for all three funds.

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7/1/07 – 8/31/09

- **Best Index: -21.2 % (Nasdaq)**
 - **PIF3: -37.3 % ; PIF2: -32.4 % * ; PIF4: -33.2 % ***

*** PIF3 is up 101.5 % YTD. Have assumed 100 % YTD for PIF2/PIF4.**

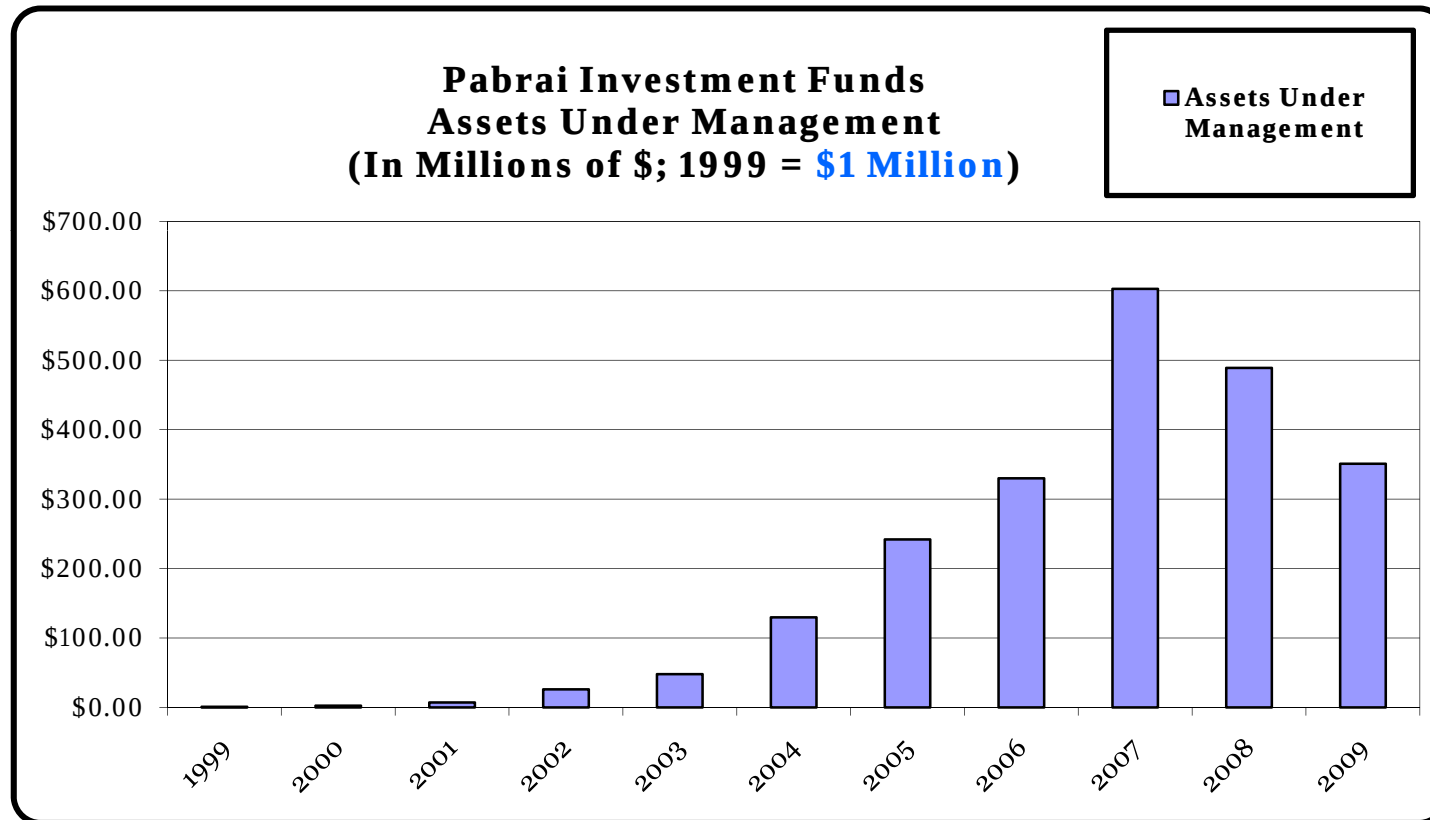
- **From 7/1/07 – 8/31/09, all three funds are lagging the indices, but are closing the gap. (100 % vs. 28 % YTD)**
- **Once the performance from 7/1/07 onwards beat the indices, the performance numbers overall will be very acceptable.**

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Assets Under Management (~\$351 Million)



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Ultra-Low Expenses

PIF2: 15 Basis Points (0.15 %)

PIF3: 18 Basis Points (0.18 %)

PIF4: 16 Basis Points (0.16 %)

A year ago ...

PIF2: 12.5 Basis Points (0.125 %)

PIF3: 6 Basis Points (0.06 %)

PIF4: 7 Basis Points (0.07 %)

Expense ratios for all three funds are amongst the lowest across the entire mutual fund and hedge fund industries.

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Performance Expectations

- ♦ **85 % of mutual funds lag the S&P 500 Index after all fees and expenses. Just 0.5 % of Mutual Funds beat the Indices by over 3 % . (Source: Bogle)**
- ♦ **Our goal is to beat the three indices over the long haul. Beating all three indices is likely to put us in the top 10 % of all US mutual funds and hedge funds.**
- ♦ **I'm quite confident we'll beat the indices over the long haul. Not sure by how much.**

Pabrai Funds Value Proposition

- ♦ No management fees. Just performance fees.
 - ♦ If we had a 2/20 structure, would be taking \$8+ Million in fees.
- ♦ Pabrai Family is Largest Investor – eating my own cooking.
 - ♦ Interests are fully aligned. No new money after reaching \$1 Billion.
- ♦ High water marks
 - ♦ No performance fees till we're at all time high and higher than 6 % annualized from 6/30/07 high.
 - ♦ New money/investors get free ride upto that point.
 - ♦ Good time to add funds – cheapest fund on fee basis.
- ♦ No Leverage, No derivatives, No margin loans, No short positions
 - ♦ Stable, diversified group of investors – 400+ families worldwide
 - ♦ Investors are long-term oriented and “get it.” Fantastic group.



Changes / Events in Q408

- ♦ Over last few years have seen large losses from large positions going south. (Delta Financial, BioScrip, Exide etc.)
- ♦ Influenced by Klarman's perspective on position sizing
 - ♦ Typical is 5 %
 - ♦ Basket / Correlated / Elevated Risk is 2 %
 - ♦ Seven Moons Lining up is 10 %
- ♦ Influenced by "The Checklist" article by Dr. Atul Gawande
 - ♦ Developed a checklist based on my losers and losers of the greats (Buffett, Munger etc.)
 - ♦ 66 Queries on Current Checklist. Very powerful tool.
 - ♦ Expect meaningfully lower error rate and results to be much better in the post-checklist world at Pabrai Funds.
 - ♦ Too early to tell, but aware of no errors since checklist incorporated.



Seth Klarman

Munger & The Checklist



B-17 Bomber



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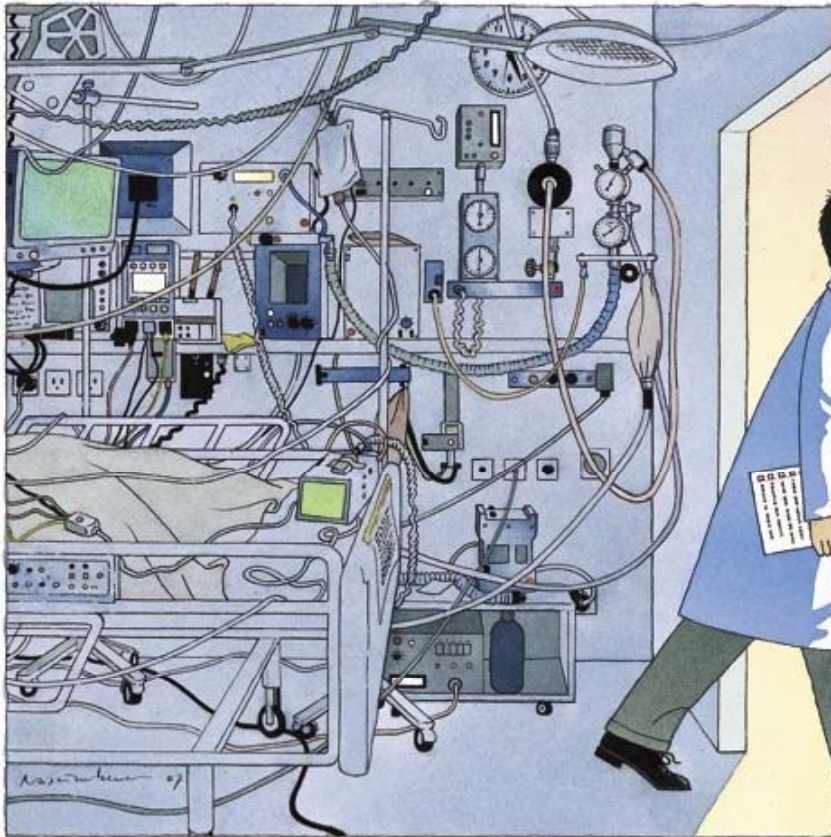
“Too Much Plane for One Man to Fly”

- After the B-17 crash, Boeing’s survival was in question.
 - The aviation checklist was born.
 - Too complex for one man’s memory
 - Four checklists – takeoff, flight, landing, after landing.
- Zero accidents – govt. ordered 12,731 B-17 bombers

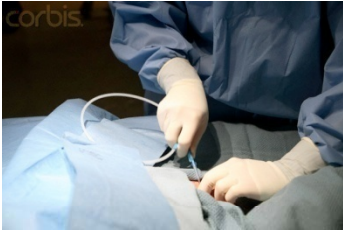




The ICU Checklist



- 5 Million Lines put into patients annually in ICUs
- 4% infected after 10 days; 80,000 people.
- Fatal 5-28% of time. Increased ICU time.
- The Line Insertion checklist.



The ICU Line Insertion Checklist

- 1. Wash hands with soap.**
 - 2. Clean patient's skin with chlorohexide antiseptic.**
 - 3. Put sterile drapes over entire patient.**
 - 4. Wear a sterile mask, hat, gown and gloves.**
 - 5. Put sterile dressing over catheter site after line in.**
-
- **Very obvious; well-known; taught to all for ages.**
 - **At least one step skipped in 1 / 3 of all insertions.**
 - **Infection rate after checklist – approached zero!**
 - **Doctors learning to appreciate checklists.**



Why are checklists so effective?

- Our brains are designed to take short-cuts and arrive at answers quickly.
 - When you see the lion, you run. You don't process your options, you just run.
- We are also a mix of rationality and emotions.
 - When we notice a great business is undervalued, we read up on it, run through a number of concerns/questions and arrive at a decision – not as effective as a checklist.



The FAA's Approach to Aviation Safety

- **Very effective; Lower probability of dying in an airplane than crossing the street.**
- **A human life is worth \$3 Million.**
- **Aviation safety comes from carefully studying each and every plane crash worldwide.**
 - **Changes to Checklists, pilot training, equipment, procedures, ATC etc.**
 - **Results are extremely compelling.**



Investing and The Checklist

- Not rocket science. Pretty obvious.
- Start with stuff we've learned from Graham, Buffett, Munger, Klarman, Fisher, Templeton etc.
 - Margin of Safety, Moats, Simple Businesses ...
 - Make a real checklist.
 - Examine all your mistakes that led to a permanent loss of capital – the plane crashed.
 - Add to the checklist.

Changes/Events in Q408

- ♦ **15 % of assets redeemed in 2008.**
 - ♦ Used this as a way to “clean house”
 - ♦ Assets were leaving at a time when funds were down 60+ %.
 - ♦ Sold the weaker names and losers to meet redemptions.
 - ♦ Portfolio ended up stronger as a result.
- ♦ **Had one large winner in 2008 – Fairfax Financial**
 - ♦ **Total assets were down to \$210MM**
 - ♦ **FFH thus needed to be down to \$10.5MM at cost – from \$90+ MM.**
 - ♦ **Over \$73MM in proceeds from sales**
 - ♦ **Used to fund a range of new positions**
 - ♦ **Some are up 3x, 4x and even 5x+ since then.**
 - ♦ **The change from 10x10 to 2-5-10 has led to better results.**
 - ♦ **Able to invest at a time of large redemptions.**

Date	FFH Qty	Price	FFH Value
9/30/08	308,798	\$319.94	\$98,796,832
12/31/08	58,001	\$305.24	\$17,704,225
3/31/09	46,032	\$260.50	\$11,991,336
6/30/09	68,812	\$249.50	\$17,168,594
9/8/09	68,812	\$342.23	\$23,549,531

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A Cross-section of Recent Past/Sold Holdings



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Compucredit

- ♦ First bought on April 10, 2007 for \$34.03 /share
 - ♦ Last sold on January 5, 2009 for \$5.59 /share
 - ♦ Avg. Buy Price: \$24.19; Avg. Sell Price: \$6.81
 - ♦ Total Amount Invested: \$81.9 Million (all 3 funds)
 - ♦ Total Proceeds (incl. dividends): \$23.1 Million
 - ♦ -72% realized loss;
-
- ♦ Did tax-loss selling in 2007 and bought back in early '08. Hence gross invested amount exceeds 10%.



Compucredit

- Sub-prime consumer lender trading at 5 times earnings
- Growing rapidly
- Leveraged – bank lines and securitizations
- The Bull Case:
 - With the growth etc. stock ought to trade at a 10-15x multiple leading to a 2-3x return in 2-3 years.
 - Book Value of about \$17 /share.
 - High Leverage had historically generated high ROE
 - Playing in under-served and misunderstood credit markets.



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Compucredit

- When the 2008 Credit crunch hit, Compucredit was badly hammered.
 - Hard to renew bank lines. Covenant Violations.
 - Securitization Market Frozen
 - Loan losses rates went up as unemployment rose.
 - Constrained capital limited ability to lend.
 - Auto lending business hit hard
- Very dumb investment in retrospect. Core checklists failures.
 - Highly leveraged. Problematic for lending institution.
 - Win-Lose proposition (High fees, interest rates, predatory)
 - No more! Ain't gonna happen again.



Sears Holdings

- ♦ First bought on Oct. 25, 2007 for **\$134.85/share**
- ♦ Last sold on June 12, 2009 for **\$68.73/share**
- ♦ Avg. Buy Price: **\$133.12**; Avg. Sell Price: **\$53.66**
- ♦ Total Amount Invested: **\$67.5 Million (all 3 funds)**
- ♦ Total Proceeds (incl. dividends): **\$27.2 Million**
- ♦ **-60%** realized loss



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Sears Holdings

- I have always thought that investing in most retailers is just not worth it – results are likely to be sub-par. Tough businesses.
 - Wrote a chapter in Mosaic entitled “Retailers Aren’t Worth The Risk.”
 - Looked at Sears/K-Mart many times after Eddie Lampert got involved and always passed.
 - Very impressed with Lampert and re-looked at Sears as a collection of assets.
 - What would happen if those assets were monetized and redeployed by Lampert?
 - Long-term leases well below market rent. Substantial owned real-estate carried at well below market price.
 - Brands – Craftsman, Kenmore, Diehard, Sears Services



Sears Holdings

- What I missed that is/was obvious.
 - Sears has 324,000 employees that stand between it and its assets. Very very hard to monetize the assets.
 - The retail business is doomed. Highly unlikely to ever turn around. Lost between Walmart and Target.
- With real-estate in doldrums, Lampert has a very very tough hand to play. Decided to exit and re-deploy.

'When a management with a reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the reputation of the business that remains intact.'

- Warren E. Buffett



Level 3 Converts – Deja vu

- ♦ Bought 3.5 % 2012 Convertible Senior Notes
- ♦ First bought on Nov. 4 2008 for \$425 (Face \$1000)
- ♦ Last sold on July 22, 2009 for \$718.75
- ♦ Avg. Buy Price: \$432; Avg. Sell Price: \$680
- ♦ Total Amount Invested: \$25 Million (all 3 funds)
- ♦ Total Proceeds (incl. interest): \$39.2 Million*
- ♦ +57 % Realized gain.

* Some yet to be sold – placeholder.



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Level 3 Converts

- ♦ Debt markets were tremendously distressed in Q408.
- ♦ Converts were trading at massive discounts to par
 - ♦ Highest discounts I'd seen.
 - ♦ Equities offered even more bang for the buck, so I focused on equities.
- ♦ Level 3 Converts looked very interesting.
 - ♦ Huge discount to par.
 - ♦ Superior to holding Fairfax from a risk/reward perspective.
- ♦ FFH Sold for \$269/share. Level 3 sold at gain of 57 %.
- Those proceeds were reinvested and up over 50 % so far.
 - ♦ Over 100 % gain since Q408 vs. 25 % gain in Fairfax.



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Past Holdings – A Cross Section



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The Company We Keep



Conyers Dill & Pearman

MorganStanley
SmithBarney



MICHAEL J. LICCAR & CO.
CERTIFIED PUBLIC ACCOUNTANTS

PRICEWATERHOUSECOOPERS 

Sonnenschein®
SONNENSCHN NATH & ROSENTHAL LLP

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The Awesome “2.5 Person” Team at Pabrai Funds

- ♦ Nickii Aleo, Administrative Assistant
- ♦ Cari Carter, Administrative Assistant
- ♦ Diana Dillman, Administrative Assistant
- ♦ Isabelle Secor, Office Manager
- ♦ Includes Dakshana support.



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Q & A

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